

IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH : BANGALORE

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND SMT. BEENA PILLAI, JUDICIAL MEMBER

ITA No.3249/Bang/2018
Assessment year: 2011-12

Avijit Dewanjee, #2/6, Dr.Rajkumar Road, Rajajinagar III Stage, Bengaluru – 560 010. PAN: AAYPD 5129R	Vs.	The Deputy Commissioner of Income Tax, Circle 1(1)(2), Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Smt. Suman Lunkar, CA
Respondent by	:	Shri Priyadarshi Mishra, Jt.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	09.02.2022
Date of Pronouncement	:	23.02.2022

ORDER

Per Chandra Poojari, Accountant Member

This appeal by the assessee is directed against the order of the CIT(Appeals)-2, Bengaluru dated 22.11.2018 on the following grounds:-

“1. The learned Assessing Officer had erred in passing the order in the manner passed by him and the CIT(A) has erred in confirming the same. The orders passed are bad in law and are liable to be quashed.

2.1 Without prejudice, the learned assessing officer had erred in disallowing the loss claimed amounting to Rs.2,24,36,701/- on account of embezzlement of cash by the staff on the ground, the said fraud and the quantum have not been ascertained and finalized and the learned CIT(A) has erred in confirming the same. The conclusion

of authorities below being contrary to available facts and law are to be disregarded and the disallowance as made is to be deleted.

2.2 On the facts and circumstances of the case, the appellant had actually incurred loss on account of employee fraud and same is rightly claimed as business loss which is to be accepted as such and the deduction as claimed is to be added.

3. In view of the above and on other grounds to be adduced at the time of hearing, it is requested that the order be quashed or atleast the disallowance of Rs. 2,24,36,701/- as done by Assessing Officer be deleted and loss as per revised return be accepted.”

2. The facts are that the assessee, an individual, is a dealer in Honda vehicles under the name and style, 'Max Motors'. On sale of the vehicles, some of the customers had made the payments by cash which was required to be deposited into bank account, but was misappropriated by the staff to the tune of Rs. 2,24,36,701/-. The assessee hopeful of recovering the embezzled cash parked the entire sum of Rs. 2,24,36,701/- under the head 'Debtors Suspense A/c' in the Balance Sheet for year ending 31.03.2011. The assessee filed a Police complaint on 10.09.2011. However after finding that even after Police complaint, the recovery is difficult, the assessee filed a revised return of income and claimed the entire embezzled cash as loss in the course of business. Further, the auditors vide para 3(a)(i) stated that the management has informed that over a period of time there has been defalcation of cash collection and improper accounting of the transactions. The management suspects fraud by the employees and it has filed an FIR in this connection. The management has represented that they are in the course of conducting an

independent investigation of the fraud committed. However, the implication of the loss on account of such fraud is not ascertainable until the final findings of the investigation have been received and it is stated that the auditors are unable to comment on the same. Thus, the Assessing Officer has given a finding that even from the above statement of the statutory Auditors of the assessee, it can be seen that the management only suspects fraud by the employees and as such a complaint has been lodged with the Police. The said fraud and the quantum have not been ascertained and confirmed by the Police. The AO hence disallowed the loss claimed on account of embezzlement of cash of Rs.2,24,36,701.

3. Before the CIT(Appeals), the assessee filed written submissions along with various documentary evidences relating to the investigation of the matter by the police and claimed that consequent to the investigation the matter has reached the court and since the embezzlement has been verified by the police and crystalized, it should accordingly be allowed.

4. The CIT(Appeals) observed that in this case embezzlement has happened and at the stage of finalization of Audit Report and the quantification of the exact amount is to be ascertained. Therefore, his predecessor vide his letter dated 02.07.2018 has forwarded the entire set of written submissions for verification of the AO calling for Remand Report u/s 250(4) of the Act. Accordingly, the Assessing Officer submitted his report dated 11.9.2018 stating that a certified copy of the charge sheet filed before the Court was called for from the assessee. The assessee submitted only FIR. In the absence of copy of the charge sheet filed before the Court, the AO stated that embezzlement of funds by staff cannot be verified and the same may be disallowed.

