

IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 24TH DAY OF MARCH 2016

PRESENT

THE HON'BLE MR.JUSTICE JAYANT PATEL

AND

THE HON'BLE MRS.JUSTICE B.V.NAGARATHNA

ITA NO.658/2015

BETWEEN:

1. THE COMMISSIONER OF INCOME-TAX
5TH FLOOR, BMTC BUILDING,
80 FEET ROAD, KORMANGALA
BANGALORE-560 095
 2. THE ASSISTANT COMMISSIONER OF
INCOME-TAX
CIRCLE-1(1)
NO.59, HMT BHAVAN,
6TH FLOOR, BELLARY ROAD,
GANGANAGAR,
BANGALORE-560 032
- ...APPELLANTS

(BY SRI.K.V.ARAVIND, ADVOCATE)

AND:

M/S. ALVARES & THOMAS
3-9-742,"ALVARES CENTER"
VIVEKANANDA ROAD, NANTHOOR,
MANGALORE
PAN:AAFFA 0107K

... RESPONDENT

THIS ITA IS FILED UNDER SEC.260-A OF INCOME TAX ACT 1961, ARISING OUT OF ORDER DATED: 14/08/2015 PASSED IN ITA NO.1676/BANG/2013, FOR THE ASSESSMENT YEAR 2010-2011 PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED ABOVE AND ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE ITAT, BENGALURU IN ITA NO. 1676/BANG/2013 DATED: 14/08/2015 CONFIRMING THE ORDER OF THE APPELLATE COMMISSIONER AND CONFIRM THE ORDER PASSED BY THE ASSISTANT COMMISSIONER OF INCOME TAX, CIRCLE-1(1), BENGALURU.

THIS APPEAL COMING ON FOR ADMISSION THIS DAY, **JAYANT PATEL J.**, DELIVERED THE FOLLOWING:

JUDGMENT

The appellant-Revenue has preferred the present appeal by raising the following substantial question of law:

“Whether under the facts and in the circumstances of the case, the Tribunal was right in law deleting the addition of Rs.81,40,232 on account of cessation of liability under Section 41(1) being outstanding liability towards M/s.Durga traders as claimed by the assessee when the assessee failed to prove the existence of the creditor and that the creditor had insisted for the payment at pay point of time or initiated any legal action against the assessee, although the entry has been appearing in the books of the assessee for past 7 to 8 years and assessing authority rightly invoked provisions sections 41(1) as all the conditions are fulfilled in the case of assessee?”

2. We may record that the relevant discussion of the Tribunal is at paragraphs 11 to 14 which reads as under:

“11. We have given a careful consideration to the rival submissions. On almost identical facts, the Hon’ble Delhi High Court in the case of Shri.Vardhaman Overseas Ltd. (supra), has

clearly laid down that neither section 41(1) nor section 68 of the Act can be applied. On the applicability of section 68, we are of the view that those provisions will not apply as the balances shown in the creditors account do not arise out of any transaction during the previous year relevant to AY 2009-10. The provisions of sec. 68 are clear inasmuch as they refer to "sum found credited in the books of account of an assessee maintained for any previous year". Since the credit entries in question do not relate to previous year relevant to AY 2009-10, the same cannot be brought to tax u/s. 68 of the Act. The proper course in such cases for the Revenue would be to find out the year in which the credits in question were credited in the books of account and thereafter make an enquiry in that year and make an addition in that year, if other conditions for applicability of section 68 are satisfied.

12. As far as applicability of section 41(1) of the Act is concerned, the question before us is limited to the applicability of Section 41(1) of the Act. The section in so far as it is relevant for our purpose is as below:

"Profits chargeable to tax.

41. (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

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[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.”

