

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated : 30.08.2012

Coram

The Honourable Mrs.Justice CHITRA VENKATARAMAN
and

The Honourable Mr.Justice K.RAVICHANDRABAABU

TC(A). Nos. 141 and 213 of 2004, 616, 621, 622,
624 to 628 of 2005, 2445, 2449 and 425 of 2006

T.C.(A). No. 141 of 2004

Shriram Chits & Investments (P) Limited

Mookambika Complex

4, Lady Desikachari Road

Mylapore,

Chennai 600 004

... Appellant

-vs-

The Assistant Commissioner of Income Tax

Central Circle II (3)

Nungambakkam High Road

Chennai 600 034

... Respondent

Tax Case (Appeal) against the order of the Income Tax Appellate Tribunal, Chennai 'A'
Bench dated 27.05.2003 in I.T.A.No. 296/ Mds/ 1991.

For Appellant : Mr.V.D.Gopal

For Respondent : Mr.N.V.Balaji
Standing Counsel for Income Tax

COMMON JUDGMENT

(Judgment of the Court was made by CHITRA VENKATARAMAN ,J)

The assessee is on appeal as against the order of the Income Tax Appellate Tribunal. The issues raised in these appeals are common except Tax Case Appeal Nos.141/2004, 425 and 426/2006, and 213/2004 . So far as Tax Case Appeal No.141/2004 relating to assessment year 1987-88, T.C.(A).Nos.425 and 426/2006 relating to the assessment year 1995-96 and T.C.(A).No.213/2004 relating to assessment year 1991-92 are concerned, the following are the substantial questions of law:-

"1. Whether in law taxable income accrues in the case of chit company rendering services to the chit subscriber only at the end of the chit period and therefore completed contract method of accounting is the proper method of accounting ?

2. Whether in law, in the light of Section 5 of the Income Tax Act 1961 and Section 2 of the Chit Funds Act 1982 commission cannot be taxed as income without meeting the cost of services to be provided till the end of the chit period and the cost of bad debts ?"

In so far as Tax Case Appeal Nos.616/2005, 628/2005, 627/2005, 624/2005, 625/2005, 617/2005, 213/2004, 618/2005, 626/2005, 620/2005, 622/2005, 623/2005, 621/2005, 619/2005, 425/2006, 2445 and 2449/2006 are concerned, they are relating to the assessment years 1988-89, 1988-89, 1989-90, 1989-90, 1990-91, 1990-91, 1991-92, 1991-92, 1992-93, 1992-93, 1993-94, 1993-94, 1994-95, 1994-95 and 1995-96, 1995-96 and 1999-2000 respectively. Apart from the above two questions of law, the assessee raised two other questions in the above Tax Case Appeals. Thus, the questions of law raised in these Tax Case Appeals are as under:-

" 1. Whether in law taxable income accrues in the case of chit company rendering services to the chit subscribers only at the end of the chit period and therefore completed contract method of accounting is the proper method of accounting ?

2. Whether in law, in the light of Section 5 of the Income Tax Act, 1961 and Section 2 of the chits funds Act, 1982 commission cannot be taxed as income without meeting the cost of services to be provided till the end of the chit period and the cost of bad debts ?

3. Whether in law, the dividends received by the appellant as a chit subscriber is exempt from taxation on grounds of mutuality between all the chit subscribers including the appellant ?

4. Whether in law, the proper course open to the ITAT was to refer the matter to a larger Bench especially when the case law cited in the grounds of appeal is in favour of appellant ?"

2. The facts in all these cases are one and the same. The assessee is engaged in the business of running chits. Till 31.12.1985, the assessee was following mercantile system of accounting as regards the commission earned by it in its capacity as foreman, conducting the chit activity. However, thereafter, while following mercantile system of accounting, the assessee changed the system of accounting to completion contract method of accounting, that the commission earned by foreman was accounted for on completion of each series of chits. The Revenue did not accept the change on the ground that on the date the auction was conducted, the right to receive the commission in the capacity as Foreman had accrued; consequently, the assessee was not entitled to wait for the completion of each chit period, as there was no accrual of income at the end of each term. The assessee's contention was rejected by the Income Tax Officer. Aggrieved by this, the assessee went on appeal before the Commissioner of Income Tax (Appeals).

