

BOMBAY HIGH COURT

Lord's Dairy Farm Ltd

Vs.

Commissioner of Income-tax

Income-tax Ref. No. 33 of 1954

(Chagla, C.J. and Tendolkar, J.)

17.02.1955

JUDGMENT

Chagla, C.J.

1. The question that arises in this reference is whether the assessee who lost a certain amount as a result of the defalcation of its employee is entitled to claim that amount as a permissible deduction.

2. Now, the facts are that one Chhaganbhai was a cashier of the assessee company and one of the duties entrusted to him was to go to the bank in which the moneys of the assessee company were kept and withdraw the moneys and bring the moneys to the office of the company for making payments from time to time in cash. In the course of discharging his duties Chhaganbhai defalcated various amounts aggregating to Rs. 53,000. These defalcations took place between May 1946 and April 1947 and when these defalcations were discovered, the company took from Chhaganbhai a promissory note for Rs. 21,000. This promissory note was taken on 28-4-1947. A criminal prosecution was launched against Chhaganbhai and certain amount was spent in connection with this litigation, and in the assessment year 1948-49 the company claimed a sum of Rs. 34,053 as a permissible deduction. This Rs. 34,053 was made up of the balance of Rs. 32,000 left over after the promissory note was given by Chhaganbhai and a sum of Rs. 2,053 as legal expenses. In this assessment we are concerned with the sum of Rs. 32,000.

3. The department's contention was that the loss caused by embezzlement of an employee was under no circumstances a permissible deduction under the Income-tax Act. The Tribunal did not accept that view. The view of the Tribunal was that if there was embezzlement and a loss had been caused to the business, it was a deduction which could be claimed under Section 10(2)(xv). But the Tribunal also took the view that inasmuch as the method of accounting of the company was the mercantile method, the assessee company was only entitled to claim deduction of Rs.

13,800 which was the amount actually embezzled in the accounting year of the assessee company which commenced on 1-4-1947, and ended on 31-3-1948. The question that now arises is whether the assessee is entitled to claim as a permissible deduction only the sum of Rs. 13,800 or the full sum of Rs. 32,000 which was lost to the assessee company as a result of its employee's defalcations.

4. Now, Mr. Pradhan has first contended that this case would fall under Section 10(2)(xi) and that he would be entitled to claim the amount when the bad debt was written off, and, according to him, as he wrote off this debt as a bad debt in the accounting year, he must be entitled to claim the whole of the amount of Rs. 32,000 as a deduction. In our opinion it is impossible to take the view that a loss caused by defalcations of a servant is a bad debt. Before a debt can be claimed as a bad debt, it must be a debt in law. At some time it must be an amount due to the assessee and at some time the debt must form part of the assets of the assessee. It is only when that amount becomes irrecoverable that it becomes a bad debt and can be claimed as a deduction. It is difficult to understand how any amount was due by the employee to the assessee company which amount became irrecoverable, and therefore the subject-matter of a deduction under Section 10(2)(xi).

5. Then it is suggested that even if the case falls under Section 10(2)(xv), the relevant time for claiming the deduction is not when the loss occurred but when the loss was written off. In the first place, in our opinion, the case cannot fall under Section 10(2)(xv). Section 10(2)(xv) deals with any expenditure laid out or expended wholly or exclusively for the purpose of business, profession or vocation. Therefore the deduction contemplated by Section 10(2)(xv) must arise out of a voluntary act on the part of the assessee. He must spend an amount for the purpose of the business, profession or vocation and then claim that amount as having been spent wholly and exclusively for the purpose of business, profession or vocation. When the money is lost to the business as a result of embezzlement, there is no expenditure on the part of the employer. It is true that there is loss to the business, but that loss is entirely involuntary, and although the loss may arise in the course of the business or be incidental to the business, it cannot be said that the amount represented by the loss was an amount spent wholly and exclusively for the purpose of the business, profession or vocation. Therefore we must differ from the view taken by the Tribunal that a case of embezzlement falls under Section 10(2)(xv). But does it then follow that an assessee who suffers a loss in his business due to an embezzlement by his employee can get no relief, because the various cases of deductions dealt with under Section 10 do not cover such a case? The answer is very simple. As has been often pointed out, the object of Section 10 is to ascertain the true profits and gains of an assessee. The profits must be ascertained from a commercial point of view. The Sub-Section (2) of Section 10 deals with certain specific cases of permissible deductions. But even apart from these permissible deductions, if there is any loss which from the commercial point of view can be considered to be a trading loss, then that loss must be deducted before the true profits can be ascertained. If therefore we take the view that a loss caused to a businessman by reason of the defalcations committed by his employee is a

trading loss, then he would be entitled to deduct that loss although such a loss may not fall within the ambit of any of the deductions mentioned in Sub-Section (2) of Section 10.

6. Now, in order to decide whether we should permit this loss as a trading loss, we must look at one or two facts which have been established. It was necessary for the business of the assessee company to employ Chhaganbhai as its cashier. It was also necessary for the business of the assessee company to delegate to the cashier certain duties. It was necessary for the cashier to go to the bank and bring money from the bank so that the money could be kept in the office of the assessee company, because the moneys had to be spent for different purposes of the company. Therefore it is clear that Chhaganbhai embezzled these moneys in the course of his duties as an employee and that the loss was caused in the course of the business of the assessee and the loss was incidental to that business. If it is found that it is not possible for an assessee to carry on its business without appointing employees and delegating to those employees certain duties, and if loss is caused by these employees embezzling moneys in the course of their duties, it seems to us clear that that is a loss inseparable from the ordinary business activities of the assessee and must be attributed to trading loss.

