

IT : Illustrations - Time-barred unpaid dues - Unpaid dues of employees, whose recovery is time barred, cease to be employer's liability and have to be added under section 41(1)



[2012] 26 taxmann.com 109 (Delhi)

HIGH COURT OF DELHI

Commissioner of Income-tax

v.

Chipsoft Technology (P.) Ltd.*

S. RAVINDRA BHAT AND R.V. EASWAR, JJ.

IT APPEAL NO. 598 OF 2011 †

JULY 20, 2012

Section 41(1) of the Income-tax Act, 1961 - Remission or cessation of trading liability - Assessment year 2006-07 - Unpaid dues of employees had been outstanding for 6-7 years and recovery of such dues was time barred - Whether assessee could not claim benefit of showing said amount as a liability - Held, yes - Whether there was cessation of such liability and, hence, said amount had to be added to income of assessee - Held, yes [Paras 9 & 10] [In favour of revenue]

Words & Phrases : Word 'Include' occurring in Explanation to section 41(1) of the Income-tax Act, 1961

Interpretation of statute : Rule of pragmatic construction

FACTS

- The assessee in its return had shown unpaid liability on account of its employees's dues. Out of this, a part pertained to salary for the year 2005-06 and the balance pertained to the previous years, some extending to as far back in period as 2000-01.
- The Assessing Officer held that there was a cessation of assessee's liability. He invoked section 41(1) and added same to its assessable income.
- On appeal, the Commissioner (Appeals) deleted the amounts holding that the liability was outstanding in its books and, therefore, did not amount to cessation of liability.
- The Tribunal upheld the order of the Commissioner (Appeals).
- On revenue's appeal to the High Court:
- The order of the Assessing Officer is hereby restored. [Para 11]

HELD

- *Two aspects are to be noticed in this context. The first is the view that liability does not cease as long as it is reflected in the books, and that mere lapse of the time given to the creditor or the workman, to recover the amounts due, does not efface the liability, though it bars the remedy. This view is an abstract and theoretical one, and does not ground itself in reality.*
- *Interpretation of laws, particularly fiscal and commercial legislation is increasingly based on pragmatic realities, which means that even though the law permits the debtor to take all defences, and successfully avoid liability, for abstract juristic purposes, he would be shown as a debtor. In*

other words, it would be illogical to say that a debtor or an employer, holding on to unpaid dues, should be given the benefit of his showing the amount as a liability, even though he would be entitled in law to say that a claim for its recovery is time barred, and continue to enjoy the amount.

- *The second reason why the assessee's contention is unacceptable is because with effect from 1-4-1997 by virtue of the Finance Act, 1996 (No.2), an Explanation was added to section 41 which spells out that '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'. The expression 'include' is significant; Parliament did not use the expression 'means'. Necessarily, even omission to pay, over a period of time, and the resultant benefit derived by the employer/assessee would therefore qualify as a cessation of liability, albeit by operation of law. [Para 9]*
- *The submission of the assessee that no period of limitation is provided for under the Industrial Disputes Act, as a result of which it is exposed to liability at any time, is insubstantial and unpersuasive. [Para 10]*
- *The order of the Assessing Officer is hereby restored [Para 11]*

CASES REFERRED TO

Kesoram Industries & Cotton Mills Ltd. v. CIT [1992] [196 ITR 845](#) (Cal.) (para 4), J.K. Chemicals Ltd. v. CIT [1966] [62 ITR 34](#) (Bom.) (para 7), CIT v. Sadabhakti Prakashan Printing Press (P.) Ltd. [1980] [125 ITR 326](#) (Bom.) (para 7), CIT v. V.T. Kuttappu & Sons [1974] [96 ITR 327](#) (Ker.) (para 7), Liquidator, Mysor Agencies (P.) Ltd. v. CIT [1978] [114 ITR 853](#) (Kar.) (para 7), Bhagwat Prasad & Co. v. CIT [1975] [99 ITR 111](#) (All.) (para 7), CIT v. Agarpara Co. Ltd. [1986] [158 ITR 78/ 27 Taxman 186](#) (Cal.) (para 8) and Nedungadi Bank Ltd. v. K.P. Madhavankutty AIR 2000 SC 839 (para 10).

Sanjeev Rajpal for the Appellant. **Parag Chawla** for the Respondent.

ORDER

S. Ravindra Bhat, J. - The present appeal by the revenue is directed against a judgment of the Income Tax Appellate Tribunal (ITAT) dated 17-10-2101, in ITA 2108/Del/2010.

2. Admit. The following question of law arises for consideration:

"Did the Tribunal fall into error of law, in its impugned judgment in setting aside the disallowance of Rs. 32,28,724/- towards unpaid liability claimed in respect of salaries of the assessee for the assessment year 2006-07?"

With consent of counsel for parties the appeal was heard finally.