3. A reading of the order of the Commissioner of Income Tax (Appeals), particularly the order passed for the assessment year 1987-88, shows that the first appellate authority considered the question as to whether at all the assessee had really changed its method of accounting. The Commissioner of Income Tax (Appeals) viewed that the assessee had merely changed its presentation and not really the method of accounting. He held that every auction is a step towards the fulfilment of a contract between the assessee company and the subscribers. The foreman continues to receive the commission before the distribution of the dividend income,

which had already accrued to the assessee; hence, assessable without postponing the same to the end of the chit period and there was no question of postponing the accounting to the end of the chit period. The Commissioner of Income Tax (Appeals) further pointed out that even though the assessee claimed that it had to suffer bad debts on the different auctions when the subscribers defaulted in not meeting their commitments, yet, the assessee had not placed before the Commissioner, materials to show that the system of accounting it followed till 01.04.1986 showed impracticable results; in the circumstances, the change in the presentation of accounts based on completion of contract, did not facilitate the determination of correct profits of the assessee. Thus, the presentation of accounts did not help in the determination of correct profits of the assessee's business. This reasoning was followed in other appeals. Aggrieved by the same, the assessee went on appeal before the Income Tax Appellate Tribunal.

4. After referring to the various provisions of the Chit Funds Act, the Tribunal pointed out that the foreman is allowed a fixed percentage 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 the problems regarding bad debts cannot be termed as a speciality of the business. Thus, remuneration or commission of the foreman accrues at the end of chit draw and it becomes due to him and is payable to him from out of the monthly subscriptions. The accrual of income as commission together with the right to receive it, is related to each draw and gets completed on that basis. In the circumstances, the Tribunal held that the foreman's commission has to be related to and determined on the basis of every auction and not to be postponed to the completion period. Thus, the assessee's appeal was dismissed. Aggrieved by this, the present appeals are filed by the assessee.

5. Learned counsel appearing for the assessee, while taking us through the decision of the Supreme Court in the case of M/s.Shriram Chits & Investment (P) Ltd., Vs. Union of India and others reported in AIR 1993 SC 2063, pointed out to the various obligations, responsibilities and liability to be discharged by the foreman and submitted that each group or each series of chit is one transaction and the foreman has statutory responsibilities and risks relating to the conduct of the chit of the series. Apart from the conduct of the chits, the draws or auction and maintenance of accounts, the responsibilities of the foreman include his obligations to pay the prize amount on the date, whether or not all the members have paid their subscriptions. As enjoined in the provisions of the Act, if the prized member defaults in instalments, the foreman has to make good the deficit out of his own resources apart from the steps to be taken by the foreman for realising all the amount. Thus, chit transaction of every series is one single transaction involving a series of activities and every stage of activity is having several obligations. The income that the company would earn has to be necessarily worked out on the basis of the completion of the transaction and not on proportionate basis.

6. Mr.V.D.Gopal, learned counsel appearing for the assessee, further pointed out to the decision of the Apex Court in the case of Commissioner of Income Tax Vs. Bilahari Investment P.Ltd reported in (2008) 299 ITR 1 (SC), wherein, the Supreme Court had an occasion to

consider the case of the subscriber to a chit and the distinction between the completed contract method of accounting and the proportionate system of accounting, income and realisation in chit transaction. Referring to the various obligations in the Chit Funds Act, particularly, dividend declaration, learned counsel pointed out that even in preparing the financial statement, the assessee is guided by the historical background; the transaction period of every chit runs over a number of months and hence, the nature of business cannot be lost sight of for the purpose of appreciating the claim of the assessee; that the income, in effect, has to be necessarily worked out only at the end of the transaction period when results are available on how much, in fact, would be the discount and the dividend accruing through the particular series. Hence, it is too impracticable for anyone to say with any degree of certainty, what could be the income for the purpose of apportioning during any particular period. In short, the submission of the learned counsel for the assessee is that the completion of contract method is the most appropriate method to arrive at the income of the assessee. He further pointed out that even though the assessee is entitled to the foreman's commission on the conduct of auction every month, yet, that, by itself, cannot be taken as a positive indicator as to the income that the assessee is likely to receive in the future months. Thus, there could be no question of estimating profit in the line of business before the end of the series; in the circumstances, he submits that the Tribunal committed serious error in rejecting the assessee's case. As regards the claim for deduction on expenditure, he pointed out that the expenditure incurred by the assessee in running the chit business cannot be apportioned to any particular chit group during any particular period and considering the nature of business carried on by the assessee, the advertisement expenditure to keep the business growing are very much part of the business expenditure, which has to be allowed as a deduction in the year in which it was incurred.

