* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA NO.774/2009**

Reserved on : **24th November, 2011**
% **Date of Decision** : **23rd December, 2011**

THE COMMISSIONER OF INCOME TAX-III ……Appellant
Through: Mr. Sanjeev Sabharwal, Advocate.

VERSUS

SHRI VARDHMAN OVERSEAS LTD. …..Respondent
Through: None.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V. EASWAR

1. Whether Reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporters or not ?
3. Whether the judgment should be reported in the Digest?

R.V. EASWAR, J.:

By order dated 10.10.2009 the following substantial question of law was formulated and admitted by a Division Bench of this Court:-

> "Whether the Ld. ITAT erred in deleting addition under Section 41(1) of Rs.1,25,46,534/- on account of non-genuine creditors?"

2. The brief facts giving rise to the present appeal filed by the revenue under Section 260A of the Income Tax Act, (`the Act' for short) may be noticed. The assessee is a company engaged in the manufacture of rice from paddy and also selling rice after purchasing the same from the local market. We are concerned in this appeal with the assessment year 2002-03. In the course of the assessment proceedings, the Assessing Officer wanted to verify the sales made by the assessee on consignment basis to 6 parties of Naya Bazar, Delhi. The total sales shown by the assessee to these parties amounted to Rs.3,40,12,459/-. While verifying the sales and the sundry debtors shown by the assessee in its books of accounts as on 31.3.2002, which is the last day of the accounting year, the assessing officer also wanted to verify the sundry creditors shown in the books of accounts as on the said date. This was because he took the view that if the consignment sales were not genuine, the purchases shown to have been made by the assessee on credit basis cannot be treated as genuine. He, therefore, called upon the assessee to submit consignment letters from the sundry creditors who were 10 in number (list of sundry creditors given at page 8 of the assessment order). The total amount due to the 10 sundry creditors on account of purchase of paddy was Rs. 1,31,17,230/-. The assessee did not submit the confirmation letters, but wrote to the assessing officer on 18.1.2005 that it was not aware of the present whereabouts of the creditors after a lapse of four years and whatever addresses were available with the assessee had been given by the suppliers at the time when the assessee purchased paddy from them. The assessee was

however able to file the confirmation letter from Shri Vardhman Rice Industries Pvt. Ltd. in whose account the assessee showed a credit balance of Rs.5,70,696/-.

3. In the aforesaid background, the assessing officer was of the view that the assessee was not interested in proving the genuineness of the creditors by filing confirmation letters or by giving the necessary information. In this view he held that the creditors were not genuine and there was no genuine outstanding in their accounts. He accordingly added Rs.1,25,46,534/- which represented the credit balances in the accounts of 9 parties, excluding Shri Vardhman Rice Industries Pvt. Ltd. who had filed confirmation letter. The Assessing Officer specifically noted that the amounts were being treated as unexplained credits in the books of accounts under Section 68 of the Act since the liabilities were not proved by the assessee. In the computation of the income also the addition was made with the narration "addition on account of unconfirmed credits as discussed above".

4. The assessee filed an appeal against the aforesaid addition before the CIT (A) and in the grounds of appeal, took the point that the addition made under Section 68 of the Act was contrary to facts and law and that since the creditors were old balances the assessing officer was wrong in treating them as income of the assessee for the year under consideration. It was further pointed out that since the liability still existed in the books of accounts, the same cannot be treated as income. Before the CIT (A) the

assessee also filed a letter dated 10.1.2006 in response to the opportunity given by the CIT (A) and informed him that since the creditors were not cooperating, the assessee was unable to give their PAN numbers and since they were demanding their dues, the CIT (A) may issue summons to them for getting their confirmations and PAN numbers.

5. The CIT (A) did not accept the assessee's submissions. According to him the assessee could not furnish the addresses and PAN numbers of the creditors before the assessing officer or confirmations from them despite several opportunities given in the course of the assessment proceedings. As regards the assessee's request made to him that he may issue summons to the creditors, the CIT (A) stated that such a request was made by the assessee knowing fully well that no summons could be issued to the creditors by the departmental authorities due to lack of details. He further held that the assessee's conduct clearly showed that the liabilities shown in the sundry creditor's account in its books did not exist. In this view of the matter, he held that the liabilities/credits have ceased to exist and, therefore, the addition of Rs.1,25,46,534/- made by the assessing officer was justified and confirmed the same under Section 41(1) of the Act.

