

आयकर अपीलिय अधिकरण, 'डी' न्यायपीठ, चेन्नई
IN THE INCOME TAX APPELLATE TRIBUNAL
'D' BENCH, CHENNAI

श्री महावीर सिंह, उपाध्यक्ष एवं श्री जी. मंजुनाथ, लेखा सदस्य के समक्ष
BEFORE SHRI MAHAVIR SINGH, VICE PRESIDENT AND
SHRI G. MANJUNATHA, ACCOUNTANT MEMBER

आयकर अपील सं./ITA No.: **1017/CHNY/2017**

निर्धारण वर्ष /Assessment Year: 2008 - 09

George Oakes Ltd.,
Greams Road,
Chennai -600 006.

The ACIT,
v. Corporate Circle-2(1),
Chennai

PAN: AAACG 1659G

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by

: Shri S. Vikram Vijayaraghavan,
Advocate

प्रत्यर्थी की ओर से/Respondent by

: Shri D. Hema Bhupal, JCIT

सुनवाई की तारीख/Date of Hearing

: 28.06.2022

घोषणा की तारीख/Date of Pronouncement

: 30.06.2022

आदेश /O R D E R

PER MAHAVIR SINGH, VICE PRESIDENT:

This appeal by the assessee is arising out of the order of Commissioner of Income Tax (Appeals)-9, Chennai in ITA No.65/CIT(A)-9/2010-11, order dated 10.01.2017. The assessment was framed by the ACIT, Company Circle II(2), Chennai for the assessment year 2008-09 u/s. 143(3) of the Income Tax Act, 1961 (hereinafter the 'Act') vide order dated 16.12.2010.

2. The only issue in this appeal of assessee is as regards to the order of CIT(A) confirming the disallowance made by AO, claimed by assessee on account of written off relating to embezzlement amounting to Rs.1,07,35,908/-.

3. Brief facts are that the assessee company is engaged in the business of trading in automobile spare parts, etc. The assessee claimed an amount of Rs.1,07,35,908/- as written off on account of embezzlement and this was noticed by AO from the profit & loss account for the year ended 31.03.2008, which was shown as Extraordinary item vide Note-V of the audited accounts. The AO required the assessee to explain and the assessee explained that during financial year 2001-02 some cheque leaves of the assessee company for their account maintained with Central Bank of India had been clandestinely removed and signature of the company officials were forged and an amount of Rs.1,07,35,908/- were withdrawn from this account. The assessee company came to know about the embezzlement in the course of bank reconciliation. It lodged a complaint with the Crime Branch of Chennai City Police in December 2001. The assessee company pursued the matter with the Central Bank of India requesting them to reimburse the amount withdrawn from the account of the company by means of forged

cheques. It was the contention of the company that primary responsibility of passing of forged cheques rested with the Bank. But, the bank consistently refused to admit the responsibility for these fraudulent withdrawals and embezzlement. The company filed a petition before Banking Ombudsman on 29.10.2004 but the same was dismissed. As there is no scope of recovery of the amounts involved from the accused, the company was left with no alternative other than to write-off the amounts in 2008 and the assessee company came to a conclusion that the amount of Rs.1,07,35,908/- embezzled from the account by way of forged cheques cannot be recovered from any person and therefore wrote off this amount for the assessment year 2008-09. The AO has not doubted the claim of embezzlement on merits but according to him, the embezzlement took place in financial year 2001-02 and assessee company came to know of it during the course of bank reconciliation and assessee company also quantified the amount of embezzlement during the period itself as evidenced by the complaint filed by the assessee with the police. According to AO, this incident happened in 2001 itself and it came to the knowledge of the assessee around the same period and the claim would have been made in assessment year 2002-03. Accordingly, he disallowed the claim. Aggrieved, assessee preferred appeal before CIT(A).