7. Referring to the amendment to Section 145 of the Income Tax Act, 1961 with effect from 01.04.1997 in the Finance Act, 1995, learned counsel pointed out that the accrual method of accounting continued as a system of accounting too. Thus, even though the assessee followed the mercantile system of accounting, yet, business necessities call for following the completed contract method and hence, due regard has to be given to the responsibilities imposed under the Chit Funds Act and the nature of business for the purpose of determining the income on the completion contract basis.

8. Assailing the claim of the assessee, learned Standing counsel appearing for the Revenue submits that there is no dispute on the fact that the assessee has the right to change the method of a particular system of accounting. But this, however, does not mean that the change in the method of accounting, which distorts the income, could be accepted by the Revenue. The only ground on which the assessee sought for change in the accounting method is that there is uncertainty with regard to the receipt of commission and secondly, the uncertainty regarding subscribers making up the instalments regularly. Learned Standing counsel pointed out that while preparing the financial statement, it is an accepted practice that estimates are used as key element. Given the nature of responsibilities of the foreman under the Chit Funds Act, on a chit holder bidding the prize amount, he becomes a prized chit holder. Under Section 31 of the Act, the prized subscriber has to furnish security for the due payment of all future subscriptions. In the event of a default committed by this prized subscriber, it is no

doubt true that the company suffers a loss. Yet, the assessee is always backed up by a good security. Thus, the uncertainty spoken to by the assessee is without any legal or factual basis. In case of non-prize chit holder, in the event of default, Section 28 of the Chit Funds Act, 1982 provides for the remedy as by way of removal of the non-prized subscriber or alternatively, a foreman may substitute any person in place of the defaulting subscriber as per Section 29 of the Chit Funds Act. Thus, in either case, there is no loss for the assessee to contend that uncertainty in respect of payment of instalments leads to indeterminate income for the assessee to follow the completed contract method. Thus, while Sections 28 and 29 of the Act provide for substitution, Section 31 of the Chit Funds Act provides for protection of the company against any risk or uncertainty in the matter of realising the amount due to the Chit Fund company. Thus certainty as regards the receipt of income is the key element in the financial statement of the company.

9. Referring to the Accounting Standards, particularly, the old provisions in Accounting Standard relating to construction contracts AS-7 and AS-11, learned Standing counsel submits that even though strictly speaking, this may not have a binding character in deciding the question, yet, for the purpose of understanding the concept of completed contract method, guidance should be taken from the accounting standards as well as research reports and financial statements prepared by the Institute of Chartered Accountants of India. Referring to the old provisions contained in Accounting Standard AS-7 relating to construction contracts - Disclosure of Accounting Policies and Accounting Standard AS-9 - Revenue Recognition, learned Standing counsel submitted that even if chit transaction is to be taken as one single transaction, revenue recognition requires revenue as measurable at the time of running of service. In other words, going by the provisions of the Chit Funds Act, a reasonably determinable nature of receipts would discount the claim of the assessee to prefer the completed contract method as regards its receipts. He pointed out that the services of the assessee are provided every month; hence, certain determinable results, particularly with reference to the commission payable to the assessee, are always available to the assessee. Hence, revenue has to be recognised on straight line basis and every act performed by the assessee every month positively point out to the commission receipt every month and hence, has to be taken as for the purpose of revenue recognition. Thus, even though there may be certain degree of uncertainty on an individual chit holder complying with his obligation, yet, the interest of the company is protected well by the provisions of the Chit Funds Act. The sheet-anchor of Revenue's contention is that there is certainty as regards income viz., that the dividend it gets by way of commission. Thus, the contention of the assessee that there is uncertainty in ascertaining the income every month, fails.