5. The copies of FIR and charge sheet were filed before the CIT(Appeals). The CIT(Appeals) observed that the assessee filed copies of charge sheet filed by the Police before the Court regarding embezzlement of funds by the staff. However, the CIT(Appeals) dismissed the contentions of the assessee on the ground that there was no final conviction so as to ascertain the quantum of embezzlement as claimed by the assessee. Against this, the assessee is in appeal before us.

6. The Id. AR submitted that in the assessee's case, the cash has been embezzled by the cashier of the assessee in connivance with the accountant. The cashier was in charge of the cash received in the course of normal business sales. The cash that has been embezzled formed part of the sales revenue which has been offered to tax. Thus this loss incurred is in the course of business of the assessee. In the light of various case laws referred to in the preceding paragraphs, the loss on account of cash embezzled has to be allowed as a deduction in computing the assessee's taxable income.

7. She further submitted that the AO has not questioned or disputed the allowability of embezzlement losses in computing business income. He however disallowed the claim for loss for following reasons:-

- a) The appellant has only filed a First Information report with the police and the matter is still pending for investigation.
- b) The fraud and quantum of fraud has not been confirmed by the police
- c) Auditor's of the appellant have in their audit report qualified that the loss on account of fraud cannot be ascertained till the final investigation report is received.
- d) Loss cannot be allowed until such time it is ascertained and confirmed by way of a final investigation report.

8. The auditors of the assessee have not disputed the quantum of loss suffered by the assessee on account of the embezzlement. They have only made a remark in their audit report that implication of loss is not ascertainable until the final findings of investigation by the management. As regards the AO's conclusion that the loss cannot be allowed until such time it is ascertained and confirmed by way of a final investigation report, the Id. AR submitted that all records and details pertaining to the embezzlement were furnished before the revenue authorities. The genuineness of the assessee's claim was nowhere in question. The AO has not brought on record any material disputing the claim for loss. The auditors have also confirmed in their audit report the fact of fraud on the appellant. The police has also accepted the complaint of the assessee and has conducted investigations into the complaint. The police has not yet completed its investigation cannot be a ground for disbelieving / disallowing the assessee's claim for loss.

9. The Id. AR submitted the Allahabad High Court in *Shiv Narain Karmendra Narain v. CIT [2005] 142 Taxman 167* has held that the loss from embezzlement is allowable not in the year when the embezzlement took place but in the year when such loss was ultimately discovered and quantified. The Apex Court in *Associated Banking Corporation of India Ltd. v. CIT [1965] 56 ITR 1* has held that the loss by embezzlement by an employee should be treated as incidental to the business and this loss should be allowed as a deduction in the year in which it is discovered. Even CBDT in Circular No. 35-D(XLVII-20) (F. No. 10/48/65-IT (A-I), dated November 24, 1965) has concluded that embezzlement loss should be allowed as deduction in the year in which it is discovered.

10. She submitted that in the case of *DCIT vs ING Vysya Bank [2014] 62 SOT 26 (Bangalore) (URO)* under similar facts, the assessee had filed an FIR with police reporting fraud by its employees. Later a detailed study

was conducted by the assessee bank and the actual amount of loss was ascertained to be higher than the loss reported in FIR. The AO restricted the assessee's claim for loss to the extent of loss reported in FIR. On appeal before the ITAT, the Tribunal held that the figures mentioned in FIR are only provisional figures which is arrived at for the purpose of filing an FIR immediately on occurrence of the fraud. The figure ascertained in the second report which was prepared after a deeper study should be considered. Applying the ratio of this case, it was submitted that final figure of loss worked out by the appellant with the assistance of auditors has to be considered for the purpose of allowance.

