

IN THE INCOME TAX APPELLATE TRIBUNAL

“A” BENCH : BANGALORE

BEFORE SHRI ARUN KUMAR GARODIA, ACCOUNTANT MEMBER AND  
SHRI PAVAN KUMAR GADALE, JUDICIAL MEMBER

ITA Nos. 2382 & 2383/Bang/2018
Assessment Years : 2014-15 & 2015-16

M/s. Indus Steels and Alloys Ltd., No. 163/B, 2 <sup>nd</sup> Floor, Kanakapura Road, Basavanagudi, Bangalore – 560 004. <b>PAN: AAACI4098M</b>	Vs.	The Deputy Commissioner of Income Tax, Circle – 3 (1) (1), Bangalore.
APPELLANT		RESPONDENT

Assessee by	:	Smt. Suman Lunkar, CA
Revenue by	:	Shri Vikas Suryavamshi, Addl. CIT (DR)

Date of hearing	:	30.07.2019
Date of Pronouncement	:	20.09.2019

**ORDER**

*Per Shri A.K. Garodia, Accountant Member*

Both these appeals are filed by the assessee and these are directed against two separate orders of Id. CIT(A)-3, Bangalore both dated 21.06.2018 for Assessment Years 2014-15 and 2015-16. Both these appeals were heard together and are being disposed of by way of this common order for the sake of convenience.

2. The grounds raised by the assessee for Assessment Year 2014-15 in ITA No. 2382/Bang/2018 are as under.

*“1. The learned Assessing Officer had erred in passing the order in the manner passed by him and the learned Commissioner of Income tax (Appeals) has erred in confirming the same. The order as passed being bad in law and are liable to be quashed.*

*2. The learned Assessing Officer had erred in disallowing the claim of deduction of Rs.20,28,200/- as loss on Chit and the learned Commissioner of Income tax (Appeals) has erred in confirming the same. The action of authorities below being wholly erroneous both on*

*facts and law are to be negated.*

*3. The learned Assessing Officer had erred in holding that the Chit discount is capital in nature and the learned Commissioner of Income tax (Appeals) had erred in holding that the Chit funds were not utilized for business purposes. The amount drawn from Chits were utilised solely for the purpose of business only and therefore the loss on Chit being the revenue expenditure in nature and having been incurred for the purpose of the business used to be allowed as the deduction and the disallowance is to be deleted.*

*4. In any case and without prejudice and in the alternative, it is submitted that in case the disallowance of Chit loss is sustained, then the income from Chit dividend be also reduced from the income.*

*5. The appellant denies the liability to pay interest. The interest having been levied erroneously is to be deleted.*

*6. In view of the above and on other grounds to be adduced at the time of hearing it is requested that the impugned order be quashed and or atleast the Chit Discount loss be allowed as a deduction or in the alternative the Chit income be reduced from the income and interest levied be also deleted.”*

3. The grounds raised by the assessee for Assessment Year 2015-16 in ITA No. 2383/Bang/2018 are as under.

*“1. The learned Assessing Officer had erred in passing the order in the manner passed by him and the learned Commissioner of Income tax (Appeals) has erred in confirming the same. The orders as passed being bad in law and are liable to be quashed.*

*2. The learned Assessing Officer had erred in disallowing the claim of deduction of Rs.2,70,500/- as loss on Chit and the learned Commissioner of Income tax (Appeals) has erred in confirming the same. The action of authorities below being wholly erroneous both on facts and law are to be negated.*

*3. The learned Assessing Officer had erred in holding that the Chit discount is capital in nature and the learned Commissioner of Income tax (Appeals) had erred in holding that the Chit funds were not utilized for business purposes. The amount drawn from Chits were utilised solely for the purpose of business only and therefore the loss on Chit being the revenue expenditure in nature and having been incurred for the purpose of the business used to allowed as the deduction and the disallowance is to be deleted.*

*4. In any case and without prejudice and in the alternative, it is*

*submitted that in case the disallowance of Chit loss is sustained, then the income from Chit dividend be also reduced from the income.*

*5. The appellant denies the liability to pay interest. The interest having been levied erroneously is to be deleted.*

*6. In view of the above and on other grounds to be adduced at the time of hearing it is requested that the impugned order be quashed and or atleast the Chit Discount loss be allowed as a deduction or in the alternative the Chit income be reduced from the income and interest levied be also deleted.”*