10. Learned Standing Counsel appearing for the Revenue further pointed out that the method adopted by the assessee is not completed contract method, even if the change in the system of accounting is to be accepted as bona fide. Pointing out to the decisions of the Supreme Court that there should be matching concept of income and expenditure, learned Standing Counsel pointed out that while the assessee has taken the commission and dividend to the end of the chit period, there are certain expenditure apart from the administrative expenditure which are claimed then and there and not deferred. Expenses incurred like

advertisement costs, which are for the particular chit group, are also claimed as expenditure in the year in which it had incurred and not deferred. While there is accumulation of profit to the chit end period while calculating the real income, there exists distortion in identifying the income and as such, the system of accounting adopted by the assessee is not completed contract method. Learned Standing Counsel pointed out that if the assessee had taken the entire costs to the end, thereby postponing the entire costs as in the case of receipts, the Revenue might not have any objection, wherein, one may find matching principle on income and expenditure. Thus, taking the cost attributable on every chit as available for the particular series on the completed contract method, taxable income identification would not be a problem. On the contrary, taking the cost alone for deduction in the year for consideration and postponing the income to the transaction period end, really results in revenue escapement. He further pointed out that even though the assessee's business is chit business, yet, the salary paid and the overhead charges are actually involved in running the particular chit series claimed as deduction in the year of incurring expenditure, thus, makes the claim of the assessee totally unscientific; hence, the system of accounting should be rejected. In this context, he placed reliance on the decision of Supreme Court in the case of Commissioner of Income Tax Vs. Bilahari Investment P.Ltd., reported in (2008) 299 ITR 1 (SC) and the decision of this Court in the case of G.Padmanabha Chettiar and Sons Vs. Commissioner of Income Tax reported in (1990) 182 ITR 1.

11. Learned Standing Counsel pointed out that what the assessee had followed is cash system for expenditure and accrual system for income, which, in fact, clearly distorts the income chargeable to tax. Thus, when the assessee has certainty of income, one by way of dividend as per Sections 28, 29 and 31 of the Chit Funds Act and the commission arising out of the conduct of the business, one may note that the ultimate income of the assessee has to be worked out only by the matching of income and expenditure.

12. Countering the claim of the Revenue, learned counsel appearing for the assessee referred to the decision in the case of Commissioner of Income Tax Vs. Bilahari Investment P.Ltd reported in (2008) 299 ITR 1 (SC), wherein, the Apex Court pointed out that every assessee is entitled to arrange its affairs and follow the method of accounting. The assessee had not taken the receipt of the dividend on accrual basis. The method adopted by the Revenue on the percentage of completed contract method on proportionate basis was wrong. The Apex Court clearly held that in the absence of any finding recorded that the completed contract method distorted the profits of the particular year and the chit scheme being one single scheme spread over a period of time, the method adopted by the Revenue in proportionate basis on the percentage of completed contract method was erroneous. Learned counsel further pointed out that the said decision was a case of a subscriber where the assessee had accepted the view of the High Court as regards chit dividend that the completed contract method was not correct. The question before the Supreme Court in the appeal at the instance of the Revenue was as to whether the completed contract method of accounting adopted by the assessee for chit discount is required to be substituted by the percentage of completed contract method. Learned counsel pointed to paragraph 16 of the judgment, wherein the Apex Court pointed out that in the completed contract method, revenue is not recognised till the contract is complete. The profit and loss is established in the last accounting period and transferred to the profit and

loss account. This determined the results on the completed contract method. The Apex Court pointed out that this method leads to the objective assessment of the results of the contract.

13. Given the fact that each chit series is a transaction by itself, with intervening activities in the conduct of the chit transaction, with the conduct of the auction of every month facing ups and downs and ultimately seen in the matter of discount, the determination of the income of the assessee, thus, has to be necessarily postponed to the end of the transaction viz., end of the each series. However, as far as the expenditure incurred by the assessee are concerned, which are administrative in character, considering the number of chit series and transactions conducted by the assessee itself being the business of the assessee, necessarily, the assessee has overhead expenses, expenses relating to business advertisement, for the purpose of running its business. Even though a particular advertisement refers to the start of a new chit series, yet, the expenditure could not be restricted to the particular chit. On the other hand, the expenses incurred are for running of the business; thus, by applying the matching principle, the expenditure incurred cannot be postponed to the end of the chit period. Hence, given the nature of the chit transaction with each series running through the number of months, the income arising out of the particular series of chit transaction could be identified only at the end of the transaction, which may consist of a series of activities and at any intermediate stage of the chit transaction, there is no possibility of identifying the income, but has to be postponed to the last performance. In the circumstances, the decision of the Apex Court in the case of CIT Vs. Bilahari Investment P. Ltd (cited supra) supports the case of the assessee that the income of the assessee on the dividend earned every month and the discounts arising therefrom have to be necessarily taken to the end of the chit period for the purpose of ascertaining the income.

