REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NOS.3286-3287 OF 2010
(Arising out of S.L.P. (C) Nos.21568-21569 of 2009)

M/s. Vijaya Bank ...Appellant(s)

Versus

Commissioner of Income Tax & Anr. ...Respondent(s)

J U D G E M E N T

S.H. KAPADIA,J.

Leave granted.

Whether it is imperative for the assessee-Bank to close the individual account of each of it's debtors in it's books or a mere reduction in the Loans and Advances or Debtors on the asset side of it's Balance Sheet to the extent of the provision for bad debt would be sufficient to constitute a write off is the question which we are required to answer in these civil appeals?

In these civil appeals, we are concerned with Assessment Years 1993-1994 and 1994-1995. For the Assessment Year 1994-1995, the Assessing Officer disallowed a sum of Rs.7,10,47,161/- which the assessee-Bank had reduced from Loans and Advances or Debtors on the ground that the impugned

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bad debt had not been written off in an appropriate manner as required under the Accounting principles. According to him, the impugned bad debt supposedly written off by the assessee-Bank was a mere provision and the same could not be equated with the actual write off of the bad debt, as per the requirement of Section 36(1)(vii) of the Income Tax Act, 1961 [`1961 Act', for short] read with ***Explanation*** thereto which ***Explanation*** stood inserted in 1961 Act by Finance Act, 2001 with effect from 1st April, 1989. The assessee carried the matter in appeal before the Commissioner of Income Tax (A) [`CIT(A)', for short], who opined that it was not necessary for the purpose of writing off of bad debts to pass corresponding entries in the individual account of each and every debtor and that it would be sufficient if the debit entries are made in the Profit and Loss Account and corresponding credit is made in the "Bad Debt Reserve Account". Against the decision of CIT (A) on this point, the Department preferred an appeal to the Income Tax Appellate Tribunal [`Tribunal', for short]. Before the Tribunal, it was argued on behalf of the Department that write off of each and every individual account under the Head `Loans and Advances' or Debtors was a condition precedent for claiming deduction under Section 36(1)(vii) of 1961 Act. According to the Department, the claim of actual write off of bad debts in relation to Banks stood on a footing different from the accounts of the Non-Banking assessee(s), <u>though it was not disputed before us that Section 36(1)(vii) of 1961 Act covers Banking as well as Non-Banking assessees</u>. According to the

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assessee, once a provision stood created and, ultimately, carried to the Balance Sheet wherein Loans and Advances or Debtors depicted stood reduced by the amount of such provision, then, there was actual write off because, in the final analysis, at the year-end, the so-called provision does not remain and the Balance Sheet at the year-end only carries the amount of loans and advances or debtors, net of such provision made by the assessee for the impugned bad debt. The Tribunal, accordingly, upheld the above contention of the assessee on three grounds. Firstly, according to the Tribunal, the assessee had rightly made a provision for bad and doubtful debt by debiting the amount of bad debt to the Profit and Loss Account so as to reduce the profits of the year. Secondly, the provision account so created was debited and simultaneously the amount of loans and advances or debtors stood reduced and, consequently, the provision account stood obliterated. Lastly, according to the Tribunal, loans and advances or the sundry debtors of the assessee as at the end of the year lying in the Balance Sheet was shown as net of "provisions for doubtful debt" created by way of debit to the Profit and Loss Account of the year. Consequently, the Tribunal, on this point, came to the conclusion that deduction under Section 36(1)(vii) of 1961 Act was allowable.

On the question whether it was imperative for the assessee to close each and every individual account and it's debtors in it's Books or a mere reduction in the loans and advances to the extent of the provision for bad and doubtful

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debt was sufficient, the answer given by the Tribunal was that, in view of the decision of the Gujarat High Court in the case of Vithaldas H. Dhanjibhai Bardanwala vs. Commissioner of Income Tax, Gujarat, reported in [1981] 130 ITR 95 (Gujarat), the CIT(A) was right in coming to the conclusion that, since the assessee had written off the impugned bad debt in it's Books by way of a debit to the Profit and Loss Account simultaneously reducing the corresponding amount from Loans and Advances or Debtors depicted on the asset side in the Balance Sheet at the close of the year, the assessee was entitled to deduction under Section 36(1)(vii) of 1961 Act. This view was not accepted by the High Court which came to the conclusion by placing reliance on a relied upon judgement in the case of Commissioner of Income Tax & Anr. vs. M/s. Wipro Infotech Limited [See Page 5 of the Paper Book], that, in view of the insertion of the *Explanation vide* Finance Act, 2001, with effect from 1st April, 1989, the decision of the Gujarat High Court in the case of Vithaldas H. Dhanjibhai Bardanwala [supra] no more held the field and, consequently, mere creation of a provision did not amount to actual write off of bad debts, hence, these civil appeals.

