

AO couldn't invoke addition under sec. 41(1) if advance written off was reflected as 'Fixed Assets': ITAT

Summary – The Pune ITAT in a recent case of Poona Bottling Company (P.) Ltd., (the Assessee) held that where assessee engaged in business of bottling-cum-manufacturing of soft drink, received advances/deposits towards security against bottles & cases which was written off during relevant assessment year, in view of fact that amount received in advance was being treated as non-trading liabilities as depreciation was allowed thereon and, moreover, no benefit was received during relevant year in respect of amount so written off, provisions of section 41(1) could not be invoked in assessee's case

Facts

- The assessee was engaged in the business of bottling-cum-manufacturing of soft drink. The assessee's business involved buying of the bottles & the cases needed for the business of bottling of said Cool drinks. Assessee sold the cold drinks to the consumers through the outlets. At the time of supply of cold drink bottles and the cases to the said outlets-cum-customers, the assessee received the repayable advances/deposits towards the security against the bottles & the cases. Thus, the books of account of the assessee contains the bottles & the cases account and those bottles & the cases were shown as 'stock-in-trade' (Trading Assets) in the books of account up to 31-3-1996. Subsequently, for some reasons, the said stock-in-trade (Bottles & the cases) was reflected in the books as Fixed Asset with effect from 1-4-1996.
- Hence, considering the capital/fixed assets, the assessee claimed depreciation on those fixed assets as per the provisions of section 32. As per the business norms, the assessee received the deposits/advances from the outlets of cool drinks and refunds the same as and when the bottles and the cases were returned to the assessee at the end of the business with that customer.
- In the relevant assessment year, the assessee wrote off the bottles & cases. The Assessing Officer taking a view that it was a case writing off of business assets, invoked provisions of section 41(1) and made addition to assessee's income.
- The Commissioner (Appeals) confirmed said addition.
- On second appeal:

Held

- There is no dispute on the basic facts that includes : (1) collecting the advances/security deposits from the customers against the cold drink Bottles and the relevant Bottle Cases as part of the Bottling business of the assessee. Assessee claimed depreciation under section 32 this block of assets over the years and Assessing Officer did not disturb the claim of depreciation. These deposits are undisputedly not written off in the books and hence the liabilities stand payable to the customers as and when the assets are returned by the customers; (2) The assessee grouped the said deposits into two types (a) the deposited collected up to March, 1996; and(b) the deposits collected

during 1996 to 2006-07; (3) The assessee wrote off these block of Bottles and Cases and derived the benefit to that extent in the assessment year 2006-07 and not written off the liabilities. However, the Assessing Officer invoked the provisions of section 41(1) of the Act in the year under consideration for taxing the said benefit to the extent of liabilities remained payable in the books of account; (4) The customers did not return the Bottles and Cases and the amounts might have to be returned as and when the customers returns the same; (5) The assessee claimed depreciation since the assessment year 1996-97 after capitalizing of the Bottles and Cases and claimed depreciation under section 32 of the Act. In the year of write off, the block of Bottles and Cases, legally the depreciable business assets and are of capital nature.

- Considering the above undisputed facts, the provisions of section 41(1) are examined and it is found that benefits of write off derived by the assessee in assessment year 2006-07 is connected to the other liabilities and not the trading liability. In the facts of the present case, the assessee did not write off the liabilities in the books of account and, therefore, the liabilities cannot be held ceased till such write off is done in the books of account of the assessee. From this point of view, the revenue's view on the issue of cessation of liabilities is unsustainable.
- In terms of section 41(1) where a deduction in respect of trading liability is incurred by the assessee and subsequently during any previous year assessee obtained some benefit in respect of such trading liability by way of remission or cessation thereof, the value of such benefit would be deemed as chargeable as income of that previous year. The existence of business in that year of taxation is not a requirement of law. From the above provisions, it is clear that the year of obtaining some benefit in respect of such trading liability is deemed to be the taxable income for the said year. Therefore, by honouring the said law and the discussion given above, it is held that the assessment year 2007-08 is not valid year in invoking the provisions of section 41(1) of the Act for taxing the value of the benefit. On this ground also, the revenue loses.
- From all the angles of the (1) non-trade liabilities nature; (2) absence of act of write off, *i.e.*, cessation of liabilities; and (3) requirement of meeting the un-uniform year of invoking the provisions of section 41(1) and year of reaping of benefits in respect of said liabilities, it is held that the order of Commissioner (Appeals) is required to be reversed on this issue.
- In the result, the appeal of the assessee is allowed.