

IN THE INCOME TAX APPELLATE TRIBUNAL DELHI 'G' BENCH
BEFORE SHRI G.C. GUPTA,VP AND SHRI A.N. PAHUJA,AM

ITA no.4625/Del./2011 With CO no.351/Del./2011 Assessment year: 2008-09		
Assistant. CIT, Circle-1, Muzaffarnagar	Vs.	M/s Samrat Rice Mills (P) Ltd., Kairana,Muzaffarnagar
[PAN AABCS 9948 M]		

Assessee by	Shri K.L. Aneja, AR
Revenue by	Smt. Veena Joshi,DR

Date of hearing	05-06-2012
Date of pronouncement	08-06-2012

ORDER

A.N. PAHUJA:- This appeal filed on 19th October, 2011 by the Revenue and the corresponding cross-objection[CO] filed on 28th October, 2011 by the assessee, against an order dated 08.07.2011 of the Id. CIT(A), Muzaffarnagar, raise the following grounds:-

I.T.A. No.4625/Del./2011[Revenue]

- i) *“ On the facts and in the circumstances of the case, the CIT(A) has erred in law in deleting the addition of ₹28,83,480/- made by the Assessing Officer on account of unsecured loans by accepting unsecured loan as genuine. The objection of the CIT(A) is not acceptable as the need for raising the loan has not been investigated into. The CIT(A) has not considered the fact that all the parties were related to assessee and no interest was paid to them. Further the CIT(A) has not discussed the issue of raising the loan when the company has turnover of ₹99,70,965.55 and was always in a position to repay the loan. Hence the CIT(A) has erred in principle by*

treating these loans as genuine only because it were accepted in past years also.

- ii) On the facts and in the circumstances of the case, as the CIT(A)'s decision of treating the unsecured loan as genuine is not acceptable, hence the interest on above unsecured loan @12% must be added to the income of the assessee and in view of this the action of the CIT(A) is not acceptable.*
- iii) The order of the CIT(A) be set aside and that of Assessing Officer be restored..”*

CO no.351/Del./2011[Assessee]

- 1. “That the learned CIT(A) was fully justified in deleting the addition of ₹28,83,480/- made by the Assessing Officer.*
- 2. That the learned CIT(A) ought to also deleted the part disallowance of ₹1,95,898/- out of total disallowance of ₹5,41,915/- made by the Assessing Officer out of interest paid. The disallowance sustained at ₹1,95,898/- also deserves to be deleted.*
- 3. That the learned CIT(A) ought to himself directed for allowance of the credit of TDS amount of ₹31,385/- as per certificates of TDS placed before the AO on 20.9.2010 in the course of assessment proceedings instead of remitting the matter to the AO.*
- 4. That the learned CIT(A) ought to also directed for giving benefit of B/f losses from the preceding yeas instead of remitting back the issue to the AO as there was placed full evidence before the CIT(A).*
- 5. That the cross objector/respondent reserves its right to add, amend, vary the grounds of cross objections before the final disposal of the appeal and the cross objections.”*

2. Adverting first to ground nos.1 & 2 in the appeal of the Revenue, facts, in brief, as per relevant orders are that e-return declaring nil income filed on 30.09.2008 by the assessee, running a rice mill, after being processed u/s 143(1) of the Income-tax Act, 1961 (hereinafter referred to as the

Act), was selected for scrutiny with the service of a notice u/s 143(2) of the Act issued on 31.08.2009. During the course of assessment proceedings, the Assessing Officer (A.O. in short) noticed that the balance sheet of the company revealed unsecured loans of ₹`28,83,480/- from the following persons:-

	[In ₹]
i. Old Balance	`10,85,000/-
ii. Akhtar Hasan	`7,50,000/-
iii. Munnawar Hasan	`5,24,480/-
iv. Sarwar Hasan	`1,60,000/-
v. Dr. Mansur Ahmad	`15,000/-
vi. Ajahar Hasan	19,000/-
vii. Aniq Ahmad	`19,000/-
viii. Shahanawaz Ahmad	`15,000/-
ix. Idrish Neta	`18,000/-
x.Nisar Ahmad	`15,000/-
xi.Asif Alvi	`15,000/-
xii.Zahir Ahmad	`18,000/-
xiii.Gayas Mohamad Khan	15,000/-
xiv14.Moh. Umar Peeru	`15,000/-
xv.Sewa Ram	<u>`2,00,000/-</u>
	<u>`28,83,480/-</u>

2.1 To a query by the AO, seeking to add the aforesaid loans as income of the assessee, the assessee replied that all the outstanding loans were more than three years old and no interest was paid on these loans. Since no fresh loans were raised in the year under consideration, no addition could be made, the assessee pleaded. However, the AO did not accept the submissions of the assessee and brought to tax the entire amount of loan of ₹`28,83,480/- u/s 41(1) of the Act, relying, inter alia on the decision of the ITAT Delhi in the case of Distinctive Properties & Leasing Ltd. Vs. Income-tax Officer ,1 SOT 460 wherein

it was held that where the liability is barred by limitation and no possibility of any claim in future, the remission or cessation of liability falls u/s 41(1) of the Act.

