Associated Banking Corporation Of ... vs Commissioner Of Income-Tax, Bombay-1 on 22 October, 1964

Equivalent citations: 1965 AIR 1188, 1965 SCR (1) 788, AIR 1965 SUPREME COURT 1188

Author: J.C. Shah

Bench: J.C. Shah, S.M. Sikri

PETITIONER:
ASSOCIATED BANKING CORPORATION OF INDIA LTD.

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX, BOMBAY-1.

DATE OF JUDGMENT:
22/10/1964

BENCH:
SHAH, J.C.
BENCH:
SHAH, J.C.
SUBBARAO, K.
SIKRI, S.M.

CITATION:
1965 AIR 1188 1965 SCR (1) 788

ACT:
Income Tax Act (11 of 1922), ss. 10(1) and 10(2) (xi) and (xv)--Scope of-Bad debts-If should be written off before claim is allowed Bank-Embezzlement by officer-If trading loss-Time of occurrence.

HEADNOTE:
The assessee was a Bank in liquidation. The official liquidator submitted a return for the assessment year 1948-49 and claimed as deductions : (i) under s. 10(2)(xi) of the Indian Income-tax Act, 1922, debts due to the Bank which had become irrecoverable, and (ii) under s. 10(2)(xv), certain amounts embezzled by one of its officers and which the bank had to pay to its constituents. The income-tax authorities and the Appellate Tribunal rejected the claim for allowance

of bad debts on the ground that the bad debts had not been written off in the books of account of the bank. They also rejected the claim for allowance of the embezzled amounts on the grounds that those amounts did not relate to the business of the bank and that, in any event, the loss, not having been ascertained in the year of account was not suffered in that year. When the matters were referred to the High Court, the Court asked for a report from the Tribunal as to : (i) whether any debts had actually become irrecoverable, and (ii) the year in which loss was suffered by the bank in consequence of the embezzlements. The Tribunal reported that debts aggregating to Rs. 15,00,000 at least, had become irrecoverable in the year of account, and that the defalcations by the bank's officer became known to the liquidator only after the ending of the year of account. After the receipt of the report, the High Court decided against the assessee holding that (i) the bad debts were not admissible deductions because they were never written off, and (ii) the loss to the bank on account of the defalcations occurred later than the year of account. The assesses appealed to the Supreme Court.

HELD : (i) The bank was entitled to claim Rs. 15,00,000 as bad debts in the year of account. [802 F-G]

Section 10(2) (xi) does not say that the income-tax officer cannot allow a bad or doubtful debt unless it is written off in the books of account; it merely states that he shall not allow any amount in excess of the amount actually written off as irrecoverable. If there is a reasonable explanation for the absence of an entry writing off the amount of a debt, such absence by itself is not a ground for denying to the officer, jurisdiction to estimate the amounts of debts which have become irrecoverable and to allow them as proper deductions in the computation of profits. The officer's power is restricted only in one direction, namely, that, when the assessee has posted an entry or entries in his books of account, the amount to be estimated as irrecoverable is not to exceed the amount actually written off by the assessee. That does not mean that an assessee who chooses not to post an entry is in a better position than one who has actually posted entries, because, he always runs the risk of the income-tax officer coming to the conclusion that the fact that he had hot chosen to post an entry is consistent with the finding that no part of the debt due to him has become irrecoverable. [794 E-F; 796 D-F; 797 G-H; 798 B-C]

Begg Dunlop and Co. Ltd. v. Commissioner of Excess Profits Tax, West Bengal. (1954) 25 I.T.R. 276, approved.