3. The brief facts of the case are that the assessee filed its return declaring nil income, on 31-11-2006. The Assessing Officer (AO) noticed that the assessee had shown unpaid liability to an extent of Rs. 38,51,893/- on account of its employees' dues. Of this, an amount of Rs. 6,23,000/- pertained to salary for the year 2005-06 and the balance pertained to the previous years; some extending to as far back in period as 2000-01. The AO called upon the assessee to furnish details and confirmation from the employees. The assessee furnished particulars and confirmation only in respect of 3 employees, out of 170 whose dues it claimed were outstanding. The assessee provided correspondence through e-mail with employees, without giving particulars such as address, etc of such employees. According to the assessee, it was struggling to survive due to a downturn in business. The AO was unconvinced with the explanation, and held that there was a cessation of the assessee's liability and that it had obtained benefit in respect of the said amounts; he invoked Section 41(1) of the Income Tax Act, and added the same to its assessable income. The assessee appealed to the CIT(A), who directed deletion of the amounts, holding that the liability was outstanding in its books and therefore, did not amount to cessation of liability. The revenue appealed to the ITAT, which endorsed the reasoning of the CIT(Appeals).

4. It is argued by Mr. Rajpal, that the ITAT fell into error in overlooking the fact that the amount due to 170 employees remained unchanged and static for about 6-7 years and no payment was made during the intervening period. Furthermore, the assessee did not reveal that its employees were actively pursuing their claims, and had taken any steps at all to recover their dues. The assessee did not file any correspondence with its employees, to substantiate its argument; even in the assessment proceedings it was unable to furnish particulars about its employees. The liability therefore, had ceased. It was urged that even if it were assumed that at some point the liability existed, the lapse of time, and the resultant defences available to the assessee under the Limitation Act, justified the AO's inclusion of the said amounts, on the ground of cessation of liability. It was underlined that the ITAT erred in not holding that benefit had accrued to the assessee by virtue of the wage liability becoming time barred. The revenue relied on *Kesoram Industries & Cotton Mills Ltd. v. CIT* [1992] [196 ITR 845](#) (Cal).

5. It was argued by Mr. Parag Chawla, on behalf of the assessee that in the absence of any action altering the treatment of wage liability in the books, or any other such act, the revenue cannot arbitrarily treat what is a liability as a profit. It was submitted that in order to attract Section 41(1) there should be some overt objective act, or act of the creditor leading to the inference that the liability ceases in law. It was submitted that the employees or workmen can always approach the court, or authorities under the Industrial Dispute Act, and claim the unpaid wages. In such event, the assessee would be remediless.

6. Section 41(1) of the Income Tax Act reads as follows:

"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
- (b) the successor in business has obtained, whether in cash or in any other manner whatsoever, any amount in respect of which loss or expenditure was incurred by the first-mentioned person or some benefit in respect of the trading liability referred to in clause (a) by way of remission or cessation thereof, the amount obtained by the successor in business or the value of benefit accruing to the successor in business shall be deemed to be profits and gains of the business or profession, and accordingly chargeable to income-tax as the income of that previous year.

[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."

In *Kesoram Industries & Cotton Mills Ltd. (supra)*, the Calcutta High Court held that the liability in such cases had to be added back:

"Whether the liability of the assessee has been fully discharged is within the special knowledge of the assessee. He has to prove that in fact the liability subsists. When the assessee itself comes to the conclusion that the amount in question would not be claimed by the concerned persons and,

thereafter, it proceeds to forfeit such amount and does not take such amount to a reserve account but writes it back in the profit and loss account, the reasonable inference that will follow from these facts and circumstances and the conduct of the assessee is that the amount which was provided for was in fact not necessary and it was an excess provision. No longer was there any liability. It is always possible that a creditor, if he so chooses, may agree to accept a smaller amount in full discharge of the whole amount due to him. An employee, casual or regular, who is entitled to wages or salary, will not allow his claim to remain unsatisfied. If the employer does not pay, he can move the authorities under the Payment of Wages Act. In his own interest, he will not permit the employer to withhold the wages, if it is due to him. When an assessee has obtained a benefit of deduction of a trading liability, it is for the assessee to establish whether such trading liability has been fully discharged or not. This court has laid down in *CIT v. Agarpara Co. Ltd.* [1986] [158 ITR 78](#), that if there be any excess over the requirement of the assessee in respect of liability claimed and allowed, such liability must be deemed to have ceased. It has also been laid down that it may be inferred from the surrounding circumstances that there has been a cessation or remission of the liability of the assessee. It has also been laid down that if unclaimed bonus being a portion of the bonus allowed as deduction in computing the income of the assessee is carried forward from year to year and thereafter written back in the account and no tax is levied thereon, the assessee would be getting a benefit to which it was not entitled."

The court in the above decision was concerned with a fact situation where the assessee had unilaterally altered the liability in its books. This aspect was sought to be highlighted as a point of distinction, by the assessee in this case, to say that here, no such change in situation had occurred and that the liability continued to be reflected in the books.

