

THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 24.05.2013
+ ITA No.235/2013

THE COMMISSIONER OF INCOME TAX DELHI-II Appellant

versus

JAIN EXPORTS PVT. LTD. Respondent

Advocates who appeared in this case:

For the Appellant : Mr Sanjeev Sabharwal, Advocate
For the Respondent : None.

CORAM:-

**HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE VIBHU BAKHRU**

JUDGMENT

VIBHU BAKHRU, J

1. This appeal is filed, on behalf of the revenue under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), challenging the order dated 30.03.2012 passed by Income Tax Appellate Tribunal, setting aside the addition of sum of ₹ 1,53,48,850/- made by the Assessing Officer on account of purported cessation of liability.

2. The assessee is a company incorporated under the Companies Act, 1956. The assessee company was engaged in the business of trading in agricultural commodities, however, the assessee did not conduct any business in the year 2007-2008 relevant to the assessment year 2008-2009. The assessee filed its

return of income, on 25.09.2008, for the assessment year 2008-2009 showing a loss and declaring taxable income as nil. The return was initially accepted under Section 143(1) of the Act, however, subsequently, the return was selected for scrutiny. The Assessing Officer examined the balance sheet of the assessee company for the relevant period and noted that the balance sheet disclosed a sum of ₹ 1,57,54,011/- as sundry creditors. The said amount comprised the following outstanding credit balances:-

S.No.	Name	Amount
1	M/s Elephanta Oil & Vanaspati Ltd.	₹ 1,53,48,850/-
2	M/s Geo-chem Laboratories (P) Ltd	₹ 41,231/-
3	M/s Jain House, Calcutta	₹ 30,210/-
4	M/s Ramji Lal Investments (P) Ltd	₹ 38,874/-
5	Sh. Sohan Lal Ghai	₹ 2,94,846/-

3. The credit balances against the aforementioned creditors have been outstanding since several years. In the case of M/s Elephanta Oil & Vanaspati Ltd., the amount of ₹ 1,53,48,850/- was outstanding in the books since 1984-1985. The Assessing Officer called upon the assessee to provide confirmations from the creditors regarding the balance outstanding to their credit. The assessee filed a balance confirmation from M/s Ramji Lal Investments (P) Ltd. but could not provide confirmations from any of the other aforementioned creditors. The Assessing Officer also issued notices under section 133(6) of the Act to the creditors, for the purpose of verifying the credit balance outstanding against their names. The notice issued to M/s Elephanta Oil & Vanaspati Ltd., M/s Geo-chem Laboratories (P) Ltd., M/s Jain House, Calcutta and Sh. Sohan Lal Ghai were returned un-served.

4. The Assessing Officer accepted the amount of ₹ 38,874/- outstanding to the credit of M/s Ramji Lal Investments (P) Ltd., but held that the balance liabilities in respect of other sundry creditors, which were lying unclaimed since several years, were liable to be added back to the income of the assessee under Section 41(1) of the Act. The Assessing Officer was of the view that there was cessation of these liabilities as there was no possibility of the creditors claiming the same in the near future. Accordingly, the aggregate of the balances outstanding to the credit of the aforementioned four creditors (i.e. M/s Elephanta Oil & Vanaspati Ltd., M/s Geo-chem Laboratories (P) Ltd., M/s Jain House, Calcutta and Sh. Sohan Lal Ghai) amounting to sum of ₹ 1,57,15,137/- were added back to the income of the assessee.

5. Aggrieved by the assessment order dated 01.11.2010 passed by the Assessing Officer, the assessee preferred an appeal before the CIT (Appeals), *inter-alia*, on the ground that there was no cessation of liabilities as the assessee continued to be liable for the amounts shown as outstanding against various creditors. In respect of the amount payable to M/s Elephanta Oil & Vanaspati Ltd., the assessee explained that M/s Elephanta Oil & Vanaspati Ltd. also owed a sum of ₹ 1,57,10,690.53/- to the assessee which was reflected as receivable in the balance sheet of the assessee company and thus in net terms M/s Elephanta Oil & Vanaspati Ltd. owed the assessee company a sum of ₹ 3,61,840.78. The amount payable to M/s Elephanta Oil & Vanaspati Ltd. was liable to be adjusted against the amount receivable from M/s Elephanta Oil & Vanaspati Ltd. and thus there could not be any cessation of liability towards the said creditor. The assessee company also provided its final accounts for the years ended on 31.03.2009 and 31.03.2010 which indicated the balances outstanding to the various sundry creditors continued to be reflected in the balance sheets of the assessee company for the subsequent years. It was, thus, contended by the assessee that, since the