4. Brief facts are that in Assessment Year 2014-15, the AO noted that the assessee has debited an amount of Rs. 20,28,200/- on account on chit discount in the P&L account. Similarly, in Assessment Year 2015-16, it is noted by the AO that assessee has debited an amount of Rs. 2,70,500/- on account of chit discount in the P&L account. In both the years, the AO asked the assessee to show cause as to why these amounts should not be treated as expense of capital nature. The assessee made submission before the AO and AO was not satisfied and he made the additions in both the years. Being aggrieved the assessee carried the matter in appeal before the Id. CIT(A) in both the years but without success. Now the assessee is in further appeal before us.
5. Various arguments were made by Id. AR of assessee. He also submitted that on pages 30 to 33.3 of the paper book is the Tribunal order rendered in the case of Kamal Raheja Vs. ITO as reported in [2016] 75 taxmann.com 274 (Lucknow-Trib.) and in this case also, this was one of the issues in dispute as to whether the loss incurred by the assessee in subscribing to chit fund to raise funds to use them in his business or for business purpose, such a loss is an allowable deduction or not and this issue was decided by the Tribunal in favour of the assessee. Our attention was drawn to para nos. 3 to 13 of this Tribunal order available on pages 32 to 33.1 of the paper book.
6. At this juncture, the bench wanted to know as to how the funds raised by the assessee by way of chit has been used by the assessee and in reply, it was submitted that on page no. 134 of the paper book is the ledger account of Sri Paranthama Chits (P) Ltd and as per the same, chit discount claimed is

Rs. 34,000/- but the chit dividend received is Rs. 41,900/- which is offered for tax. It was also pointed out that Rs. 4.66 Lakhs was received on the chit auction on 17.05.2013. She submitted that this is an additional evidence being filed by the assessee which should be admitted because these evidences goes to the root of the matter. She further pointed out that on page no. 136 of the paper book is the copy of bank statement for the relevant period and amount of Rs. 4.66 Lakhs was credited in the bank account and thereafter, funds were transferred to Attur Steels Pvt. Ltd. of Rs. 60 Lakhs and Rs. 50 Lakhs on two dates for business purpose. Thereafter she submitted that on page no. 138 of the paper book is the ledger copy of Koppam Chits Pvt. Ltd. and as per the same, chit discount is of Rs. 25,000/- and chit dividend received is Rs. 53,440/- and an amount of Rs. 4.75 Lakhs was received on 21.01.2014 and this amount was credited in the bank account as per the bank statement available on page no. 141 of the paper book and various cheques were issued from this bank account for business purpose and hence, the funds raised from the chit was used for business purpose. She further pointed out that on page no. 151 of the paper book is the ledger copy of Chalam Chits (P) Ltd. and as per the same, chit discount is Rs. 35,000/- and chit dividend received is Rs. 73,400/- and an amount of Rs. 5.65 Lakhs was received on 19.12.2013 on account of chit auction and as per the bank statement available on page no. 153 of the paper book, this amount was credited to the bank account. Thereafter various cheques were issued from this bank account for business purpose. She thereafter pointed out that on page no. 157 of the paper book is the ledger copy of Chalam Chits (P) Ltd. in which chit discount is Rs. 32,000/- and the chit dividend received is Rs. 73,400/- and an amount of Rs. 5.68 Lakhs was received on 15.03.2014 towards chit prize and on page no. 160 of the paper book is the relevant bank statement where this amount was credited in the bank account and thereafter various cheques were issued from this bank account for business purpose. Thereafter she pointed out that on page no. 164 of the paper book is the ledger copy of Sri Paranthama Chits (P) Ltd. as per which there is chit discount of Rs. 50,200/- and chit dividend received is Rs. 69,900/- and an amount of Rs. 4,69,500/- was received on 19.10.2013 on account of chit

auction and the same was credited in the bank account available on page no. 174 of the paper book, thereafter, various cheques were issued from this bank account for business purpose. She again pointed out that on page no. 175 of the paper book is the ledger copy of Sri Paranthama Chits (P) Ltd. as per which there is chit discount of Rs. 27,000/- and chit dividend received is Rs. 50,200/- and an amount of Rs. 4.73 Lakhs was received on 12.12.2013 which has been credited in the bank account available on page no. 178 of the paper book. Thereafter various cheques were issued from this bank account for business purposes. She submitted that from these additional evidences, it is apparent that the funds received by the assessee through chit was used for business purpose and in addition to chit discount claimed by the assessee in respect of various chits, the assessee has earned income of chit dividend also which is offered to tax. It was her submission that either chit discount should be allowed in full or the same should be reduced from chit dividend income and only the net chit dividend income should be taxed and not the gross. As against this, the Id. DR of revenue supported the orders of authorities below.