7. Now, the same view of the law has been taken by the Madras High Court in - '*Venkata-chalapathy Iyer and S.K. Sundaramanier and Co. v. Commr. of Inc.-tax*'", and in that judgment Satyanarayan Rao and Raghava Rao JJ. have reviewed the English authorities and have also considered the English practice with regard to claiming embezzlement as a trading loss. In that judgment reference is made to the well-known case of - '*Curtis v. J. and G. Oldfield Ltd.*', There Rowlatt J. drew the line between a case where the loss caused by embezzlement can be successfully claimed by the assessee and where it cannot be so done, and it is there laid down that if the money of the assessee has reached the till and the embezzlement took place after that, then the loss caused by the embezzlement cannot be claimed as a trading loss, but if the money is intercepted before it reaches the till, then the loss can be properly claimed. Rowlatt J. also puts it this way that if the receipt by the assessee is made away with 'dehors' the trade, then the loss of that receipt cannot be claimed as a permissible deduction.

8. The Advocate General also wants us to apply this test to the facts of this case and he says that the moneys had reached the till of the assessee company because they were lying in the bank to the credit of the assessee company, and the loss took place after the moneys had got home to the assessee. In our opinion that is not the correct view to take of the facts found in this case. In this case the till was the office of the assessee company. Moneys were being brought by the cashier to be kept in the till at the office for the purpose of the business of the assessee, and the moneys were intercepted before, to use the expression used by Rowlatt, J. they got home to the assessee, because they could only have got home provided they had reached the till of the business. We would like to point out that there may be cases where the rather artificial line drawn by Rowlatt J. may not do justice to the assessee. As rightly pointed out by the Advocate General, if Rowlatt J.'s definition was applied where a businessman asks his employee to go and collect the bills of his

customers and he embezzles the money, he would satisfy the definition laid down by Rowlatt J., but in the converse case where the assessee were to ask his employee to go and pay his creditors and the employees were to embezzle that money, the case may not come within the ratio of Rowlatt J.'s decision. Therefore, it seems to us that the better and more satisfactory test is the test which is pointed out at page 240 of the judgment and which finds place in Snelling's Dictionary of Income-tax and Super-tax Practice, and the test is :

"If a loss by embezzlement can be said to be necessarily incurred in carrying on the trade, it is allowable as a deduction from profits. In the ordinary case, it springs directly from the necessity of deputising certain duties to an employee, and should therefore be allowed."

Therefore if in any case it is found that it was necessary to

¹ AIR 1952 Mad 238

² (1925) 9 Tax Cas 319

deputise certain duties to an employee and it was also found that the loss sprang directly from the necessity of doing so, then the loss would be a trading loss and the assessee would be entitled to claim that amount as a proper deduction.

9. If we were to apply that test to this case, then there can be no doubt that it was necessary for the assessee company to employ the cashier, it was necessary for the assessee company to deputise the duty of getting the money from the bank to the cashier and that the loss directly arose from the necessity of deputizing these duties to the cashier. Therefore, in our opinion, on the facts of this case the loss caused by the embezzlement is a trading loss and the assessee is entitled to claim deduction.

10. Perhaps it may be necessary in passing to refer to another decision on which the Advocate General relies, and that is a decision of the Patna High Court reported in - '*Mulchand Hiralal v. Commr. of Inc.-tax, B. and O³.*', That was a case of theft and the Patna High Court refused to permit the amount lost by theft as a permissible allowance. They considered the earlier case of the Patna High Court in - '*Jagarnath Therani v. Commissioner of Income-tax⁴*', It was a case of embezzlement and they came to the conclusion that that decision was erroneous and they did not find any principle which would permit them to distinguish between a case of theft and a case of embezzlement. It must be borne in mind that this decision proceeds on the basis that the loss due to the theft in this case was claimed under Section 10(2)(xv), and with respect, we entirely agree with the Patna High Court that if a claim be made under Section 10(2)(xv), whether the loss is claimed by theft or embezzlement, a deduction is not permissible as falling under the provisions of that sub-clause.

11. The next question that we have to consider is whether the whole of this amount can be permitted as an allowance to the assessee. If we are right in the view that we have taken that what is claimed as a trading loss is not a permissible deduction under Section 10(2)(xv), then the material date obviously is not the date when the embezzlement took place but the material date is when the loss is caused. So long as there is any possibility of the money being recovered from

the employee who has embezzled the moeny, there is no loss to the assesses. It is only when it is clear that the money cannot be recovered that the loss is caused. In this case it is in evidence that the assessee wrote off this amount of Rs. 32,000 in the year of account. The Advocate General says that there is no finding that this amount became irrecoverable in this year. When a business man writes off an amount, there is 'prima facie' evidence that that amount is irrecoverable. Undoubtedly the department can rebut the 'prima facie' inference by drawing attention to circumstances or by leading some evidence to suggest that the position taken up by the assessee was not correct. In this case there is no evidence whatsoever on the record except the fact that the assessee wrote off this amount in the year of account. In the absence of any evidence we are entitled to presume that the amount became irrecoverable when the assessee wrote it off in its books of account. Therefore, in our opinion, not only is the assessee entitled to claim this amount of Rs. 32,000 as a trading loss but it is also entitled to claim this amount in the assessment year, viz., 1948-49.

12. We will, therefore, reframe the question in the following way :

³ AIR 1938 Pat 159

⁴ AIR 1925 Pat 408

"Whether the assessee was entitled to claim a sum of Rs. 32,000 as a permissible allowance under the circumstances of the case?"

and answer it in affirmative. The Commissioner to pay the costs.

Answer in affirmative.