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(ii) The bank was not entitled to claim as a business loss or deduction the amount embezzled by the officer. L802 G]

Loss had been suffered by the bank as a result of the defalcations by its officer, but the withdrawal and misapplication of the funds came to the liquidator's

knowledge only after the accounting year, and so, the amount would not be a Permissible deduction under s. 10 (2)(xv) of the Act. Though the embezzlements took place in 1946, they were then unknown to the bank; and even after they became known to the liquidator, a trading loss could not be deemed to have resulted. A trading loss does not occur to a bank as soon as embezzlement takes place of its funds, whether or not the bank was aware of it. So long as there was a reasonable prospect of recovering the amounts, trading loss, in a commercial sense, would not be deemed to have resulted. L800 D; 801 G-H]

M. P. Venkatachalapathy Iyer v. Commissioner of Income-tax, Madras. (1951) 20 I.T.R. 363, approved.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 956 of 1963.

Appeals from the judgment and order dated April 22, 1960, of the Bombay High Court in Income-tax Reference No. 72 of' 1957.

A. V. Viswanatha Sastri, J. B. Dadachanji, O. C. Mathur and Ravinder Narain for the appellant.

C.K. Daphtary, Attorney-General, K. N. Rajagopala Sastri, R. H. Dhebar and R. N. Sachthey, for the respondent. The Judgment of the Court was delivered by Shah J. One M. C. Javeri was appointed Secretary to the Associated Banking Corporation of India Ltd., and under a power of attorney dated August 14, 1943 he was entrusted with powers, amongst others, to supervise, manage and conduct the business, to lend and make at such rate or rates or interest as he thought fit with or without security to any person, and to receive and give good discharge for repayment of any moneys so lent or advanced and all interest thereon and to borrow money upon the security of any securities, assets or property of the Bank and upon such terms as he thought fit for the benefit of the Bank. On March 5, 1945 Javeri was appointed a Director of the Bank. On April 21, 1947 by order of the High Court of Bombay the Bank was ordered to be compulsorily wound up and an Official Liquidator was appointed to liquidate the business of the Bank. On August 23, 1949 the liquidator submitted a return for the assessment year 1948-49 disclosing for the previous year ending June 30, 1947 business loss computed at Rs. 9,71,664, after debiting against the gross profits in the profit & loss account an amount exceeding Rs. 12,00,000 as debts which became irrecoverable. On February 26, 1953 the liquidator informed the Income-tax Officer that in the course of investigations it was found that the bad debts of the Bank including the amounts embezzled by the Secretary amounted to Rs. 48,50,952. It is common ground that entries adjusting the books of account and writing off the amounts claimed to be irrecoverable were not posted in the books of account either before the return was filed, or even till the proceeding reached the Tribunal. The departmental authorities and the Tribunal rejected the claim for allowance of bad debts on the ground that the bad debts were not written off in the books of account of the Bank as required by s. 10(2) (xi) of the Income-tax Act. The claim for allowance of Rs. 10,15,000 and Rs. 98,892 being the loss resulting from embezzlements by

the Secretary was rejected by the departmental authorities on the grounds, that the embezzlements did not relate to the business of the Bank and could not be treated as loss suffered by the Bank in the course of the business, and in any event the loss was not suffered in the year of account because it was not ascertained in that year. The Income-tax Appellate Tribunal agreed with the departmental authorities for the second of the two reasons.

The Tribunal referred under s. 66(1) of the Act, two ques- tions which were later modified by the High Court to read as follows :-

> (1) Whether on the facts and in the circumstances of the case the assessee is entitled to claim bad debts amounting to Rs. 38,35,654 or any lesser sum ?
>
> (2) Whether on the facts and in the circumstances of the case the assessee is entitled to claim two sums of Rs. 10,15,000 and Rs. 98,892 as a business loss or as a deduction under s. 10 (2) (xv) of the Income-

tax Act ?