6. It may thus be noted that while the assessing officer made the addition under Section 68 on the ground that the credits were not properly explained, the CIT (A) invoked a different section, namely, Section 41(1)

of the Act to uphold the addition. His reasoning in brief was that the liability towards the sundry creditors ceased to exist.

7. The assessee took the matter in further appeal before the Tribunal in ITA No.440/DEL of 2006. In the course of the appeal proceedings before the Tribunal the assessee submitted a chart as under:-

"Name of the party	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	Remarks
Ambey Rice & General Mills (P17-19)	-	310239	same	-do-	-do-	310239	
Badinpur Rice & General Mills (P.20-22)	-	-	-	293300	293300	293300	
Bhagwati Trading Co. (P.23-28)	-	70531	-	50531	50531	40531	Confirmation enclosed
Bharat Rice Mills (P.15-16)	-	-	-	97061	100061	100061	Confirmation enclosed PAN: AABFB2620G (P 29)
Giani Ram Anil Kumar (P.29-36)	4146006	4136006	4134716	4099716	4099716	4099716	Confirmation enclosed PAN : AABFG4121H
Jaipal Ravinder Kumar	586890	5608902	5208902	4705402	4665402	4665402	Confirmation enclosed

(P.37-43)							
Malwa Agro Industries (P.43-45)	-	-	-	351670	351670	351670	
Suleman security (P.46-48)	-	-	2518200	2518200	2518200	2518200	
Hari Chand Roshan Lal Sain (P.49-52)	-	167410	167410	167410	167410	167410	Confirmation Enclosed PAN : AAAJH8561P
						12546529	Difference of Rs.5 is due to paise"

On the basis of the above chart it was contended by the assessee that there was no fresh credit during the relevant accounting year ended 31.3.2002 in any of the accounts of the sundry creditors, and that the balances as on the last day of the accounting year represented opening balances only. It was, therefore, pleaded that the provisions of Section 68 cannot be invoked to add the balances in the accounts of the sundry creditors. As regards the applicability of the Section 41(1), it was contended before the Tribunal that no addition can be made under that section unless it is shown that the liability had ceased to exist. The assessee relied upon the judgment of the Supreme Court in the case of ***CIT v. Sugauli Sugar Works (P) Ltd.*** (1999), 236 ITR 518 and contended that the question whether the liability ceased to exist or not was not a matter to be decided

by considering the assessee's conduct alone, but was a matter to be decided only if the creditor was also before the concerned authority and that in the absence of the creditor it is not possible for the concerned authority to come to the conclusion that the debt was barred by limitation and had become unenforceable. It was further pointed out on behalf of the assessee that the aforesaid view was reiterated by the Supreme Court in the case of ***Chief Commissioner of Income Tax v. Kesaria Tea Co. Ltd.*** (2002) 254 ITR 434. It was pointed out that in this judgment the Supreme Court had considered its earlier decision in ***CIT v. T.V.Sundaram Iyengar & Sons Ltd.*** (1996) 222 ITR 344 and distinguished the same on the ground that the factual matrix and the provision of law considered therein were entirely different. A few other authorities were also cited before the Tribunal.

8. The Tribunal after taking note of the rival contentions, held that the applicability of Section 68 was ruled out since no fresh amounts were credited in the accounts of the creditors under consideration during the relevant accounting year. As regards the applicability of Section 41(1), the Tribunal held that the assessee was a limited company whose accounts were accessible to general public and that the balances in the accounts of the sundry creditors were only brought forward balances. It was held that the question whether the liabilities were genuine or not cannot be examined in the assessment proceedings for the year under consideration and such question could be examined only in the year in which the entries

were first made in the accounts of the sundry creditors. As regards the assessee's plea that there was no cessation of any liability to the sundry creditors in the relevant accounting year and, therefore, the provisions of Section 41(1) of the Act were not attracted, it was held by the Tribunal that the plea has to be accepted in light of the judgment of the Supreme Court in the case of ***CIT v. Sugauli Sugar Works (P) Ltd.*** **(supra).** The Tribunal also applied the judgment of the Supreme Court in the case of ***Chief Commissioner of Income Tax v. Kesaria Tea Co. Ltd.*** **(supra)** and held that resort to Section 41(1) can be had only if the liability of the assessee ceased finally in the relevant accounting year without the possibility of being revived.