3. On appeal, the Id. CIT(A) allowed the claim of the assessee after having a remand report from the AO and comments of the assessee thereon, in the following terms:-

“The facts of the case as well as submissions made by the appellant have been carefully considered. It is observed that the A.O. had disallowed unsecured loans to the extent of ₹.28,83,480/- on the ground that these loans were outstanding for more than three years therefore exceeded time limit available in Schedule 19 & 21 of Laws Limitation Act. Further the loans were raised by the appellant without any financial need and the depositors had not filed legal suits against the appellant for recovery of the aforesaid loans. The A.O. on such basis held that the loan amounts were income of the assessee and the profits were chargeable to tax u/s 41(1) of the Act as the appellant was getting benefit in respect of such trading liability. On the other hand it has been contended by the appellant that the aforesaid loans were brought forward from preceding years and there had been no transaction during the year nor any amount received or repaid. It is observed that the aforesaid loans were raised in A. Y.1992-93 and subsequent assessment years and continued in the year under consideration also. It is further observed that the C.I.T. Muzaffarnagar had issued show cause notice u/s 263 dated 31-01-2007 for A.Y. 2002-03 wherein the appellant was required to furnish details/evidence/documents so as to establish the identity, creditworthiness of the creditors and genuineness of transactions totaling to Rs.28,83,480/-. Further, in the order passed u/s 263 of the Act dated 26-03-2007 no adverse inference has been drawn by the C.I.T., Muzaffarnagar in respect of unsecured loans totaling to Rs.28,83,480/-. Furthermore, the A.O. vide order passed u/s 263/143(3) dated 12-11-2007 for A.Y. 2002-03 has discussed the unsecured loans at ₹.27,18,840/- as under:-

“.. ... It has been stated by the assessee company that all these loans are old and no fresh loans have been taken in the year under consideration as evident from the figures of previous year shown in Balance sheet itself. It has been stated that no interest has been paid on these loans. It has further been mentioned that the Ld. CIT has raised this issue but not taken any adverse view in the matter. Considering the reply and the fact that the Ld. CIT has not

taken any adverse inference in this regard, contention of the assessee appears to be correct....”

From the above is evident that neither the CIT, Muzaffarnagar in her order passed u/s 263 nor the A.O. in his assessment order passed u/s 263/143(3) for A.Y. 2002-03 dated 12-11-2007 have accepted the genuineness of unsecured loans totaling to ₹.27,18,8401- which were raised much prior to A.Y. 2002-03. The A.O's observations that the loans had exceeded the time limit available in Schedule 19 & 21 of Law Limitation Act for making disallowance u/s 41 (1) of the Act is not correct in as much as even if the loans had exceeded the time limit that does not by itself constitute cessation of the liability of the debtor because such expiry only restricts the liability of the creditor to sue the debtor in the Court of Law but does not restricts the liability of the debtor in any way to pay the same under the substantive law. Further indebtedness of the debtor continues even after the expiry of the period of limitation which only deprives the creditor of his liability to institute a suit in Court of Law to recover the debt. Thus it cannot be presumed that the creditor has remitted the debt when remedy to sue is barred by limitation period or that liability of the debtor has finally ceased because of the same. It would be a different situation if the creditor abandons his right to recover the debt or the creditor intends not to honour the liability even when demanded. Further, the A.O. has not discharged the onus to establish that these liabilities had ceased finally without the possibility of survival. Reliance is placed on the decision of the Hon'ble ITAT, Delhi in the case of Shri Vardhman Overseas Ltd. vs. ACIT (2008) 24 SOT 393 (Del). The unsecured loans have been raised by the appellant from relatives and do not represent trading liability for invoking provisions of section 41 (1) of the Act. In view of the above facts it is held that the A.O. was legally and factually incorrect in invoking provisions of section 41(1) of the Act and make disallowance at ₹.28,83,480/-. Addition of ₹.28,83,480/- is directed to be deleted. Ground NO.2 is allowed.”

4. The Revenue is now in appeal before us against the aforesaid findings of the Id. CIT(A). The Id. DR supported the order of the AO while the Id. AR on behalf of the assessee relied upon the findings in the impugned order..