11. The Id. AR further submitted that as per section 29 of the I.T. Act, profits from business have to be computed in accordance with the provisions contained in sections 30 to 43D. There is no specific provision in the Act providing for deduction of losses incurred in the course of business. However courts have consistently held that what is chargeable to income-tax in respect of a business are the profits and gains of a year; and in assessing the amount of the profits and gains of a year, account must necessarily be taken of all losses incurred. Else one cannot arrive at true profits and gains. It is like wise well settled that profits and gains which are liable to be taxed under section 28 are what are understood to be such according to ordinary commercial principles. The word profit is to be understood in its natural and proper sense — in a sense which no commercial man would misunderstand. Therefore having regard to accepted commercial practice and trading principles, if it can be said that the loss has arisen out of the carrying on of the business and is incidental to it, the same have to be allowed as a deduction even though there is no specific provision for allowance thereof.

12. In the context of embezzlement losses, in *Badridas Daga v. CIT* [1958] **34 ITR 10** (SC) where sums withdrawn by an employee from a bank account were misappropriated, the Supreme Court summed up the legal position on allowability of loss on account of embezzlement in the following words:

"... A business especially such as is calculated to yield taxable profits has to be carried on through agents, cashiers, clerks and peons. ... If employment of agents is incidental to the carrying on of business, it must logically follow that losses which are incidental to such employment are also incidental to the carrying on of the business. Human nature being what it is, it is impossible to rule out the possibility of an employee taking advantage of *his position as such employee and misappropriating the funds of his employer, and the loss arising from such misappropriation must be held to arise out of the carrying on of business and to be incidental to it*" (p. 15)

"In the result, we are of opinion that the loss sustained by the appellant as a result of misappropriation by Chandratan is one which is incidental to the carrying on of his business, and that it should therefore be deducted in computing the profits under section 10(1) of the Act."

13. In *Lord's Dairy Farm Ltd. v. CIT* [1955] **27 1TR 700 (Bom.)** it has been held that amounts misappropriated by a cashier of a company during the course of his duties, including withdrawals from the bank are allowable trading loss under section 10(1) of the 1922 Act (Corresponding to sec. 28 of I.T. Act, 1961).

14. In *Gotham Chand Galada v. CIT* [1961] **42 ITR 418** (Mad.), where a cashier employed in a money-lending business embezzled certain sum in the course of handling the cash and said that the sum was irrecoverable it was held that loss thus caused was an allowable deduction.

15. The Id. AR submitted that in the following cases it has been held that if the loss on account of embezzlement / theft was incidental to carrying on the business and there was direct and proximate connection and nexus between the loss and the business the same has to be allowed as a deduction:

- CIT v. Smt. Pukhraj Wati Bubber [2007] 199 Taxation 107 (Punj. & Har.)
- CIT v. Nainital Bank Ltd. [1965] 55 ITR 707 (SC).
- Ramchandar Shivnarayan v. CIT, AP [1978] 111 ITR 263 (SC),
- Associated Banking Corporation of India Ltd. v. CIT [1965] 56 ITR 1

16. It was further submitted that even CBDT in its Circulars No.25 of 1939 and Circular No. 13 of 1944 has instructed the assessing officers that losses arising due to embezzlement by 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.

17. In view of the above, it was submitted that the claim of fraud of the appellant is bona fide. The auditors of the assessee have confirmed the fraud. The loss incurred is in the course of business of the assessee. The embezzlement loss in the assessee's case has been identified in the year under appeal. The loss has been fully quantified and provided for in the books for the year under appeal. The loss has to therefore be allowed in the year under appeal as claimed by the assessee.

18. The Id. DR submitted that there is no entry passed in the books of accounts of the assessee and it is not quantified on any scientific basis. The auditor is also not aware of it which is apparent from the audit report. Further, the assessee debited this amount to the suspense account and not

to the respective customers account so as to claim it as a deduction. He relied on the orders of the CIT(Appeals).