(underlining ours)

13. Explanation 1 which was inserted w.e.f. 1.4.1997 is not attracted to the present case

since there was no writing off of the liability to pay the sundry creditors in the assessee's accounts. The question has to be considered *de hors* Explanation 1 to Section 41(1). In order to invoke clause (a) of Sec.41(1) of the Act, it must be first established that the assessee had obtained some benefit in respect of the trading liability which was earlier allowed as a deduction. There is no dispute in the present case that the amounts due to the sundry creditors had been allowed in the earlier assessment years as purchase price in computing the business income of the assessee. The second question is whether by not paying them for a period of four years and above the assessee had obtained some benefit in respect of the trading liability allowed in the earlier years. The words "remission" and "cessation" are legal terms and have to be interpreted accordingly. In the present case, there is nothing on record to show that there was either remission or cessation of liability of the assessee. In fact, there is no reference either in the order of the AO or CIT(A) to the expression "remission or cessation of liability". In such circumstances, we are of the view that the provisions of section 41(1) of the Act could not be invoked by the Revenue. In fact the decision of the Hon'ble Delhi High Court in the case of Vardhaman overseas Ltd. (*supra*) clearly supports the plea of the Assessee in this regard. On identical facts, the Hon'ble Delhi High Court on the applicability of Sec.41(1) of the Act, held:-

"12. That takes us to the next question as to what constitutes remission or cessation of the liability. It cannot be disputed that the words "remission" and "cessation" are legal terms and have to be interpreted accordingly. In State of Madras vs. Gannon Dunkerley & Co. AIR 1958 SC 560 Venkatarama Aiyar J. explained the general rule of construction that words used in statutes must be taken in their legal sense and observed :

"The ratio of the rule of interpretation that words of legal import occurring in a statute should be construed in their legal sense is that those words have, in law, acquired a definite and precise sense and that, accordingly, the legislation must be taken to have intended that they should be understood in that sense. In interpreting an expression used in a legal sense, therefore, we have only to ascertain the precise connotation which it possesses in law".

In our opinion, this rule should be applied to the interpretation and understanding of the words "remission" and "cessation" used in the section.

13. In Bombay Dyeing & Mfg. Co. Ltd. vs. State of Bombay AIR 1958 SC 328 the legal position was summarized by T.L. Venkatarama Aiyar, J., in the following manner :

"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. Indeed, it is on that footing that there can be statutory transfer of the debts due to the employees, and that is how the board gets title to them. If then a debt subsists even after it is barred by limitation, the employer does not get, in law, a discharge therefrom. The modes in which an obligation under a contract becomes discharged are well-defined, and the bar of limitation is not one of them. The following passages in Anson's Law of Contract, 19th Edition, p. 383, are directly in point :

"At Common Law lapse of time does not affect contractual rights. Such a right is of a permanent and indestructible character, unless either from the nature of the contract, or from its terms, it be limited in point of duration."

But though the right possesses this permanent character, the remedies arising from its violation are withdrawn after a certain lapse of time; interest reipublicae ut si finis litium. The remedies are barred, though the right is not extinguished.'

And if the law requires that a debtor should get a discharge before he can be compelled to pay, that requirement is not satisfied if he is merely told that requirement

is the normal course he is not likely to be exposed to action by the creditor."

(underlining, italicised in print, ours)

This was also the view taken by the Supreme Court in CIT vs. Sugauli Sugar Works (P) Ltd. (supra).

14. *Since the Tribunal has relied on the judgment of the Supreme Court in the case of CIT vs. Sugauli Sugar Works (P) Ltd. (supra) we may usefully refer to the decision in order to appreciate the controversy therein and the ratio laid down. That was a case of a private limited company. In respect of the asst. yr. 1965-66, it transferred a sum of 3,45,000 from the suspense account running from 1946-47 to 1948-49 to the capital reserve account. The ITO found that a sum of 1,29,000 out of the above amount repaid deposits and advances which were paid back by the assessee. He, therefore, deducted this amount from the amount of 3,45,000 and the balance of 2,56,529 was brought to assessment under s. 41(1) of the Act. The assessee appealed unsuccessfully to the AAC and thereafter carried the matter in further appeal to the Tribunal. Its contention before the Tribunal was that the unilateral entry of transferring the amount from the suspense account to the capital reserve account would not bring the said amount within s. 41(1). The contention was accepted by the Tribunal whose decision*