14. Heard learned counsel appearing on either side and perused the documents available on record.

15. Before going into the various contentions of the assessee, we need to know the provisions of the Chit Funds Act, 1982 and the definitions therein. "Discount" and "dividend" under Sections 2(g) and (h) respectively, are as follows:-

" 2(g) 'discount' 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:

2(h) 'dividend' 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. "

Section 12 of the Chit Funds Act speaks on the prohibition on chit company from carrying on any other business and if a company desires to carry on other business, it has to get the permission of the State Government. Section 14 of the Chit Funds Act provides for the utilisation of funds. In Chapter III, Sections 20 to 28 of the Act refer to the rights and duties of the foreman and Chapter IV (Sections 27 to 30) refers to the rights and duties of non-prized subscribers. Section 21 in Chapter III speaks about the rights of the foreman. Sub Section

(1)(b) of Section 21 states that the foreman would be entitled as by way of commission, remuneration or for meeting the expenses of running the chit, a sum not exceeding five per cent of the chit amount. Section 25 deals with the liability of the foreman to the subscribers that every foreman shall be liable to account to the subscriber for the amounts due to them. Section 27 in Chapter IV speaks about the payment of the subscription by a non-prized subscriber and Section 28 deals with the removal of defaulting subscribers. Section 29 refers to the circumstances under which there could be substitution of subscribers in the place of defaulting subscribers. Section 30 speaks about the amounts due to defaulting subscribers and the payment to be made to the defaulting subscribers. Chapter V (Sections 31 to 33) speaks about the rights and duties of the prized subscribers. Section 31 states that the prized subscriber has to furnish security for the due payment of future subscription in the event of the subscriber not offering to deduct the future subscriptions from out of the prize amount.

16. A reading of the rights of the subscribers and responsibilities of the foreman points out to the duty cast on the foreman to conduct the chit to a duration assured and in the event of any default of payment of any one of the instalments, the foreman has the responsibility to make good that loss. In the end of the chit period, the subscriber is assured of the amount for which he participated in the scheme. Thus, in the background of these provisions, read in the context of the definition of "discount" and "dividend", it is evident that on every auction, the discount that is arrived at is taken for the purpose of meeting the expenses of running the chit. The expenses normally include all expenses apart from the commission payable to the foreman and the dividend that are payable to the subscriber, which are normally carried to the end of the chit period.

17. Given the fact that every chit is an independent transaction containing a series of activities to be undertaken during the course of the transaction, one may note that even though the discount and commission are recognised with the conduct of auction every month, yet, with all the load that are mounted on the discount, the uncertainties in the payment of subscriptions and the commitments that the assessee has to discharge under the Chit Funds Act, the revenue recognition, as a business proposition becomes determinable only at the end of the particular chit transaction. In Accounting Standard 9, as published by the Institute of Chartered Accountants of India, it is stated that in a Chit Fund Business, the following items of revenue ordinarily arise viz., (1) Foreman's commission, (2) Default interest and (3) Interest on loans and advances.

18. Revenue referred to the old AS-7, which deals with accounting standards on Construction Contracts. It is fairly stated by the Revenue that even though this has no relevance to the case on hand, yet, the concepts stated for revenue recognition with reference to completed contract method and proportionate completion method offer the guidance and hence, need to be referred to. Accounting Standard AS-7 provides for Revenue recognition in case of construction contracts. Revenue recognition on the rendering of services is made either by proportionate completion method or completed service contract method, which reads as under:-

" (i) Proportionate completion method Performance consists of the execution of more than one act. Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.

(ii) Completed service contract method Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable."