19. We have heard both the parties and perused the material on record. In this case, the assessee claimed a sum of Rs.2,46,36,701 as loss on account of embezzlement of cash which was done by one of the employees of the assessee. The contention of the Id. AR is that the cashier while working in the assessee's firm embezzled cash on day to day basis which came to be known in the assessment year under consideration against which assessee lodged a FIR and also charge sheet is filed and the case is pending before the Court. As such, the said amount is to be allowed as a deduction while computing income of the assessee. We have carefully gone through the financial statements of the assessee. The assessee has shown the amount of Rs.2,46,36,701 under the head Sundry Debtors Suspense. The auditor reported on this issue as follows:-

“A perusal of annexure to balance sheet shows an amount of Rs.2,24,36,701/- shown under the head sundry debtors suspense. The management has informed that over a period of time there has been defalcation of cash collection and improper accounting of the transactions. The management suspects fraud by the employees and it has filed an FIR in this connection. The management has represented that they are in the course of conducting an independent investigation of the fraud committed. However the implication of the loss on account of such fraud is not ascertainable until the findings of the investigation have been received and we are unable to comment on the same.”

20. Thus it is seen from the audit report that the liability is not ascertained properly in assessment year under consideration and the assessee has shown the liability of Rs.2,24,36,701 under the head Sundry Debtors Suspense.

21. According to the Id. AR, the assessee need not write off the said amount to the Sundry Debtors Account to claim the deduction on this count. In our opinion, writing of the debt without charging to the same to the P&L account is not write of at all because assessment is made based on audited accounts and P&L account, balance sheet filed along with the return of income. It is not enough if the assessee reduces the amount in some of the books maintained by it which is not part of the audited accounts including the P&L account based on which assessment is made. Unless the write off takes place at the time of finalisation of account and reflected in the books of account, it cannot be treated as write of at all. This view of ours is supported by the judgment of the Karnataka High Court in the case of *CIT v. Hotel Ambassador, 253 ITR 430 (Ker)*. The assessee herein wants to claim the loss as business deduction without writing off the same in the customary accounts. In our opinion, in the instant case, the assessee is still having a ray of hope of recovery of the amount and the issue has not reached finality. Only on the issue reaching finality, the assessee could claim it as business loss in the relevant assessment year. The assessee has not made necessary attempts to recover the loss from the concerned employee and it cannot be said that it was useless to make attempts for recovery of the amount from Smt. K.P. Parvathi. The alleged loss by embezzlement which is not proved cannot be allowed as deduction. Reference is made to the judgment of the Allahabad High Court in the case of *CIT v. Ashwani Kumar Liladhar, 225 ITR 576 (All)*.

22. The assessee relied on CBDT Circular No.139 of 1944 dated 24.5.1944 where it was clarified that the AO has to see that the claim is bonafide and that there is unimpeachable evidence to support the actual loss. Where the ITO is not fully satisfied on these two points, the claim could be refused. In the present case, as noted by the lower authorities,

there was no actual quantification of loss and the assessee has not taken any steps for recovery. In these circumstances, this CBDT Circular is of no assistance to the assessee.

23. Further, the Id. AR relied on the CBDT Circular No.35-D(XL VII-20) (F.No.10/48/65-IT(A-1) dated 24.11.1965 and submitted that the approach of the lower authorities was not correct. According to the assessee, the loss by embezzlement by employee should be treated as incidental to the business and this loss should be allowed as deduction in the year in which it is discovered. In our opinion, there can be no dispute as to the loss being incidental to the business, if the cash in hand has been kept for the purpose of business of the assessee at the business premises. On this count, the assessee has to prove the business exigency of keeping such a huge amount in the form of cash at the business premises, which is not proved by the assessee. Further, even if the cash is kept for business purposes, the assessee should see the reasonable process of recovery of amount of embezzlement. Unless recovery is impossible, it could not be stated that it is a business loss in a commercial sense.