The High Court agreed with the Tribunal that the claim for allowance of bad debts could not be sustained under s. 10(2)

(xi) as the debts had not been written off in the books of account of the Bank. But at the request of counsel for the liquidator they called upon the Tribunal to submit a supplementary statement on the question whether the debts had actually become irrecoverable during the year of account, and whether they were debts arising in the course of the business of the Bank. The High Court being of the opinion that the facts set out in the statement of case were not sufficient to enable them to record an answer on the second question, called upon the Tribunal to submit a supplementary statement about the powers entrusted to the Secretary, and the year in which loss was suffered by the Bank in consequence of embezzlements by the Secretary. The Tribunal reported that debts aggregating to "Rs. 15,00,000 at least" had become irrecoverable in the year 'of account, and that the Secretary had misused powers entrusted to him under the power of attorney (a copy of which was annexed to the report) after posting fictitious entries in the books of account, but the defalcations of Rs. 18,00,000 and Rs. 98,892 by the Secretary became known to the liquidator only after the year of account ending June 30, 1947. At the further hearing of the reference the High Court observed that they were bound by the finding recorded at the earlier hearing that bad debts were not admissible deductions because the debts were never written off in the books of account of the Bank, and that the time when loss resulting from embezzlement or defalcation by a servant or agent of the assessee occurs must be decided on the facts and circumstances of each case, and no general rule could be laid down in that behalf. In the view of the High Court loss of Rs. 10,15,000 did not occur when fictitious entries had been posted at the instance of the Secretary in the books of account of the Bank, but much later. The item of Rs. 98,892 was also not admissible as a business loss in the year of account for the same reason. With certificate granted by the High Court, this appeal is preferred by the liquidator of the Bank.

In considering whether writing off in the books of account is a condition precedent to the admissibility of allowance for bad debts, attention must first be directed to the terms of s. 10(2) (xi). The clause provides :

> " (2) Such profits or gains shall be computed after making the following allowances, namely
>
> (xi) When the assesse's accounts in respect of any part of his business, profe ssion or vocation are not kept on the cash basis, such sum, in respect of bad and doubtful debts, due to the assessee in respect of that part of his business, profession or vocation, and in the case of an assesee carrying on a banking or money-leading business, such sum in respect of loans made in the ordinary course of such business as the Income-tax Officer may estimate to be irrecoverable but not exceeding the amount actually written off as irrecoverable in the books of the assessee provided The assessee is a Banking Company it has in the ordinary course of its business granted loans and on the finding of the Tribunal, debts of the value of Rs. 15,00,000 are estimated to be irrecoverable in the year of account. Could this amount be allowed as a deduction in the computation of taxable income, when it is not written off as irrecoverable in the books of account ?

It is for the assessee to claim allowance in respect of debts which have become irrecoverable either in his return or in the statement accompanying the return. By his supplementary statement, the liquidator claimed that an amount of Rs. 48,50,952 should be treated as bad debts in the year of account. It was, therefore, clear that the claim was made by the liquidator for treating as bad debts the amounts which were claimed to be irrecoverable in the year of account. But it is contended that it is a condition of admissibility of allowance of bad debts that an entry or entries must be posted in the books of account writing off the debts as irrecoverable.

The Income-tax Officer is by the Act entrusted with the power to estimate as irrecoverable the debts which are claimed as bad or doubtful, but the power is subject to the restriction that the allowance will not exceed the amount actually written off as irrecoverable in the books of the assessee. If the assessee in his books of account has written off a certain amount as irrecoverable, the Income- tax Officer may not, even if his estimate exceeds the amount written off, allow the amount exceeding the amount actually written off. Can it be said that when the assessee has not posted entries in the books of account writing off any amount representing bad or doubtful debts, there is no restriction upon the power of the Income-tax Officer to allow a permissible deduction under the head "bad debt" ? On this question there is conflict of opinion in the High Courts. Chagla C.J.. in the judgment under appeal held that the view that writing off in the books of account was a condition precedent to the admissibility of a bad or doubtful debt was in conformity with the view which the Courts had consistently taken for many years in interpreting s. (10) (2) (xi). The learned Chief Justice observed : -

> "We are not aware of any single case where either the Department or the assessee ever contended in this Court that an assessee is entitled to a certain amount as a bad

> debt which amount has in fact not been written off in his books of account. But apart from the settled practice, there are decisions of this Court which have also proceeded on that view of the section."