19. As is evident from the reading of both these methods, while in proportionate completion method, revenue is recognised proportionately by referring to the performance of each act, the possibility of revenue recognition in the proportionate completion method being a fairly determinable one, in the completed services contract method, the difficulty in determining the revenue arises by reason of the significant nature of the services yet to be performed in relation to the transaction that normally, the revenue recognition is taken to the end of the performance. Thus, even while advocating the proportionate completion method, where there is every possibility of identifying the revenue vis-a-vis the extent of services completed, there is a line of caution stated that when there is a better method available to assess the better performance, the same may be adopted to the straight line basis for ascertaining the income. However, when the services yet to be performed are so significant in relation to the transaction, difficulty arises in recognising the revenue in the performed services. Thus in contrast to the proportionate completion method, necessarily, revenue recognition is postponed till the completion of the services of the contract; thus, under Clause 9, "Basis for Revenue recognition", it is stated that so long as there is uncertainty on the ultimate collection, revenue is not normally recognised along with rendering of services; thus, even though payment may be made on instalments, when the consideration is not determinable within the reasonable limits, recognition of revenue is postponed. A.S.7 gives the instances as to how the cost incurred by the contractor could be divided into, (i) Costs that relate directly to a specific contract (ii) Costs that can be attributed to the contract activity in general and can be allocated to specific contract and (iii) costs that relate to the activities of the contractor generally, or that relate to the contract activity but cannot be related to specific contract. Accounting Standards also describe about selection of a method of accounting for a construction contract.

20. A reading of Accounting Standards 7 and Accounting Standards 9 shows that both speak in one voice at least as regards the proportionate completion method, completion contract method and both these methods aim at the methodology for arriving at the revenue recognition with a certain degree of certainty, taking into consideration, the significance of the services performed and to be performed in relation to the particular transaction.

21. In the decision reported in (2008) 299 ITR 1 (SC) (CIT Vs. Bilahari Investment P.Ltd.), cited supra, the Supreme Court considered the relevance of completed contract method, particularly with reference to chit transactions. The said decision was an appeal by the Revenue as against the decision of this Court reported in (2007) 288 ITR 39 (Mad) (Bilahari Investments P.Ltd. Vs. Commissioner of Income Tax). The assessee therein conducting chit business is a subscriber to chits too as business activity. It maintained its accounts on mercantile basis, computing loss or profit as the case may be at the end of the chit period in respect of chits terminating in a particular year, following the completed contract method. As far as the discount was concerned, the assessee contended that the discount was not an amount paid in advance like rent or interest, but was a single amount giving rise to a single liability not only legally enforceable but also actually enforced by the foreman by deducting it from the chit amount and by paying only the balance to the prized subscriber as the prized amount; once the prized subscriber offered the highest bid, his liability for the discount became crystallized, adjusted and totally discharged and the chit discount which was payable and adjusted against the bid amount leaving only the prized amount to be disbursed to the prized subscriber, did not leave any scope for showing a part of the discount as an advance referable to the remaining period of the respective chit and it would be a misconception to call the discount amount as a time based liability and it would be legally untenable to dissect it on time basis. The assessee also contended that in the mercantile system of accounting, the liabilities were incurred irrespective of the date of payment, whereas, in the instant case, by virtue of the provisions of the Chit Funds Act and the agreement entered into between the foreman and the assessee, the liability by way of discount arose in full measure at the moment the subscriber became a prized subscriber and it was a liability in praesenti and also a statutory liability, which could not even be postponed by the act of the parties concerned. Referring to the nature of chit transactions, this Court held that the measure of future instalments does not depend upon the prized amount or the discount, nor the discount an expenditure to be incurred in future. Discount is not a deferred expenditure for which payment has been made or liability incurred and there is no deferred benefit. Hence, discount was allowable in the very same year of accrual. Hence, dividend was also to be taxed in the year of accrual. Thus, this Court confirmed the Tribunal's view rejecting the completed contract method of accounting adopted by the assessee, that the assessee cannot contend uncertainty on the discount. This Court, however, held that it is not correct to hold that the discount should be spread over for the remaining period on a proportionate basis. This Court held against the assessee, holding that the dividend was assessable in the year of accrual itself; as regards discount/loss claimed by the assessee in the year of its accrual, this Court answered the same against the Revenue that the same was allowable in the year of accrual itself and cannot be postponed or allowed on a proportionate basis. The Revenue took on appeal before the Apex Court as regards the assessability of the discount in the year itself.