4. The CIT(A) relying on the CBDT Circular No.035D (XL VII-20), F.No.10/48/65-IT(AI) dated 24.11.1965 and the decision of Hon'ble Allahabad High Court in the case of Shiv Narain Karmendra Narain, 277 ITR 27 and the decision of Hon'ble Supreme Court in the case of Associated Banking Corporation of India Ltd., 56 ITR 1 confirmed the action of the AO and dismissed the assessee's claim by stating that the assessee is entitled for deduction of embezzlement loss either in the year of discovery or in the year in which the amount was crystallized or the year in which the assessee realizes that the amount cannot be recovered, whichever is later. According to CIT(A), the embezzlement took place in financial year 2001-02 and this was discovered by assessee in that very year because the assessee filed a petition before bank Ombudsman on 29.10.2004. According to CIT(A), although the assessee made claim for the financial year 2007-08 relevant to assessment year 2008-09 (the present year) but assessee could not provide any proof that the bank officials made it clear in March, 2008 that the bank will not be paying any amount to the assessee company. Aggrieved, assessee preferred appeal before the Tribunal.

5. Before us, the Id.counsel for the assessee reiterated the same submissions as where placed before the AO and CIT(A) and further

argued that the company perused the matter with the Central Bank of India requesting them to reimburse the amount withdrawn from the account of the assessee company by means of old cheques. The bank consistently refused to admit the responsibility for these fraudulent withdrawals and embezzlement and finally the assessee company filed petition before banking Ombudsman on 29.10.2004. But the banking Ombudsman dismissed the complaint lodged by the assessee company. He stated that despite the fact that the Ombudsman dismissed the complaint, the company continued dialogue with the bank and it had personal meeting with their Executive Director and even Chairperson. However the bank had steadfastly refused to accept any responsibility and it was made clear to the company that bank will not pay any amount. It was contended by Id. counsel that as a final attempt, the company had met officials of bank in March, 2008 and bank replied the same answer. Hence, there being no scope of recovery for the above amount of Rs.1,07,35,908/-, the assessee company was left with no other alternative except to write off the amounts in financial year 2007-08. The company came to the conclusion that the amount of Rs.1,07,35,908/- embezzled from its account by way of old cheques cannot be recovered from any person and therefore, written off this amount for the relevant assessment year 2008-09. The Id.counsel

for the assessee relied on the same Circular which was relied on by the CIT(A) and also relied on the decisions of Hon'ble Supreme Court in the case of Badridas Daga vs. CIT, 34 ITR 10, Hon'ble Jammu & Kashmir High Court decision in the case of J and K Bank Ltd., order dated 29.08.2017 and Hon'ble Supreme Court in the case of Associating Banking Corporation of India Ltd., vs. CIT, 56 ITR 1.

6. On the other hand, the Id. Senior DR relied on the assessment order and the order of CIT(A) and stated that the facts are undisputed and the assessee came to know about the embezzlement during the first year i.e., 2002-03 relating to financial year 2001-02, when it was known to the assessee company that cheque leaves of the company from their accounts maintained with Central Bank of India had been clandestinely removed and signature of the company officials were forged and total amount of Rs.1,07,35,908/- were withdrawn from this account. According to Id. Senior DR, the assessee company came to know about the embezzlement in the course of bank reconciliation carried out during the financial year 2001-02 relevant to assessment year 2002-03 and hence, claim can be allowed only in assessment year 2002-03.

7. We have heard rival contentions and gone through facts and circumstances of the case. We noted that the facts are very clear that during the financial year 2001-02, the assessee company maintained bank account with Central Bank of India and company officials namely Shri J.C. Joseph (who was employee of the assessee company from December, 1995 to January, 2002) clandestinely removed some cheque leaves, forged signature of the official of the company and withdrawn a total sum of Rs.1,07,35,908/- from this bank account. The company came to know about the embezzlement in the course of bank reconciliation and accordingly, a complaint was lodged with the Crime Branch of City Police in December, 2001. The assessee also pursued the matter with the Central Bank of India and bank also conducted internal enquiry, since there was no fault on the part of the bank, bank took a stand that it was not responsible for paying the alleged amount of forged cheques. The assessee filed complain with Central Bureau of Investigation (CBI) also and the CBI filed charge sheet in FIR No.RCMAI 2001A0052 dated 28.12.2001 accusing Shri R. Anantharaman, S/o Shri Raghavan, Shri R.K. Kannan, S/o Late R. Krishnamurthy, Shri N.Hemkumar, S/o Shri Narayanasamy, Shri N.C. Prabhu, S/o Shri N.V. Chandran, Shri S. Venkatesan, S/o Shri Subramanian and Shri J.C. Joseph, S/o Shri James. The assessee

