

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'E': NEW DELHI**

**BEFORE SHRI CHALLA NAGENDRA PRASAD, JUDICIAL MEMBER
AND
SHRI AVDHESH KUMAR MISHRA, ACCOUNTANT MEMBER**

ITA No.1717/Del/2019, A.Y. 2003-04

M/s. National Housing Bank Core-5A, 4 th Floor, India Habitate Centre, Lodhi Road, New Delhi-110003 PAN: AABCN2600H	Vs.	Assistant Commissioner of Income Tax, Circle-17(2), New Delhi
(Appellant)		(Respondent)

ITA No.1158/Del/2023, A.Y. 2003-04

M/s. National Housing Bank Core-5A, India Habitate Centre, Lodhi Road New Delhi-110003 PAN: AABCN2600H	Vs.	Additional Commissioner of Income Tax, Special Range 6, New Delhi
(Appellant)		(Respondent)

Appellant by	Sh. Sumant Chadha, CA
Respondent by	Ms. Monika Dhama, CIT DR

Date of Hearing	02/04/2025
Date of Pronouncement	25/06/2025

ORDER

PER AVDHESH KUMAR MISHRA, AM

Common facts arise in the above captioned appeals of the assessee; therefore, these appeals were heard together and are being disposed off by this common order. At the outset, it is worth mentioning that this is third round of appeal before the Tribunal. On earlier two occasions, the Tribunal remanded

the matter back (both quantum and penalty appeals) to the AO with certain directions. The issues in disputes in both appeals remain same every time.

2. The appeal ITA No. 1717. Del.2019 for Assessment Year (AY) 2003-04 filed by the assessee is directed against order dated 31.12.2018 of the Commissioner of Income Tax (Appeals)-06, New Delhi and second appeal ITA No.1158/Del/2023 for AY 2003-04 filed by the assessee is directed against order dated 23.02.2023 of the CIT(A), NFAC, New Delhi.

3. Following grounds have been raised in appeal ITA No. 1717. Del.2019:

“Ground No: 1

a) That the Ld. CIT(Appeal), New Delhi has erred both on law as well as on facts, while affirming the disallowance of the loss on account of loss on security transactions amounting to ₹150,45,32,696/ on the alleged contention that the loss is of capital loss without properly appreciating the explanations and documents filed by the appellant and the fact that the securities under consideration were held for trading as a part of the appellant's business activity and not as investments.

b) That the Ld. CIT(Appeal), New Delhi has erred both on law as well as on facts, while affirming that the loss claimed did not pertain to the assessment year 2003-04.

That the appellant craves the leave to add, modify, amend or delete any of the grounds of appeal at the time of hearing and all the above grounds are without prejudice to each other.”

3.1 The sole ground has been raised in appeal ITA No. 1158. Del.2023:

“Penalty u/s 271(1)(c) of the Income Tax Act, 1961 for the addition made on account of disallowance of business expenditure/loss crystalized during the relevant assessment year w.r.t. Securities transaction of 1991-92.”

ITA No.1717/Del/2019:

4. The relevant facts giving rise to these appeals are that the assessee, a banking and financial institution established under the National Housing Bank Act, 1987. The assessee provides refinance to various banks and housing finance companies and derives interest on such loans and advances. It also earns revenue from investment in bonds, mutual funds, shares and securities. The assessee claimed an 'Expenditure on account of loss on security transactions of FY 1991-92 amounting to Rs.1,50,45,32,696/-' in its Profit & Loss Account. This loss was generated from transactions in FY 1991-92 wherein the assessee had paid Rs.707.56 Crores to State Bank of India for entering into back-to-back transactions for purchase of certain securities for an aggregate amount of Rs.707.56 Crores during FY 1991-92. However, the Cheques aggregating to Rs.707.56 Crores issued by the assessee in favour of State Bank of India (SBI) for securities transactions were credited to the account of Share Broker, Shri Harshad Mehta, by SBI after collecting proceeds of the cheques. Since the assessee did not receive any securities against the sum Rs.707.56 Crores; therefore, it insisted for refund of the same.