assessee continued to acknowledge the credit balances in the subsequent period also, there could be no cessation of its liability to pay the creditors.

6. It was also submitted on behalf of the assessee that the amounts payable to M/s Elephanta Oil & Vanaspati Ltd. were on account of certain bank guarantees which had been furnished by M/s Elephanta Oil & Vanaspati Ltd., on behalf of the assessee company, to the custom authorities. The assessee also gave details of the bank guarantees that had been issued by the bank against certain imports that had been made by the assessee company in the year 1984-85. M/s Elephanta Oil & Vanaspati Ltd. had become a sick company and had filed a reference before the Board of Industrial and Financial Reconstruction (BIFR). The BIFR was of the opinion that M/s Elephanta Oil & Vanaspati Ltd. be wound up and accordingly, winding up proceedings have been initiated in this Court and the official liquidator has been appointed as the provisional liquidator to take over possession of the books and accounts and other records of the M/s Elephanta Oil & Vanaspati Ltd.

7. The CIT (Appeals) deleted the addition made by the Assessing Officer with regard to the balance outstanding to the credit of M/s Geo-chem Laboratories (P) Ltd., M/s Jain House, Calcutta and Sh. Sohan Lal Ghai on the ground that the assessee had continued to reflect the liabilities against the names of these creditors in the subsequent period i.e. in the final accounts for the years ended on 31.03.2009 and 31.03.2010. The CIT (Appeals) held that as the assessee company continued to reflect amounts payable to those creditors there was no cessation of liability and consequently, the provisions of Section 41(1) of the Act were inapplicable. However, in the case of M/s Elephanta Oil & Vanaspati Ltd., the CIT (Appeals) upheld the addition made by the Assessing Officer, not on the ground that there was cessation of liability, but on the basis

that the assessee had failed to establish the genuineness of the liability towards M/s Elephanta Oil & Vanaspati Ltd. The decision of the CIT (Appeals) was, *inter-alia*, based on the fact that the assessee had not been able to trace or produce any evidence with regard to the bank guarantees on account of which the liability to pay a sum of ₹ 1,53,48,850/- had arisen. The contention of the assessee that the transaction related back to the year 1984-1985 and had been accepted as genuine by the revenue through a series of scrutiny assessment made in the past, was not accepted. The plea of the assessee that, since the matter related to 1984-1985, the assessee could not produce the evidence of the initial transaction, was also not found to be acceptable by the CIT (Appeals).

8. While, the decision of the CIT (Appeals) was accepted by the revenue, the assessee preferred an appeal before the Income Tax Appellate Tribunal, *inter-alia*, challenging the confirmation of addition of ₹ 1,53,48,850/- by the CIT (Appeals). The Tribunal accepted the contention of the assessee that a sum of ₹ 1,57,10,690.53 was owed by M/s Elephanta Oil & Vanaspati Ltd. to the assessee company and thus, the net effect of the same would be that no amount would be payable by the assessee to M/s Elephanta Oil & Vanaspati Ltd. and a sum of ₹ 3,61,840.78 would be receivable after setting off the amount of ₹ 1,53,48,849/- which was standing to the credit of M/s Elephanta Oil & Vanaspati Ltd. The Tribunal was of the view that it was not correct to only accept the figure relating to the amount that was receivable by the assessee company while rejecting the amount payable by the assessee company to M/s Elephanta Oil & Vanaspati Ltd.