22. It is a matter of record that the assessee accepted the view of this Court as regards the assessability of the dividend income in the year of accrual itself and thereby rejection of the assessee's case of completed contract method in dividend aspect.

23. In considering the question as to whether discount was to be considered as in the case of dividend on accrual basis, the Apex Court considered the difference between the completed contract method and the proportionate contract method. While pointing out that Recognition/identification of income under the 1961 Act is attainable by several methods of accounting, the Apex Court pointed out to the distinction between the completed contract method and the percentage of completion method in paragraphs 16 and 17, which is as follows:-

" 16. Under the completed contract method, the revenue is not recognised until the contract is complete. Under the said method, costs are accumulated during the course of the contract. The profit and loss is established in the last accounting period and transferred to the profit and loss account. The said method determines results only when the contract is completed. This method leads to objective assessments of the results of the contract.

17. On the other hand, the percentage of completion method tries to attain periodic recognition of income in order to reflect current performance. The amount of revenue recognised under this method is determined by reference to the stage of completion of the contract. The stage of completion can be looked at under this method by taking into consideration the proportion that costs incurred to date bears to the estimated total costs of contract. "

24. A reading of the judgment thus points out that the principal difference between these two methods is that in the proportionate completion method, there is possibility of a periodic recognition of income with reference to the stage of performance of the transaction; that the proportionate costs and income to the possible cost of the contract enables one to identify the income with reference to the stage of completion of contract. In the context of this, the Supreme Court also referred to the chit scheme as one integrated concept over a period of time and on an analysis of the transaction, the Apex Court held on a perusal of the statement arising out of change of method from completed contract method to deferred revenue expenditure, that the entire exercise is revenue neutral, particularly when the scheme is read as one integrated scheme spread over a period of time. The judgment also pointed out to the settled principle on the matching concept of income and expenditure, that the ultimate analysis results in true income for the purposes of assessment.

25. It is no doubt true that the decision rendered was in the case of the subscriber to the chit; nevertheless, the decision of the Apex Court is an authority for the proposition that the revenue recognition in any system or method of accounting followed must rest on the matching concept of income and expenditure. On a reading of this decision along with Accounting Standards 9, it is clear that in following any system of accounting, one has to have the correlation of income in relation to the extent of service performed, that the income earned must be an ascertainable one with reference to the services rendered and the services to be performed and its significance in relation to the transaction.

26. In the context of the decision of the Apex Court dealing with completed contract method and the proportionate completion method, the claim of the assessee, running the business in chit transaction, assumes significance. As noted already, every transaction on chit

spreads over a fairly good number of months from twelve months and exceeding 12 months, with auction held for every month for every series. The multiple acts performed over the chit transaction period, thus relate to the transaction cycle of the chit scheme. As held by the Apex Court, in the chit transaction, which is an integrated scheme on savings, the responsibility of the chit subscribers to keep the contributions made till the term of the chit period, is absolute.

27. With all the responsibilities of the chit subscriber spoken to in the Chit Funds Act, conscious of the range and possibilities of compliance from the subscribers' end, the Chit Funds Act casts an onerous responsibility on the foreman to see that the chit runs through the series and it is not aborted in the midst of the series either on account of a default committed by the prized subscriber or on account of the non-prized subscriber. As already seen, Section 21 speaks about the rights of the foreman. Section 21(1)(b) of the Act speaks about the entitlement to receive commission, remuneration or for meeting the expenditure of running the chit at the rate not more than 5%. Thus, at a given point of time, a foreman cannot, with any certainty, assert that his commission be paid irrespective of the expenses that he may have to incur for the conduct of the transaction. As held in the decision in the case of *M/s. Shriram Chits & Investment (P.) Ltd Vs. Union of India* reported in AIR 1993 SC 2063, the Chit Funds Act itself is one of the socio-economic legislations which had been enacted primarily and predominantly to safeguard the interests of the chit subscribers who are gullible and unwary public and who have been subjected to exploitation by chit foreman. The Act is intended to regulate and to bring in financial discipline in the chit business, as the foremen deal in and dabble with the funds of the subscribing public.