4.1 The SBI refunded the sum Rs.707.56 Crores to the assessee on 13.06.1992 under protest and filed a case against Harshad Mehta for wrongful credit. The SBI also filed a suit No.35 of 1995 against the assessee in the Special Court claiming the amount of Rs.707.56 Crores and justifying its

action based on certain market practices and alleging that the assessee had entered into such transactions with Harshad Mehta. The Hon'ble Special Court, Mumbai had given decision in favour of the SBI. Aggrieved, the assessee filed a petition before the Hon'ble Supreme Court against the order dated 04.02.2002 of the Special Court, Mumbai. The Hon'ble Supreme Court, vide its order dated 29.07.2002 directed to settle the issue/dispute through the Ministry of Finance. Thereafter, Ministry of Finance worked out a proposal to resolve the dispute; Both SBI and the assessee will bear the loss of Rs.707.56 Crores @ 50% each. Accordingly, a settlement was drawn in pursuance thereof. The said settlement became final by the order dated 30.10.2002 of the Hon'ble Supreme Court. Consequentially, the assessee was required to pay Rs.353.78 Crores. The part of the settlement amount was adjusted out of the sum of Rs.131.20 Crores given to State Bank of Saurashtra on 13.07.1998 and interest @ 12% per annum thereon and remaining sum of Rs.150.45 Crores was paid to the SBI vide a Cheque No.209919 dated 17.12.2002. The said sum Rs.150.45 Crores was claimed as loss/expenditure in the relevant year. However, the said claim was not allowed by the AO on the reasoning that the nature of the said loss (whether the said loss was incurred due to loss of investment or stock-in-trade) was not established by the assessee. Further, the AO also held that the said loss had been incurred on account of illegal activities carried out by the assessee to provide benefit to Late Mr. Harshad

Mehta, etc. The AO also held that the said loss could not be allowed as business loss because the same had neither crystalized nor discovered during the relevant year. Subsequently, the AO, on addition of Rs.150.45 Crores, levied penalty under section 271(1)(c) of the Act.

4.2 Aggrieved with the third round of assessment and penalty orders, the assessee appealed before the CIT(A), who dismissed both appeals. The quantum appeal was dismissed by the Ld. CIT(A) on the reasoning that the loss of Rs.150.45 Crores was capital loss as the same had arisen from the purchases of securities as capital assets. The Ld. CIT(A) further held that the said loss was not a business loss. Alternatively, the Ld. CIT(A) also held that the said loss could not be allowed in the relevant year as the same had neither crystalized nor discovered during the relevant year. Consequentially, the penalty appeal was also dismissed.

5. The Ld. AR, emphasizing various paras of Janaki Raman Committee interim reports and final report, contended that the employees of the assessee were involved in breaking the rules and regulations and committing frauds entailing losses to the assessee. To buttress the said contention, the Ld. AR placed emphasis on the following part of Janaki Raman Committee's sixth interim report:

"22. (a) A second key element in the perpetration of the irregularities was the complete breakdown of internal control in a number of banks.

(b) It is an essential element of internal control in securities transactions that there should be a clear segregation between the front office and the back office. The front office consists of the dealers who actually negotiate the deals. The back office has the responsibility to complete the paper work, receive and effect delivery of the securities, and receive the proceeds and authorise payment. Thirdly, there is the accounting section which records the transactions and reconciles the investment accounts.

(c) In a number of banks this segregation of duties did not exist or was not operative. Thus, in NHB, (as pointed out in the Committee's second Report) Shri C. Ravikumar, Assistant General Manager functioned like a one-man orchestra. He was not only the dealer but also one of the signatories to the cheques and all the back-up functions were with Shri S. Suresh Babu, Assistant Manager who reported to Shri Ravikumar and acted under his instructions. In the SBI, the segregation of duties did not operate in practice. A special facility of collection and credit of bankers' cheques issued in favour of SBI and issue of bankers' cheques by SBI as per his instructions was extended by SBI to HSM in the Investment Division of the Bombay Main branch which facilitated irregular operation HSM. Shri R. Sitaraman, Officer in Scale, virtually looked after his interests single handedly. Similarly, in Stanchart (as pointed out in the fourth Report of the Committee) there have been significant violations of internal control procedures. The deliveries were effected without receiving sale proceeds, payments were made without receiving securities, BRs or SGL transfer forms, and even where BRs were received, discharged receipts were handed over to the broker to be exchanged against bonds and there was inadequate follow-up to ensure that bonds were in fact ultimately delivered to Stanchart.

(d) In almost all banks a market practice developed whereby there was no independent confirmation of contracts between counterparty banks and in many cases, deliveries of securities, BRs and SGL transfer forms were made to and received from brokers, and even cheques for settlement of dues were given to or received from brokers. Incidentally this resulted in brokers delaying delivery of securities, BRs and SGL transfer forms as also cheques for settlement." (pg. 287 of Paper Book-II)."

