

## Demystifying the Mist: Balance Sheet Entries as Acknowledgment under Code?

(By [Ritik Khatri](#) and [Chitransh Bhansali](#))

### Background

The Insolvency & Bankruptcy Code, 2016 (**Code**) is young legislation developing through its loopholes with time by amendments and judicial pronouncements. The implication of the Limitation Act, 1963 (**Limitation Act**) over the code has been the talk of the town since the code's inception. The Hon'ble Supreme Court (**SC**) in [B.K Educational Services v Parag Gupta & Associates](#)<sup>1</sup> has already clarified the application of Article 137 of the Limitation Act over the CIRP applications which gives a breathing period of three years post the occurrence of default. This limitation of three years only extends through the virtue of Section 18 of the Limitation Act, which talks about the acknowledgment of the debt by the debtor.

One of the significant questions that, does the balance sheet entries in the books of accounts of corporate debtor amounts as acknowledgment under Section 18 of Limitation Act, was answered in negation by the NCLAT with a 4:1 majority in the [V Padmakumar v. Stressed Asset Stabilisation Fund Anrs.](#)<sup>2</sup> (**V. Padmakumar**)

Recently, a 3- Judge bench referred V Padmakumar to a 5- Judge bench stating that the judgment requires reconsideration and the dissenting view to be relooked into.

### Facts of the case

In [Bishwal Jaiswal v ARCIL](#)<sup>3</sup>, the Corporate Debtor had been declared NPA dated on 28/02/2014 and the Section 7 application was filed in December, 2018 which rendered the application time-barred.

### Argument by the Creditors

The creditors argued that the Corporate Debtor had acknowledged the debts from time to time in its balance sheets in the years ending 31/03/2015, 31/03/2016, and 31/03/17; thereby, their right to sue was extended under Section of 18 of the Limitation Act.

The creditors submitted that showing the entry in Books of Accounts indicates a subsisting liability and indicate the existence of a jural relationship between the parties and buttressed their claim relying on [Gautam Sinha v. UV Asset Reconstruction Company Limited and others](#)<sup>4</sup>, [Sheetal Fabrics v. Coir Cushions Ltd.](#), [The Commissioner of Income Tax-III v. Shri Vardhman Overseas Ltd.](#) and [M/s Mahabir Cold Storage Versus C.I.T., Patna](#), which held the balance sheet entries as valid acknowledgment pursuant to Section 18 of the Limitation Act.

It is worthwhile to note that various High Courts and NCLTs have propounded the same principle of law in various judgments which include [In re. Padam Tea Company Ltd.](#), [Larsen & Tubro Ltd. v. Commercial Electric Works](#), [Rishi Pal Gupta v. S.J. Knitting & Finishing Mills Pvt. Ltd.](#), [S.C. Gupta v. Allied Beverages Company Pvt. Ltd.](#)<sup>5</sup>. and [In Ambika Mills Ltd. Ahmedabad v. CIT](#) to name a few.

The SC has also considered balance sheet entries as acknowledgment in [L.C. Mills v. Aluminium](#)

[Corpn. of India Ltd.](#) and [S. Natarajan Vs. Sama Dharman.](#)

### Argument by the Corporate Debtor

The Corporate Debtor expounds that the [Section 92](#) of the Companies Act, 2013 mandates a company to prepare a return on the close of the financial year to reflect different details in books of accounts failing which attracts penal actions. The NCLAT in [V Hotels Limited vs. Asset Reconstruction Company \(India\) Limited](#)<sup>6</sup> held that “*the Books of Account cannot be treated as an acknowledgment of liability in respect of debt payable.*”

The NCLAT in [Sh. G Eswara Rao v. Stressed Assets Stabilisation Fund](#)<sup>7</sup> held that “*If the argument is accepted that the Balance Sheet / Annual Return of the ‘Corporate Debtor’ amounts to acknowledgement under Section 18 of the Limitation Act, 1963 then in such case, it is to be held that no limitation would be applicable because every year, it is mandatory for the ‘Corporate Debtor’ to file Balance Sheet/ Annual Return, which is not the law.*”

### Findings of the 5- Judge Bench

The larger bench showed dissatisfaction with the fact that the referral bench missed the distinction made in V. Padmakumar was to remove the uncertainty caused by the conflicting verdict of benches of co-equal strength in [V Hotels Limited vs. Asset Reconstruction Company \(India\) Limited](#)<sup>6</sup> and [Ugro Capital Ltd. v. Bangalore Dehydration and Drying co. Pvt. Ltd.](#)<sup>8</sup> It is pertinent to note that the SC in Jignesh Shaw has clarified that a suit for recovery which is a separate and independent proceeding before other fora than NCLT/NCLAT would not extend the limitation for the purpose of the code.

The bench relied on the SC’s pronouncement in [Sampuran Singh & Ors v. Niranjana Kaur & Ors](#) “*that the acknowledgment, if any, has to be prior to the expiration of the prescribed period for filing the suit. In the present case, the account was declared NPA since 1st December, 2008 and therefore, the suit was filed. Thereafter, any document or acknowledgment, even after the completion of the period of limitation i.e., December, 2011 cannot be relied upon.*”

Recently, the SC in [Babulal Vardharji Gurjar v. Veer Gurjar Aluminium Industries Pvt. Ltd. & Anr](#)<sup>9</sup> observed that Section 18 of the Limitation Act would have no application to the proceedings under the code. This, on the very outset clears the ambiguity regarding the acknowledgment of the balance sheet entries.

The Insolvency Law Committee report holds NPA as the starting point for limitation and stretching forward the concept of default beyond NPA would give a new lease of life to the debt which will go against the objective of the code. Hence, the 5 Judge bench upheld the V Padmakumar and clarified that the balance sheet entries in the books of account of the Corporate Debtor would not amount as acknowledgment under Limitation Act for the purpose of proceedings under the code.

### 5 Judge Bench’s rebuke on the Referral Bench

The larger bench found the referral bench incompetent in following the judicial discipline. Relying on Central Board of [Central Board of Dawoodi Bohra Community & Anr. Vs. State of Maharashtra & Anr.](#), the SC held that a decision delivered by a larger bench is binding on the bench of lesser or co-

equal strength. In case of doubt, attention of Lord Chief Justice (in present case, in the cognisance of the Chairperson) is to be invited with a request to place the matter before a bench of larger quorum. A bench of co-equal strength can only express an opinion doubting the correctness of the view taken by the earlier bench of co-equal strength.

The larger bench expressed its discontent that the referral bench overlooked all the legal considerations.

### **Concluding Remarks**

The Limitation Act is dormant yet powerful legislation as it has the authority to extinguish the debt in law which may amount to crores of rupees. The unsettled principle of the balance sheet entries has reached its constructive conclusion and it is appreciating that the mist has now been cleared; otherwise, the ambiguity could have far reaching consequences.

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## References:

1. [2018] ibclaw.in 32 SC[[↔](#)]
2. [2020] ibclaw.in 255 NCLAT[[↔](#)]
3. (2020) ibclaw.in 414 NCLAT[[↔](#)]
4. [2020] ibclaw.in 224 NCLAT[[↔](#)]
5. I.A. No.7987 of 2004 in Suit No.542 of 2004.[[↔](#)]
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