9. It was noted by the Tribunal in paragraph 11 of its order that the decision of the Supreme Court in ***CIT v. Sugauli Sugar Works (P) Ltd.*** **(supra)** would apply with greater force to the assessee's case because in the said decision the assessee had credited the profit and loss account with the amounts standing to the credit of the sundry creditors, whereas in the present assessee's case the amounts payable to the sundry credits were not credited to its profit and loss account for the year and were still shown as outstanding as on 31.3.2002. It was, therefore, held that the provisions of Section 41(1) were not attracted to the case. It was further observed that since the liabilities were shown as outstanding in the balance sheet as on 31.3.2002, the onus had not been discharged. In the aforesaid view of the

matter, the Tribunal deleted the addition of Rs.1,25,46,529/- holding that neither Section 68 nor Section 41(1) of the Act was applicable.

10. In support of the appeal, the learned standing counsel for the income tax department drew our attention to the fact that the assessee itself had admitted that the amounts were outstanding for more than four years and contended that, therefore, the assessee obtained a benefit in the course of its business which was assessable under Section 41(1) of the Act. He did not dispute the fact that the liabilities were not written back to the profit and loss account for the year under consideration, but contended that it would make no difference to the applicability of Section 41(1) because according to him what was to be seen was whether the assessee had obtained a benefit in a practical sense and since the amounts remained unpaid to the parties for more than four years, there could be a reasonable inference that the assessee was no longer liable to pay those parties. In support of this submission the learned standing counsel relied on the words "some benefit in respect of such trading liability" appearing in clause (a) of sub-section (1) of Section 41. The benefit, according to him, arose on account of the fact that the debts had become more than three years old and were, therefore, not recoverable from the assessee in view of the law of limitation. With regard to the finding of the Tribunal that the assessee did not write back the liabilities in its profit and loss account for the year, the learned standing counsel clarified that this fact made no difference to the applicability of Section 41(1) since the

Explanation 1 to Section 41(1) which was introduced by the Finance (2) Act, 1996 w.e.f. 1.4.1997 was not being relied upon by him. According to him, the writing back of the accounts of the sundry creditors in the profit and loss account can only be considered as one of the many unilateral acts done by the assessee and even in the absence of such write back it is open to him to contend, de hors the Explanation, that there was a remission or cessation of the trading liability which resulted in a benefit to the assessee. Strong reliance was placed by him on the judgment of the Supreme Court in ***CIT v. T.V.Sundaram*** **(supra)**. Our attention was also drawn by him to a judgment of a Division Bench of this Court in **Jay *Engineering Works Ltd. v. CIT*** (2009) 311 ITR 299 in which case the judgment of the Supreme Court in ***CIT v. T.V.Sundaram*** **(supra)** was applied.

11. 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

xx xx xx xx xx xx xx xx xx xx xx xx

[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)

We may straightaway clarify that 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. Therefore, as rightly pointed out by the learned standing counsel for the income tax department, the question has to be considered de hors Explanation 1 to Section 41(1). When we do so, what we find from clause (a) is that in order to invoke the section, 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 argument of the learned standing counsel that the non-payment or non-discharge of the liability in favour of the sundry creditors resulted in "some benefit in respect of such trading liability" in a practical sense or common sense and, therefore, the section was rightly invoked, with respect, overlooks the words following the above quoted words, namely, "by way of remission or cessation thereof". As a matter of construction, it seems to us that it is not enough that the assessee derives some benefit in respect of such trading liability, but it is also essential that such benefit arises "by way of" remission or cessation of the liability. The words in clause (a) viz., "some benefit in respect of such trading liability by way of remission or cessation thereof" should be read as a whole and not in the manner suggested by the learned standing counsel.