company came to know that Shri J.C. Joseph and Shri N. Hemkumar made wrongful use of facility provided to them as they had access to the banking transactions of the assessee company. The investigation has also revealed that the assistance of the other accused was made use of towards encashing cheques stolen from George Oakes Ltd., and drawn in favour of fictitious companies by fraudulently affixing the signature of the Managing Director. The assessee has explained the entire sequence of fraud committed and the assessee company raised the issue of fraudulent encashment of cheques with Central Bank of India vide various letters starting from 04.12.2001. The company perused the matter by filing complaint with Banking Ombudsman on 29.10.2004 but the same was dismissed. The assessee pursued the matter with the Executive Director and Chairperson of the Bank but refused to pay the amount to the assessee company. As a final attempt, the assessee company met with the officials in March, 2008 but the bank officials finally said they are not paying any amount to the assessee company on this account. There was no scope of recovery of the amount involved from the accused as well as from the bank, the assessee company came to the conclusion that the amount of Rs.1,07,35,908/- embezzled from this account by way of forged

cheques cannot be recovered and therefore wrote of this amount in assessment year 2008-09.

7.1 In view of the above facts, now we have to go through the CBDT Circular relied on by the assessee's counsel as well as the CIT(A) and the relevant circular reads as under:-

**CIRCULAR NO. 035D(XLVII-20) [F. NO. 10/48/65-IT(AI)] DT. 24TH
NOVEMBER, 1965**

Loss by embezzlement by employees-Deductibility thereof

24/11/1965

BUSINESS INCOME
SECTION 29,

A reference is invited to the instructions on the above subject contained in Board's Circular No. 25 of 1939 and Circular No. 13 of 1944. In these circulars it was clarified that losses arising due to embezzlement of employees or due to negligence of employees should be allowed if the loss took place in the normal course of business and the amount involved was necessarily kept for the purpose of the business in the place from which it was lost. Since the above circulars were issued, the Supreme Court has further considered the matter and laid down the law in this regard in the following two cases :-

- (1) Badri Das Daga vs. CIT (1958) 34 ITR 10 (SC): TC 14R.202.
- (2) Associated Banking Corporation of Ltd. vs. CIT (1965), 56 ITR 1 (SC) : TC

In the first case, the Supreme Court has affirmed the view that the loss resulting from embezzlement by an employee or agent of a business is admissible as a deduction under s. 10(1) of the IT Act, 1922 (corresponding to s. 28 of the IT Act, 1961) if it arises out of the carrying on of the business and is incidental to it. In the second case the decision is that loss must be deemed to have arisen only when the employer comes to know about it and realises that the amounts embezzled cannot be recovered.

2. In the light of the above decisions of the Supreme Court, the legal position now is that loss by embezzlement by employees should be related as incidental to a business and this loss should be allowed as deduction in the year in which it is discovered.

7.2 The Id.counsel for the assessee has drew our attention to para 2, wherein it is clearly mentioned that the loss should be allowed as deduction in the year in which it is discovered. The Id.counsel for the assessee then took us through the decision of Hon'ble Jammu & Kashmir High Court in the case of J and K Bank Ltd., *supra*, wherein the meaning of expression 'discovery' is explained and the relevant para 9 & 10 reads as under:-

“9. The expression detection and discovery have different connotations. When embezzlement comes to the notice of an employer, it can be said that such embezzlement is detected by the employer. However, the expression „discovers“ indicates detection as the result of uncovering, revealing or laying open to view what was hidden, concealed or unknown. But words do not always retain their abstract or primary definitions and their meanings vary in accordance with contextual use. The work „discovers“ has been interpreted by English Courts to mean "comes to the conclusion from the examination the Inspector makes, and from any information he may choose to receive" or "has reason to believe" or "finds or satisfied himself" or "honestly comes to the conclusion from information before him." [See: Commissioner of Income Tax, Punjab, Himachal Pradesh and Bilaspur, Shimla v. Shree Jagannath Maheshwari Amritsar AIR 1957 PUNJAB 226 (V 44 C 87 Oct.).

