

IN THE INCOME TAX APPELLATE TRIBUNAL
SMC, BENGALURU BENCH 'B', BENGALURU

BEFORE SHRI GEORGE GEORGE K, JUDICIAL MEMBER

I.T.A No.1702/Bang/2016
(Assessment Year : 2012-13)

M/s. Shabina Steels,
No.12, Dresser Rajappa Lane,
SJP Road, Bengaluru 560 002
PAN : AAFFS9512G

.. Appellant

v.

Asst. Commissioner of Income-tax,
Circle -2(3)(1), Bengaluru

.. Respondent

Assessee by : Shri. S. Ganesh Rao
Revenue by : Smt. S. Praveena, Addl. CIT

Heard on : 01.12.2016
Pronounced on : 07.12.2016

ORDER

PER GEORGE GEORGE K, JUDICIAL MEMBER :

This appeal, at the instance of the assessee, is directed against the order of the CIT (A)-5, Bangalore, dated: 4.7.2016. The relevant assessment year is 2012-13.

2. The assessee has, in its grounds of appeal, raised a solitary ground, namely, that the AO was not justified in adding the liability of Rs.12,31,049/- to the total income u/s 41(1) r w s.28(iv) of the Act.'

3. Briefly stated, the facts of the issue are as follows:

The assessee, an individual, is a dealer in Iron and steel. For the period under dispute, the assessee had filed a return of income on 9.9.2012, admitting a total income of Rs.27,72,420/-. The case was taken up for scrutiny. During the course of assessment proceedings, it was observed by the assessing officer that the assessee had shown Rs.1,84,54,601/ as sundry creditors. On examination of the ledger account, it was noticed by the AO that those liabilities were in existence for more than three years and that the advances received by the assessee related to business which were neither paid back either in cash or in kind in subsequent years nor the clients enforced the collection of the same. In response to the AO's query as to why the liability should not be added back u/s 41(1) r w s. 28(iv) of the Act, the assessee, according to the AO, came up with a reply that there were two sundry creditors viz., Shobha Vijaya Steel Corporation out-standing from FY 2008-09 of Rs.4,31,049 /- and Subba Rao, outstanding of Rs.8 lakhs from FY 2006-07 and that the outstanding amounts represent advances received long back for supply of goods which did not materialize and that the parties did not collected the amounts and, hence, the same was outstanding. After recording the elaborate reasoning and also relying on the rulings of the (i) Hon'ble jurisdictional High Court reported in 111 Taxman 446; (ii) the Hon'ble Delhi High Court reported in 210 Taxman 173; (iii) the Hon'ble Apex Court reported in 124 Taxman 373; and (iv) the findings of Hon'ble Mumbai Tribunal in ITO v. Shailesh D Shah [ITA 7012/M/10], the AO had added a sum of Rs.12,31,049/- u/s 41(1) r w s.28(iv) of the Act.

4. Aggrieved, the assessee took up the issue with first appellate authority for consideration. After due consideration of the assessee's contentions and also the case laws as cited by the AO (supra), the CIT (A) upheld the AO's action in treating those credits as income by invoking the provisions of s. 41(1) r w s. 28(iv) of the Act for the following reasons, namely:

"6.1. Deduction in respect of loss, expenditure or trading liability incurred by the assessee must have been allowed in earlier years. In a later year, there has to be recoupment of the loss, expenditure or trading liability. The recoupment/benefit could be by way of: (i) remission; or (ii) cession. The liability must cease by way of writing off, remission, cessation, operation or law or in any other manner. Section 41(1) taxes income on legal fiction and has to be strictly construed. It is an established principle that in construing a provision creating a statutory fiction, two rules operate. The statutory fiction should be carried to its logical conclusion, but, the fiction cannot be extended beyond the language of the section by which it is created or by importing another fiction. Hence, till an amount is written off/back, it cannot be considered as income in terms of sec. 41(1) even if it becomes barred by limitation. Remission connotes a positive act on the part of the creditor. A liability may cease on account of judicial pronouncement provided it has become final and has not been subjected to an appeal because cessation u/s 41(1) is an irrevocable. The liability must be trading one and should have been allowed as a deduction earlier. When the assessee had not written of any liability in its books of account, the said amount could not be treated as income unless the assessing officer brought something from records to prove that those liabilities ceased to exist in the appellant's case, the assessing officer has proved that the trade liability ceased to exist in FY 2011-12 and, therefore, it is considered as profit for the year under consideration. The view that I am, thus, taking, find support from the following decisions. The Hon'ble Mumbai Tribunal in the case of ITO v. Shailesh D Shah (ITA No. 7012/M/10) wherein it was held that the assessee has just continued the entry in his books of account without any intention to pay back the same. Hence, upheld the addition u/s 41(1). The Hon'ble Apex Court in the case of Polyflex India (P) Ltd v. CIT (124 Taxman 373), also confirmed the addition u/s 41(1) on cession of liability....."

