

Shiv Narain Karmendra Narain Vs. Cit

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Court : Allahabad

Decided On : Oct-11-2004

Reported in : [2005]142TAXMAN167(All)

Appeal No. : IT Reference No. 25 of 1987 11 October 2004

Appellant : Shiv Narain Karmendra Narain

Respondent : Cit

Advocate for Pet/Ap. : Rithik Upadhyaya *for the Assessee Shambhu Chopra, for the Revenue.*

Judgement :
ORDER

R.K. Agrawal, J.

The Income Tax Appellate Tribunal, Delhi has referred the following two questions of law under section 256(1) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') for opinion of this court :

'1. Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the trading loss of embezzlement was not allowable during the previous year ending on 31-12-1977 relevant to the assessment year 1978-79?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in upholding the disallowance of Rs. 11,474 under section 80VV?'

2. Briefly stated the facts giving rise to the present Reference are as follows:

The present reference relates to the assessment year 1978-79. The applicant is a firm deriving income from the running of oil mill, Khandsari business and the running of ice and cold storage plant. It maintains its account on calendar year basis. For its business, it maintains depots at various places including Calcutta, Cuttack and Haldwani. At Haldwani, the depot is utilized both as sales outlet and as purchasing agency. The depot is in the charge of a Manager, Assistant Manager and an Accountant. Sometime in October 1977, the supplies of raw materials from the Haldwani Depot, became irregular. While trying to find out the reasons for this irregularity of supplies, the assessee-firm came to discover considerable embezzlement at the said depot by the Manager, Assistant Manager and the Accountant. Accordingly, an employee was deputed for the detailed examination of the accounts and ascertaining the extent of the embezzlement. The said employee, Shri Har Govind, completed the preliminary investigation and arrived at a rough figure of Rs. 8,50,000 as embezzled amount. In the meanwhile the Manager, the Assistant Manager and the Accountant appeared before the partners of the assessee-firm and confessed having done the embezzlement in question. Accordingly, the assessee firm lodged an FIR with Civil Lines Police Station, Aligarh on 31-12-1977 claiming the embezzlement loss to be Rs. 8,50,000. As the aforesaid figure was only tentative, the assessee firm appointed one S.M. Gupta & Co., Chartered Accountant to investigate the full extent of the embezzlement and report the matter to the firm who submitted the report on 7-7-1979, reporting an embezzlement of Rs. 11,17,014. In the meantime, the assessee firm filed a civil suit on 20-4-1979 against the three persons before the Civil Judge, Aligarh. We are not in a position to say anything as to whether the criminal and civil cases have been disposed of or not. On the basis of the aforesaid facts, the applicant claimed embezzlement loss of Rs. 11,17,014 in respect of the assessment year 1978-79 on the ground that the embezzlement in question came to the knowledge of the assessee in the accounting period corresponding to the assessment year 1978-79 and that there was no prospect of

its recovery. The Inspecting Assistant Commissioner of Income Tax did not accept the above claim of the assessee inter alia on the ground that there were discrepancies between the claim of embezzlement made before the assessing officer and that contained in the FIR lodged with the Police, that, in the absence of stock register, the extent of the embezzlement loss could not be verified, and that the appellant had not taken necessary steps to realize the amount within the previous year in question.

3. The applicant has also incurred a sum of Rs. 20,876 in respect of the previous year corresponding to the assessment year 1978-79 for making payment to its Income Tax Advisers and others for representing their cases before the various income-tax authorities. Out of the said amount the assessing officer allowed a sum of Rs. 5,000 and the balance of Rs. 15,876 was disallowed by invoking provisions of section 80VV of the Act.

4. The appellant preferred an appeal before the CIT (A) who accepted the plea and directed that the loss of Rs. 11,17,014 be allowed to it as it was a real loss and that there was no hope of recovering the same and that it was not necessary for allowing the said loss that conviction of the accused must result before the loss was allowed. He also deleted the aforesaid amount of Rs. 15,876 on the ground that it cannot be regarded as expenses for appearing before the Income Tax authorities as it pertains to retainership etc. and even if the expenses in question was not allowable under section 37 of the Act they would be allowable under section 28 of the Act.