The Calcutta High Court in Begg Dunlop and Co. Ltd. v. Commissioner of Excess Profits Tax, West Bengal(') has expressed an equally emphatic opinion to the contrary. Chakravartti C.J., who delivered the judgment of the Court observed that by the last clause of S. 10 (2) (xi) the Income-tax Officer is given a discretion to allow such amount as he himself may estimate to be irrecoverable, a maximum limit or rather a ceiling is at the same time set, beyond or higher than which he may not go. It is necessary in resolving the conflict to examine carefully the pro- visions relating to the allowance of bad debts in computing the profits or gains of a business carried on in the year of account.

Under the Income-tax Act, 1922 as originally enacted there was no provision in sub-s. (2) of s. 10 for allowance of bad or doubtful debts in the computation of profits or gains of a business carried on by the assessee. But bad or doubtful debts could properly be allowed as necessary business deductions under s. 10(1). In Commissioner of Income-tax, Central Provinces and Berar v. Sir S. M. Chitnavis(2) the Judicial Committee held that a debt which has become a bad debt during the year of account can properly be treated as a loss and deducted from profits. The Judicial Committee observed at p. 296 :

> "Although the Act nowhere in terms authorizes the deduction of bad debts of a business, such a deduction is necessarily allowable. What are 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, otherwise you would not arrive at the true profits and gains. But the losses must be losses incurred in that year. You may not, when setting out to ascertain the profits and gains of one year, deduct a loss which had in fact been incurred before the commencement of that year. If you did, you would not arrive at the true profits and gains of the year..... It thus follows that a debt, which had in fact become a bad debt before the commencement of a particular year, could not properly be deducted in ascertaining the profits of that year because the loss had not been sustained in that year."

(1)(1954) 25 I.T.R. 276, 284.

(2) (1932) L.R. 59 I.A. 290.

The Judicial Committee however, did not regard the entries writing off the debts as irrecoverable as a condition precedent to admissibility of the claim for allowance. It is true that in any recognised system of accounting, the claim made that a debt has become barred, where the accounts are maintained according to the commercial method of accounting, an entry or entries-if not in the account of the debtor-at some appropriate place or places in the books would be posted recording that in the view of the assessee the debt had become irrecoverable, and without such an entry or

entries it would, in normal cases, be difficult to make up a profit and loss account of the year. But the entries need not be in respect of each individual debt regarded by the assessee as bad or doubtful : a composite entry relating to the debts regarded as bad or doubtful may suffice. After the judgment of the Privy Council in Chitnavis's case(1) the Legislature has inserted by s. 11 of the Indian Income-tax (Amendment) Act 7 of 1939 cl. (xi) in sub-s. (2) of S. 10, which expressly deals with the admissibility of bad or doubtful debts as allowances in the computation of profits and gains. In cases governed by the amended Act undoubtedly the question of admissibility of bad or doubtful debt as allowance must be adjudged in the light of the express provision of the statute, and not on general considerations of commercial accountancy, or business necessity. It is pertinent to bear in mind the language used by the Legislature : the clause does not say that the Income-tax Officer cannot allow a bad or doubtful debt, unless it is written off in the books of account; it merely states that the Income-tax Officer shall not allow any amount in excess of the amount actually written off as irrecoverable. It is, therefore, for the Income-tax Officer to ascertain what debts have become bad or doubtful in the year of account. This would require an investigation by the Income-tax Officer whether any debts claimed to be bad or doubtful have become irrecoverable, and for what' amount. If the assessee has posted a composite entry debts exceeding in value the amount entered may not be allowed as irrecoverable by the assessing authority. If he has posted entries in respect of individual debts, the restriction on the power of the assessing authority must operate in respect of each such debt written off. This much is however, clear that in respect of any individual debt, writing off in the books of account is not a condition of its allowance in the computation of profits.