5. We have heard both the parties and gone through the facts of the case. Indisputably, the aforesaid loans of ₹28,83,480/- raised in the preceding

years, are outstanding for a number of years. The AO brought to tax these loans u/s 41(1)(a) of the Act on the ground that these debts were barred by limitation, being outstanding for more than three years. On appeal, the Id. CIT(A) deleted the addition on the ground that provisions of sec. 41(1) were not attracted. The provisions of sec. 41(1)(a) stipulate that where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently during any previous year, the assessee obtains, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly, chargeable to income-tax as the income of that previous year, whether or not the business or profession in respect of which the allowance or deduction has been made is in existence in that year. Indisputably, the assessee did not receive any benefit nor the amount has been transferred to profit and loss account nor even written off and thus, the amount did not become the assessee's own money. Rather the Id. CIT(A) concluded that the aforesaid liabilities were not trading liabilities and subsisted in the year under consideration. Not only that these liabilities are not trading liabilities, even otherwise there is nothing on record to establish that the aforesaid liabilities had ceased to exist or were remitted by the creditors in the year under consideration. In these circumstances, as concluded by the Hon'ble Gujrat High Court in CIT Vs. Bharat Iron and Steel Industries (1993) 199 ITR 67 (Guj) (FB), the provisions of sec. 41(1)(a) are not attracted.

5.1 Hon'ble Gujrat High Court in the case of CIT Vs. Silver Cotton Mills Co. Ltd., 254 ITR 728(Guj) held that simply because the period of limitation had come to an end for the purpose of filing a suit for recovery of the said amount or for taking appropriate action against the assessee, it cannot be said that there was a cessation of liability. The liability still remains, though it may not be enforceable at law on account of the provisions of the law of limitation. Relying

upon the decision in the case of Sugauli Sugar Works (P.) Ltd. [1999] [236 ITR 518](#).SC), Hon'ble High Court further held that unless there is a cessation of liability or there is a remission of liability by the creditor, the liability subsists and, therefore, even if the entries are made to write back the expenditure, the amount so written back cannot be added in the income of the assessee as per the provisions of section 41(1) of the Act.

5.2 Hon'ble Bombay High Court in the case of CIT Vs. Chase Bright Steel Ltd., 177 ITR 128(Bombay) while relying upon their judgment in J. K. Chemicals Ltd. Vs. CIT, [1966] [62 ITR 34](#) held that the liability of an assessee does not cease merely because the liability has become barred by limitation. The liability ceases when it has become barred by limitation and the assessee has unequivocally expressed its intention not to honour the liability even when demanded.

5.3 Hon'ble Supreme Court in the case of Bombay Dyeing & Manufacturing Co. Ltd. v. State of Bombay, AIR 1958 SC 328, in para 23 of their decision observed as follows :

" 23. It has been already mentioned that when a debt becomes time barred, it does not become extinguished but only unenforceable in a court of law. "

5.4 Hon'ble Supreme Court in the case of Sugauli Sugar Works (P.) Ltd. [1999] 236 ITR 518 held that unless there is a cessation of liability, income cannot be added as per the provisions of section 41(1) of the Act. Similarly, Hon'ble Gujarat High Court in the case of CIT Vs. Chetan Chemicals Pvt. Ltd. 267 ITR 770 (Guj) held that:

"On a reading of the provisions, it is apparent that before the section can be invoked, it is necessary that an allowance or a deduction has been granted during the course of assessment for any year in respect of loss, expenditure or trading which is incurred by the assessee, and subsequently during any previous year the assessee obtains, whether in cash or in any other manner, any amount in respect of such trading liability by way of remission or cessation of such liability. In that case, either the amount obtained by the assessee or the value of the benefit occurring to

the assessee can be deemed to the profits and gains of business or profession and can be brought to tax as income of the previous year in which such amount or benefit is obtained. In the facts of the case on hand, without entering into the aspect as to whether the liability to repay the loans would be a trading liability or not, it is an admitted position that there had been no allowance or deduction in any of the preceding years and, hence, there is no question of applying the provision as such.

Section 28 of the Act deals with profits and gains of business or profession and clause (iv) thereof says that the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession shall be chargeable as income under the head "Profits and gains of business or profession." In the facts of the present case, it cannot be said that the assessee-company was carrying on business of obtaining loans and that the remission of such loans by the creditors of the company was a benefit arising from such business."