28. As rightly pointed out by the learned counsel appearing for the assessee, if one is to look at the integrated scheme of the chit transaction spread over a period of time and the computation of income on completed contract basis, the exercise would be seen as revenue neutral. As already seen from the provisions of the Chit Funds Act, the discount is the sum of money which is set apart under the chit agreement to meet the expenses of running the chit. This also has to take note of the default among the different classes of subscribers. The decision of the Apex Court, even though related to the case of the subscriber, has relevance to the case on hand, particularly as regards the completed contract method. In the circumstances, the decision reported in (1990) 182 ITR 1 (*G. Padmanabha Chettiar and Sons Vs. Commissioner of Income Tax*), relied on by the Revenue, does not, in any manner, advance its case.

29. Looked at from the angle of the subscriber, while there may be a certainty as to the dividend received every month for considering the same for assessment on accrual basis, as far as a company running the chit business is concerned, the dividend and the discount can properly be ascertained only at the completion of the transaction and not in the midway. Given the significant nature of the service yet to be performed in relation to the chit series, till the series come to an end, it is difficult to assess with any certainty, the amount that would be properly called as income for the purpose of assessment. "Discount" as defined under Section 2(g) of the Chit Funds Act, means the money set apart under the chit agreement to meet the expenses of running the chit or for distribution among the subscribers or for both. Dividend is the share of the subscriber in the amount of discount available for reasonable distribution

among the subscribers at each instalment of the chit. Given the rights of the subscriber, when Section 21 provides for 5% chit amount to be given to the foreman, the same is stated therein as commission, remuneration or for meeting the expenses of running the chits. Thus, going by these provisions, when dividend to the foreman has to come only from out of the discount, we do not find any justifiable ground to agree with the Revenue that the assessee cannot claim completed contract method for income recognition. In the circumstances, we agree with the assessee and have no hesitation in setting aside the order of the Tribunal.

30. As far as the expenditure of the company is concerned, it is seen that the same related both to the administrative costs as well as to the advertisement costs. Taking note of the business of the assessee, we agree with the assessee's contention that the expenses cannot be viewed as relatable to the particular series alone, but as relating to the running of the business. Thus it has to be revenue expenditure to be considered in the year in which the same is incurred. The fact that the advertisement referred to the beginning of a new series, per se, does not mean that it is not relatable to the conduct of the business of the assessee in general. The advertisement is more in the nature of information as to the business of the assessee and for its promotion. Hence, the contention of the Revenue based on the observation in paragraph 16 in the case of CIT Vs. Bilahari Investment P.Ltd., (cited supra) does not, in any manner, find favour with us.

31. It may also be pointed out that even though the Revenue took the plea that the change in the system of accounting is not a bona fide one, it is only a plea taken without material and we do not find good ground to uphold such contention.

32. In the light of the above discussions, we have no hesitation in setting aside the order of the Income Tax Appellate Tribunal by allowing the Tax Case Appeals. Thus, the assessee is justified in following the mercantile system of accounting and adopting the completed contract method, to arrive at the real income.

33. As far as the issue raised on mutuality is concerned, learned counsel for the assessee has not made serious arguments on the said aspect. Hence, on this aspect, the contention of the assessee stands rejected.

34. Except for the third question of law on mutuality relating to the assessment years 1988-89 to 1995-1996 and 1999-2000 in T.C.(A).Nos.616/2005, 628/2005, 627/2005, 624/2005, 625/2005, 617/2005, 213/2004, 618/2005, 626/2005, 620/2005, 622/2005, 623/2005, 621/2005, 619/2005, 425/2006, 2445 and 2449/2006, the findings of the Tribunal regarding the method of accounting are answered in favour of the assessee and the order of the Income Tax Appellate Tribunal to that extent is set aside. Accordingly, the Tax Case Appeals are partly allowed. No costs.

Index : Yes
Internet : Yes

(C.V.,J) (K.R.C.B.,J)
30.08.2012

nvsri

CHITRA VENKATARAMAN, J.
and
K.RAVICHANDRABAABU, J.

nvsri

To

1. The Assistant Commissioner of Income Tax
Central Circle II (3), Nungambakkam High Road, Chennai 600 034
2. The Commissioner of Income Tax (Appeals) I, Chennai
3. The Income Tax Appellate Tribunal, Chennai Bench 'A'

TC(A). Nos. 141 and 213 of 2004,
616, 621, 622, 624 to 628 of 2005,
2445, 2449 and 425 of 2006

30.08.2012