7. We have considered the rival submissions. We find that as per the assessment order para no. 4.1 for Assessment Year 2014-15, this is the stand of the AO that the assessee company is making investment in chits and the chit money is used to create assets and increase capital base of the company and hence, any loss related to investment in chit fund should not have been claimed as revenue expenditure. As per ledger copy of this account available on page no. 28 of the paper book, the assessee has claimed chit discount of Rs. 20.28 Lakhs and as per page no. 29 of the paper book, the assessee has offered for tax Rs. 15,35,770/- on account of chit dividend received. At this juncture, we feel it proper to reproduce para nos. 3 to 13 of the Tribunal order rendered in the case of Kamal Raheja Vs. ITO (supra). These paras are as under.

*“3. Ground No. 2 and 3 relate to the disallowance of Rs. 2,15,090/-. The facts relating to this ground are that the Assessing Officer during the course of hearing noted that the assessee has debited a sum of Rs. 2,15,090/- as the chit loss in its Profit & Loss account. The Assessing Officer disallowed the same and added that the same in the income of the assessee.*

4. When the assessee went in appeal before Ld. CIT(A), Ld. CIT(A) confirmed the order of the Assessing Officer. In view of the decision of Hon'ble Punjab & Haryana High Court in the case of Soda Silicate and Chemicals Works Vs. CIT 179 ITR 588.

5. I have heard the rival submissions and carefully considered the same along with the orders of the tax authorities below. No doubt, a chit fund incidentally partake of the nature of saving scheme. Chit fund is primarily intended to operate as a scheme for advancing loans from the common fund to this subscribers, their turns for getting such loans being determined either by auction or by drawing lots.

6. There is no dispute that the assessee incurred the chitty loss of Rs. 2,15,090/- and claimed the same as deduction. The Assessing Officer disallowed it holding as a capital expenditure relying on the decision of the Punjab and Haryana High Court in the case of Soda Silicate & Chemical Works 179 ITR 588. The assessee subscribed to various chitties and the chits were bid for raising funds, for business purposes of the firm. The chit instalments were being paid on the due dates and when the chitty was terminated, the balance represented interest was treated as chitty loss and written off in the profit and loss account. The object of subscribing to a chitty was to finance the business and not for saving money by the subscriber. Usually the subscriber will join a chitty and after remitting certain instalments he would bid it and the money so obtained would be utilised for the purpose of business. It is a means of raising finance at easy means without paying interest and at a discount and this discount foregone after deducting the discount received for the loss of a subscriber and so it was a business loss.

7. The Kerala High Court in the case of CIT v. Kottayam Co-operative Bank Ltd. [1974] 96 ITR 181 held that –

“The dominant motive which prompts most people to join chit fund schemes is to avail themselves of the facility of bidding the kuris when they are in urgent need of finance so that they may receive the chit amount in lump as a loan with the facility of repaying it in monthly instalments. A chit fund does, no doubt, incidentally partake of the nature of a saving scheme also. But, unless amounts are advanced to the prizing subscribers through a scheme of competitive bidding or by drawing lots, there will be no income derived either by way of interest or by way of amounts forgone, by the bidders at the auction. Thus, the chit fund is primarily intended to operate as a scheme for advancing loans from the common fund to the subscribers, their turns for getting such loans being determined either by auction or by drawing lots. The Tribunal was, therefore, perfectly right in holding that, in conducting the chit funds, the assessee was providing credit facilities to its members and that the income earned by the assessee from the said business is entitled to

*deduction under section 80P(2)(a)(i) of the Act.”*

*In the above referred case, the point involved was a deduction by the Co-operative Bank under section 80P(2)(a)(i) of the Act. However, the Punjab and Haryana High Court took a different view in the above referred case and held that the loss so incurred is not allowable.*

