

Question 3 of the notice dated 11.10.2020.

1. At point no. 3 of notice dated 11.10.2020, your goodself had show caused why the outstanding balance of creditor namely M/s. XYZ shall be added to the total income u/s 41(1) of the act being address of such party is not furnished. In this regard, it is submitted that assessee's liability to pay to the creditor has not ceased to exist merely on the ground that assessee was not able to provide address of such party. Our detailed submission is as under:

1.1 It is submitted that the provisions of section 41(1) of the act cannot be imposed on the fact that the creditor's address is incorrect and the liability of assessee to pay balance of Rs.6,30,003/- to the creditor had ceased. Relevant extract of aforesaid provisions is reproduced hereunder for your kind perusal:

"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*

(b)

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."

On perusal of the aforesaid provisions of section 41(1) of the act, it is clearly inferred that the addition to the income of assessee shall be made only in case where assessee had obtained certain benefit by way of cessation or remission of any trading liability. Whereas, as per the renowned dictionary, word remission and cessation means as under:

- Remission means "an act of reducing or cancelling the amount of money that somebody has to pay"
- Cessation means "the stopping of something; a break in something"

In light of the aforesaid provision of law and meaning of term 'remission' and 'cessation' in normal understanding of any indifferent person, it is clearly inferred that the addition to the income of assessee shall be made under the said provision of act only in case the assessee receives any benefit by way of either reduction or cancellation of any amount for

which he/she was liable to pay in respect of such trading liability or his liability to pay such amount will extinguish due to specific event. As such, for applying the provisions of section 41(1) of the act, it is necessary that a benefit of reduction or extinguishment of existing liability shall accrue to the assessee in concrete manner i.e. either by the act of the creditor the liability is reduced or waived off or under specific circumstances wherein by an act of law or under agreement, liability ceases to exist. Further, in pursuance of explanation 1 to the aforesaid provisions, a voluntary action of assessee itself by removing such trade liability from his books of accounts will also mandate the addition of impugned benefit to the total income under said provision of act.

2. In this regards, we would like to draw your attention towards judicial pronouncement by Hon'ble Bombay High Court in case of **JK Chemical Ltd. vs. CIT [1966] 62 ITR 34** , wherein the terms 'Remission' and 'Cessation' is discussed in context of the aforesaid provision of the act and stated as under:

- a. *"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."*

It is clearly evident from the aforesaid judicial pronouncement that for applicability of the provisions of section 41(1) of the act, the liability must either be remitted by the creditor himself or the liability ceases to exist due to operation of law or under any specific agreement. As such, the provisions of section 41(1) of the act is not applicable to the instant case of assessee, wherein neither the creditor had waived off the liability of the assessee in person nor there was any agreement between the assessee and the said party wherein any such kind of terms and condition was enumerated which had forced extinguishment of such liability. Further, in respect of application of explanation 1 to section 41(1) of the act, it is crystal clear that such explanation is only applicable where the assessee had by himself written off such trading liability. Whereas, in our case, we had duly reported the liability in the financial statements as sundry creditor in respect of which impugned amount is admitted to be paid. *(Copy of Financial Statements for FY 2018-19 relevant to AY 2019-20 is attached herewith on page no. for your kind perusal.)*

3. Further, it is pertinent to note that the principle that expiry of period of limitation prescribed under the Limitation Act could not extinguish the debt but it would only prevent the creditor from enforcing the debt, has been well-

settled vide numerous judicial pronouncements be Hon'ble Apex Court as well as various high courts. In this regards, we place our reliance on following judicial pronouncements:

- i. Hon'ble Apex Court in case of **CIT vs. Sugauli Sugar Works Pvt. Ltd. [1999] 102 Taxman 713 (SC)**, held as under:

*"The question whether the liability is actually barred by limitation, is not a matter which could 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 was barred and had become unenforceable. There may be circumstances which may enable the creditor to come with a proceeding for enforcement of the debt even after expiry of the normal period of limitation as provided in the Limitation Act. **The principle that expiry of period of limitation prescribed under the Limitation Act cannot extinguish the debt but it will only prevent the creditor from enforcing the debt is well-settled.**"*

However, in the instant case of assessee, even the said limitation period of three years prescribed in The Limitation Act, 1963 has not been elapsed till the end of impugned financial year i.e. till 31.03.2019, since the last purchase made from the said creditor was on 01.10.2016 i.e. in FY 2016-17. *(In this regards, copy of account of such party alongwith invoices and relevant bank statement indicating payments made to such party is attached herewith for your kind perusal on page no. A separate application for admission of these documents as additional evidences is being filed).*

4. In this regard, we place our reliance on following judicial pronouncements:
 - i. In the case of **CIT vs. Sugauli Sugar Works (P.) Ltd. (supra)**, it was stated as under:

*"the section contemplates the 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 the application of this section.**"*

In the instant case, no such benefit is obtained by the assessee as no such liability is reduced or extinguished. The assessee had to continue recording such amount as sundry creditor in his books of account being such amount is an admitted liability and assessee is not entitled to remove such amount from sundry creditor by specific statement by the creditor or by the operation of law or under any agreement.