5. Feeling aggrieved by the said order the revenue preferred an appeal before the Appellate Tribunal. The Tribunal had allowed the appeal of the revenue by holding that even if the embezzlement had taken place but the extent of the embezzlement become known to the applicant only on 7-7-1979 when the auditors submitted their report to it and as the aforesaid date falls beyond the previous year under consideration and as also the date of filing of the civil suit i.e., 21-4-1979 falls beyond the previous year under consideration it is not possible to hold that the embezzlement which took place resulted in a trading loss to the assessee during the previous year under consideration. The Tribunal had further held that the sum

of Rs. 15,876 was hit by the provisions of section 80VV of the Act and, therefore, it could not have been allowed as deduction.

6. We have heard Sri Rithik Upadhyaya learned counsel for the applicant and Sri Shambhoo Chopra, learned standing counsel for the revenue.

7. Learned counsel for the applicant submitted that the fact of the embezzlement came to the notice of the applicant only sometime in October, 1977 and, therefore, the sum is allowable as a deduction as business loss during the assessment year in question. He further submitted that a sum of Rs. 20,876 which has been paid by the applicant to the Income Tax Advisers and others for representing its case before the various Income-tax authorities did not relate to one or same proceedings and, therefore provisions of section 80VV of the Act would not be attracted. In support of his aforesaid submissions he relied upon the following decisions :

1. Bombay Forgings (P) Ltd. v. CIT : [1994]206ITR562(Bom)

2. Kainla Cotton Co. v. CIT : [1997]226ITR605(Guj)

3. Saurashtra Cement & Chemical Industries Ltd. v. CIT : [1995]213ITR523(Guj)

8. He also referred to a Circular No. 35-1)(XLVII-20) (F. No. 10/48/65IT(A4)) dated 24-11-1965 issued by Central Board of Direct Taxes in which it has been stated that the loss by embezzlement by employees should be treated as incidental to a business and this loss should be allowed as deduction in the year in which it is discovered.

9. Sri Shambhoo Chopra, learned standing counsel for the revenue, however, submitted that even if the applicant had come to know about some embezzlement having taken place in its Haldwani Depot in the month of October, 1977 the exact amount of embezzlement was found only on 7-7-1979 when the Chartered Accountant M/s. S.M. Gupta & Co. who was appointed by the applicant to investigate the full extent of the embezzlement submitted the report and, therefore, it was if at all admissible as a business loss only in the assessment year 1980-81

and not during the assessment year 1978-79. He further submitted that under section 80VV of the Act the amount in excess of Rs. 5,000 paid towards the income-tax proceedings are liable to be disallowed and, therefore, the Tribunal has not committed any error in upholding disallowing of the embezzlement loss as also the sum of Rs. 15,876.

10. Having heard learned counsel for the parties we find that it is now well settled by the Apex Court in the case of *Badridas Daga v. CIT* : [1958]34ITR10(SC) that 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 the business and to be incidental to it.

11. The Apex Court in the case of *Associated Banking Corpn. of India Ltd. v. CIT* : [1965]56ITR1(SC) has held that it is wrong to say that irrespective of other considerations, as soon as an embezzlement of the employer's fund takes place, whether the employer is aware or not of the embezzlement, there results to trading loss. So long as there is a reasonable prospect of recovery of the amounts embezzled, trading loss in a commercial sense cannot be deemed to have resulted. Embezzlement of funds by an agent, like a speculative adventure, does not necessarily result in loss immediately when the embezzlement takes place, or the adventure is commenced. Embezzlement may remain unknown to the principal, and the assets embezzled may be restored by the agent or servant. In such a case in the commercial sense no real loss has occurred. Again it cannot be said that in all cases when the principal obtains knowledge of the embezzlement loss results. The erring servant may be persuaded or compelled by process of law or otherwise to restore wholly or partially his ill-gotten gains. Therefore, so long as a reasonable chance of obtaining restitution exists, loss may not in a commercial sense be said to have resulted.