At the outset, we may state that, in these civil appeals, broadly, two questions arise for determination. The first question which arises for determination concerns the manner in which actual write off takes place under the Accounting principles. The second question which arises for

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determination in these civil appeals is, whether it is imperative for the assessee-Bank to close the individual account of each debtor in it's Books or a mere reduction in the "Loans and Advances Account" or Debtors to the extent of the provision for bad and doubtful debt is sufficient?

The first question is no more *res integra*. Recently, a Division Bench of this Court in the case of Southern Technologies Limited vs. Joint Commissioner of Income Tax, reported in [2010] 320 ITR 577, [in which one of us [S.H. Kapadia,J.] was a party] had an occasion to deal with the first question and it has been answered, accordingly, in favour of the assessee *vide* Paragraph (25), which reads as under:

> **"Prior to April 1, 1989, the law, as it then stood, took the view that even in cases in which the assessee(s) makes only a provision in its accounts for bad debts and interest thereon and even though the amount is not actually written off by debiting the profit and loss account of the assessee and crediting the amount to the account of the debtor, the assessee was still entitled to deduction under section 36(1)(vii). [See *CIT v. Jwala Prasad Tiwari* (1953) 24 ITR 537 (Bom) and *Vithaldas H. Dhanjibhai Bardanwala vs. CIT* (1981) 130 ITR 95 (Guj)] Such state of law prevailed up to and including the assessment year 1988-89. However, by insertion (with effect from April 1, 1989) of a new *Explanation* in section 36(1)(vii), it has been clarified that any bad debt written off as irrecoverable in the account of the assessee will not include any provision for bad and doubtful debt made in the accounts of the assessee. The said amendment indicates that before April 1, 1989, even a provision could be treated as a write off. However, after April 1, 1989, a distinct dichotomy is brought in by way of the said**

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> ***Explanation*** to section 36(1)(vii). Consequently, after April 1, 1989, a mere provision for bad debt would not be entitled to deduction under Section 36(1)(vii). To understand the above dichotomy, one must understand `how to write off'. If an assessee debits an amount of doubtful debt to the profit and loss account and credits the asset account like sundry debtor's account, it would constitute a write off of an actual debt. However, if an assessee debits `provision for doubtful debt' to the profit and loss account and makes a corresponding credit to the `current liabilities and provisions' on the liabilities side of the balance-sheet, then it would constitute a provision for doubtful debt. In the latter case, the assessee would not be entitled to deduction after April 1, 1989."

One point needs to be clarified. According to Shri Bishwajit Bhattacharya, learned Additional Solicitor General appearing for the Department, the view expressed by the Gujarat High Court in the case of Vithaldas H. Dhanjibhai Bardanwala [supra] was prior to the insertion of the ***Explanation vide*** Finance Act, 2001, with effect from 1st April, 1989, hence, that law is no more a good law. According to the learned counsel, in view of the insertion of the said ***Explanation*** in Section 36(1)(vii) with effect from 1st April, 1989, a mere debit of the impugned amount of bad debt to the Profit and Loss Account would not amount to actual write off. According to him, the E***xplanation*** makes it very clear that there is a dichotomy between actual write off on the one hand and a provision for bad and doubtful debt on the other. He submitted that a mere debit to the Profit and

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Loss Account would constitute a provision for bad and doubtful debt, it would not constitute actual write off and that was the very reason why the *Explanation* stood inserted. According to him, prior to Finance Act, 2001, many assessees used to take the benefit of deduction under Section 36(1)(vii) of 1961 Act by merely debiting the impugned bad debt to the Profit and Loss Account and, therefore, the Parliament stepped in by way of *Explanation* to say that mere reduction of profits by debiting the amount to the Profit and Loss Account *per se* would not constitute actual write off. To this extent, we agree with the contentions of Shri Bhattacharya. However, as stated by the Tribunal, in the present case, besides debiting the Profit and Loss Account and creating a provision for bad and doubtful debt, the assessee-Bank had correspondingly/simultaneously obliterated the said provision from it's accounts by reducing the corresponding amount from Loans and Advances/debtors on the asset side of the Balance Sheet and, consequently, at the end of the year, the figure in the loans and advances or the debtors on the asset side of the Balance Sheet was shown as net of the provision "for impugned bad debt". In the judgement of the Gujarat High Court in the case of Vithaldas H. Dhanjibhai Bardanwala [supra], a mere debit to the Profit and Loss Account was sufficient to constitute actual write off whereas, after the *Explanation*, the assessee(s) is now required not only to debit the Profit and Loss Account but simultaneously also reduce loans and advances or the debtors from the asset side of the Balance Sheet to the extent of the

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corresponding amount so that, at the end of the year, the amount of loans and advances/debtors is shown as net of provisions for impugned bad debt. This aspect is lost sight of by the High Court in it's impugned judgement. In the circumstances, we hold, on the first question, that the assessee was entitled to the benefit of deduction under Section 36(1)(vii) of 1961 Act as there was an actual write off by the assessee in it's Books, as indicated above.

