
(2011) 12 DEL CK 0221
In the Delhi High Court
Case No : ITA No. 1073 of 2011

CIT

APPELLANT

Vs

Hotline Electronics Ltd

RESPONDENT

Date of Decision : 23-12-2011

Acts Referred:

Income Tax Act, 1961 — Section 133(6), 143(1), 143(2), 260A, 41(1)
Limitation Act, 1963 — Section 18

Citation : (2012) 205 TAXMAN 245

Hon'ble Judges : Sanjiv Khanna, J; R.V. Easwar, J

Bench : Division Bench

Advocate : N.P. Sahni, for the Appellant; Mayank Bugani and Mr. Saurabh Mishra, for the Respondent

Judgement

R.V. Easwar, J.—In this appeal by the revenue filed u/s 260A of the Income Tax Act, 1961 (the Act, for short), the order of the Income

Tax Appellate Tribunal (The Tribunal, for short) dated 28.01.2011 in ITA No. 2635/Delhi of 2010 (assessment year 2005-06) is challenged.

2. The respondent assessee is a limited company engaged in the business of manufacturing and trading in television sets. In respect of the

assessment year 2005-06, it filed a return of income declaring income of Rs. 1,79,90,660/- . The return was processed u/s 143(1) of the Act but

was later selected for scrutiny and notice was issued to the assessee u/s 143(2) asking for details in support of the return. In the course of the

assessment proceedings, the Assessing Officer called upon the assessee to furnish the details of advances received from customers and also show

when those advances were repaid. From the reply filed by the assessee, the Assessing Officer noticed that there were several advances which had

not been repaid till date. He, therefore, called upon the assessee to explain why in the case of advances which had not been repaid, it should not

be held that there was a cessation of liability. The assessee responded by saying that the amounts were in the nature of credit balances which arose

on account of credit notes issued in respect of rate difference, difference in calculation of raw material costs or sales returns. On these facts, the

Assessing Officer was of the view that the assessee's reply was very general without being supported by any documentary evidence. He held that

the following balances were outstanding till date and no confirmation was furnished by the assessee in respect of them:

S. No. Name Amount (in Rs.)

1. HOTLINE CALCOM ELECTRONICS Company 1114049

2. INDICA TRADERS PVT. LTD. 743155

3. KELON CORPORATION-CTV 24598

4. KC MERCHANTILE LTD-SAMSUNG 131898

5. KEMIL MARKETING P.LTD 2672517

6. SONA IMPEX PVT.LTD. 341514

TOTAL 5027731

According to the Assessing Officer since the advances had not been liquidated till date and the assessee was not able to file any confirmation from

the creditors, it was clear that there was a cessation of liability in respect of those advances and that the assessee had no further obligation to return

them. In this view of the matter, the receipt of Rs. 50,27,731/- received by the assessee was taken as a revenue receipt and was added to income

of the assessee in the assessment order passed on 24.12.2007.

3. The assessee appealed and contended that it had given advances to parties for purchases and also received advances against supplies, that it

would be evident from the balance sheet that the credit balances in favour of the customers represented a running account with them and were

pending adjustment for claims and counter claims and that in these circumstances it is not permissible to hold that the assessee was no longer liable

to return the amounts to the creditors. It was thus contended that the addition was unsustainable.

4. The CIT (A) observed that the conditions for the applicability of Section 41(1)

of the Act were satisfied in the present case. He noted that the credit balances remained static for the past several years as noticed by the Assessing Officer in the assessment order. He further held that by establishing this fact, namely that the credit balances remained static for the past several years the revenue has discharged its burden and thereafter the burden shifted to the assessee who was required to establish and prove that the liability to the creditors subsisted and in this, the assessee has failed. He accordingly sustained the addition and dismissed the assessee's appeal on this point.

5. The assessee carried the matter in further appeal before the Court in ITA No. 2635/Delhi of 2010. The Tribunal found that the credit balances

had not been written off in the books of account. As regards the applicability of Section 41(1) of the Act, the Tribunal held as under:-

From the above, it is clear that Act postulates there should be benefit obtained by the assessee by way of remission or cessation of liability. In this

case, we note that there is no document on record which prove that there is actual remission and cessation or the liability. It is not the case the

Assessing Officer has issued notices to the creditors and they have declined that they have paid said amount. Under the circumstances, when

Assessing Officer has not brought about any cogent basis and these amounts have been written off in the books of accounts, we do not find any

reason to hold that the amount is liable to be added u/s 41(1) of the IT Act.

The assessee's appeal on this point was thus allowed by the Tribunal.

6. The revenue challenges the order of the Tribunal and has raised the following questions of law as substantial questions of law:

1. Whether on the facts and circumstances of the case, the Income Tax Appellate Tribunal was correct in law in deleting the addition of Rs.