was affirmed by the Calcutta High Court CIT vs. Sugauli Sugar Works (P) Ltd. (1981) 23 CTR (Cal) 226 : (1983) 140 ITR 286 (Cal). The Revenue carried the matter in the appeal to the Supreme Court. The contention of the Revenue (as noted at p. 520 of 236 ITR) was that on the facts of the case, the liability came to an end as a period of more than 20 years had elapsed and the creditors had not taken any steps to recover the amount and consequently there was a cessation of the debt which would bring the matter within the scope of s. 41(1). It may be noted that the contention of the Revenue in the case before us is precisely the same. To recapitulate, the learned standing counsel contended before us that since a period of more than 4 years has admittedly elapsed from the debt on which the debts were incurred and since the creditors had not taken any steps to recover the amount, there was a cessation of the debts which brought the matter under s. 41(1). Turning back to the judgment of the Supreme Court, we find that the judgment of the Calcutta High Court under appeal was affirmed for two reasons. The first reason was based on a judgment of the Full Bench of the Gujarat High Court in CIT vs. Bharat Iron & Steel Industries (1992) 105 CTR (Guj)(FB) 331 : (1993) 199 ITR 67 (Guj)(FB). It was held by the Supreme Court that the Gujarat High Court was right in saying that in order to attract taxability under s. 41(1) the assessee should have obtained, whether in cash or in any other manner whatsoever, any amount in

respect of the loss or expenditure earlier allowed as a deduction. This part of the reasoning, in the light of the amended cl. (a) of sub-s. (1) of s. 41 may not be relevant after substitution of the said clause by the Finance Act, 1992 w.e.f. 1st April, 1993, by which the words "some benefit in respect of such trading liability by way of remission or cessation thereof" were inserted. After the amendment, therefore, it is not necessary that in respect of a trading liability earlier allowed as a deduction, the assessee should have received any amount, in cash or otherwise, but it is necessary that the assessee should have received "some benefit" in respect of such trading liability. However, we have already seen that this benefit in respect of trading liability should be "by way of remission or cessation of the liability", after the amendment made to the clause w.e.f. 1st April, 1993. The second part of the reasoning of the Supreme Court in CIT vs. Sugauli Sugar Works (P) Ltd. (supra) is based on the interpretation of the words "cessation or remission" of the trading liability. The Supreme Court noticed a judgment of the Bombay High Court in J.K. Chemicals Ltd. vs. CIT (1996) 62 ITR 34 (Bom) in which it was explained as to what could bring out a cessation or remission of the assessee's liability. The observations of the Bombay High Court in the judgment cited above are as under :

"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 Co. Ltd. vs. CIT (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 s. 33C(2) of

the Industrial Disputes Act, no bar of limitation comes in the way of the employees."

15. The Supreme Court noticed that the above observations of the Bombay High Court were quoted by the Calcutta High Court in the judgment under appeal before them, and observed as under while upholding the judgment of the Calcutta High Court :

"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. To reinforce the conclusion, the Supreme Court also noticed its earlier judgment in Bombay Dyeing & Mfg. Co. Ltd. vs. State of Bombay AIR 1958 SC 328 wherein it was held that the expiry of the period of limitation prescribed under the Limitation Act could not extinguish the debt but it would only prevent the creditor from enforcing the debt.

16. In our opinion, the judgment of the Supreme Court in CIT vs. Sugauli Sugar Works (P) Ltd. (supra) is a complete answer to the contention of the learned standing counsel. In the case before the Supreme Court for a period of almost 20 years the liability remained unpaid and this fact formed the basis of the contention of the Revenue before the Supreme Court to the effect that having regard to the long lapse of time and in the absence of any steps taken by the creditors to

recover the amount, it must be held that there was a cessation of the debts bringing the case within the scope of s. 41(1). In the case before us, the identical contention has been taken on behalf of the Revenue, though the period for which the amount remained unpaid to the creditors is much less. It was held by the Supreme Court that a unilateral action cannot bring about a cessation or remission of the liability because a remission can be granted only by the creditor and a cessation of the liability can only occur either by reason of operation of law or the debtor unequivocally declaring his intention not to honour his liability when payment is demanded by the creditor, or by a contract between the parties, or by discharge of the debt."

14. From the ratio laid down in the aforesaid decision, we are of the view that there is nothing on record to show any cessation or remission of liability by the creditor or even an unilateral act by the Assessee in this regard. In view of the above, we are of the view that the impugned addition cannot be sustained and the same was rightly directed to be deleted by the CIT(A). The order of the CIT(A) is therefore confirmed."

3. The aforesaid shows that, the Tribunal has considered that the issue is already covered by the

decision of Delhi High Court that Section 41(1) cannot be invoked and based on the decision of Delhi High Court, the Tribunal held that unless there is no material on record either for cessation or remission of liability by the creditor, Section 41 (1) of the Income Tax Act cannot be invoked and the addition made cannot be sustained. Consequently, the Tribunal has directed the deletion made by the assessing officer.