24. In the present case, till the point of time the assessee entertained the hope of recovering the loss, the said amount cannot be allowed as a deduction in this assessment year under consideration, as the assessee has not ascertained the loss in the books of account and it is shown as sundry debtors suspense account without charging it to the P&L account. At this stage, it is not possible to hold that it is ascertained liability to allow the loss as a deduction.

25. Further, at the time of hearing, the Bench put a specific query to the Id. AR whether loss on account of embezzlement of cash at Rs.2,24,36,701 was actually debited to the P&L account or not while making deduction in the return of income. The Id. AR outrightly submitted that it was not

originally charged to P&L a/c while filing return of income. However, the assessee while filing revised return, the assessee charged it to P&L a/c and balance sheet filed before the authorities. The Bench directed the Id. AR to file the P&L a/c and balance sheet along with audit report filing with the revised return before the Tribunal. The Id. AR filed a letter dated 9.12.2012 as follows:-

BEFORE THE INCOME TAX APPELLATE TRIBUNAL; "B" BENCH;
BENGALURU

AVIJT DEWANJEE
PROP: MAX MOTORS,
#2/6, Dr. RAJKUMAR ROAD,
3RD STAGE, RAJAJI NAGAR,
BENGALURU-560010

APPELLANT

V/S.

THE DEPUTY COMMISSIONER OF
INCOME TAX
CIRCLE- 1(1)(2),
BENGALURU

RESPONDENT

ITA No. 3249/Bang/2018
Assessment Year : 2011-2012
Appeal got heard on 09/02/2022

The following is submitted for the kind consideration of honourable Income Tax Appellate Tribunal, "B" Bench, Bangalore:

1. The only disputed issue in the above appeal is disallowance of loss claimed amounting to Rs. 2,24,36,701/- on account of embezzlement of cash by the staff of the appellant.
2. The appeal got heard on 09/02/2022. During the course of hearing, it was asked to show whether the loss on embezzlement of cash was debited to Profit and Loss Account. In the course of hearing it was submitted that for the AY 2011-12, the loss on account of embezzlement of cash was quantified at Rs. 2,24,36,701/- As the appellant was still under hope of recovery, this sum was shown as under Debtors Suspense Account. The details of Debtors suspense A/c is available at page nos. 63 and 64 of the Paper Book filed. Therefore, in the original return filed on 13/09/2011, this loss was never claimed. Subsequently, it was realized that even after police complaint, the recovery is difficult, the appellant filed a revised return of income on 27/9/2012 and claimed the entire embezzled cash of Rs. 2,24,36,701/- as loss in the course of business.

3. It was erroneously submitted during the course of hearing that there is a revised financial statements to this effect, however, it is humbly submitted that the audited financial statements were not revised. The appellant in the revised statement of Total Income (Copy available at Page no. 22 of the Paper Book filed), had claimed this loss under Profit and Loss Adjustment Account.

4. The inconvenience caused is deeply regretted.

Date: 09/02/2022


CA for APPELLANT

26. Thus, it is clear that the assessee has not filed any revised P&L a/c or balance sheet incorporating the loss in books of account of assessee. The assessee in the original return has not claimed the loss on account of embezzlement of cash. Later the assessee filed a revised return of income on 27.9.2012 as against original return filed on 13.9.2012 claiming loss of Rs.49,02,585 on reason for such variation which forced assessee to file revised return claiming this loss of Rs.2,24,36,701 towards embezzlement of cash. The assessee continued to show this loss in the balance sheet as "Sundry Debtors – Debit Balance - Suspense Account" without charging it to P&L a/c and debited in Debtors account from whom alleged person collected the cash. Being so, in our opinion, it is not ascertained liability in the assessment year under consideration. Accordingly, we reject the claim of assessee and the grounds raised in this regard are dismissed.

27. In the result, the appeal by the assessee is dismissed.

Pronounced in the open court on this 23rd day of February, 2022.

Sd/-
(BEENA PILLAI)
JUDICIAL MEMBER

Sd/-
(CHANDRA POOJARI)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 23rd February, 2022.

/Desai S Murthy/

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.