Income Tax Appellate Tribunal - Cochin

The Kerala State Financial ... vs Assessee on 30 April, 2010

IN THE INCOME TAX APPELLATE TRIBUNAL
COCHIN BENCH, COCHIN
BEFORE S/SHRI N.R.S.GANESAN, JM and B.R.BASKARAN, AM

I.T.A. No. 131/Coch/2009
Assessment Year : 2005-06

The Assistant Commissioner of Income-tax, Circle-1(1), Thrissur	The Kerala State Financial Enterprises Ltd., 'Bhadratha', Museum Road, Thrissur-680 020. [PAN: AABCT 3817A]
(Revenue-Appellant)	(Assessee-Respondent)

I.T.A. Nos.43/Coch/2009 and 01 & 02/Coch/2012
Assessment Years : 2005-06-2007-08

The Kerala State Financial Enterprises Ltd., 'Bhadratha', Museum Road, Thrissur-680 020. [PAN: AABCT 3817A]	The Addl. Commissioner of Income-tax, Range-1, Thrissur.
(Assessee-Appellant)	(Revenue-Respondent)

Revenue by Smt. Susan George Varghese, Sr. DR
Assessee by Shri Jose Pottokkaran, FCA

Date of hearing 07/03/2013
Date of pronouncement 07/06/2013

ORDER

Per B.R.BASKARAN, Accountant Member:

All these appeals are directed against the orders passed by Ld CIT(A)-V, Kochi and they relate to the assessment years 2005-06 to 2007-08. The revenue is in appeal before us for assessment year 2005-06 and the assessee is in appeal before us for all the years. Since certain issues urged in these appeals were identical in nature, they 43/Coch/2009 and 01 & 02/Coch/2012 were heard together and are being disposed of by this common order, for the sake of convenience.

2. The facts relating to the case are stated in brief. The assessee is a Kerala Government undertaking and is engaged in the business of conducting chitties and advancing loans under different schemes. In all the three years, the assessing officer completed assessments by making various additions and disallowances. The appeals filed by the assessee before Ld CIT(A) were partly allowed in all the three years. Still aggrieved, the assessee has filed appeals before us for all the three years. The revenue has filed appeal in respect of assessment year 2005-06 only.

3. We shall take up the appeal filed by the revenue. The solitary issue urged by the revenue is whether the Ld CIT(A) was justified in deleting the disallowance of claim of payment of "Service charges to the Kerala State Government" amounting to Rs.9,44,29,834/-. The assessee had paid this amount as per the executive orders of the Government of Kerala and claimed the same as expenditure. The AO, during the course of assessment proceedings sought clarification on the necessity of making this payment. Though the assessee explained that this payment is made to the Government of Kerala to compensate the support it obtained from the Government in carrying over its business activities, yet the AO took the view that the impugned payment is merely an application of income. Accordingly, he disallowed the said claim. In the appellate proceedings, the Ld CIT(A), by following his order for the assessment year 2004-05, deleted the disallowance made by the AO. Aggrieved, the revenue is contesting the decision taken by Ld CIT(A) before us.

4. We have heard the rival submissions on this issue and carefully perused the record. We notice that the co-ordinate bench of the Tribunal has decided an identical issue in favour of the assessee in the appeal relating to the assessment years 2001-02 to 2003-04 in ITA Nos. 200, 201, 202, 386 & 389/Coch/2006, vide its common order dated 30-04-2010. We further notice that the Hon'ble Jurisdictional Kerala High Court 43/Coch/2009 and 01 & 02/Coch/2012 has also considered about the allowability of identical payments made to the Government of Kerala in the case of CIT Vs. M/s Travancore Titanium Products Ltd in ITA No.262 of 2009 and the Hon'ble Court, vide its order dated 09-09-2009, has held that the payments made to the Government as per its orders has to be considered as a business expenditure. For the sake of convenience, we extract below the relevant observations made by the Hon'ble Kerala High Court:-