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 v. Gannon Dunkerley & Co.***, AIR 1958, SC 560, Venkatarama Aiyyar 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 & Manufacturing Co. Ltd. v. 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, page 383, are directly in point:
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> > " 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 ours)

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

14. Since the Tribunal has relied on the judgment of the Supreme Court in the case of ***CIT v. 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 assessment year 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 Income Tax Officer found that a sum of ₹1,29,000/- out of the above amount repaymented 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 Section 41(1) of the Act. The assessee appealed unsuccessfully to the Appellate Assistant

Commissioner and thereafter carried the matter in further appeal to the Tribunal. Its contention before the Tribunal was that the unilateral entry of transfering the amount from the suspense account to the capital reserve account would not bring the said amount within Section 41(1). The contention was accepted by the Tribunal whose decision was affirmed by the Calcutta High Court [reported as ***CIT v. Sugauli Sugar Works (P) Ltd.*** (1983) 140 ITR 286]. The revenue carried the matter in the appeal to the Supreme Court. The contention of the revenue (as noted at page 520 of 236 ITR) was that on the facts of the case, the liability came to an end as a peirod 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 Section 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 Section 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 ***Commissioner of Income-Tax v. Bharat Iron and Steel Industries*** (1993) 199 ITR 67. It was held by the Supeme Court that the Gujarat High Court was right in saying that in order to

attract taxability under Section 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 clause(a) of sub-section (1) of Section 41 may not be relevant after substitution of the said clause by the Finance Act, 1992 with effect from 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 ncessary 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 with effect from 1st April, 1993. The second part of the reasoning of the Supreme Court in ***CIT v. 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. v. CIT (19966) 62 ITR 34*** 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' 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. "

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 and Manufacturing Company Ltd. v. State of Bombay*** *AIR 1958 SC 328* wherein it was held that the expiry of the period of limitaiton prescribed under the Limitaiton 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 v. 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 Section 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.

17. In the case before us, as rightly pointed out by the Tribunal, the assessee has not transferred the said amount from the creditors' account to its profit and loss account. The liability was shown in the balance sheet as on 31st March, 2002. The assessee being a limited company, this amounted to acknowledging the debts in favour of the creditors. Section 18 of the Limitation Act, 1963 provides for effect of acknowledgement in writing. It says where before the expiration of the prescribed period for a suit in respect of any property or right, an acknowledgement of liability in respect of such property or right has been made in writing signed by the party against whom such property or right is claimed, a fresh period of limitation shall commence from the time when the acknowledgement was so signed. In an early case, in England, in ***Jones vs. Bellgrove Properties,*** *(1949) 2KB 700*, it was held that a statement in a balance sheet of a company presented to a creditor- share holder of the company and duly signed by the directors constitutes an acknowledgement of the debt. In ***Mahabir Cold Storage v.CIT*** *(1991) 188 ITR 91*, the Supreme Court held:

> "The entries in the books of accounts of the appellant would amount to an acknowledgement of the liability to Messrs. Prayagchand Hanumanmal within the meaning of Section 18 of the Limitation Act, 1963, and extend the period of limitation for the discharge of the liability as debt."

In several judgments of this Court, this legal position has been accepted. In ***Daya Chand Uttam Prakash Jain vs. Santosh Devi Sharma*** *67 (1997) DLT 13*, S.N.Kapoor J. applied the principle in a case where the primary question was whether a suit under Order 37 CPC could be filed on the basis of an acknowledgement. In ***Larsen & Tubro Ltd. v. Commercial Electric Works and Ors.*** *67 (1997) DLT 387* a Single Judge of this Court observed that it is well settled that a balance sheet of a company, where the defendants had shown a particular amount as due to the plaintiff, would constitute an acknowledgement within the meaning of Section 18 of the Limitation Act. In ***Rishi Pal Gupta v. S.J. Knitting & Finishing Mills Pvt. Ltd.*** *73 (1998) DLT 593*, the same view was taken. The last two decisions were cited by Geeta Mittal, J. in ***S.C. Gupta v. Allied Beverages Company Pvt. Ltd.*** (decided on 30/4/2007) and it was held that the acknowledgement made by a company in its balance sheet has the effect of extending the period of limitation for the purposes of Section 18 of the Limitation Act. In ***Ambika Mills Ltd. Ahmedabad v. CIT Gujarat*** *(1964) 54 ITR 167*, it was further held that a debt shown in a balance sheet of a company amounts to an acknowledgement for the purpose of Section 19 of the Limitation Act and in order to be so, the balance sheet in which such acknowledgement is made need not be addressed to the creditors. In light of these authorities, it must be held that in the present case, the disclosure by the assessee company in its balance sheet as on 31st March, 2002 of the accounts of the sundry creditors amounts to an acknowledgement of the debts in their favour for the purposes of Section

18 of the Limitation Act. The assessee's liability to the creditors, thus, subsisted and did not cease nor was it remitted by the creditors. The liability was enforceable in a court of law.