5.1 The Ld. AR submitted that even the AO had held the said loss of Rs.150.45 Crores claimed during the year as business loss resulted due to frauds committed by some of employees. He placed reliance on following decisions:

- i. Badri Das Daga, 34 ITR 10 (SC),
- ii. J & K Bank Ltd. order dated 29.08.2017 in ITA No.17/2007 (J& K),
- iii. Associated Banking Corp. of India 56 ITR 1 (SC) and
- iv. Standard Chartered Bank, ITA No. 884/Mum/2003 order dated 29.08.2017 (ITAT).

6. The Ld. CIT-DR defended impugned orders and prayed for dismissal of both appeals.

7. We have heard both parties and have perused the material available on records. The Tribunal, vide its order dated 01.02.2017 in ITA No. 1517/Del/2013 in the present case, remanded the matter to the AO as under:

*“34. In view of above notes on accounts it is also necessary to record a clearcut finding by looking at the annual accounts of the company when such losses have been accrued to the assessee in accordance with the accounting standards applicable to the assessee. Therefore, in our view if the loss is arising to the assessee during the course of the business, then same shall be allowable to the assessee in the year in which it is incurred. **In the present case the lower authorities have viewed it as loss arising on purchase of securities but in fact there is no information about whether the securities were at all purchases by the assessee or not. If the assessee has lost sum paid by it for purchase of security i.e. advance for security and the same has***

been lost then it would be business loss allowable in the year in which it is incurred. It is undoubtedly this money has been lost by assessee in Shri Harshad Mehta scam. This aspect is also required to be examined with respect to the provisions of National Housing Bank Act wherein section 14 of that act provides nature of business it can carry on. In view of the above facts, it is necessary to examine whether the assessee has incurred loss on account of securities transactions entered transaction or it is a case of loss of advances given by the assessee for purchase of securities. If the transactions of securities are backed by physical possession of security notes or securities in Demat form then only it can be considered as loss on transaction in securities. If it is advance given by the assessee for the purchase of security and lost then it may be considered as business loss provided same is incurred during the course of the business of the assessee. If the same is incurred during the course of the business of the assessee, then same shall be allowable as revenue loss in the year in which it is incurred. In the present case it is not available before us that assessee was engaged in business of trading of the securities for which money was paid to the state bank of India. As the assessee itself claims that it is managing two portfolios of securities: one as trader and another as investor then if the funds were given for purchase of securities which are to be held as stock in trade, then it can be considered as allowable loss and if it is given for the purpose of purchase of securities to be held as investor it cannot be allowed as business loss. Furthermore, if the loss is held to be business loss, then it can be allowed only in the year in which it is incurred. As the reason for the loss is Shri Harshad Mehta Scam it also needs to be examined whether the loss is allowable in the year it is detected or in the year in which it crystallized. All these issues need to be examined afresh along with the year incurring of the loss. In view of this we set aside the whole issue to the file of Id. Assessing Officer to reexamine the claim of allowability of the loss of the security transaction during the year. In the result ground No. 8 of the appeal of the assessee is allowed with above direction.”

[Emphasis is supplied by us.]

8. From perusal of the above order of the Tribunal, it is evident that the remanded proceeding is limited to the ascertainment of nature of the loss and year of the allowability of the claim of the said loss of Rs.150.45 Crores and whether any security was purchased/acquired in lieu of the sum of Rs.150.45 Crores. was capital loss or business loss.

9. From the above, it is evident that the assessee had paid the sum of Rs.707.56 Crores to State Bank of India for entering into back-to-back transactions for purchase of certain securities for an aggregate amount of Rs.707.56 Crores during FY 1991-92. However, the Cheques aggregating to Rs.707.56 Crores issued by the assessee in favour of State Bank of India (SBI) for securities transactions were credited to the account of Share Broker, Shri Harshad Mehta, by SBI after collecting proceeds of the cheques and no securities against the sum Rs.707.56 Crores was made available to the assessee. Thus, the assessee lost the said sum of Rs.707.56 Crores without acquiring/getting/receiving any security in lieu thereof in Harshad Mehta Scam. From the above, it can be inferred that the assessee lost the said sum of Rs.707.56 Crores without acquiring/getting/receiving any security in lieu thereof. In view of the above facts and the decision of the Tribunal in the assessee's own case in ITA No. 1517/Del/2013, we are of the considered view that the said loss is nothing but the business loss as the same had happened due to fraudulent activities carried out by employees of the assessee, etc. Now,

the issue before us is that whether the claimed loss of Rs.150.45 Crores is allowable in the relevant year. The assessee's share out of the loss of Rs.707.56 Crores as mentioned above is only 50% of the said loss; i.e. Rs.353.78 Crores, which was borne as under:

- i. The sum of Rs.131.20 Crores given to State Bank of Saurashtra on 13.07.1998 along with interest @ 12% per annum thereon and
- ii. Rs.150.45 Crores was paid to the SBI vide a Cheque No.209919 dated 17.12.2002.