5. Aggrieved, the assessee has come up before us with the present appeal. During the course of hearing, the learned counsel for the assessee reiterated what has been contended before the first appellate authority. In furtherance, it was submitted that the AO had erroneously come to the conclusion that those two credits out-standing constituted 'remission or cessation' of liability and, accordingly, added a sum of Rs.12,31,049/- u/s 41(1) r w s. 28(iv) of the Act. It was, further, submitted that the AO relied on the findings of the Hon'ble Mumbai Tribunal cited supra and also the ruling of the Hon'le Supreme Court in the case of Polyflex India (P) Ltd (supra) in coming to an erroneous conclusion. The AO had failed to notice the fact that there was neither any 'cession nor remission' of liability nor was there any benefit of accrual of income to the assessee by his unilateral act of such extinguishment. It was the contention of the learned counsel that the AO should have noticed that the outstanding amounts represented advances received by the assessee for supply of goods and for some obvious reason the transactions did not take place and those amounts were lying unpaid as the concerned parties did not turn up to collect the advance amounts. Our reference was also invited by the learned counsel to the effect that the ruling of the Apex Court in the case of Polyflex India (P) Ltd (supra) cited by the AO was totally different from the facts of the present case, i.e., that the issue before the Hon'ble Court was that the business expenditure which had been allowed in the preceding assessment years got reimbursed to the assessee and, hence, s.41(1) was applicable, but, in the instant case, there was no allowance of such expenditure in the preceding years or was there any benefit accrued to the assessee by way of 'unilateral remittance'. Likewise, it was argued, in the case of CIT v. Comfund Financial Services

(111 Taxman 446) cited by the AO in her assessment order, the issue before the Hon'ble Court was 'waiver of interest' by the assessee's bankers and, as such, there was benefit accrued to the assessee which attracted the provisions of s. 41(1) of the Act whereas in the present case, there was no such waiver. It was, therefore, pleaded that the addition of Rs.12,31,049/- made by the AO which was sustained by the CIT(A) requires to be deleted.

6. On the other hand, the learned DR present supported the stand of the authorities below and, accordingly, prayed that the assessee's appeal deserves to be dismissed.

7. I have carefully considered the rival submissions, duly perused the relevant materials on record, the reasoning of the AO in making the addition and also the findings of the CIT (A) in sustaining the AO's action. As conceded by the AO (on para 3.2.3. of the asst. order), according to s. 41(1) of the Act, there has to be a remission or cessation of a liability or the liability must be as trading liability and not on capital account. It was the case of the AO that in the assessee's case, it was a trading liability and ceased to exist for the period F.Y 2011.12. However, it was contested by the assessee that there was neither 'cessation' or 'remission' of liability nor there was any benefit of accrual of income to the assessee by its unilateral act of such extinguishment. Further, it was contended that the outstanding amounts represented only advances received by the assessee for supply of goods and, for the reason beyond its control, the transaction did not materialize. Thus, the said amounts were lying unpaid as the said parties made no attempt to collect the advances so made for the supply of materials. To support its claim, the assessee has furnished an affidavit during

the course of hearing, according to which, there was neither 'cession nor remission' of liability nor was there any benefit of accrual of income to the assessee. As the amounts shown in its books of account as outstanding and to this effect, the assessee has furnished an affidavit to vouch its bona fide claim, I am of the view that there was no remission or cessation of a liability, without assessee writing off it in its books of account. Thus, the provisions of s. 41(1) r w s. 28(iv) of the Act have no application.

7.1. I have, with due respects, perused the ruling of the Hon'ble Apex Court as relied on by the AO to support her stand. However, the fact before the Hon'ble Court was that the business expenditure which had been allowed in the preceding assessment year got reimbursed to the assessee and, thus, the Hon'ble Court was of the view that the provisions of s. 41(1) of the Act were applicable. However, in the case on hand, neither there was any allowance of such expenditure in the preceding years nor was there any benefit accrued to the assessee by way of 'unilateral remittance' and, as such, we are of the view that the ruling of the Hon'ble Court (supra) cited by the AO, cannot come to her rescue. Further, in the case reported in 111 Taxman 446, the Hon'ble jurisdictional High Court had held that the waiver of interest by bank was cessation of liability and, therefore, upheld the addition u/s 41(1) r w s. 28 (iv) of the Act. However, in the present case, there was no such waiver and, as such, the ruling of the jurisdictional High Court cited, in our view, has no application to the instant case.

8. Taking into account the facts and circumstances of the issue as discussed elaborately in the fore-going paragraphs, I am of the view that the provisions of s. 41(1) r w s. 28(iv) have no application to the issue under dispute, since AO cannot take

unilateral view that the liability had ceased to exist. It is ordered accordingly. In substance, the assessee's appeal is allowed.

9. In the result, the assessee's appeal is allowed.

Order pronounced in the open court on 7th day of December, 2016.

Sd/-
(GEORGE GEORGE K)
JUDICIAL MEMBER

MCN*

Copy to:

1. The assessee
2. The Assessing Officer
3. The Commissioner of Income Tax
4. The Commissioner of Income Tax (A)
5. DR
6. GF, ITAT, Bangalore

By Order

Assistant Registrar