18. The judgment of the Supreme Court in ***CIT v. Sugauli Sugar Works (P) Ltd. (supra)*** was followed and applied by a three Judges Bench of the Supreme Court in ***Chief Commissioner of Income Tax v. Kesaria Tea Co.Ltd.(supra)***. The assessee in this case was engaged in the business of tea, spices etc and made provision in its account for the years from 1978 to 1981 for the purchase tax liability. The tax liability was in dispute with the sales tax department. In the previous year relevant to the assessment year 1985-86, on the basis of an order in the Kerala State's Special Leave Petition filed before the Supreme Court, the assessee wrote back a sum of ₹ 14,65,997/- out of the provision for the purchase tax liability. The assessing officer brought this amount to tax under Section 41(1). On appeal, the CIT(Appeals) held that only an amount of ₹1,25,46,534/- could be brought to tax under Section 41(1). On further appeal by the assessee, the Tribunal held that even this amount could not be brought to tax since the sales tax department was pursuing the matter even as late as in 1993 and cases were still pending decision before the sales tax authorities and that the matter had not been concluded by the decision of the Kerala High Court. The Tribunal thus held that there was no extinguishment of the statutory liability and, therefore, the write back could not be assessed under Section 41(1). The Kerala High Court

affirmed the decision of the Tirbunal [(2000) 243 ITR 362]. The revenue carried the matter in appeal to the Surpeme Court. Applying its earlier judgment in ***CIT v. Sugauli Sugar Works (P) Ltd. (supra)*** it was held that because there were certain issues which had a bearing on the liability to pay purchase tax which still remained disputed between the assessee and the sales tax department.

19. Since strong reliance was placed by the learned standing counsel for the income-tax department on the judgment of the Supreme Court in ***CIT vs T.V. Sundaram Iyengar & Sons*** (supra), it is necessary to refer to the same in some detail. In that case, the ITO found that for the assessment years 1982-83 and 1983-84 the assessee had transferred amounts of Rs.17,381 and Rs.38,975 respectively to its profit and loss accounts for the respective accounting years. However these amounts were not included in the total income in the returns filed by the assessee. It was explained that the amounts were payable by the assessee-company to its customers but since they were not claimed by them, they were transferred to the profit and loss account. The ITO rejected the explanation. He held that because the surplus in the accounts of the creditors arose on account of trading transactions, it had the character of income and had to be added to the total income for tax purposes. The CIT(A) and the Tribunal deleted the additions holding that neither section 41(1) nor section 28 applied, as the amounts represented excess trading advances given by the customers to the assessee and that since at the time

they were received they were capital receipts they could not change character and become assessable as revenue receipts. At the instance of the revenue, the following question of law was referred to the High Court of Madras:

> "Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in deleting the addition made by the Income-tax Officer representing unclaimed sundry credit balances written back to the profit and loss account by the assessee during the previous year relevant for the assessment year under consideration?"

The question for decision which arose before the Supreme Court, in the words of the court itself (page 347 of 222 ITR) was that "even though the deposits were of capital nature at the point of time of receipt by the assessee, could their character change by efflux of time?" The Supreme Court thereafter referred to several authorities including the celebrated decision of the Court of Appeal in England in the case of **Morley v Tattersall** (1939) 7 ITR 316, and the test propounded by Lord Greene in that case that the taxability of the receipt was fixed with reference to its character at the moment it was received and not at any subsequent point of time and not because the recipient treated it subsequently in his income account as his own, and also to some decisions of courts in India in which the principle was applied and ultimately held as under:

> "In other words, the principle appears to be that if an amount is received in the course of trading transaction, even though it is not taxable in the year of receipt as being

> of revenue character, the amount changes its character when the amount becomes the assessee's own money because of limitation or by any other statutory or contractual right. When such a thing happens, commonsense demands that the amount should be treated as income of the assessee.
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> In the present case, the money was received by the assessee in the course of carrying on his business. Although it was treated as deposit and was of capital nature at the point of time it was received, by efflux of time the money has become the assessee's own money. What remains after adjustment of the deposits has not been claimed by the customers. The claims of the customers have become barred by limitation. The assessee itself has treated the money as its own money and taken the amount to its profit and loss account. There is no explanation from the assessee why the surplus money was taken to its profit and loss account even if it was somebody else's money. In fact, as Atkinson J. pointed out that what the assessee did was the commonsense way of dealing with the amounts."

