IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL No.1532 of 2011

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COMMISSIONER OF INCOME TAX-IV - Appellant(s)
Versus
G K PATEL & CO - Opponent(s)

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Appearance:
MS PAURAMI B SHETH for Appellant(s): 1,
None for Opponent(s): 1,

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CORAM : HONOURABLE MR. JUSTICE AKIL KURESHI

and

HONOURABLE MS. JUSTICE HARSHA DEVANI

Date : 16/10/2012

ORAL ORDER
(Per : HONOURABLE MS. JUSTICE HARSHA DEVANI)

1. The appellant revenue has challenged order dated 5th August, 2011 made by the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') in relation to assessment year 2006-07 by proposing the following two questions:-

[A] *"Whether the Appellate Tribunal is right in law and on facts in deleting the addition of Rs.35,84,077/- made on account of diesel expenses paid in case to B.P.; Sanchor, a company pump of BPCL?"*

[B] "Whether the Appellate Tribunal is right in law and on facts in deleting the addition made u/s. 41(1) of Rs.96,50,432/-?"

2. Proposed question [A] pertains to deletion of addition of Rs.35,84,077/- made on account of diesel expenses paid to Bharat Petroleum, Sanchor, a company pump of M/s. Bharat Petroleum Corporation Limited (BPCL). The assessee purchased diesel worth Rs.82,20,254/- from BPCL, out of which Rs.35,84,077/- was paid in cash. The Assessing Officer asked the assessee to explain the genuineness and necessity for making payment of such large sums in cash for the purpose of purchase of diesel. After taking into consideration the reply submitted by the assessee, the Assessing Officer was of the view that the assessee had procured accommodative bills from M/s. BPCL, Sanchor and made payment in cash to curtail any investigation and treated the sum of Rs.35,84,077/- as bogus purchase and added the same back to the income of the assessee. The assessee went in appeal to the Commissioner (Appeals), who called for a remand report from the Assessing Officer and also obtained the assessee's comments thereon. After taking into consideration all these materials, the Commissioner (Appeals) deleted the addition. Revenue carried the matter in appeal before the Tribunal but did not succeed.

3. Ms. Paurami Sheth, learned senior standing counsel for the appellant, assailed the impugned order by submitting that the assessee had failed to explain as to why such huge amounts of payments were made in cash and the Assessing Officer after considering the material on record had given

detailed reasons for disallowance of diesel expenses paid in cash. Under the circumstances, the Tribunal was not justified in sustaining deletion of the addition made on this count.

4. As can be seen from the impugned order, the Tribunal upon appreciation of the evidence on record has concurred with the findings recorded by the Commissioner (Appeals) who had granted relief to the assessee on the basis of the confirmatory letter given by the officer in charge of Bharat Petroleum Limited stating that diesel worth Rs.82,20,254/- was supplied by it to the assessee. The Tribunal has further taken note of the fact that the confirmatory letter issued by BPL clearly mentioned that the bills issued to the assessee have also been verified before issuance of the certificate. Considering the fact that the petrol pump of Bharat Petroleum Limited was run by the company itself, the Tribunal was of the view that the contents of the certificate could not be doubted and accordingly upheld the deletion made by the Commissioner (Appeals).

5. Thus, it is apparent that the conclusion arrived at by the Tribunal is based upon concurrent findings of fact recorded by it. The learned counsel for the appellant is not in a position to point out any material to the contrary so as to dislodge the concurrent findings of fact recorded by the Tribunal. Nothing has been pointed out to show that the Tribunal has placed reliance upon any irrelevant material or that any relevant material has been ignored. On the evidence which has come on record, it cannot be stated that the view adopted by the Tribunal is, in any manner, unreasonable or perverse in the absence of any contrary evidence being brought to the notice

of the court. Under the circumstances, this ground of appeal does not merit acceptance.

6. As regards proposed question [B], the same relates to addition of Rs.96,50,432/- with respect to cessation of liability under section 41(1) of the Income Tax Act, 1961 (hereinafter to be referred to as 'the Act') which was restricted by the Commissioner (Appeals) to Rs.18,27,608/-.