12. In the case of Kamla Cotton Co. (supra) the Gujarat High Court has held that the requirement that a debt has become bad or irrecoverable does not mean that the department can insist upon demonstrative and infallible proof that the debt had become bad. It is not compulsory for the assessee to take legal proceedings against the debtor for recovery of the claim before writing it off as a bad debt. When a creditor bona fide writes off the debt because there appears no chance of its recovery in the foreseeable future or where the recovery proceedings would be so cumbersome and expensive as to outweigh any advantage of instituting any recovery proceedings, the assessee discharges the onus and would be entitled to claim deduction of the bad debt under clause (vii) of section 36(1) of the Act.

13. In the case of Shitla Prasad Shyam Lal v. CIT : [1991]188ITR514(All) this court has held that simply because a criminal case was pending or a civil suit had not been filed, the claim of the assessee could not be left undetermined. Referring to the Circular dated 24-11-1965 wherein it has been provided that the claim of embezzlement was allowable as a business loss in the year in which it was discovered this court has held that the Tribunal was not justified in holding that the assessee's claim of loss was premature. The court had held that proper course for the Tribunal was to go into the matter and record its finding on the said plea.

14. In the case of Bombay Forgings (P) Ltd. (supra) the Bombay High Court has held that where the embezzlement had taken place during the relevant previous year 1975-76 and the same was duly reflected in the books of account by omission of the value of such goods from the sales as well as the closing stock of the assessee in preparation of the final accounts in such situation, so far as loss was concerned, detection was not relevant. The loss caused to the assessee by embezzlement during the relevant previous year was allowable as deduction in the computation of the income in that previous year itself.

15. Applying the principle laid down in the aforesaid cases to the facts of the present case, we find that even though the applicant has come to know about the embezzlement having taken place in its Haldwani Depot some time in October, 1977. In the preliminary investigation made by Shri Har Gobind, an employee of the applicant, rough figure of Rs. 8,50,000 was arrived at as embezzled amount.

However, the exact embezzlement loss of Rs. 11,17,014 which the applicant is claiming as business loss during the assessment year 1978-79 came to be known to it only on 7-7-1979 when M/s. S.M. Gupta & Co. the Chartered Accountant who have been appointed to investigate and find out the exact amount of embezzlement had submitted the report. Thus in the instant case it would be treated that the applicant had discovered the loss of Rs. 11, 17,014 only on 7-7-1979 and not prior to it. In this view of the matter, we are of the considered opinion that the Tribunal was justified in holding that the aforesaid amount of embezzlement loss could not have been claimed as business loss during the assessment year 1978-79 as the aforesaid trading loss was not fall in that year. In view of the above conclusion we are not going into the question as to in which year it should have been allowed.

16. So far as the allowability of sum of Rs. 15,876 is concerned, we find that section 80VV of the Act deduction of expenditure incurred by the assessee in the previous year in respect of any proceeding before any Income Tax Officer or Appellate Tribunal or any court relating to the determination of any liability under the Act by way of tax, penalty or interest is allowed. However, the ceiling has been fixed at Rs. 5,000.

17. The Gujarat High Court in the case of Sabirashtra Cement & Chemical Industries Ltd. (supra) has held that the ceiling of Rs. 5,000 fixed under section 80VV of the Act relates to any one proceeding for the determination of any liability relating to a particular assessment year and not to the expenditures incurred in that previous year in respect of proceedings for more than one year.

18. With great respect we are unable to persuade ourselves to the view taken by the learned Judge of the Gujarat High Court in the aforesaid case. Section 80VV of the Act refers to the expenditure incurred in a previous year in respect of any proceedings. It does not refer to expenditure of a particular year and, therefore, all expenses which are incurred in the previous year in respect of any proceedings before the Income Tax Authority or the Appellate Tribunal or the court relating to the determination of any liability under the Act whether it is by way of tax, penalty or interest is covered by section 80VV of the Act and the ceiling of Rs. 5,000 would

be applicable.

19. In this view of the matter, we are of the considered opinion that the Tribunal was right in holding that the sum of Rs. 15,876 cannot be allowed as deduction.

20. In view of the foregoing discussions we answer both the questions of law referred to us in the affirmative, i.e., in favour of the revenue and against the assessee. However, there shall be no order as to costs.

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