*8. In these days it has become very common for the business class as well as the general investors to contribute to chit fund companies and subscribe to various chits for raising finances. In a chit fund scheme, every member subscribes a certain sum of money periodically by way of installments over a determined period of time and each subscriber gets a sum determined by a chit fund company during the tenure of the chit or at the time of completion of chit. The subscriber who receives the money in the earlier period receives a lesser amount as compared to the subscribers who receive the amounts in later periods. The scheme of the chit fund companies is covered by the Chit Fund Act, 1982 which enacted to have a control on the operation of Chit Fund Companies and to protect the interests of the subscribers to a chit fund company.*

*9. It was contended that there is a concept of mutuality in subscribing to the chit fund. The nature of chit fund companies suggests that all the members participate together and make contributions to the chit fund and the company distributes the prize money amongst the members in a prescribed manner. The identity of all the contributors of the Chit Fund is established and it can be presumed that the chit fund concept is based on the concept of mutuality. These principles derive support from the judgment of the Andhra Pradesh High Court in the case of (i) CIT v. Merchant Navy Club [1974] 96 ITR 261; CIT v. Royal Western India Turf Club Ltd. [1953] 24 ITR 551 (SC), Sports Club of Gujarat Ltd. v. CIT [1988] 171 ITR 504/37 Taxman 38 (Guj.) and (iv) CIT v. Nataraj Finance Corpn. [1988] 169 ITR 732/[1987] 35 Taxman 280 (AP). Based on these principles of mutuality, the Punjab and Haryana High Court in the case of Soda Silicate & Chemical Works (supra) has held that the surplus sum received from a chit fund cannot be treated as income in the hands of the participants. The Court has further held that in case there is a loss to a chit fund holder by way of participation in the chit, the same cannot be allowed as business expenditure, since, the principle of mutuality is applicable and no member of the chit fund can incur a loss/or earn gain from mutual participation in the fund. While delivering the above judgment, the Punjab and Haryana High Court also referred to a direct decision on the subject in the case of CIT v. Kovur Textiles & Co. [1982] 136 ITR 61 in which it was held by the Andhra Pradesh High Court that in case an assessee subscribes to a chit fund by joining in a chit group and after paying few instalments, bids the chit and claims the difference between the total payments towards the chit and the prize for which it was bid as business loss, then the assessee is entitled to the same if the*

*chit fund money is utilised for business purposes and the chit is only a method of funding the business needs just like any other borrowing. However, the above judgment of the Andhra Pradesh High Court did not find favour with the Punjab & Haryana High Court and it proceeded to consider the aspect of mutuality and came to the conclusion that neither a member of a chit fund company is entitled to any loss on account of shortfall of the prize received by him over the payments made by him nor any income on account of excess receipt by him is liable to be taxed as income in his hands.*

*10. It may not be out of place to point out here that on a similar issue a decision has been delivered by the Tribunal, New Delhi, in the case of ITO v. Singh Radio Co. (India) (P.) Ltd. [1991] 41 TTJ (Delhi) 296 in which it has been held that in case the chit amount is used for the purposes of business, the loss, if any, incurred on account of the shortfall of the receipt over the subscription is allowable as business expenditure.*

*11. Thus, there are three decisions before me, one is of Kerala High Court in Kottayam Co-operative Bank Ltd's case (supra), another is Andhra Pradesh High Court and the third is the decision of the Tribunal Delhi Bench, on the point of allowing the loss incurred in subscribing to the chit fund and utilising the funds raised from such chit for the purpose of business is an allowable expenditure.*

*12. The Central Board of Direct Taxes also issued instructions in this connection. However, in all the above mentioned judgments, Instruction No. 1175 issued by the CBDT under order F. No. 169/21/78-IT (80) dated May 16, 1978 was not taken into account. The gist of the instructions is reproduced below :-*

*"(a) If any person organises Chit Funds and for this purposes brings the members together, administers the Chit Funds and thereby earns commission, etc., profits made by such a person is income from business and if for any special reason there is loss then it is business loss. Normally there should be no loss to the organiser unless he takes over the liability of some of the members. In such a case the unrecovered amount due from such members will have to be treated as bad debts and the test to be adopted in usual business assessment for the allowance of bad debts would be applicable in such cases also.*