Coming to the second question, we may reiterate that it is not in dispute that Section 36(1)(vii) of 1961 Act applies both to Banking and Non-Banking businesses. The manner in which the write off is to be carried out has been explained hereinabove. It is important to note that the assessee-Bank has not only been debiting the Profit and Loss Account to the extent of the impugned bad debt, it is simultaneously reducing the amount of loans and advances or the debtors at the year-end, as stated hereinabove. In other words, the amount of loans and advances or the debtors at the year-end in the balance-sheet is shown as net of the provisions for impugned debt. However, what is being insisted upon by the Assessing Officer is that mere reduction of the amount of loans and advances or the debtors at the year-end would not suffice and, in the interest of transparency, it would be desirable for the assessee-Bank to close each and every individual account of loans and advances or debtors as a pre-condition for claiming deduction under Section 36(1)(vii) of 1961 Act. This view has been taken by

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the Assessing Officer because the Assessing Officer apprehended that the assessee-Bank might be taking the benefit of deduction under Section 36(1)(vii) of 1961 Act, twice over. [See Order of CIT (A) at Pages 66, 67 and 72 of the Paper Book, which refers to the apprehensions of the Assessing Officer]. In this context, it may be noted that there is no finding of the Assessing Officer that the assessee had unauthorisedly claimed the benefit of deduction under Section 36(1)(vii), twice over. The Order of the Assessing Officer is based on an apprehension that, if the assessee fails to close each and every individual account of it's debtor, it may result in assessee claiming deduction twice over. In this case, we are concerned with the interpretation of Section 36(1)(vii) of 1961 Act. We cannot decide the matter on the basis of apprehensions/desirability. It is always open to the Assessing Officer to call for details of individual debtor's account if the Assessing Officer has reasonable grounds to believe that assessee has claimed deduction, twice over. In fact, that exercise has been undertaken in subsequent years. There is also a flip-side to the argument of the Department. Assessee has instituted recovery suits in Courts against it's debtors. If individual accounts are to be closed, then the Debtor/Defendant in each of those suits would rely upon the Bank statement and contend that no amount is due and payable in which event the suit would be dismissed.

Before concluding, we may refer to an argument advanced on behalf of the Department. According to the Department, it is necessary to square off each individual

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account failing which there is likelihood of escapement of income from assessment. According to the Department, in cases where a borrower's account is written off by debiting Profit and Loss Account and by crediting Loans and Advances or Debtors Accounts on the asset side of the Balance Sheet, then, as and when in the subsequent years if the borrower repays the loan, the assessee will credit the repaid amount to the Loans and Advances Account and not to the Profit and Loss Account which would result in escapement of income from assessment. On the other hand, if bad debt is written off by closing the borrower's account individually, then the repaid amount in subsequent years will be credited to the Profit and Loss Account on which the assessee-Bank has to pay tax. Although, prima facie, this argument of the Department appears to be valid, on a deeper consideration, it is not so for three reasons. Firstly, the Head Office Accounts clearly indicate, in the present case, that, on repayment in subsequent years, the amounts are duly offered for tax. Secondly, one has to keep in mind that, under the Accounting practice, the Accounts of the Rural Branches have to tally with the Accounts of the Head Office. If the repaid amount in subsequent years is not credited to the Profit and Loss Account of the Head Office, which is ultimately what matters, then, there would be a mis-match between the Rural Branch Accounts and the Head Office Accounts. Lastly, in any event, Section 41(4) of 1961 Act, inter alia, lays down that, where a deduction has been allowed in respect of a bad debt

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or a part thereof under Section 36(1)(vii) of 1961 Act, then, if the amount subsequently recovered on any such debt is greater than the difference between the debt and the amount so allowed, the excess shall be deemed to be profits and gains of business and, accordingly, chargeable to income tax as the income of the previous year in which it is recovered. In the circumstances, we are of the view that the Assessing Officer is sufficiently empowered to tax such subsequent repayments under Section 41(4) of 1961 Act and, consequently, there is no merit in the contention that, if the assessee succeeds, then it would result in escapement of income from assessment.

For the afore-stated reason, we uphold the judgement of the Tribunal dated 31st July, 2003, and set aside the impugned judgement of the High Court. Consequently, the assessee's appeals stand allowed with no order as to costs.

.....J.
[S.H. KAPADIA]

.....J.
[SWATANTER KUMAR]

New Delhi,
April 15, 2010.