20. It may at once be noticed that the decision cannot be understood as explaining the conditions of applicability of section 41(1) of the Act, for the simple reason that the section was not invoked by the revenue authorities in that case and there was a finding of the appellate authorities to the effect that neither section 41(1) nor section 28 was attracted to that case. That was a case of certain deposits being received by the assessee. At the time of the receipt they were admittedly treated as capital in nature, and the assessee credited them to separate accounts. In due course of

time, they were depleted by adjustments made from time to time. The balance in the accounts remained unclaimed for a long time and in the accounts for the accounting periods relevant to the assessment years 1982-83 and 1983-84, the balance remaining in the accounts was taken to the credit of the profit and loss account. The assessee could not explain why the balance was taken to its profit and loss account even though the money belonged to somebody else. It was in these circumstances that the Supreme Court applied a common sense view of the matter and held that the assessee had become richer by the amount transferred to the profit and loss account. The matter was thus decided on general principles and on the footing that the assessee committed and overt act indicating that it had appropriated the balances in the deposit amounts belonging to its customers as its own monies and was not able to explain why it took the step. The general principles and the common sense point of view were applied to decide the case. Section 41(1) specifically deals with amounts that were allowed as deduction in the past assessments as trading liabilities, which in a later year cease or are remitted by the creditors. If and when there is evidence in a particular later year to show that the liability has ceased or has been remitted, the same can be brought to tax as provided in Section 41(1). In this manner the statute prescribes that a deduction for a trading liability allowed earlier can be brought to tax on the ground that the liability to pay the same has been remitted or ceased.

21. Another distinguishing feature in the present case is that the sundry creditors continue to be shown in the assessee's balance sheet as on 31.3.2002. In the case before the Supreme Court in ***CIT Vs. T.V.Sundaram Iyengar*** (supra), the assessee took a positive step of transferring the unclaimed balances in the deposit accounts to its profit and loss account, an act, which was considered to be of considerable significance in demonstrating the intention of the assessee to appropriate the money belonging to the depositors as its own monies. That case was dealing with items of receipt received in the course of the business of the assessee, though of capital nature at the time when they were received. The present case is one of a trading liability being earlier allowed as a deduction and which is sought to be recalled under Section 41(1) of the Act. At the cost of repetition it may be added that in ***CIT Vs. Kesaria Tea Co. Ltd.*** (supra) the revenue sought to raise the argument based on the judgment of the Supreme Court in ***CIT Vs. T.V.Sundaram Iyengar*** (supra), but it was rejected by the Supreme Court holding that the decision was of no relevance to the question involved in the case before them, which was about the applicability of Section 41(1), and because the factual matrix and the provision of law considered therein were entirely different. For these reasons we are unable to give effect to the argument of the ld. standing counsel based on the judgment of the Supreme Court in ***CIT Vs. T.V.Sundaram Iyengar*** (supra).

22. The other judgment which the ld. standing counsel for the income tax department relied upon before us is of this Court in ***Jay Engineering Works Ltd. v. CIT*** (supra). A perusal of the judgment shows that though Section 41(1) was invoked to tax amounts that were unilaterally written back to the profit and loss account of the assessee, this Court had applied the judgment of the Supreme Court in ***CIT Vs. T.V.Sundaram Iyengar*** (supra) to hold that the unclaimed liabilities written back were taxable under Section 41(1). A perusal of question No.3 referred to this Court under Section 256(1) of the Act shows that there is a specific reference to Section 41(1) of the Act. However, this judgment cannot be invoked to the present case for the simple reason that in the present case, the assessee did not write back the sundry creditors to its profit and loss account, a finding which is not disputed by the Revenue. The judgment of this Court in ***Jay Engineering Works Ltd. v. CIT*** (supra) is therefore distinguishable.

