

**IMPACT ON THE CLARIFICATIONS IN THE BUDGET PROPOSAL / FINANCE BILL, 2013 FOR  
AMOUNT TO BE ELEGIBLE FOR DEDUCTION AS BAD DEBTS IN CASE OF BANKS**

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The Finance Minister while presenting the Finance Bill 2013, in the memorandum explaining the provisions of the finance bill under Clause 6 has issued a clarification with regard to the amount to be eligible for deduction as bad debt in the case of banks. If one is to lucidly go through the said explanation, it can be crystal clear that the said explanation is a result of the recent judgment by the Hon'ble Supreme Court in the case of Catholic Syrian Bank Vs Commissioner of Income Tax, Thrissur. Before I explain the background of the said judgment, I would like to draw to the attention of all concerned towards the section 36(1)(viiia) of the Income Tax Act, 1961. The section reads as under:

**Section 36 - Other Deductions:** (viiia) *"In respect of any provision for bad and doubtful debts made by -*

*(a) A scheduled bank not being a bank incorporated by or under the laws of a country outside India or a non-scheduled bank, an amount not exceeding five per cent of the total income (computed before making any deduction under this clause and Chapter VI-A) and an amount not exceeding ten per cent of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner;*

*Provided that a scheduled bank or a non-scheduled bank referred to in this sub-clause shall, at its option, be allowed in any of the relevant assessment years, deduction in respect of any provision made by it for any assets classified by the Reserve Bank of India as doubtful assets or loss assets in accordance with the guidelines issued by it in this behalf, for an amount not exceeding five per cent. of the amount of such assets shown in the books of account of the bank on the last day of the previous year.*

*(b) A bank, being a bank incorporated by or under the laws of a country outside India, an amount not exceeding five per cent of the total income (computed before making any deduction under this clause and Chapter VI-A);*

*(c) A public financial institution or a State financial corporation or a State industrial investment corporation, an amount not exceeding five per cent of the total income (computed before making any deduction under this clause and Chapter VI-A)."*

The section provides that in computing the business income of certain banks and financial institutions, deduction is allowable in respect of bad and doubtful debts made by such entities subject to certain limits specified therein. Section also restricts the claim of deduction for proviso for bad and doubtful debts of certain banks which are no incorporated outside India and certain co-operative banks to 7.5% of the gross total income before deduction under section 36(1)(viia) of such banks and 10% of the aggregate advances made by the rural branches of such banks. The limit is 5% of the gross total income under section 36(1)(viia)(b) and 36(1)(viia)(c) for a bank incorporated outside India and certain financial institutions.

Provisions of clause (vii) of section 36(1) of the Act provides for deduction for bad debt actually written off as irrecoverable in the books of account of the assessee. The proviso to this clause provides that for an assessee, to which section 36(1) (viia) of the Act applies, deduction under said clause (vii) shall be limited to the amount by which the bad debt written off exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1) (viia) of the Act.

The provisions of section 36(1) (vii) of the Act are subject to the provisions of section 36(2) of the Act. The clause (v) of section 36(2) of the Act provides that the assessee, to which section 36(1) (viia) of the Act applies, should debit the amount of bad debt written off to the provision for bad and doubtful debts account made under section 36(1) (viia) of the Act.

Therefore, the banks or financial institutions are entitled to claim deduction for bad debt actually written off under section 36(1) (vii) of the Act only to the extent it is in excess of

the credit balance in the provision for bad and doubtful debts account made under section 36(1) (viia) of the Act.

The Finance Bill, 2013 states that the reason for such clarification about the interpretation of Section 36(1)(vii) of the said Act, arises out of certain judicial pronouncement, as it has created certain doubts about the scope and applicability of provision Of the said section.

In the case of **Catholic Syrian Bank Vs Commissioner of Income Tax, Thrissur in civil appeal no. 1143 of 2011, the Hon'ble Supreme Court** had a chance to interpret the said section. The Hon'ble Supreme Court overruled the findings of the Kerala High Court Full Bench which held that, there cannot be any distinction between the rural lending and other lending because the legislature does not make any distinction between provisions created in respect of advances by rural branches and advances by other branches of the bank. It tried to distinguish the earlier decision of the Division Bench of the same Court i.e. Kerala High Court in South Indian Bank which allowed the distinction and held that the said distinction was incorrect. However, the Hon'ble Supreme Court while overruling the full bench decision of the Kerala High court held as under:

*"To conclude, we hold that the provisions of Sections 36(1) (vii) and 36(1)(viia) of the Act are distinct and independent items of deduction and operate in their respective fields. The bad debts written off in debts, other than those for which the provision is made under clause (viia), will be covered under the main part of Section 36(1)(vii), while the proviso will operate in cases under clause (viia) to limit deduction to the extent of difference between the debt or part thereof written off in the previous year and credit balance in the provision for bad and doubtful debts account made under clause (viia). The proviso to Section 36(1)(vii) will relate to cases covered under Section 36(1)(viia) and has to be read with Section 36(2)(v) of the Act. Thus, the proviso would not permit benefit of double deduction, operating with reference to rural loans while under Section 36(1)(vii), the assessee would be entitled to general deduction upon an account having become bad debt and being written off as irrecoverable in the accounts of the assessee for the previous year. This, obviously, would be subject to satisfaction of the requirements contemplated under Section 36(2)."*

In our view the interpretation of the Kerala High Court, Full Bench which is reinforced by the legislature in bringing the clarification in the finance bill is the correct interpretation of the section which reflects the intention of the legislature in allowing banks and other financial institution to claim, a deduction from its income to the extent of the bad debt written off by the bank and financial institutions in terms of the said section. Therefore, in order to get more clarity on this issue, the finance bill has chosen to insert explanation in Clause vii of section 37 to state that for the purpose of provision to section 36(1)(viia) and section 36(2)(v), only one account was referred to therein is made in respect of provision for bad and doubtful debts under section 36(1)(viia) and such account relates to all types of advances, including advances made by rural branches. Therefore, for an assessee to which clause (viia) of section 36(1) applies, the amount of deduction in respect of the bad debts actually written off under section 36(1)(vii) shall be limited to the amount by which such bad debts exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) without any distinction between rural advances and other advances.

The impact of this will not adversely affect any bank. In fact it will put an end to the large number of litigation and interpretational issues. This is a major provision as far as the bank and financial institutions and therefore, the amendment i.e. the explanation and insertion of a new clause is equally important to all the banks from the point of view of the claim of deduction under bad and doubtful debts.

The said explanation to Section 36(1)(vii) referred in the Finance Bill, 2013 will be effective from 1<sup>st</sup> April 2014.

***“The views expressed herein are that of the Author of the Article and do not represent the views of the institution wherein he is employed.”***

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