> "The only question to be considered is whether service charges paid by the respondent company to the State Government is eligible for deduction u/s. 37(1) of the Act as held by the first appellate authority in the appeal filed against revised assessment which is confirmed by the Tribunal. As pointed out by the Division Bench in the earlier judgment, we have to consider the exact nature and scope of services, sacrifices and incentive provided by the Government justifying the payment of service charges by the respondent company to the State Government. However, before proceeding to consider the issue in detail, we are constrained to take a little different view from the one taken by the earlier Division Bench of this Court while remanding the case. The court has forgotten the fact that respondent company is a fully owned Government company under the Government of Kerala with 80 per cent shares held by the Government. Being a company under the control of the Government, it is bound to comply with all the Government Orders and the Board of Directors itself is constituted with the Government Secretaries and other nominees as members. The Department does not raise a dispute that the claim of the company is not bona fide or that the company has not made payment of service charges to the Government in terms of the Government Order. Therefore, the claim of deduction has to be considered with reference to the peculiar circumstances of the company which has no discretion in regard to the payment of the service charges to the Government as it is bound to comply with the Government Orders. So much so, we are of the view that the parameters applicable in the case of a private company that too with respect to

> the claim for business expenditure, are exactly not applicable in the case of public sector company whether it is under the control of the State Government or Central Government. In fact, many public sector companies are not formed just to make profit alone but are supposed to achieve larger objectives for the Society and the State. Section 37(1) is the residuary provision provided under the Income Tax Act enabling assessee engaged in business to claim all expenditure laid out or expended wholly and exclusively for the purposes of the business. By making payment of service charge, the respondent company has discharged only the obligation under Government Orders. It cannot carry on business by violating Government Orders and remain as a defaulter to the Government. Therefore, on the face of it, payment of service charge to the Government is a business expenditure and it is paid every year and the payment is mandatory for carrying on 43/Coch/2009 and 01 & 02/Coch/2012 business. The expenditure so incurred by the company is not hit by the negative clauses in section 37 which are in the nature of capital or personal expenditure of assessee. Besides this, the payment is also not prohibited by law and so much so it is not hit by the explanation contained in section 37(1). Therefore the payment is a bona fide expenditure incurred by the company for carrying on business which is not prohibited by law".

In view of the decisions rendered by the Hon'ble jurisdictional High Court and also the co-ordinate bench of the tribunal in the assessee's own case, we do not find any reason to interfere with the decision rendered by Ld CIT(A) on this issue.

5. We shall now take up the appeal filed by the assessee for the assessment year 2005-06. Following issues are agitated in this appeal.

(a) Disallowance of prior period expenses.

(b) Assessment of part of "undistributed Vethapalisa" as income.

(c) Disallowance made u/s 40(a)(ia) of the Act.

6. The first issue relates to the disallowance of prior period expenses. The assessing officer noticed that the assessee had claimed an amount of Rs.1,20,96,967/- as expenditure relating to prior years. The Assessing officer, by following the decision of Hon'ble Supreme Court in the case of Madras Industrial Investment Corporation Vs. CIT (1997)(225 ITR 802 & 803), took the view that the concept of deferred revenue expenditure can be adopted only in rare occasions. Accordingly, he disallowed the entire claim of Rs.1,20,96,967/- on the reasoning that they do not belong to the year under consideration . Before Ld CIT(A), the assessee furnished the details of prior period expenses and claimed that the liability to pay these expenses has got crystallized during the year under consideration and accordingly contended that these expenses are allowable in the current year. The first appellate authority examined the contentions of the assessee and accepted the claim wherever he found that the liability to pay the expenses got crystallized in the current year. The break-up details of "prior period expenses", the expenses allowed and disallowed by Ld CIT(A) are tabulated

below:-

43/Coch/2009 and 01 & 02/Coch/2012 S. No. Item Amount Allowed by Not Allowed (in Rs.) CIT(A) by CIT(A)

1. Salary & Allowances 8,09,694 2,56,702 5,52,992

2. Office Rent 4,92,812 4,41,441 51,371

3. Interest on FD 3,503 3,503 -

4.	Loss on Chitty substitution	98,488	-	98,488
5.	Amount payable on Terminated Chitty	1,44,178	1,44,178	-
6.	Loss on foreman's investment on substitution of Chitty	2,87,904	-	2,87,904
7.	Loss on foreman's investment in Chitty	15,29,954	-	15,29,954
8.	Interest on FD with Treasury	65,37,059	-	65,37,059
9.	Interest on new Chitty Loan	8,73,889	-	8,73,889
10.	General Suspense Amount	2,08,774	2,08,774	-
11.	Others	8,91,593	-	8,91,593
12.	Interest on Bhadratha Deposits	2,19,119	-	2,19,119
	Total	1,20,96,967	10,54,598	1,10,42,369