(1) (1932) L.R. 59 I.A. 290.

Our attention has not been invited to any decision (except the judgment under appeal) in which it has been ruled that the power of the Income-tax Officer to allow deductions of debts which are regarded as bad or irrecoverable, can only be exercised when there is an entry posted in the books of account of the assessee that a certain amount has become irrecoverable. Two cases to which Chagla C.J., referred in the course of his judgment as illustrative of a settled practice of the Bombay High Court do not support that view. In Commissioner of Income-tax and Excess Profits Tax, Central Bombay v. Jwala Prasad Tiwari(1) the assessee had claimed in the course of assessment of his profits and gains that certain debts had become doubtful of recovery in the year of account. The assessee had in fact debited the two sums in the profit and loss account and credited them under the head "doubtful debts" in the suspense account. The Income-tax authorities held that as the individual accounts of the debtors in the books of the assessee had not been credited with the amounts, the debts had not been written off as required by the section. The High Court held that the amount of the debts had in fact been written off in the assessee's books. The Court held in that case that S. 10(2)(xi) did not demand that individual ledger entries writing off debts claimed to be bad or doubtful should be posted. The Court was not called upon in that case to consider whether absence of an entry writing off the amount deprived the Incometax Officer of his power to allow bad or doubtful debts to the extent estimated by the Officer to be irrecoverable. This case does not lay down that to the admissibility of a bad debt as an allowance under s. 10 (2) (xi) writing off of the debt is a condition precedent.

The other case is Karamsey Govindji, Bombay v. Commis- sioner of Income-tax, Bombay City(1). In that case the assessee had advanced in 1945 and 1946 without security certain loans to a film producer and had written off the loans is bad debts in November 1947. On the evidence in the case the Income-tax authorities held that the loans had not become irrecoverable in 1947, and the High Court of Bombay in a reference under s. 66(2) held that the finding of the Income-tax authoritics that the debts had not become bad in 1947 could -not be regarded as not justified on the evidence. The case evidently did not directly deal with the writing off a debt in the books of account of the assesee being a condition precedent to allowance under s. 10 (2)

(xi).

(1) (1953) 24 I.T.R. 537.

(2) (1957) 31 I.T.R. 953.

It was conceded by Counsel for the revenue that the allowance of a bad debt may be granted even if the entry writing off the amount as irrecoverable is posted during the course of the hearing before the Income-tax office. The Department therefore submit& that though an entry writing off the amount of a debt claimed to be bad or doubtful is a condition precedent to the allowance, the entry need not be posted before the return is submitted, or even before the hearing of the assessment proceeding by the Income-tax Officer is concluded. The Legislature has not made an express provision that an entry in the books of account writing off a debt as irrecoverable is a condition of its admissibility as an allowance under s. 10(2) (xi), and the language used in the clause examined in the light of the scheme of the Act does not compel such an interpretation. On the power of the Income-tax Officer-and therefore all superior authorities-undoubtedly a restriction is placed. It is not open to the Income-tax Officer to estimate the debts as irrecoverable in excess of the amount which the tax-payer regards as irrecoverable. But if for some adequate reason the tax-payer has not posted an entry and there is a reasonable explanation for that default, absence of entry writing off the amount of a debt which has become bad or doubtful which may be posted at any time in the appropriate place in the books of account before the proceedings are concluded before the authority is by itself not a ground for denying to the Income-tax Officer jurisdiction to estimate the debts as irrecoverable, and to allow it as proper deduction in the computation of profits. It might at first sight appear somewhat paradoxical that if the assessee has actually written off as irrecoverable in his books of account individual debts or a collective sum as debts irrecoverable, the power of the Income-tax Officer is restricted and the amount he may allow as irrecoverable debts cannot exceed the amount actually written off : where the amount is not written off in the books of account, the Income-tax Officer's jurisdiction is at large and he may allow any amount as irrecoverable. But the provisions of the statute should not be construed in a narrow spirit of technicality. It may be noticed that cl. (xi) does not restrict the power to estimate bad debts : it limits the 'power to grant allowance under the head of bad and doubtful debts, any amount in excess of the amount actually written off by the assessee in his books of account. It would therefore be reasonable to hold that if after estimating the bad debts, there is no express statutory restraint on the exercise of the power to grant allowance, no implication of a restraint on the exercise of the power may be evolved, unless such implication is on the scheme of the Act intended. And in the scheme of the Act we find no such res-

