

Sec. 41(1) couldn't be invoked if existence of liabilities was doubted: HC

Summary – The High Court of Gujarat in a recent case of Dattatray Poultry Breeding Farm (P.) Ltd., (the Assessee) held that where existence of liabilities was doubted, same could have been disallowed in year in which it was claimed, or could have been treated as unexplained cash credit in hands of assessee under section 68, but same could not be taxed under section 41(1), inasmuch as if liability itself was not genuine, question of remission or cessation thereof would not arise

Facts

- The assessee was engaged in the business of job work of hatching of eggs for 'S' Farm Ltd. During the course of scrutiny assessment, the Assessing Officer noted from the balance sheet filed by the assessee that the assessee had shown huge amount of sundry creditors.
- The Assessing Officer carried out an inquiry into the genuineness of the creditors and came to the conclusion that the assessee company was doing job work only and hence, there would be no purchases and hence, there was no possibility of such huge amount outstanding in respect of such sundry creditors. He issued notices to the creditors and found that in case of several creditors, the notices were returned unserved and that in case of some of the creditors, they categorically denied having had made any transactions with the assessee. The Assessing Officer, therefore, recorded a finding that there was no genuine creditors appearing in the balance sheet.
- He, accordingly, treated the amount in question as cessation of liability within the meaning of section 41(1) and added the same to the income of the assessee.
- The Tribunal confirmed order of Assessing Officer.
- On appeal:

Held

- In the facts of the present case, it is not even as if the assessee debtor has unilaterally made any entry in the books of account. Merely on the ground that a considerable time has elapsed since the debts were incurred and more particularly on the ground of genuineness of such debts, the Assessing Officer has passed the order under section 41(1). There is no material whatsoever on record to show that there was cessation or remission of liability during the previous year relevant to assessment year 2010-11, namely the year under consideration.
- From the findings recorded by the Assessing Officer as well as the Tribunal, it appears that the very genuineness of such entries has been doubted, inasmuch as the Assessing Officer has tried to verify the existence of such liabilities from the creditors, however, many were not found at the given address and some of them had categorically denied having any transaction with the assessee. If the existence of liabilities was doubted, the same could have been disallowed in the year in which it was claimed, or could have been treated as unexplained cash credit in the hands of the assessee under

section 68 in the relevant assessment year, but the same could not be taxed under section 41(1), inasmuch as if the liability itself was not genuine, the question of remission or cessation thereof would not arise.

- Section 41(1) can be applied, provided the following conditions are fulfilled:
 - In the assessment of any assessee, an allowance or deduction has been made in respect of any loss, expenditure or trading liability incurred by him;
 - any amount is obtained in respect of such loss or expenditure; or any benefit is obtained in respect of such trading liability by way of remission or cessation thereof;
 - such amount or benefit is obtained by the assessee;
 - such amount or benefit is obtained in a subsequent year.
- Thus, where a debt due from the assessee is foregone by the creditor in a later year, it can be taxed under section 41(1) in such later year when it was foregone. Section 41(1), therefore, contemplates existence of a debt/liability and the remission or cessation thereof in the year under consideration. Therefore, for the purpose of taxing any income on account of remission or cessation of liability, the Assessing Officer has to establish that there was an existing liability and that there was remission or cessation of such liability in the previous year relevant to the assessment year in which such income is sought to be taxed.
- In the facts of the present case, while the assessee has shown the trading liability in its books of account, no benefit has been obtained in respect of such trading liability by way of remission or cessation thereof; under the circumstances, the requirements of section 41(1) are not satisfied in the present case. Moreover, any such cessation or remission of liability has to be in the previous year relevant to the assessment year under consideration, in the facts of the present case, it is not the case of the Assessing Officer that the liabilities ceased to exist in the previous year relevant to the assessment year under consideration. In fact the Assessing Officer has doubted the very genuineness of such liabilities. Therefore, in the absence of any liability, the question of taxing any income on the ground that there was remission or cessation of such non-existent liability would not arise.
- The Tribunal, in the impugned order, has held that the Assessing Officer was right to hold the financial year in question as the right year for taxability when the facts concurring the non-existence were unrevealed (sic. revealed). Thus, the Tribunal has doubted the very existence of the trading liabilities. Thus, the reasoning adopted by the Tribunal is contrary to the provisions of section 41(1), which can be invoked provided there is trading liability in existence and there is remission or cessation of such liability. If no trading liability exists, the question of invoking section 41(1) would not arise.
- Another relevant aspect of the matter is that the assessee has written off some of the liabilities in the subsequent assessment years and offered the same as income, therefore, taxing such income in the year under consideration would amount to taxing the same income twice, which is impermissible in law.

- In the light of the above discussion, it is held that the impugned order passed by the Tribunal suffers from various infirmities and therefore, cannot be sustained.
- The appeal, therefore, succeeds and is, accordingly, allowed.