9. Aggrieved by the order passed by the Tribunal, the revenue has preferred the present appeal. It is contended before us on behalf of the revenue that there has been a cessation of liability of ₹ 1,53,48,849/- and the Tribunal has erred in

setting aside the addition made on that account. It is further urged that the Tribunal was in error in taking note of the amount receivable from M/s Elephanta Oil & Vanaspati Ltd. while, considering the provisions of Section 41(1) of the Act. Whilst, it was conceded before us that the genuineness of the initial transaction was not in challenge, it was contended that the fact that the amount payable to M/s Elephanta Oil & Vanaspati Ltd. has been outstanding for 25 years indicated that the liability has ceased. It has been pleaded on behalf of the revenue that the following questions arise for our consideration:

1. "Whether ITAT erred in setting aside an amount of ₹ 1,53,48,850.00 holding that there was no cession of liability?"
2. "Whether while considering provisions of section 41(1) the net liability that after providing for receivables is to be considered or is relevant?"

10. We are unable to appreciate the stand taken on behalf of the revenue, which has, apparently, not been consistent. The Assessing Officer, *inter-alia*, added a sum of ₹ 1,57,15,137, being the aggregate of the amounts shown as payable to various sundry creditors, as income under Section 41(1) of the Act. Whilst the Assessing Officer held that the liabilities due to the sundry creditors had ceased, the genuineness of the initial transaction on account of which the amounts were payable to various creditors was not made an issue. The only issue raised by the Assessing Officer was that since the outstanding balances had remained static on the books of the assessee for several years (in the case of M/s Elephanta Oil & Vanaspati Ltd. for over 25 years), there was no possibility of any claim being made by the creditors and the amount of liabilities outstanding were liable to be added as income of the assessee.

11. The CIT (Appeals) did not accept the reasoning of the Assessing Officer and deleted the addition made by the Assessing Officer with respect to amounts reflected as payable to various sundry creditors on the ground that assessee company continued to reflect the amounts payable even in the subsequent periods. The CIT (Appeals) held that there could be no cessation of liability as the assessee company continued to acknowledge its debt towards the creditors. However, the CIT (Appeals) concluded that the amount outstanding to the credit of M/s Elephanta Oil & Vanaspati Ltd. was not genuine as the assessee could not produce any confirmation or evidence of the original transaction which was undertaken in 1984-1985. It is relevant for us to notice that the revenue did not prefer any appeal against the order of the CIT (Appeals), and thus, accepted his decision that there was no cessation of liability in cases where the assessee company continued to acknowledge the amount owed by it to its creditors.

12. The question whether there had been any cessation of liability was thus not before the Tribunal as the Tribunal was only considering the correctness of the decision of the CIT (Appeals) wherein the transaction giving rise to the liability payable to M/s Elephanta Oil & Vanaspati Ltd. had been doubted. The Tribunal came to the conclusion, and rightly so, that the books of the assessee had been examined in the past and it would not be correct to accept a part of the account relating to a party and rejecting another part of the account. Whereas, the part of the account relating to dealings with M/s Elephanta Oil & Vanaspati Ltd. which resulted in the amount being receivable from M/s Elephanta Oil & Vanaspati Ltd. was accepted by the CIT (Appeals), the amount payable to the same entity was rejected. Accordingly, the Tribunal deleted the addition of ₹ 1,53,48,850/- confirmed by the CIT (Appeals).

13. The genuineness of the transaction entered into by the assessee in 1984-85 with M/s Elephanta Oils & Vanaspati Ltd. is not being assailed before us and the only controversy sought to be raised before us is whether there has been cessation of liability owed by the assessee to M/s Elephanta Oil & Vanaspati Ltd. In our view, that question doesn't arise in the present case since the decision of the CIT (Appeals) that there is no cession of liability in cases where the debt has been acknowledged by the assessee company has already been accepted by the revenue. However, as the question whether there is any cessation of liability in the relevant previous year warranting an addition in terms of Section 41(1) of the Act has been urged on behalf of the revenue, we consider it appropriate to examine the same.

14. Section 41(1) of the Act is relevant and is quoted below:-

“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,-

- (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) or the successor in business under clause (b) of that sub-section by way of writing off such liability in his accounts.”