traint imperatively intended, for it cannot be assumed in all cases that absence of an entry writing off the amount of bad debts necessarily implies that no debts have become irrecoverable in the year of account.

In our view Chakravartti C.J., was right when he observed in Begg Dunlop and Co. Ltd.'s case(1) at p. 284 :

> "I am entirely unable to hold that Section 10 (2) (xi) of the Income-tax Act imperatively requires that in order that any amount may be allowed as irrecoverable in any particular year, such amount or a larger amount must be "actually written off as irrecoverable in the books of the assessee". The relevant language of the Section, if I may recall its terms, is "such sum as the Income-tax Officer may estimate to be irrecoverable but not exceeding the amount actually written off". What that language means, to my mind, clearly is that while the Income-tax Officer is given a discretion to allow such amount as he himself may estimate to be irrecoverable, a maximum limit or rather a ceiling is at the same time set, beyond or higher than which he may not go. It does not seem to be even a requirement of the Section that a debt which the Income-

tax Officer may treat as irrecoverable must be written off at all. All that the Section seems to mean, in my view, is that if a debt has actually been written off by the assessee in his books as irrecoverable in a particular year, then the Income-tax Officer, in making an allowance in respect of bad debts for that year, must not allow anything in excess of the amount which the assessee has himself written off."

But this does not mean that an assessee who chooses not to post an entry in the books of account about bad or doubtful debts places himself in a better position than an assessee who has actually posted entries writing off amounts as irrecoverable in his books of account. On the materials' placed before him, it is always open to the Income-tax Officer to come to the conclusion that the fact that the assessee has not chosen to post an entry is consistent with the circumstance that no part of the debt due to him in the year of account has become bad or doubtful and therefore irrecoverable, and on that account to disallow the (1) (1954) 25 I.T.R. 276.

claim which may be made at the hearing that some or all debts had become bad or doubtful. Even when no entry has been posted in the books of account, the question is one of power to be exercised on the facts and circumstances on the record by the Income-tax Officer to allow deductions in the computation of profits and gains. If the Income-tax Officer estimates certain debts to be irrecoverable, it would be within his power under S. 10(2)(xi) to allow the same in computing the profits. That power is only restricted in one direction, namely, that where the assess has posted an entry or entries in the books of account the amount to be estimated as irrecoverable is not to exceed the amount actually written off as irrecoverable by the assessee. Under the Income-tax Act 43 of 1961, by s. 36 (1) (vi) the amount of any debt or part thereof which is established to have become a bad debt in the previous year has to be allowed in computing the income under S. 28 : but that allowance is subject to sub ss. (2) which provides insofar as it is material that "in making any

deduction for a bad debt or a part thereof the following provisions shall apply:

(i) no such deduction shall be allowed unless such debt or part thereof

(a) has been taken into account in computing the income of the assessee of that previous year or of an earlier previous year or represents money lent in the ordinary course of the business of banking or money lending which is carried on by the assessee, and

(b) has been written off as irrecoverable in the accounts of the assessee for that previous year.

(ii) . . . .
(iii) . . . .
(iv) . . . .

It is manifest that the material clause has been wholly redrafted and the Legislature has expressed its intention clearly.

