

Shriram Chits And Investments P. Ltd. vs Assistant Commissioner Of Income-Tax on 27 May, 2003

Equivalent citations: [2003]263ITR65(CHENNAI)

ORDER

A. Kalyanasundharam, Senior Vice-President

1. The appeal by the assessee, a company carrying on the business of running of chits, is on the aspect of proper method of accounting of its income from the running of chit business. The issue raised in this present appeal is a matter of concern of companies and other persons carrying on the chit business all over Tamil Nadu. The hon'ble President of this Tribunal accordingly constituted this Special Bench, to examine the concept of the chit business governed by the Chit Funds Act, 1982 (hereinafter referred to as "the CFA"), enacted by the State Legislature and determine the system of accounting that would reflect the proper income for the previous year relevant to the assessment year for assessment of income under the provisions of the Income-tax Act, 1961 (hereinafter referred to as "the Act").

2. The assessee was represented by learned counsel, Mr. Gopal, and the Department was represented by Mr. Acharya, who holds the rank of the Commissioner of Income-tax. Both Mr. Gopal and Mr. Acharya extended full cooperation and assistance to this Bench in the appreciation of the nature of the chit business and on the proper of system of accounting. We place on record our appreciation for the both the representatives in this regard.

3. The assessee is a registered company with the main object to carry on the business of chit. The assessee was following the mercantile system of accounting in regard to the commission earned by it in its capacity as foreman conducting the chit activity and this practice continued till December 31, 1985. For the three months from January 1, 1986, to March 31, 1986, the assessee chose to change its system of accounting to completion method accounting, i.e., the income of foreman was being accounted on completion of the chits. The authorities below did not accept this change on the reasoning that the commission accrued and was due to the foreman on the day of conduct of the auction of the chit. The effort of learned counsel, Mr. Gopal had been to show that the income accrues only at the closure of the chit because, it is at that point of time, the financial impact of running and maintaining of chit could be determined. The effort of the learned representative of the Department, Mr. Acharya, was to show that the income earned for the services as foreman has nothing to do with the final result of profit or loss from the running of the chit.

4. Learned counsel, Mr. Gopal, carried us through the provisions of the CFA and this was so done so that we appreciate the constraints that are placed on foreman in the running and maintaining of the chit. Section 2 of the CFA dealt with definitions of the various terms used in the said Act and the terms relevant to the issue before us are, chit, chit agreement, chit amount, defaulting subscriber, discount, dividend, draw, foreman, non-prized subscriber, prize amount, Registrar, subscriber and

ticket. Chapter II of the CFA deals with registration of chits, commencement and conduct of chit business, from Sections 4 through to Section 19. Chapter III prescribes rights and duties of the foreman and this is so expressed from Section 20 through 26. Chapter IV covers rights and duties of non-prized subscriber from Section 27 through Section 30. Chapter V touches upon rights and duties of prized subscribers from Section 31 through 33. Chapter VI has the caption "transfers" and covers, restriction on transfer of rights of foreman (Section 34), transfer of non-prized subscriber's rights to be in writing (Section 35), recognition of transfer (Section 36), entering of transferee's name in the books (Section 37). Chapter VII deals with the meeting of the general body of subscribers and Chapter VIII deals with termination of chits. The other Chapters deal with inspection of documents including the power to inspect by Reserve Bank of India, appointment of officers and to levy fee for such inspection and the winding up of the chit. We shall reproduce from the CFA the provisions contained in the relevant sections that are of material importance to the issue before us.

5. Section 2(b) of the CFA defines "chit" and it reads, "means a transaction whether called chit, chit fund, chitty, kuri or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical instalments over a definite period and that such subscriber shall, in his turn, as determined by lot or auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount". The term "chit agreement" is defined as "means, the document containing the articles of agreement between the foreman and the subscribers relating to the chit.(Section 2(c) of the CFA). Chit amount is defined in Section 2(d) of the CFA as means the sum total of the subscriptions payable by all the subscribers for any instalment of a chit without any deduction of discount or otherwise. "Defaulting subscriber" is defined in Section 2(f) of the CFA as, "means a subscriber who has defaulted in the payment of subscriptions due in accordance with the terms of the chit agreement". Discount in Section 2(g) of the CFA is defined as means the sum of money or the quantity of grain which a prized subscriber is under the terms of the chit agreement, required to forego and which is set apart under the said agreement to meet the expenses of running the chit or for distribution among the subscribers or for both. "Dividend" is defined in Section 2(h) as "means the share of the subscriber in the amount of discount available under the chit agreement for rateable distribution among the subscribers at each instalment of the chit". "Foreman" is defined as "means the person who under the chit agreement is responsible for the conduct of the chit and includes any person discharging the functions of the foreman under Section 39".

6. Section 6 of the CFA describes the chit agreement and its contents and in Sub-section (2), the duration of a chit is limited to five years from the date of its commencement. Section 7 of the CFA requires the filing of every chit agreement with the Registrar by the foreman. Section 8 of the CFA prescribes the minimum capital requirements for the commencement of a chit and the creation of the reserve fund by the company. Section 9 touches upon the duty of the foreman to file with the Registrar a declaration to the effect that all the tickets specified in the chit agreement are fully subscribed. The CFA also places a limit on the maximum chit amount as rupees one lakh. It also places restrictions on the amount of chit business as is applicable to a firm, association of persons, others, a company, co-operative society who carries on the chit business. Section 14 of the CFA

prescribes utilisation of funds and this reads, "(1) no person carrying on chit business shall utilise the moneys collected in respect of such business (other than commission or remuneration payable to such person or interest or penalty, if any received from defaulting subscriber), except for--(a) carrying on chit business ; or (b) giving loans and advances to non-prized subscribers on the security of subscriptions paid by them ; or (c) ..."