50,27,731/- made by the AO on account of cessation of liability"

2. Whether on the facts and circumstances of the case, the order of the Income Tax Appellate Tribunal is not perverse as, it being a final fact

finding authority, has failed to appreciate that necessary conditions u/s 41(1) of the Income Tax Act are satisfied in this case"

3. The appellant craves leave to add, alter and modify any question of law at the time of admission of appeal.

After hearing both the sides the following substantial question of law is framed:

Whether on the facts and in the circumstances of the case, and on proper interpretation of Section 41(1) of the Income Tax Act, 1961, the

Tribunal was right in law in holding that the assessee's liability to pay the creditors had not ceased and therefore, the income tax authorities were

not justified in making an addition of Rs. 50,27,731/"

7. In our opinion, the interpretation placed by the Tribunal on Section 41(1) of the Act is in conformity with the legal position that unless there is

evidence to show that the creditor has remitted the debt or otherwise by operation of law the liability to pay him has ceased, there can be no

benefit arising to the assessee within the meaning of clause (a) of Section 41(1). The Tribunal is also right in its view that unless notices were issued

to the creditors and they had stated that they have given up the claims against the assessee, no decision can be taken by the income tax authorities,

merely on the ground that the debts remained unpaid in the assessee's books for a number of years, that the liability has ceased or has been

remitted. In the present case the Assessing Officer has not issued any notice to the creditors to confirm from them whether they have given up their

dues from the assessee. It must be remembered that the debts were not written back in the assessee's accounts as found by the Tribunal. Except

for the fact that the amounts were outstanding there was no material or evidence to show that there was remission or cessation of liability. It is the

Assessing Officer who has invoked Section 41(1). It is he who has stated that there was a remission or cessation of the assessee's liability. It was,

therefore, incumbent upon him to make inquiry and bring on record material. By virtue of the powers vested in him u/s 133(6) or any other

provision of the Income Tax Act to seek clarification or confirmation from the creditors, the said material/evidence could have been ascertained.

The assessee herein is a limited company and as per the legal position the acknowledgment of the liability in favour of the creditors in its balance

sheet extends the period of limitation for the purpose of Section 18 of the Limitation Act. It is the assessee's claim that the debts are subsisting and

it continues to be liable to pay the creditors. It is not open to the income tax authorities to draw the conclusion that the creditors have remitted the

liability or that the liability has otherwise ceased without evidence or material when the assessee acknowledges a liability in the balance sheet and

Explanation-1 is not applicable. In the present case, the liability to the creditors continues to be shown in the assessee's books of accounts and the accounts of the creditors have not been written back. This finding of fact by the Tribunal is not under challenge.

8. In Commissioner of Income Tax, Calcutta Vs. Sugauli Sugar Works P. Ltd., , the Supreme Court disapproved the reasoning of the Bombay

High Court in Commissioner of Income Tax Vs. Bennett Coleman and Co. Ltd., . In this judgment, the Bombay High Court had distinguished its

earlier judgment in Kohinoor Mills Co. Ltd. Vs. Commissioner of Income Tax, Bombay City I, by holding that cessation of liability can take place

even as a result of an unilateral act and where a debt has become barred by limitation by operation of law, the unilateral act of the assessee

transferring the same to his profit and loss account and thereby treating as his income would attract the provisions of Section 41(1) of the Act. The

Bombay High Court had also observed that there was a cessation of the liability due to the expiry of period of limitation to enforce the same.

Disapproving the line of reasoning of the Bombay High Court in CIT v. Bennett Coleman & Company Ltd. (supra) the Supreme Court held as

under:-

We are unable to accept the reasoning of the Bombay High Court in that case. Just because an assessee makes an entry in his books of account

unilaterally, he cannot get rid of his liability. The question whether the liability is actually barred by limitation is not a matter which can be decided

by considering the assessee's case alone but it is a matter which has to be decided only if the creditor is before the concerned authority. In the

absence of the creditor, it is not possible for the authority to come to a conclusion that the debt is barred and has become unenforceable. There

may be circumstances which may enable the creditor to come with a proceeding for enforcement of the debt even after the expiry of the normal

period of limitation as provided in the Limitation Act.

It may be observed that in the present case, as noted earlier, the Assessing Officer has not brought on record any evidence or material, including

any statement from the creditors, that the debts had been extinguished and the liability of the assessee to pay them has ceased, despite the

extension of the period of limitation by acknowledgment made in the assessee's

balance sheet. Section 41(1)(a) cannot be invoked on these facts.

9. In ITA No. 774/2009 by judgment of even date we have decided a similar matter where the income tax authorities had invoked Section 41(1)

(a) of the Act. We have held that unpaid liabilities cannot be added as the assessee's income u/s 41(1) merely because they remained unpaid for a

sufficiently long time and that it is required of the revenue authorities to show that the liability to pay the creditors has ceased or has been remitted

by the creditors.

10. For the reasons stated by us hereinabove and in the aforesaid judgment, we answer the substantial question of law raised by the revenue in the

present appeal in the affirmative and in favour of the assessee. The appeal of the revenue is dismissed. There shall be no order as to costs.