In dealing with the second question some more facts may be stated. The Secretary M.C. Javeri was invested with exten- sive powers of management and the Directors of the Bank appeared to have remained supine. The Secretary helped himself to large amounts out of the assets of the Bank. On November 1, 1946, the Bank entered into an underwriting agreement with the Government of Bhopal underwriting a loan of the value of Rs. 2 crores issued by the Government of Bhopal. On December 3, 1946 V. R. Ranade and Sons applied to the Bank for purchasing Bhopal Government loan and remitted in full the amount of Rs. 15 lakhs to the Bank. This amount was in the first instance credited in the sundry deposit account, but at the instance of the Secretary the entry in the sundry deposit account was reversed and the sum of Rs. 15 lakhs was broken up into smaller amounts and credited in the account books in different names. V. R. Ranade and Sons pressed for delivery of the loan certificates and the Secretary delivered to them a forged allotment letter for certificates of the value of Rs. 15 lakhs purported to have been received from the Bank of Bhopal Ltd. After the Bank was ordered to be wound up, V. R. Ranade and Sons made a claim on December 5, 1947 for preferential payment of Rs. 15 lakhs out of the assets of the Bank. On February 28. 1949 the liquidator submitted to an order that V. R. Ranade and Sons, be paid Rs. 8,80,000 as preferential creditors within one month of the date of the order. This amount was, under the direction of the Court actually paid some time later by the Official Liquidator to V. R. Ranade and Sons.

Early in 1947 the Bank of Bhopal had instructed their broker Shantilal L. Thar to purchase on its behalf Bhopal Government loan of the face value of Rs. 3,00,000 and Thar contracted to purchase the Bhopal Government loan from the assessee Bank. On February 11, 1947 an amount of Rs. 3,00,000 was paid to the Bank, but no letter of allotment was issued. Loancertificates were never delivered to the Bank of Bhopal Ltd. and Rs. 3,00,000 paid to the assessee Bank were transferred to the account of Haroon Haji Abdul Satar of Bantwa in the Jetpur Branch of the Bank showing as if that person had sold bonds of the value of Rs. 3,00,000. This amount was withdrawn by the Secretary and misappropriated. The Bank of Bhopal Ltd. filed a suit against the assessee Bank in the

Bombay High Court for an order for delivery of the Bhopal Government bonds and in the alternative for a decree for Rs. 3,00,000. A settlement was arrived at in the suit and the assessee Bank agreed to pay to the Bank of Bhopal Ltd. Rs. 1,35,000 in full and final settlement. A consent decree was passed on September 20, 1951, and was satisfied by the liquidator sometime thereafter.

There is another amount of Rs. 98,892 which it was claim- ed by the liquidator was embezzled by the Secretary. At the hearing counsel for the liquidator has given up this part of the claim and it is unnecessary for the purpose of this appeal to set out the details in respect of this amount. The claim under the second question must therefore be restricted to Rs. 10,15,000. The Income-tax authorities disallowed this claim. In their view it was not suffered by the Bank in the course of its business and therefore could not be treated as a loss by the Bank, and in any event the loss was not suffered in the year of account because it was ascertained in the year 1949 or later and could be taken into account in the assessment relating to that period alone. The embezzlements undoubtedly took place in the year of account ending June 30, 1947. The Secretary misused the powers con- ferred upon him under the power of attorney and withdrew Rs. 18,00,000 by posting entries in the names of persons who did not exist, or who had no dealings with the Bank. But until an investigation of the dealings of the Bank was made, the embezzlements could not come to the knowledge of the Directors of the Bank or the liquidator. The Bank had to pay Rs. 10,15,000 to its constituents to satisfy the liability arising out of the Secretary's dealings with the funds of the Bank. Loss has, therefore been suffered by the Bank as a result of the withdrawals made by the Secretary, and the only question relevant for the purpose of the appeal is whether the loss occurred in the year of account ending June 30, 1947.