5.5 Hon'ble jurisdictional High Court in CIT Vs. Vardhman Overseas Ltd., 16 Taxman.com 350(Delhi) while referring the judgment of the Hon'ble Supreme Court in Sugauli Sugar Works (P.) Ltd. (supra) and a number of other decisions, upheld the findings of the Tribunal, holding that since amounts payable to sundry creditors were not credited to assessee's profit and loss account and were still shown as outstanding at end of relevant year and the assessee having not unilaterally written back accounts of sundry creditors in its profit and loss account, provisions of sec. 41(1)(a) were not attracted.

5.6 In the light of view taken by the Hon'ble Supreme Court and jurisdictional High Court in their aforesaid decisions, it is apparent that unless there is a cessation of liability or there is a remission of liability by the creditor, the liability subsists and the assessee having not unilaterally written back accounts of the aforesaid creditors in its profit and loss account, the provisions of section 41(1) of the Act and explanation 1 thereto, are not attracted. In the instant case, there is nothing to suggest that the assessee obtained any benefit either by way of remission or cessation of any liability while the aforesaid liabilities are continually admitted by the assessee in their balance sheet. In these circumstances, especially when the Revenue have not placed before us any material,

controverting the aforesaid findings of the Id. CIT(A) nor brought to our notice any contrary decision, we have no alternative but to uphold the findings of the Id. CIT(A) in deleting the addition of ₹28,83,480/-. Therefore, ground no. 1 in the appeal of the Revenue is dismissed while that in the CO, being supportive only, becomes infructuous.

6. Ground no.2 in the appeal of the Revenue relates to charging of interest on the aforesaid loans. The Id. DR did not make any submissions on this ground nor any such issue of interest arises from the impugned order or considered in the assessment order. Therefore, this ground is also dismissed.

7. Now advertent to ground no.2 in the CO, the AO on perusal of profit and loss account noticed that the assessee debited a sum of ₹10,18,745/- under the head interest to bank while it had advanced loans to the following persons without charging any interest:-

	[In ₹]
i) M/s Kishan Rice & General Mills	₹20,00,000/-
ii) M/s Hasan Steels & Alloys (P) Ltd.	₹9,50,000/-
iii) M/s B.B. Rice & General Mills	<u>₹15,65,960/-</u>
	<u>₹45,15,960/-</u>

7.1 To a query by the AO, the assessee replied that the aforesaid concerns were sister concerns and, therefore, the assessee was not charging any interest. After considering the reply of the assessee, the AO disallowed an amount of ₹5,41,915/- on account of interest paid to others.

8. On appeal, the Id. CIT(A) reduced the disallowance to ₹1,95,898/- in the following terms:-

“The facts of the case as well as submissions made by the appellant have been carefully considered. It is observed that the A.O. had made addition of ₹5,41,915/- on the ground that an

amount of ₹.10,18,745/- was debited under the head 'interest to bank' whereas the appellant had not charged interest on the amount of ₹.45,15,960/- on the loans given to sister concerns. Each assessment year is a separate year. Definitely the appellant's liability of paying interest to the bank would have considerably reduced had no interest free advances were made by the appellant to its sister concerns. Therefore, A.O's action in disallow in interest proportionate to interest free advances is upheld in principle. However, since the appellant is also having interest free unsecured loan of ₹.28,83,480/- as upheld in Ground no.2 above, the disallowance is restricted at the balance resultant amount of ₹.16,32,480/- (₹.45,15,960-₹.28,43,480). Therefore, the disallowance is restricted at ₹.1,95,898/- . The appellant gets relief of ₹.3,46,017/- on this score. Ground NO.3 is partly allowed."

9. The assessee is now in appeal before us against the findings of the Id. CIT(A) for upholding the addition of ₹`1,95,898/-.The Id. AR on behalf the assessee did not make any submissions before us on this ground.

10. We have gone through the facts of the case. As is apparent from the impugned orders, the assessee did not place any evidence before the AO or the Id. CIT(A) as to how the funds borrowed by it had been utilized and what was the commercial expediency in such borrowings. In this connection, the relevant provisions of section 36(1)(iii) of the Act provide for deduction of interest on the borrowed funds raised for business purposes. Once the assessee claims any such deduction, the onus is on the assessee to satisfy the AO that loans raised by the assessee were used for business purposes. If in the process of examination of claim for such a deduction, it transpires that the assessee had diverted certain funds to associate or sister concerns without any interest, there would be a very heavy onus on the assessee to be discharged before the AO to the effect that in spite of pending loans on which the assessee was incurring the liability to pay interest, still there was justification for diversion of funds to associate or sister concerns for non-business purposes . In Madhav Prasad Jatia v. CIT [1979] [118 ITR 200](#) (SC) Hon'ble Supreme Court observed that under s. 10(2)(iii) of the 1922 Act(now sec. 36(1)(iii) of the 1961 Act), three conditions were required to be satisfied in order to enable the assessee to claim a deduction