10. In view of aforesaid enunciation of law, we hold that the expression detection and discovery have different and distinct connotations in law and the expression „discovery“ has to be interpreted so as to mean that loss must be deemed to have arisen only when employer comes to know about it and realizes that the amount embezzled cannot be recovered and not merely from the date of acquiring knowledge in which that embezzlement has

taken place. Accordingly, the first substantial question of law is answered in favour of the assessee and against the Revenue. On ITA No.17/2007 c/w ITA No.10/2007 ITA No.18/2007 the same analogy, the second substantial question of law framed by this Court is answered by stating that loss by embezzlement being incidental to the banking business should be allowed as deduction in the year it is discovered and the expression „discovered“ has to be read in the context of Circular dated 24.11.1965 issued by Central Board of Direct Taxes. Accordingly, the second substantial question of law is answered in favour of the assessee and against the Revenue.”

7.3 We have also gone through the decision of Hon'ble Supreme Court in the case of Associated Banking Corporation of India, *supra*, wherein it was held as under:-

“The Tribunal has found in its supplementary report that the withdrawals and misapplication of funds by the Secretary came to the knowledge of the liquidator after the accounting year under reference, because no one suspected that the entries posted in the books of account were false entries to cover up his dealings by the Secretary. That conclusion is based on evidence and the loss must, in the circumstances of the case, be deemed to have occurred to the Bank after the liquidator came to know about the embezzlements and came to know that the amounts embezzled could not be recovered. One of the prime conditions inviting the deduction of a trading loss under s. 10(1) is therefore absent. We accordingly agree with the High Court that the amount of Rs. 10,15,000 was not a permissible deduction under S. 10(1).”

7.4 We have gone through the entire facts and case laws, we noted that Hon'ble Supreme Court in the above case i.e., Associated Banking Corporation of India, *supra*, held that loss must be deemed to have arisen only when the employer comes to know about it and realized that the amount embezzled cannot be recovered, no doubt, it came to its knowledge prior. We noted that in the present case

also, the assessee came to know of embezzlement in 2001-02 but he tried his level best for recovery of embezzled amount by filing police complaints and even the matter was referred to CBI by filing FIR against the accused persons as noted above. The assessee also pursued the matter with the Banking Ombudsman and the bank officials, when finally everybody refused and there was no chance of recovery, the assessee reversed this amount in the accounts of the assessee for assessment year 2008-09, when finally discovered that this amount is not recoverable. Hence, in such circumstances, we are of the view that the loss on account of embezzlement claimed by assessee is allowable in this year and we allow the same accordingly.

8. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on 30th June, 2022 at Chennai.

Sd/-

(जी. मंजुनाथ)

(G. MANJUNATHA)

लेखा सदस्य /ACCOUNTANT MEMBER

Sd/-

(महावीर सिंह)

(MAHAVIR SINGH)

उपाध्यक्ष /VICE PRESIDENT

चेन्नई/Chennai,

दिनांक/Dated, the 30th June, 2022

RSR

आदेश की प्रतिलिपि अग्रेषित/Copy to:

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|------------------------|--------------------------|------------------------------|
| 1. अपीलार्थी/Appellant | 2. प्रत्यर्थी/Respondent | 3. आयकर आयुक्त (अपील)/CIT(A) |
| 4. आयकर आयुक्त /CIT | 5. विभागीय प्रतिनिधि/DR | 6. गार्ड फाईल/GF. |