It was urged by counsel for the liquidator that loss occurs to a Banking institution when funds are withdrawn or misapplied by an agent or servant and misappropriated, and therefore the withdrawals or misapplication by the Secretary having taken place in the year of account, the loss was admissible as an allowance in the year of account against the profits of that year. We are unable to agree with that contention. A claim to deduct an amount lost to the assessee because of embezzlement by his agent does not fall within the description of any allowance under cls. (i) to

(xv) or sub-s. (2) : to be admissible it must, if at all, fall within sub-s. (1). This position was conceded in the High Court, in our judgment properly, by counsel for the Bank. The problem as to when loss resulting from misapplication of funds by an agent occurs must be viewed like many other problems arising under the Income-tax Act on a conspectus of all the facts and circumstances in the context of principles of commercial trading. 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 a commercial sense no real loss has occurred. again it cannot be said that in all cases when the principal obtains knowledge of the embezzlement the 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, oss may not in a commercial sense be said to have resulted. In M. P. Venkatachalapathy Iyer and Anr. v. Commissioner of Income-tax, Madras(1) it was held by the Madras High Court that profits and gains

of a business must be ascertained by ordinary commercial principles of trading, and a working rule is that until the loss resulting from misappropriation "becomes actual and certain" there can be no accrual of loss. In Venkatachalapathy's case(1) the assessee employed a clerk who wrote books of account of a business, acted as salesman, received and disbursed cash in the absence of the managing partner and collected bills. By manipulation of accounts the clerk misappropriated large amounts at diverse times. In May 1941 it was discovered that the clerk had embezzled Rs. 36,298-3-6 during the period between October 17, 1939 and October 24, 1940. In June 1941 a criminal prosecution was launched against the clerk and about the same time a civil suit for recovery of the amount was also instituted. The claim was compromised in August 1941 and the clerk paid the assessee Rs. 16,250 in full settlement of his liability. The assessee claimed in the assessment year 1942-43 (accounting year ending with April 12, 1942) a deduction Rs. 21,372 being the difference of the sum embezzled by the clerk and the amount recovered from him, and it was rightly held that the sum could be treated as a loss in the accounting period deductible from the profits of that period.

In the case under discussion the embezzlements of funds of the Bank took place in 1946. They were then unknown to the Bank. Even after the embezzlements came to the knowledge of the Liquidator, trading loss cannot be deemed to have resulted. We are unable to countenance the proposition that irrespective of other considerations, as soon as the embezzlement takes place of the employer's funds, whether the employer is aware or not of the embezzlement, there results a trading loss. So long as there was a reasonable prospect of recovering the amounts embezzled by the Bank, trading loss in a commercial sense may not be deemed to have resulted.

(1) (1951) 20 I.T.R. 363.

There is no evidence that in the year of account Javeri the Secretary could not have met the obligations either wholly or partially if he was called upon to refund the amounts embezzled. The embezzled amounts did not come to the knowledge of the liquidator even from the report dated April 1, 1947, of Messrs. M. N. Raiji & Co. who were appointed auditors to investigate the affairs of the Bank by the Registrar of the Joint Stock Companies. The embezzlements came to the knowledge of the liquidator very much later, only when the liquidator made demands from the various persons in whose names the amounts were debited in the books of account of the Bank, and the demands were' made upon the liquidator for preferential payment by V. R. Ranade and Sons and by the Bank of Bhopal Ltd. for repayment of the amounts or in the alternative for delivery of the stock purchased by them through the Bank.

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). The appeal will therefore be partially allowed. The

answer to the first question recorded by the High Court will be discharged, and it will be recorded that the Bank is entitled to claim under s. 10 (2)(xi) Rs. 1 5,00,000 as bad debts in the year of account ending June 30, 1947. On the second question, the answer will be in the negative. There will be no order as to costs in this appeal.

Appeal partly allowed.