in respect of interest on borrowed capital, namely, (a) that money (capital) must have been borrowed by the assessee, (b) that it must have been borrowed for the purpose of business, and (c) that the assessee must have paid interest on the said amount and claimed it as a deduction. It was also held that the expression "for the purpose of business" occurring under the provision is wider in scope than the expression "for the purpose of earning income, profits or gains". In the case under consideration, there is nothing in the order of lower authorities to suggest that the assessee discharged the onus laid down upon them that borrowed funds had indeed been utilized for the purpose of its business so as to entitle it to claim deduction u/s 36(1)(iii) of the Act. In case the assessee had some surplus amount which, according to him, could not be repaid prematurely to its creditors, still the same were either required to be circulated and utilised for the purpose of business or to be invested in a manner in which it generates income and not that these were diverted towards associate or sister concerns free of interest. This would result in not presenting the true and correct picture of the accounts of the assessee as at the cost being incurred by the assessee, the associate or sister concerns would be enjoying the benefits thereof. It cannot be held that the funds to the extent diverted to associate concerns without charging any interest, were required by the assessee for the purpose of its business and loans to that extent were required to be raised. Since the assessee failed to establish nexus of use of borrowed funds for the purpose of business to claim deduction under section 36(1)(iii) of the Act, there is no escape from the finding that interest being paid by the assessee to the extent the amounts are diverted to sister concerns or other persons on interest free basis, are to be disallowed.

10.1 In *K. Somasundaram and Brothers v. CIT* [1999] [238 ITR 939](#), while dealing with a similar proposition, the Hon'ble Madras High Court held

"..... The assessee clearly diverted the funds which had been borrowed, had been invested in the contract work, after the investment was recovered and was available either for the purposes of the business or by way of repayment of the loan. The assessee did neither, but chose to divert the money for non-business purposes. After such diversion, the interest paid on the capital borrowing to the

extent of the amounts diverted can no longer be an item of expenditure which can be claimed for deduction as an item of business expenditure. If the amounts diverted was subsequently brought back into the business and utilised in the business, the assessee could thereafter claim the interest paid as a deduction. But so long as the diversion continues the assessee would be disentitled."

10.2 In view of the foregoing, especially when the Id. AR did not make even a whisper before us on the issued raised in this ground, we do not find any infirmity in the findings of Id. CIT(A) and therefore, reject the ground no.2 raised by the assessee in the CO.

11. Ground no.3 in the cross objection relates to credit of TDS amounting to ₹31,385/-. There is no discussion on the credit for TDS in the assessment order. However, the Id. CIT(A) directed the AO to allow the credit for TDS after necessary verification in terms of provisions of section 155(14) of the Act. The Id. AR appearing before us did not make any submissions on this issue nor placed any material before us so as to enable us to take a different view in the matter.. In these circumstances, we do not find any infirmity in the directions of the Id. CIT(A).Therefore, ground no.3 in the cross objection is dismissed.

12. Ground no.4 in the cross objection relates to set off of brought forward loss. There is no discussion on this aspect in the assessment order while the assessee raised an additional ground before the Id. CIT(A), seeking set off of brought forward losses. The Id. CIT(A) after admitting the additional ground directed the AO to verify the claim and allow set off of brought forward losses. Since the Id. AR on behalf of the assessee did not make any submissions on this issue before us nor placed any material before us so as to enable us to take a different view in the matter , we do not find any infirmity in the conclusion of the Id. CIT(A) while directing to allow set off of brought forward losses in accordance with law. Therefore, ground no.4 in the cross objection is also dismissed.

13.. Ground no.3 in the appeal of the Revenue and ground no. 1 in the cross objection, being general in nature, do not require any separate adjudication

while no additional ground having been raised before us in terms of residuary ground no.5 in the cross objection, accordingly, these grounds are dismissed.

14. No other plea or argument was made before us.

15. In the result, both the appeal of the Revenue and the CO filed by the assessee, are dismissed.

Order pronounced in open Court

Sd/-
(G.C. GUPTA)
VICE PRESIDENT

Sd/-
(A.N. PAHUJA)
ACCOUNTANT MEMBER

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Copy of the Order forwarded to:-

1. Assessee
2. Assistant. CIT, Circle-1, Muzaffarnagar
3. CIT concerned
4. CIT(Appeals), Muzaffarnagar.
5. DR, ITAT, 'G' Bench, New Delhi
6. Guard File.

By Order,

Deputy/Asstt.Registrar
ITAT, Delhi