7. The CFA also prescribes that the chit agreement shall state the date, time and place of each draw and requires the foreman to issue the prescribed notice in that connection to all the subscribers. It also prescribes the minimum number of subscribers required for a draw as two and for some reason a draw could not be held, it states that the Registrar may direct to hold the draw in his presence or any person appointed by him. Each draw shall be recorded and its minutes shall be filed with the Registrar.

8. We have brought out above the salient features of the CFA. The foreman is appointed under the CFA to perform various functions, for which he is paid remuneration for such functions. His main function is to draw up the chit agreement, fix the period, of the chit, and fix the instalments and the instalment amount and the number of subscribers for the chit. He shall then file the agreement with the Registrar for his approval, followed by placing in deposit fifty per cent, of the chit amount in a bank and provide a bank guarantee for the balance fifty per cent. He shall bring together subscribers who shall sign the chit agreement and contribute towards their subscription amount. He shall notify the date and place of the draw and conduct the draw on the appointed date after making sure that the quorum required for the conduct of the draw is satisfied, i.e., the number of subscribers present are more than two in numbers. He is permitted to make the draw by auction and in case of two persons offering identical discounts to the maximum the prized subscriber shall be determined by lot. He is required to record the minutes of the draw and file it with the Registrar. He is required to call upon the subscriber who is the prized subscriber to furnish security covering the future instalments of the chit subscription, after which only the prize money could be paid. Alternatively, if the prized subscriber agrees to the deduction of the amount covering the future instalments, he may deduct such amount from the prize money and pay him the balance. The amount so deducted that covers the future subscription is required to be kept in a deposit with the approved bank and shall be utilised for payment of the subscription amount only. He shall keep track of all the subscribers and the amount of subscription payable by each. He shall also notify a defaulting subscriber as mentioned in the chit agreement that his name is liable to be removed unless he deposits the defaulted amount together with interest within seven days from the receipt of such intimation or notice. He shall make entries in the relevant book maintained for this purpose and file its copy with the Registrar.

9. The CFA, in Section 14 prescribes the utilisation of moneys collected in a chit business for certain purposes, like, carrying on of the chit business, giving loans and advances to non-prized subscribers, investing in trustee securities and making of deposits in approved banks. The exception to the above rule is on the commission or remuneration payable to the foreman. Section 21 of the CFA deals with the rights of foremen and covers his right to an amount not exceeding five per cent, of the chit amount as may be fixed in the chit agreement by way of commission, remuneration or for meeting the expenses of running the chit. The term "chit amount" is defined in Section 2(d) of the CFA as

"means the sum total of the subscriptions payable by all the subscribers for any instalment of a chit without any deduction of discount or otherwise". The draw is held each month on the appointed date and time as is mentioned in the chit agreement. The subscriber who offers the maximum discount to the chit amount is the prized subscriber and the discount so offered is allowed to be used for meeting the expenses for running of the chit or for distribution among the subscribers or for both.

10. The foreman is thus allowed to a fixed amount as commission or remuneration at the time of each monthly draw, and is permitted to pay himself from the subscription amount his commission or remuneration that becomes due to him at that draw. The chit business is run as any other business and is surrounded by problems of subscribers defaulting in the payment of subscription, following it up with the defaulting subscriber to pay the instalments with interest and remove him after giving a notice, distribute the discount amount earned at each draw to all the subscribers and draw his commission or remuneration too. Every business has its problems and the profit or a loss that the running business has earned or suffered is related to a year, and by the drawing up of the profit and loss account and the balance-sheet at the end of each year. The remuneration or commission that is the right of a foreman is earned by him at each monthly draw and the CFA also allows him to pay himself his remuneration or commission, from out of the subscription collections. The remuneration or commission of the foreman accrues at each monthly draw and it becomes due to him and is payable to him from out of the monthly subscriptions. The accrual of income of remuneration or commission together the right to receive it is related to each draw and gets completed on that basis.

11. The decision of the Bombay Bench in Corrosion Control Services (Bombay) (P.) Ltd. v. DCIT [1999] 70 ITD 109 is inapplicable to the present case because, the said case related to an agreement between a contractor and contractee and the contractee retaining certain per cent of the contract amount as retention amount payable on successful completion of the warranty period. In the instant case, the chit has a specified period, the agreement specifying the instalments of each subscriber together with the number of subscribers to each chit. It also mentions the date of draw, the discount amount and the manner of utilisation of the discount amount by paying the foreman's commission and the distribution to the subscribers. From the subscription amount collected each month, the foreman is permitted to pay his commission or remuneration as is indicated in the chit agreement. Therefore, there is no restriction at all in the determination of the commission or remuneration of the foreman and its payment. We are therefore of the opinion that the claim that the foreman's commission or remuneration should be related to or determined on the basis of each chit completing its period, is not justified in view of the clear provisions of the CFA in regard to both accrual and right over it as brought out above. The change in the method of accounting of commission or remuneration from January 1, 1986, is therefore, not justified for the aforesaid reasons. The claim of the assessee is accordingly rejected.

12. The other issue in appeal is with reference to the rate of depreciation permissible to generators driven by petrol or diesel. The authorities were of the opinion that the rate of 30 percent, is applicable to generators that run on wind energy or other renewable energy device and rejected the claim of the appellant. In our opinion and on the facts of the present case, no interference is called

for with the orders of the authorities and we uphold the orders.

13. In the result, the appeal fails and is dismissed.