15. Indisputably, Explanation 1 to section 41(1) of the Act, which was inserted, w.e.f. 01.04.1997 is not applicable, as the assessee has not written off the liability to pay M/s Elephanta Oil & Vanaspati Ltd. in its books of accounts.

16. The Supreme Court in the case of **CIT v. Sugauli Sugar Works (P.) Ltd.**: [1999] 236 ITR 518 (SC) has held that section 41(1) of the Act contemplates obtaining by the assessee an amount either in cash or any other manner or any benefit by way of cessation or remission of liability. In order to come within the sweep of section 41(1) it is necessary that the benefit derived by an assessee results from cessation or remission of a trading liability. The relevant extract from the decision of the Supreme Court in the case of **CIT v. Sugauli Sugar Works (P.) Ltd.** (*supra*) is quoted below:

“3. It will be seen that the following words in the section are important: ‘the assessee 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 him’. Thus, the section contemplates obtaining by the assessee of an amount either in cash or in any other manner whatsoever or a benefit 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 sine qua non for application of this section.”

17. The only issue that needs to be considered is whether the liability towards M/s Elephanta Oil & Vanaspati Ltd. has ceased on account of efflux of time.

18. The Supreme Court in the case of '**Bombay Dyeing and Manufacturing Co. Ltd.**' v. **State of Bombay**: AIR 1958 SC 328 has clearly held that even in cases where the remedy of a creditor is barred by limitation the debt itself is not extinguished but merely becomes unenforceable. The Court observed as under:-

“The position then is that, under the law, a debt subsists notwithstanding that its recovery is barred by limitation.....”

19. This view has also been taken by the Supreme Court in the case of **CIT v. Sugauli Sugar Works P. Ltd.** (*supra*). In the said case, it was contended on behalf of the revenue that the liability has come to an end as the creditors in the said case had not taken any action to recover the amounts due to them for twenty years. The Supreme Court affirmed the decision of the Bombay High Court in the case of **J. K. Chemicals Ltd. v. CIT**: [1966] 62 ITR 34 (Bom) wherein the words “cessation or remission” had been interpreted. The Supreme Court quoted the following passage from the judgment of the Bombay High Court in the said case of **J. K. Chemicals Ltd. v. CIT** (*supra*): -

“The question to be considered is whether the transfer of these entries brings about a remission or cessation of its liability. The transfer of an entry is a unilateral act of the assessee, who is a debtor to its employees. We fail to see how a debtor, by his own unilateral act, can bring about the cessation or remission of his liability. Remission has to be granted by the creditor. It is not in dispute, and it indeed cannot be disputed, that it is not a case of remission of liability. Similarly, a unilateral act on the part of the debtor cannot bring about a cessation of his liability. The

cessation of the liability may occur either by reason of the 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. We have already held in *Kohinoor mills'* case [1963] 49 ITR 578 (Bom) that the mere fact of the expiry of the period of limitation to enforce it, does not by itself constitute cessation of the liability. In the instant case, the liability being one relating to wages, salaries and bonus due by an employer to his employees in an industry, the provisions of the Industrial Disputes Act also are attracted and for the recovery of the dues from the employer, under section 33C(2) of the Industrial Disputes Act, no bar of limitation comes in the way of the employees.”

After quoting the above passage, the Supreme Court held as under:-

“This judgment has been quoted by the High Court in the present case and followed. We have no hesitation to say that the reasoning is correct and we agree with the same.”