7. During the course of assessment proceedings, the Assessing Officer called upon the assessee to furnish ageing analysis of the creditors. Upon perusal of the statement furnished by the assessee, the Assessing Officer found that the assessee had not paid the money to many of such creditors for years together. In all, an amount of Rs.96,50,432/- was outstanding for several years. In many cases, there was no evidence to show that there was any movement for payment of the dues since more than three years. In some other cases credits were pending for more than five years. Since the assessee could not furnish any evidence except that the amounts were still payable by the assessee, the Assessing Officer added the same as income under the provisions of section 41(1) of the Act. The assessee carried the matter in appeal before the Commissioner (Appeals) who restricted the addition to Rs.18,27,608/- and thereby gave relief of Rs.78,22,824/-. The revenue went in appeal to the Tribunal to the extent of the relief granted to the assessee whereas the assessee filed cross objection to the extent of the addition which was sustained by the Commissioner (Appeals). The Tribunal after appreciating the evidence on record placed reliance upon its earlier decision in the case of M/s. Supriya

Textiles Industries v. Income Tax Officer wherein it was held that the concept of cessation in section 41(1) of the Act implies that liability of the assessee has ceased to exist in the year under consideration, either by operation of law, or by mutual contract between the parties. Operation of law would indicate that the liability has become unenforceable at law, that is, the limitation prescribed for recovery of dues by the creditor has expired or there is a court decree or order finally against the creditor whereby he loses his right to recover the money from the debtor, that is, the assessee. Thus, it is either expiry of limitation or a decree of a court that would make the liability cease to exist. However, a further condition has been imposed where limitation has expired. It is that the debtor, that is, the assessee should unequivocally declare his intention not to honour his liability when payment is demanded by the creditor. Further, if there is a contract between the parties and the creditor discharges the debtor of the debt either fully or partly then to the extent the debt is discharged by the creditor without payment by the assessee, liability would cease to exist. Thus, there has to be an event for cessation of liability to take place. If nothing happens during the assessment year then it cannot be said that the liability has ceased to exist. In case of remission there has to be a waiver by the creditor in favour of the assessee either unilaterally or through contractual agreement. To the extent such remission or waiver of the liability is granted the assessee would get benefit and accordingly to that extent would be taxable under section 41(1) subject to the basic condition that such liability remitted has been taken into account in the trading account or in the profit and loss account in the current year or in an earlier year. Thus, there has to be a positive act on the part of the creditor

in the current year which would provide the benefit to the assessee by way of remission. If no such act takes place then there is no case for holding that a liability has been remitted in favour of the assessee. Merely because certain amount is outstanding for a number of years it cannot be said that there is cessation or remission. Applying the said decision to the facts of the present case wherein also no event had taken place in the year under consideration, the Tribunal held that the provisions of section 41(1) could not have been invoked in the year under consideration as the event has to be triggered either on the side of the creditor or the debtor or by law. Since nothing had happened in the year under consideration, it could not be said that such liabilities were chargeable to tax under section 41(1) of the Act in the year under consideration.

8. Section 41 of the Act, insofar as the same is relevant for the present purpose, reads thus:

> ***41. Profits chargeable to tax****.—(1) 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 (hereinafter referred to as the first-mentioned person) and subsequently during any previous year,—*
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> > *(a) the first-mentioned person has obtained, 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 by such person 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 the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not; or*

(b) the successor in business has obtained, whether in cash or in any other manner whatsoever, any amount in respect of which loss or expenditure was incurred by the first-mentioned person or some benefit in respect of the trading liability referred to in clause (a) by way of remission or cessation thereof, the amount obtained by the successor in business or the value of benefit accruing to the successor in business shall be deemed to be profits and gains of the business or profession, and accordingly chargeable to income tax as the income of that previous year.

Explanation 1.—For the purposes of this sub-section, the expression "loss or expenditure or some benefit in respect of any such trading liability by way of remission or cessation thereof" shall include the remission or cessation of any liability by a unilateral act by the first mentioned person under clause (a) of the successor in business under clause (b) of that sub-section by way of writing off such liability in his accounts.

Thus, insofar as a trading liability is concerned, what is envisaged under section 41(1) of the Act is that an allowance or deduction should have been made in the assessment for any year in respect of any trading liability incurred by the assessee and subsequently during any previous year, the assessee should have obtained some benefit in respect of such trading liability by way of remission or cessation thereof in which case, the value of the benefit accruing to the assessee shall be deemed to be the profits and gains of business or profession and shall be chargeable to income-tax as income of that previous year. Thus, for the purpose of invoking sub-section (1) of section 41 of the Act, there has to be remission or cessation of the trading liability in the previous year and in the light of Explanation 1 thereto, such remission or cessation shall include the remission or cessation of any liability by a unilateral act of the assessee by way of writing off such liability in his accounts. Undisputedly in the facts of the present case the assessee has