From the careful analysis of the order passed by Ld CIT(A), we notice that the first appellate authority has confirmed the disallowance wherever he found that the expenses were found booked during the year due to accounting errors committed in the earlier years. For example, the assessee had claimed a sum of Rs.8,09,694/- as salary relating to the prior years. The Ld CIT(A) noticed that a sum of Rs.2,56,702/- only got crystallized during the year under consideration and accordingly allowed the same. In respect of the balance amount of Rs.5,52,992/-, the Ld CIT(A) noticed that it represented salaries either short deducted or erroneously accounted for in the earlier years in other heads resulting in non-deduction of the same as "salary" in the relevant year. In case of such kind of accounting errors, in our view, it cannot be said that they got crystallized during the year in which the accounting error was corrected. It is not a case where there was dispute about the payment of salary and the dispute got resolved 43/Coch/2009 and 01 & 02/Coch/2012 in the instant year, in which case it can be said that the liability got crystallized in the instant year. Correction of accounting errors would mean only that the relevant expenditure got crystallized in any of the earlier years, but omitted to be claimed as expense in that year. The Ld CIT(A) has given clear finding in respect of certain expenditure about the year of accrual. For example, in respect of the expenditure claimed under the head "interest on new chitty loan", the Ld CIT(A) has given a clear

finding that it relates to the assessment year 2004-05. Thus, it is seen that the Ld CIT(A) has examined the claim of the assessee in respect of each of the item of expenditure included under the head "Prior period expenditure" and accordingly taken a decision. Before us, though the Ld A.R claimed that the expenses disallowed by Ld CIT(A) got crystallized during the year under consideration, yet no material was placed on record to contradict the clear findings given by Ld CIT(A), some of which were discussed earlier. Under these circumstances, we have no other option, but to confirm the decision rendered by Ld CIT(A) on this issue.

7. The next issue relates to the assessment of "Undistributed Vethapalisa" amount. This issue is common in all the three years under consideration. The facts relating to the same are discussed in brief. Under the chit fund scheme, the chit amount is put to auction every month amongst the subscribers to the chit and the same will be allotted to the subscriber who offers maximum permissible discount. For example, in a chit fund scheme of Rs.1.00 lac, the maximum discount offered is say, Rs.25,000/-, the successful bidder will be given the bid amount of Rs.75,000/-. Out of the discount amount of Rs.25,000/-, the foreman shall take his commission, say Rs.5,000/- and the balance amount of Rs.20,000/- shall be distributed amongst all the subscribers. The discount amount so distributed between the subscribers is called "Vethapalisa". The subscribers shall adjust their share of Vethapalisa against the instalments due from them, either against the current instalment or against the succeeding month's instalment, depending upon the terms of chit scheme. Since the Vethapalisa is payable to the subscribers, it is shown as a "current liability" in the books of the assessee. It was submitted that the undistributed vethapalisa got accumulated over the years and 43/Coch/2009 and 01 & 02/Coch/2012 were continued to be shown as Current liability in the books of the assessee, even after the termination of a chit scheme.

8. The assessing officer took the view that the undistributed vethapalisa on terminated chitties partakes the character of income in the hands of the assessee. For this proposition, the AO placed reliance on the following case law:-

(a) Popular Kuries Ltd (Cochin bench of ITAT)

(b) CIT Vs. Sundaram Iyengar & Sons Ltd (SC)

(c) CIT Vs. Karamchand Thapar (1996)(222 ITR 113)(SC)

(d) Protos Engg. Co. P Ltd Vs. CIT (1995)(211 ITR 919)(Bom) Before the assessing officer, the assessee contended that the balance shown under the head "Vethapalisa A/c" represents amounts accumulated over the years. The assessee further contended that the undistributed vethapalisa on the terminated chits continue to remain as a liability in the hands of the assessee, since it is payable to the concerned chit subscriber. In this regard, the assessee placed reliance on the decision of Hon'ble Supreme Court in the case of KSFE Vs. Jacob Alexander 1976 AIR 1552. However, the AO rejected the claim of the assessee by placing reliance on the decisions referred supra and accordingly held that the undistributed vethapalisa on the terminated chitties has to be assessed as income in the hands of the assessee. Since the amount

shown as liability under the Vethapalisa account was accumulated over the years, the AO estimated the income at Rs.10.00 crores for the assessment year 2005-06. For the assessment years 2006-07, the AO assessed the annual accretion made to this account.