4. However, Mr.Arvind, learned counsel appearing for the revenue relied upon the decisions of Rajasthan and Punjab & Haryana High Courts reported in (2013) 35 Taxmann.com 262 (Rajasthan) and (2014) 47 Taxmann.com 268 (P & H) in case of Rama Steel Rolling Mills & General Engg.Works v. Income Tax Officer and Mrs.Adarsh Sood v. Commissioner of Income Tax, Faridabad respectively. He also relied upon the provisions of Section 41 of the Income Tax Act.

5. The principal contention is that unless the burden is discharged with regard to the existence of the liability by the assessee, it is open for the Revenue to invoke the provisions of Section 41(1) of the Act and to make addition on the premise that, the liability has ceased to pay the amount of the creditor.

6. In his submission, the decision of Delhi High Court which has been referred to by the Tribunal in case of Sri Vardhman Overseas Ltd., supra cannot be applied to the facts of the present case since in the said decision, it was not a case where the party/creditor was not verifiable or that the address was not changed. He therefore, submitted that Court may consider the present appeal.

7. As in the above referred order of the Tribunal, the relevant portion of Section 41 is reproduced, we may

not reproduce the same. But, the relevant aspect is that, there are two requirements for invoking the provision of Section 41. The *Sine qua non* is, the remission or cessation of the trading liability and the additional requirement is, some benefit in respect of such trade liability is taken by the Assessee. If the aforesaid conditions are satisfied, then only Section 41(1) could be invoked by the Assessing Officer.

8. Examining of the facts of the present case reveals that, it is not the case of the Department that, any benefit in respect of such trading liability was taken by the assessee but, the Revenue contends that since the burden was not discharged of existence of the liability, it be treated as cessation of the liability and therefore, Section 41(1) could be invoked. Further, stand of the Revenue is that, when in respect of debt in question, confirmation was called for, a letter was

produced of the creditor with its address but, when the same was verified, the report was that, party could not be traced and therefore, it was not verifiable.

9. In our view, even if we accept the contention of the Revenue that the party could not be traced and therefore debt could not be verified then also, by no stretch of imagination can it be held that it would satisfy the requirement of cessation of liability. In legal parlance, merely because the creditor could not be traced on the date when the verification was made, same is not a ground to conclude that there was cessation of the liability. Cessation of the liability has to be cessation in law, of the debt to be paid by the assessee to the creditor. The debt is recoverable even if the creditor has expired, by the legal heirs of the deceased creditor. Under the circumstances, in the present case, it can hardly be said that the liability had ceased. If the liability had not ceased or the benefit was

not taken by the assessee in respect of such trade liability, in our view, the conditions precedent were not satisfied for invoking Section 41(1) of the Act in the instant case.

10. The Tribunal has rightly relied upon the decision of Delhi High Court in case of Vardhman Overseas Ltd.,. The discussion of the decision of Delhi High Court was relevant, for consideration of the facts of the case in order to find out as to under what circumstances it could be said that there is cessation of liability. Further, the decision of Delhi High Court is after considering the view taken by the Apex Court in case of CIT vs. Sugauli Sugar Works P Ltd., (1999) 236 ITR 518 (SC).

11. In the decision of Rajasthan High Court in the case of Rama Steel Rolling Mills, the question examined was with regard to discharge of the liability, whether by

remission or cessation was not concluded but was rather referred to the assessing authority for fresh assessment. In the decision of High Court of Punjab and Haryana in case of Mrs. Adarsh Sood, there were entries shown in the books of accounts of the assessee as not in the nature of debts but as credits. Such are not the fact situations in the present case.

12. Under the circumstances, the aforesaid decisions of High Court of Rajasthan and High Court of Punjab and Haryana cannot be applied to the facts of the case.

13. In view of the aforesaid, we find that when the issue is already covered by the decision of Delhi High Court read with the reasons recorded by us hereinabove, it cannot be said that any substantial question of law would arise for consideration as sought to be canvassed.

Hence, the present appeal is dismissed.

**Sd/-
JUDGE**

**Sd/-
JUDGE**

Sk/-