10. In fact, the assessee has paid of Rs.353.78 Crores to the SBI in the relevant year on account of loss on security transactions of FY 1991-92. The sum of Rs.150.45 Crores out of the said loss of Rs.353.78 Crores has been claimed as expenditure routed through the Profit & Loss Account. It appears that the remaining balance amount; Rs.150.12 Crores (Rs.353.78 Crores minus Rs.150.45 Crores) has been routed through the Balance Sheet. The dispute before us is only the claim of 'Expenditure on account of loss on security transactions of FY 1991-92 amounting to Rs.1,50,45,32,696/-' in its Profit & Loss Account. Hence, we are refraining to make any comment on the sum of Rs.150.12 Crores (Rs.353.78 Crores minus Rs.150.45 Crores) routed through the Balance Sheet.

11. In view of the foregoing discussion, we are of the considered opinion that the issue that whether the claimed loss of Rs.150.45 Crores is allowable in the relevant year is squarely covered by the decision of the Hon'ble J & K High Court in the case of J & K Bank Ltd. (supra). The relevant part of that decision reads as under:

“6. We have considered the submissions made by both the sides and have perused the record. The Supreme Court in the case of Associated c/w Banking Corporation of India Ltd (supra) has held that 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. 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, loss may not in a commercial sense be said to have resulted. 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. 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 is not tenable. 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.

7. The Central Board of Direct Taxes has issued a circular dated 24.11.1965 by taking note of the decision of the Supreme Court in the

case of Associated Banking Corporation of India ltd (supra) and in Badri Das Daga v. CIT (1958) 34 ITR 10(SC) which reads as under:-

" 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 c/w 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 India Ltd vs. CIT (1965) 56 ITR 1 (SC): TC 14R.211.*

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 it and realizes 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."

8. From a conjoint reading of the decision of the Supreme Court in the case of Associated Banking Corporation of India Ltd supra as well as circular dated 24.11.1965 issued by the Central Board of Direct Taxes, it is evident that 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 was discovered. In Badri Das Daga supra, the Supreme Court has held that loss resulting from embezzlement by employee or agent of a business as deduction under Section 10(1) of the

Act if it arises out of carrying on of business and is incidental to it. In the c/w case of Associated Banking Corporation of India Ltd supra, it has been held that loss must be deemed to have arisen only when employer comes to know about it and it realizes that the amount embezzled cannot be recovered. Thus, the date of discovery in view of circular issued by CBDT has to be treated as the date from which the employer comes to know that the amount embezzled cannot be recovered.

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 c/w 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.”

[Emphasis is supplied by us.]

12. We therefore, respectfully following the decision of the Hon'ble J & K High Court in the case of J & K Bank Ltd. (supra), we hold that the said claim of expenditure on account of loss of Rs.1,50,45,32,696/- is allowable in the relevant year. Accordingly, we delete the disallowance/addition of Rs.1,50,45,32,696/- made by the AO and sustained by the Ld. CIT(A). Consequentially, the respective grounds raised by the assessee stand allowed as above. The assessee gets consequential relief in this regard.

ITA No. 1158. Del.2023:

13. Since the quantum/addition of Rs.150.45 Crores, on which the penalty under section 271(1)(c) of the Act levied has been deleted; therefore, the consequential penalty also hereby stands deleted accordingly.

14. In the result, both appeals of the assessee are allowed as above.

Order pronounced in open Court on 25th June, 2025.

Sd/-

**(C. N. PRASAD)
JUDICIAL MEMBER**

Sd/-

**(AVDHESH KUMAR MISHRA)
ACCOUNTANT MEMBER**

Dated: 25/06/2025

ITA No.1717/Del/2019
ITA No. 1158/Del/2023
National Housing Bank

Binita, Sr. PS

Copy forwarded to:

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2. Respondent
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ASSISTANT REGISTRAR
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