not written off the liability in its accounts and as such there is no remission or cessation of liability by a unilateral act of the assessee as envisaged under Explanation 1. The case of the revenue appears to be that since many of the debts are outstanding for a period beyond three years, it would amount to cessation of liability by operation of law, viz. the law of limitation. In this regard reference may be made to the decision of the Supreme Court in ***Commissioner of Income-tax v. Sugauli Sugar Works (P) Ltd.,*** *(1999) 236 ITR 518*. The assessment year was 1965-66, that is prior to insertion of Explanation 1 which includes a unilateral act of the assessee of writing off such liability in his accounts within the ambit of the expression “remission or cessation thereof”. In the facts of the said case the assessee had transferred Rs.3,45,000/- out of the suspense account running from 1946-47 to 1948-49 to the capital reserve account. The Income-tax Officer found that out of the said amount Rs.2,56,529/- represented liabilities for expenses which had been allowed in earlier years. He, accordingly, included the said amount under section 41 of the Act in the total income of the assessee. The Tribunal as well as a Full Bench of this High Court held that the said amount did not fall within the scope of section 41. The contention of the revenue was that since the liability of the assessee in respect of the amount in question had come to an end as a period of more than 20 years had elapsed and the creditor had not taken any step to recover the amount, there was a cessation of the debt and the matter would fall within the scope of section 41 of the Act. The Supreme Court held that section 41 contemplates the obtaining by the assessee of an amount either in cash or by way of remission or cessation and it should be of a particular amount obtained by him. Thus, the obtaining by the

assessee of a benefit by virtue of remission or cessation is the sine qua non for the application of this section. Since at the relevant time a unilateral act of the assessee by making an entry in his accounts did not amount to remission or cessation of liability, the court held that mere making of such entry would not attract section 41 of the Act. In the present case, it may be recalled that there is no unilateral act of the assessee of making any entry in respect of the trading liabilities in its books of account. Therefore, a sine qua non for attracting section 41 of the Act in the present case, is that the assessee should have obtained a benefit by way of remission or cessation of a particular amount in the previous year corresponding to the assessment year in question. As noted by the Tribunal, there was no positive act on the part of either the assessee or the creditors which would amount to the assessee having gained the benefit of remission or cessation of the liabilities in question. The case of the revenue is that several years having passed the recovery of the debts in question have become time barred and hence by operation of law there is cessation of the liability, thereby attracting section 41(1) of the Act. As regards the debt becoming time barred by operation of law, the Supreme Court in the above decision, recorded with approval the following observations made by the Bombay High Court in ***J.K. Chemical Ltd. v. Commissioner of Income-tax,*** *(1966) 62 ITR 34 (Bom)*: *"xxx a unilateral act on the part of the debtor cannot bring about a cessation of his liability. The cessation of liability may occur either by reason of operation of law, i.e., on the liability becoming unenforceable at law by the creditor and the debtor declaring unequivocally his intention not to honour his liability when payment is demanded by the creditor, or a contract between the parties, or by discharge of*

the debt – the debtor making payment thereof to his creditor. Transfer of an entry is neither an agreement between the parties nor payment of the liability. "

To the extent the said decision holds that a unilateral act on the part of the debtor cannot bring about a cessation of his liability, the same would not be applicable to the facts of the present case, in view of the insertion of Explanation 1. However, at the cost of repetition it may be stated that in this case there is no unilateral act on the part of the debtor so as to bring about a cessation of its liability. Therefore, the other part of the decision would still apply to the facts of the present case, namely that the cessation of liability has to be either by reason of operation of law, i.e., on the liability becoming unenforceable at law by the creditor and the debtor declaring unequivocally his intention not to honour his liability when payment is demanded by the creditor, or a contract between the parties, or by discharge of the debt – the debtor making payment thereof to his creditor. In the present case, admittedly there in no declaration by the assessee that it does not intend to honour its liabilities nor is there any discharge of the debt. In the aforesaid premises, as no event had taken place in the year under consideration to indicate remission or cessation of the liabilities in question, the provisions of section 41(1) of the Act could not have been invoked. The reasoning adopted by the Tribunal while holding that section 41(1) would not be applicable to the facts of the present case is in line with the principles enunciated in the above decision. The Tribunal, therefore, committed no legal error so as to give rise to any question of law warranting interference by this court.

9. In the absence of any question of law arising from the impugned order of the Tribunal, the appeal is dismissed.

(Akil Kureshi, J.)

(Harsha Devani, J.)

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