In effect, the AO assessed following amounts as the income of the assessee in all the three years:-

Assessment year 2005-06	-	Rs.10.00 crores
Assessment year 2006-07	-	Rs. 5.20 crores
Assessment year 2007-08	-	Rs. 1.85 crores

9. In the appellate proceedings, the Ld CIT(A) accepted the contention of the assessee that the Vethapalisa is a liability in the hands of the assessee. However, the 43/Coch/2009 and 01 & 02/Coch/2012 Ld CIT(A) noticed that the assessee did not make any payment out of the said liability except in the case of Jacob Alexander, as per the decision rendered by Hon'ble Supreme Court in the suit filed by him.. The Ld CIT(A) noticed that the assessee, however, could not pinpoint or prove that there actually existed a liability to pay the amount to the individual depositors. Accordingly, the Ld CIT(A) affirmed the view taken by the AO that the undistributed vethapalisa amount has partaken the character of income in the hands of the assessee. However, the Ld CIT(A) did not accept the estimate of Rs.10.00 crores made by the assessing officer in assessment year 2005-06. The Ld CIT(A) took the view that the annual accretion made to the "Vethapalisa account" should be considered as income in the hands of the assessee. In the year relevant to the assessment year 2005-06, the annual accretion worked out to Rs.4.29 crores and accordingly, the Ld CIT(A) directed the AO to assess Rs.4.29 crores in the place of Rs.10.00 crores assessed by him. In the assessment years 2006-07 and 2007- 08, since the assessing officer has actually assessed the annual accretion, the Ld CIT(A) confirmed the same. Aggrieved, the assessee has come up on appeal before us challenging the decision of Ld CIT(A).

10. Before us, the Ld Counsel appearing for the assessee reiterated the contentions that the Vethapalisa account represents a liability in the hands of the assessee, by placing reliance on the decision of Hon'ble Supreme Court in the case of Jacob Alexander. On the contrary, the Ld D.R strongly placed reliance on the decision rendered by Ld CIT(A). Prima facie, it cannot be denied that the Vethapalisa does not constitute income in the hands of the assessee herein. As stated earlier, the Vethapalisa determined at the end of each bid is required to be distributed to the eligible subscribers to the chit. The payment is usually made by way of adjustment against the monthly chit instalment payable by the subscribers, i.e., the subscribers usually make payment after adjusting the Vethapalisa amount. For example, if the monthly instalment is say Rs.5,000/- and the Vethapalisa amount distributed to him is Rs.1,000/-, he usually makes payment of Rs.4,000/- only to the assessee. The adjustment is permitted either in the same month's instalment or in the succeeding 43/Coch/2009 and 01 & 02/Coch/2012 month's instalment, depending upon the terms of concerned chit scheme. Hence it constitutes a liability in the hands of the assessee till its payment to the concerned subscriber. Since the Vethapalisa is usually adjusted against the payment due from the subscribers, its non-distribution would normally signify that there is some amount due from the

concerned subscriber (defaulting subscriber), i.e., the assessee would be withholding the vethapalisa amount only when some amount is due from a subscriber.

11. Each chit group scheme floated by the assessee shall have fixed monthly span, say 20 months, 40 months etc., meaning thereby, the chit fund scheme shall automatically come to an end after completion of the concerned time period. Thus, after the completion of the time period, the assessee would be in a position to determine the undistributed Vethapalisa account and also the amount due from the defaulting subscriber. The accounting system followed by the assessee in this regard was not brought on record. We shall take an example to understand the position of Vethapalisa after the termination of a Chit fund scheme. Let us say that in a Chit fund scheme, Mr. X has defaulted in making payment of Rs.10,000/-. The assessee would also normally withhold the Vethapalisa amount payable to him and let us assume that the amount so withheld was Rs.2,000/-. Then it is possible that the assessee would be showing Rs.2,000/- as a liability in the Vethapalisa account and Rs.10,000/- in the debtors account. If this accounting system is followed, then the amount of Rs.2,000/- cannot be considered as income in the hands of the assessee till the defaulted amount of Rs.10,000/- is collected from the concerned subscriber. Normally, it is expected that the concerned debtor would pay only the net amount of Rs.8,000/- (Rs.10,000/- (-) Rs.2,000/-) in settlement of his account.