*(b) In the hands of the subscribers, a few will be receiving more than what they have subscribed. This extra amount is the nature of interest and as such, taxable. Members who take the money earlier from the chit will necessarily have to contribute more which means that they incur loss, which is nothing but interest paid for moneys taken in advance. The claim of such a loss will have to be considered for the purpose of allowance according to the provisions of the Act depending upon how*

*the money was utilised by the subscriber."*

*After the judgment of the Punjab & Haryana High Court in the case of Soda Silicate & Chemical Works (supra), the Income-tax Department in Delhi started reopening several completed assessments by invoking the provisions of section 263 or section 147 of the Income-tax Act, 1961 and in the pending assessments, it started refusing the claim of loss on account of a chit. However, in one of the cases, the Commissioner in proceedings under section 263, having been satisfied about the allowability of the claim on the basis of the judgment of Andhra Pradesh High Court as well as the Board's Instruction No. 1175 on the subject, referred the matter again to the CBDT for issuing the necessary guidelines. The CBDT has recently issued instructions to all the Commissioners vide letter dated March 25, 1992 holding that the existing Instruction No. 1175 on the subject cannot be withdrawn on the basis of the judgment of Punjab & Haryana High Court. In a way, the CBDT has upheld the position that in case the amount of chit fund money is utilised for the purposes of business, any loss incurred out of the same is allowable as business expenditure.*

*13. In accordance with the above referred three decisions and the Instruction No. 1175 issued by the CBDT, it is obvious that if a subscriber incurs loss in subscribing to the chit fund to raise funds to use them in his business or for the business purpose, such a loss is an allowable deduction. In this view of the matter, I set aside the order of the Ld. CIT(A) on this issue and delete the addition of Rs. 2,15,090/-“*

8. We find that this Tribunal order is of SMC Bench and not binding on the Division Bench but still it has got persuasive value. Moreover in this case, the Tribunal has considered the CBDT Instruction No. 1175 as well as the judgment of Hon'ble Kerala High Court rendered in the case of CIT Vs. Kottayam Co-operative Bank Ltd. as reported in (1974) 96 ITR 181 (Ker.) and also considered the judgment of Hon'ble Andhra Pradesh High Court rendered in the case of CIT Vs. Merchant Navy Club as reported in [1974] 96 ITR 261 (AP). The Tribunal has also considered the division bench Tribunal order of the Delhi Bench of the Tribunal in the case of ITO Vs. Singh Radio Co. (India) (P.) Ltd. as reported in [1991] 59 Taxman 367 (Mag.) (Delhi) and in all these judgments, it was held that the loss incurred in subscribing to chit fund is allowable if funds raised from such chit is utilized for the purpose of business. On this aspect, there is no finding of authorities below. Before us, the assessee has brought certain additional evidences on record in the form of ledger account of various

chits as well as copy of bank statements and it is being claimed before us that the money raised through chit was used for the business purpose. Under these facts, we feel it proper to restore back the matter to the file of Id. CIT(A) for fresh decision after examining these additional evidences and if the assessee is able to establish that the money raised through chit was utilized for the purpose of business, then the loss incurred in the chits being net of chit discount (-) chit dividend should be allowed as revenue expenditure. Even if the assessee is not able to establish that the money raised through chit was used for business purpose then also, disallowance should be of net amount of chit discount (-) chit dividend and not of gross amount of chit discount. The Id. CIT(A) should pass necessary order as per law as per above discussion after providing reasonable opportunity of being heard to both sides. His order should be a speaking and reasoned order.

9. In the result, both the appeals filed by the assessee are allowed for statistical purposes.

Order pronounced in the open court on the date mentioned on the caption page.

Sd/-  
(PAVAN KUMAR GADALE)  
Judicial Member

Sd/-  
(ARUN KUMAR GARODIA)  
Accountant Member

Bangalore,  
Dated, the 20<sup>th</sup> September, 2019.  
/MS/

Copy to:  
1. Appellant  
2. Respondent  
3. CIT  
4. CIT(A)  
5. DR, ITAT, Bangalore  
6. Guard file

By order

Assistant Registrar,  
Income Tax Appellate Tribunal,  
Bangalore.