7. There is some authority in favour the assessee's position that there is neither remission nor cessation of its trading liability in such cases, since there is neither any unilateral act of the creditor amounting to remission nor any bilateral act of the parties resulting in the liability ceasing to exist in law, merely because the recovery of the same has become time-barred. *J.K. Chemicals Ltd. v. CIT* [1966] [62 ITR 34](#) (Bom), *CIT v. Sadabhakti Prakashan Printing Press (P.) Ltd.* [1980] [125 ITR 326](#) (Bom), *CIT v. V.T. Kuttappu & Sons* [1974] [96 ITR 327](#) (Ker), *Liquidator, Mysore Agencies (P.) Ltd. v. CIT* [1978] [114 ITR 853](#) (Kar), and *Bhagwat Prasad & Co. v. CIT* [1975] [99 ITR 111](#) (All). It was also held in those judgments that the mere fact that the assessee did not show the amount as his trading liability in his account books did not affect the consequence since such unilateral act of the assessee was neither remission nor cessation of his trading liability.

8. On the other hand, this Court has considered *Kesoram Industries & Cotton Mills Ltd.* (*supra*) which upholds a view that favours the revenue. A similar view was spelt out in *CIT v. Agarpara Co. Ltd* [1986] [158 ITR 78](#) / [27 Taxman 186](#) (Cal.).

"26. Whether a trading liability that was once incurred ceases to exist for the purpose of Section 41(1) has to be decided in the light of the provisions of the Income-tax Act, 1961, and the statute, if any, governing such liability. The assessee who maintains his accounts on the mercantile basis would be entitled to a deduction in respect of bonus in the year in which a liability arises under the statute, or the employees' claim for bonus is admitted by the assessee or is settled by an agreement between the parties or is adjudicated upon by an award. Under Section 36(1)(ii) of the Income-tax Act, 1961, payment of bonus to the employees is an allowable deduction. Under the Payment of Bonus Act, 1965, liability to pay bonus has become a statutory obligation imposed upon the employer covered by the said Act. Under the Bonus Act bonus is payable within a period of eight months from the close of the accounting year unless there is a dispute regarding such payment, in which case it is payable within a month from the date of the award becoming enforceable. Contravention of any of the provisions of the Bonus Act or the Rules made there under is punishable with imprisonment for a term which may extend to six months or with fine which may extend to Rs. 1,000 or with both. As the liability for bonus became a statutory one, a provision made therefor or even where no provision is made, in the mercantile accounting, the amount payable is allowable if the same is in accordance with the law about the payment of bonus. Any

provision over and above that payable under the Bonus Act shall not be allowable to the extent of such excess. It is not the case of the assessee before us that time to pay bonus was extended or any dispute as regards payment of bonus has been raised. The assessee has provided for bonus for its employees but a part of the bonus so provided for three several years remained unclaimed. Once bonus has been offered by the employer, but remains undrawn, it cannot be said that the liability subsists even after the expiry of the time prescribed by the statute, particularly when there is no dispute pending regarding the payment of bonus. In the context of such facts and circumstances, it may be inferred that unclaimed or unpaid bonus is an excess of the requirement of the assessee and, therefore, to that extent, in any event, the liability has ceased."

9. Two aspects are to be noticed in this context. The first is that the view that liability does not cease as long as it is reflected in the books, and that mere lapse of the time given to the creditor or the workman, to recover the amounts due, does not efface the liability, though it bars the remedy. This view, with respect is an abstract and theoretical one, and does not ground itself in reality. Interpretation of laws, particularly fiscal and commercial legislation is increasingly based on pragmatic realities, which means that even though the law permits the debtor to take all defences, and successfully avoid liability, for abstract juristic purposes, he would be shown as a debtor. In other words, would be illogical to say that a debtor or an employer, holding on to unpaid dues, should be given the benefit of his showing the amount as a liability, even though he would be entitled in law to say that a claim for its recovery is time barred, and continue to enjoy the amount. The second reason why the assessee's contention is unacceptable is because with effect from 1-4-1997 by virtue of Finance Act, 1996 (No.2), an Explanation was added to Section 41 which spells out that "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". The expression "include" is significant; Parliament did not use the expression "means". Necessarily, even omission to pay, over a period of time, and the resultant benefit derived by the employer/assessee would therefore qualify as a cessation of liability, albeit by operation of law.

10. The submission of the assessee that no period of limitation is provided for under the Industrial Disputes Act, as a result of which it is exposed to liability at any time, is insubstantial and unpersuasive.

This is because in *Nedungadi Bank Ltd. v. K.P. Madhavankutty* AIR 2000 SC 839 the Supreme Court held that even though under the Act no period of limitation has been prescribed, a stale dispute one where the employee approaches the forum under the Act after an inordinate delay cannot be entertained and adjudicated.

11. In view of the foregoing reasons, the question of law is answered in the affirmative, in favour of the revenue, and against the assessee; consequently the orders of the Commissioner (Appeals) and the impugned order of the ITAT are hereby set aside. The order of the Assessing Officer is hereby restored. The appeal is allowed in the above terms without any order on costs.

*In favour of revenue.

†Arising from order of ITAT, Delhi in IT Appeal No. 2108 (Delhi) of 2010, dated 17-10-2010.