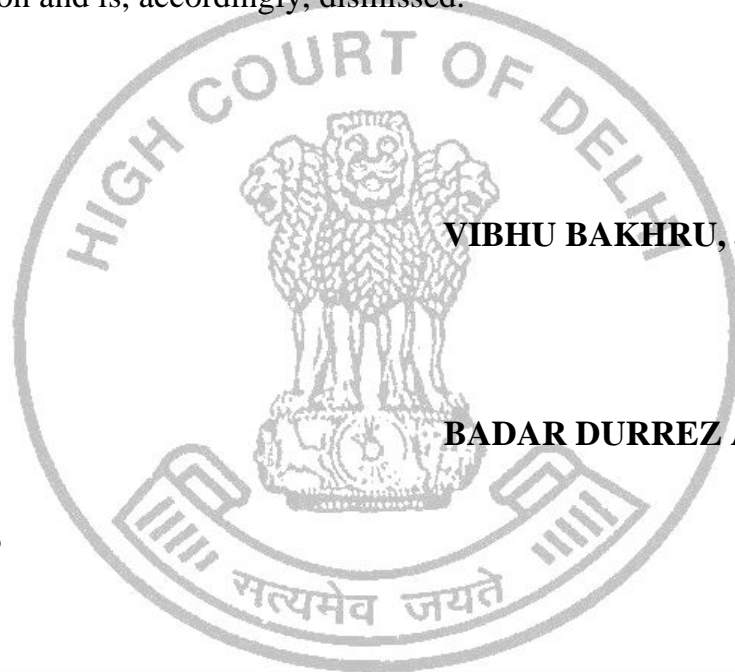
20. In order to attract the provisions of Section 41(1) of the Act, it is necessary that there should have been a cessation or remission of liability. As held by the Bombay High Court, in the case of ***J. K. Chemicals Ltd.*** (*supra*), cessation of liability may occur either by the reason of the liability becoming unenforceable in law by the creditor coupled with debtor declaring his intention not to honour his liability, or by a contract between parties or by discharge of the debt. In the present case, the assessee is acknowledging the debt payable to M/s Elephanta Oil & Vanaspati Ltd. and there is no material to indicate that the parties have contracted to extinguish the liability. Thus, in our view it cannot be concluded that the debt owed by the assessee to M/s Elephanta Oils & Vanaspati Ltd. stood extinguished.

21. Although, enforcement of a debt being barred by limitation does not *ipso facto* lead to the conclusion that there is cessation or remission of liability, in the facts of the present case, it is also not possible to conclude that the debt has become unenforceable. It is well settled that reflecting an amount as outstanding in the balance sheet by a company amounts to the company acknowledging the debt for the purposes of Section 18 of the Limitation Act, 1963 and, thus, the claim by M/s Elephanta Oil & Vanaspati Ltd. can also not be considered as time barred as the period of limitation would stand extended. Even, otherwise, it cannot be stated that M/s Elephanta Oil & Vanaspati Ltd. would be unable to claim a set-off on account of the amount reflected as payable to it by the assessee. Admittedly, winding up proceedings against M/s Elephanta Oil & Vanaspati Ltd. are pending and there is no certainty that any claim that may be made by the assessee with regard to the amounts receivable from M/s Elephanta Oil & Vanaspati Ltd. would be paid without the liquidator claiming the credit for the amounts receivable from the assessee company. It is well settled that in order to attract the provisions of Section 41(1) of the Act, there should have been an irrevocable cession of liability without any possibility of the same being revived. The assessee company having acknowledged its liability successively over the years would not be in a position to defend any claim that may be made on behalf of the liquidator for credit of the said amount reflected by the assessee as payable to M/s Elephanta Oil & Vanaspati Ltd.

22. We may also add that, admittedly, no credit entry has been made in the books of the assessee in the previous year relevant to the assessment year 2008-2009. The outstanding balances reflected as payable to M/s Elephanta Oil & Vanaspati Ltd. are the opening balances which are being carried forward for several years. The issue as to the genuineness of a credit entry, thus does not arise in the current year and this issue could only be examined in the year when

the liability was recorded as having arisen, that is, in the year 1984-1985. The department having accepted the balances outstanding over several years, it was not open for the CIT (Appeals) to confirm the addition of the amount of ₹ 1,53,48,850/- on the ground that the assessee could not produce sufficient evidence to prove the genuineness of the transactions which were undertaken in the year 1984-85.

23. The present appeal does not disclose any substantial question of law for our consideration and is, accordingly, dismissed.



VIBHU BAKHRU, J

BADAR DURREZ AHMED, J

MAY 24, 2013
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