23. In the course of his arguments, the learned standing counsel referred to Section 28(iv) of the Act, according to which "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 to income tax under the head "profits and gains of business or profession". He submitted that since the amounts remained unpaid to the sundry creditors for a period of 4 years or more, the monies were available to the assessee in its business which amounted to a benefit arising from the business

carried on by the assessee. The contention seems attractive at first blush but cannot bear scrutiny. The provisions of Section 41(1) have been specifically incorporated in the Act to cover a particular fact situation. The section applies where a trading liability was allowed as a deduction in an earlier year in computing the business income of the assessee and the assessee has obtained a benefit in respect of such trading liability in a later year by way of remission or cessation of the liability. In such a case the section says that whatever benefit has arisen to the assessee in the later year by way of remission or cessation of the liability will be brought to tax in that year. The principle behind the section is simple. It is a provision intended to ensure that the assessee does not get away with a double benefit once by way of deduction in an earlier assessment year and again by not being taxed on the benefit received by him in a later year with reference to the liability earlier allowed as a deduction. In ***CIT, Mysore v. Lakshmamma***, *(1964) 52 ITR 789* Hegde, J., (as he then was) speaking for the Mysore High Court observed that Section 10(2A) of the Indian Income Tax Act, 1922, which is the fore-runner of Section 41(1) of the present Act, was introduced w.e.f. 01.4.1955 to get over the judgment of the Bombay High Court in ***Mohsin Rehman Penkar v. CIT*** *(1948) 16 ITR 183* holding that remission of a liability in a subsequent assessment year in respect of which the assessee had obtained a deduction in an earlier assessment year, can never become income for the purpose of taxation, where the assessee maintains accounts in the mercantile system of accounting. Thus, it may be seen that Section 10(2A) of the Indian

Income Tax Act, 1922 and Section 41(1) of the present Act of 1961 were intended only to govern a particular factual situation. Section 28(iv), on the other hand, is a general provision which brings to assessment the value of any benefit or perquisite arising to the assessee from the business carried on by him. If, as contended before us by the learned standing counsel for the revenue, the alleged benefit enjoyed by the assessee by utilizing the amounts payable to the sundry creditors in its own business for a period of four years or more is to be brought to tax under Section 28(iv), notwithstanding that the conditions of Section 41(1), which govern the factual situation, are not satisfied, then it would render the latter section otiose or a dead letter. If we accept the argument of the learned standing counsel for the revenue, it would also introduce an element of uncertainty or subjectiveness in ascertaining as to what would be the lapse of time that would be necessary to render a liability to pay the creditors ineffective, which would result in an alleged benefit to the assessee. Moreover, if after the taxing of the amount u/s 28(iv) on the ground that considerable time has elapsed from the date of the debt during which the assessee had the benefit of the monies in his business, it is found that in another later year the creditor has recovered the money from the assessee, there is no provision in the Act to allow deduction for such payment. The section cannot be made subject to such vagaries or subjectiveness in its applicability. It is also necessary to bear in mind that in the case of ***CIT v. Sugauli Sugar Works (P) Ltd.*** **(supra)** a contention was in fact advanced before the Supreme Court on behalf of the revenue that the liability to the

creditors remained unpaid by the assessee for more than 20 years and there was practically a cessation of the debt which resulted in a benefit to the assessee which should be brought to tax under Section 41(1). This argument was not given effect to by the Supreme Court, nor did it consider fit to apply Section 28(iv). It is a well settled rule of interpretation of statutes that a construction that reduces one of the two provisions in a statute to a useless lumber or a dead letter would not amount to a harmonious construction and that a familiar approach in such cases is to find out which one of the two provisions is a special provision made to govern a certain situation and to exclude that situation from the applicability of the general provision. If we apply this rule of interpretation to the case before us, we must necessarily hold that while Section 28(iv) would apply generally to all benefits or perquisites which arise to the assessee from the business carried on by him, the benefit which he obtains by way of remission or cessation of a trading liability in a later year, in respect of which he has obtained a deduction in an earlier year in computing the business income, should be governed by Section 41(1) which is the specific provision governing the factual situation and not by Section 28(iv). This way there would be no conflict between the two provisions and both will be given effect to.

24. We may clarify that in the present case we are not concerned with Explanation-1 to Section 41(1)(a). Our judgment is only on the applicability of Clause (a) of sub-section (1) of Section 41 and as to what

would constitute remission or cessation of a trading liability. It may be noted that in the present case, the assessee has not unilaterally written back the accounts of the sundry creditors in its profit and loss account.

25. For the above reasons we answer the substantial question of law in the negative and in favour of the assessee. The appeal of the revenue is accordingly dismissed with no order as to costs.

(R.V. EASWAR)
JUDGE

(SANJIV KHANNA)
JUDGE

DECEMBER 23, 2011
BMV