12. If the assessee collects only Rs.8000/- from Mr. X, then the question of taxability of Rs.2,000/- does not arise at all. However, if the assessee collects Rs.10,000/- and did not allow the adjustment of vethapalisa amount of Rs.2,000/-, then the said amount has to be necessarily treated as the income of the assessee, since the liability in respect of the Vethapalisa automatically ceases on the settlement of accounts. If the assessee 43/Coch/2009 and 01 & 02/Coch/2012 writes off of the whole or part of the amount due from Mr. X, then also the Vethapalisa amount relatable to Mr. X and which remains unadjusted would become the income of the assessee. Thus, it our view, the Vethapalisa amount of a subscriber can be treated as the income of the assessee only upon settlement of the account of the concerned subscriber.

13. In the instant case, the accounting treatment adopted by the assessee, the status of the settlement of accounts of the concerned subscriber, the terms and conditions regarding payment of Vethapalisa amount to the subscriber, particularly when there is a default in payment of instalment/instalments, any other terms and conditions relating to payment of Vethapalisa etc., were not brought on record. In our view, the taxability of Vethapalisa amount can be determined only upon examination of the various factors discussed supra. Hence, we are unable to agree with the view taken by Ld CIT(A) that the annual accretion to Vethapalisa account would automatically become income of the assessee. The view taken by Ld CIT(A), in our view, would be correct only if the transfer to the Vethapalisa account is related to the settled accounts. Since the facts surrounding the vethapalisa account were not brought on record, in our view, this issue requires fresh examination at the end of the assessing officer in the light of discussions made supra, by duly considering the terms and conditions and the relevant accounting treatment followed by the assessee. Accordingly, we set aside the order of Ld CIT(A) on this issue in all the three years and restore the same to the file of the assessing officer with the direction to examine the issue afresh and take appropriate decision in accordance with the law. The assessee is also directed to co- operate

with the AO and furnish all the information and explanation that may be called for by the assessing officer.

14. The next issue contested by the assessee in the appeal relating to the assessment year 2005-06 relates to the disallowance made u/s 40(a)(ia) of the Act for delayed remittance of the tax deducted at source. Though the Ld CIT(A) did not adjudicate this issue, yet in our view, this issue requires fresh examination at the end of 43/Coch/2009 and 01 & 02/Coch/2012 the AO in view of the subsequent amendments brought in sec. 40(a)(ia) of the Act. Accordingly, we set aside this matter also to the file of the assessing officer with the direction to examine this issue afresh.

15. In assessment year 2006-07, the assessee is contesting about the levy of interest u/s 234A of the Act. According to the assessee, it has filed its return of income for assessment year 2006-07 on 28.11.2006, where as the assessing officer has recorded the date of filing of return of income as 31.12.2006. Since the fact relating to the date of filing of return requires verification at the end of the assessing officer, we set aside this matter also to his file with the direction to examine the claim of the assessee and take appropriate decision in accordance with the law.

16. In the result, the appeal of the revenue for the assessment year 2005-06 is dismissed. The appeals of the assessee for the assessment year 2005-06 and 2006-07 are treated as partly allowed for statistical purposes. The appeal of the assessee for the assessment year 2007-08 is treated as allowed for statistical purposes.

Pronounced accordingly on 07-06-2013.

sd/-	sd/-
(N.R.S.GANESAN)	(B.R.BASKARAN)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Place: Kochi
Dated: 7th June, 2013
GJ
Copy to:

1. The Kerala State Financial Enterprises Ltd., 'Bhadratha', Museum Road, Thrissur-680 020.

2. The Addl. Commissioner of Income-tax, Range-1, Thrissur.

3. The Assistant Commissioner of Income Tax, Circle-1(1), Thrissur.

43/Coch/2009 and 01 & 02/Coch/2012

4. The Commissioner of Income-tax(Appeals)-V, Kochi.

5.The Commissioner of Income-tax, Thrissur.

6. D.R., I.T.A.T., Cochin Bench, Cochin.

7. Guard File.

By Order (ASSISTANT REGISTRAR) I.T.A.T, COCHIN