- ii. In case of **Pr. CIT vs. New World Synthetics Ltd. [2018] 97 Taxmann.com 399 (Delhi)**, Hon'ble jurisdictional high court held as under:

"9. Non-payment of outstanding liability which is admitted and acknowledged as due and payable by an assessee does not indicate remission or cession of liability. Delay or non-payment, even when the

Assessing Officer is of the opinion that likelihood of payment was remote as business has stopped, would by itself not denote and mean cessation or remission of liability. In the winding up or bankruptcy proceedings, payments are made, mostly partly, on sale of assets.

10. In **Bombay Dyeing & Mfg. Co. Ltd. v. State of Bombay** AIR 1958 SC 328, it was held and observed that the debt or liability may subsist notwithstanding its recovery was barred by limitation for the law of limitation merely bars the creditor from invoking legal remedy. In **CIT v. Sugauli Sugar Works (P.) Ltd.** [1999] 236 ITR 518/102 Taxman 713 (SC), it was elucidated that expiry of period of limitation as prescribed in the Limitation Act does not extinguish the debt but only prevents the creditor from enforcing the debt. This is the right and correct position in law as held by the Bombay High Court in **Kohinoor Mills Co. Ltd. v. CIT** [1963] 49 ITR 578 and **Bhagwat Prasad & Co. v. CIT** [1975] 99 ITR 111 (All). In this context the admission and acknowledgement of the debt and liability by the respondent-assessee is significant and important.

12. In the present case the respondent-assessee has not obtained any money or benefit under the first part or the deeming part of Clause (a) to Sub-section 1 to Section 41 of the Act.

13. There was no remission or cessation of liability.

14. In view of the aforesaid settled legal position, we are not inclined to issue notice in the present appeal and the same is dismissed."

In the instant case of assessee, the liability is duly admitted and reported in the financial statements prepared for the period under consideration and also in the Income Tax Return filed for the year. Further, the same was audited by the chartered accountant and no adverse comment was made by him in this regards.

- iii. In the case of **Pr. CIT vs. Eco Auto Components Pvt. Ltd.** [2019] 101 Taxmann.com 216 (P&H), Hon'ble High Court of Punjab and Haryana held as under:

*"The issue to be decided by the Tribunal is squarely covered by the judgment cited as **Sugauli Sugar Works Limited (supra)** because merely by virtue of fact that a debt become time barred the right of the creditor will not come to an end nor the liability will cease and in these circumstances, Section 41(1) of the Act is not attracted. So, when the liability qua the amount which is still standing in the balance sheet of the assessee, which fact has not been disputed by the A.O, the same cannot be said to have ceased. So, we are of the considered view that there is no scope to interfere in the findings returned by Ld. CIT (A). Hence, ground No.5 is determined against the revenue."*

- iv. In the case of **Bombay Dyeing & Manufacturing Co. Ltd. v. State of Bombay** [1958] SCR 1122, Hon'ble Supreme Court held as under:

"a debt subsists notwithstanding that its recovery is barred by limitation, it was hardly possible to sustain the view taken by the Tribunal, that the trading liability incurred by the assessee in respect of the said amount had ceased to be

its trading liability in the year 1955 by reason of the expiry of the period of three years."

- v. In the case of **Kohinoor Mills Co. Ltd. vs. CIT [1963] 49 ITR 578 (Bom.)**, Hon'ble Bombay High Court held as under:

*"It is not in dispute before us that in view of the provisions of section 10(2A), it is open to the income-tax authorities to include in the income of the assessee the amount of the trading liability of the assessee, which had ceased to be its trading liability in the relevant accounting year. The question, however, is whether the trading liability to the extent of Rs. 30,190 representing the unclaimed wages, which was the trading liability of the assessee incurred in the year 1952 had ceased to be its trading liability in the year 1955 by reason of the expiry of three years, and thus barring the remedy of the labourers and workmen to recover that amount by way of suits. The answer to this question has been given by their Lordships of the Supreme Court in *Bombay Dyeing & Manufacturing Co. Ltd. v. State of Bombay [1958] SCR 1122*. At page 1135, their Lordships observed:*

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

That being the principle of law laid down by their Lordships, it is hardly possible to sustain the view taken by the Tribunal, that the trading liability incurred by the assessee in respect of the said amount of Rs. 30,190 had ceased to be its trading liability in the year 1955 by reason of the expiry of the period of three years.

We therefore answer the question referred to us in the negative. We make no order as to costs."

In light of the aforesaid submissions and judicial pronouncements, it is clearly evident that the provisions of section 41(1) of the act cannot be imposed merely on the suspicion that the assessee have not provided correct address of the said party as such the liability should have ceased to exist. As such, in the instant case of assessee, no such circumstances persisted which indicates that the actual benefit of remission and cessation had been obtained whereas, assessee had duly admitted the liability in his financial statements prepared for the period under consideration and is bound to pay the said amount. Thus, the said amount should not come under purview of 41(1) of the act.