REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION
CIVIL APPEAL NO. 1143 OF 2011

Catholic Syrian Bank Ltd. ... Appellant

Versus

Commissioner of Income Tax, Thrissur ... Respondent

WITH

CIVIL APPEAL NO. 1147 of 2011
CIVL APPEAL NO. 1151 OF 2011
CIVIL APPEAL NO. 1155 OF 2011
CIVIL APPEAL NOS. 1156-1160 OF 2011
CIVIL APPEAL NO. 1170 OF 2011
CIVIL APPEAL NO. 1171 OF 2011
CIVIL APPEAL NO. 1172 OF 2011
CIVIL APPEAL NO. 1173 OF 2011
CIVIL APPEAL NO. 1174 OF 2011
CIVIL APPEAL NO. 1175 OF 2011
CIVIL APPEAL NO. 1176 OF 2011
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CIVIL APPEAL NO. 1178 OF 2011
CIVIL APPEAL NO. 1179 OF 2011
CIVIL APPEAL NO. 1180 OF 2011
CIVIL APPEAL NO. 1181 OF 2011
CIVIL APPEAL NO. 1182 OF 2011
CIVIL APPEAL NO. 1183 OF 2011
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CIVIL APPEAL NO. 1185 OF 2011
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CIVIL APPEAL NO. 1187 OF 2011
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CIVIL APPEAL NO. 1189 OF 2011
CIVIL APPEAL NOS. 1190-1193 OF 2011
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CIVIL APPEAL NO. 1396 OF 2011
CIVIL APPEAL NO. 1397 OF 2011

J U D G M E N T

Swatanter Kumar, J.

1. The assessee in C.A. No. 1143 of 2011, a Scheduled Bank, filed its return of income for the assessment year 2002-2003 on 24th October, 2002, declaring total income of Rs. 61,15,610/-. The return was processed under Section 143(1) of the Income Tax Act, 1961 (for short 'the Act') and eligible refund was issued in favour of the assessee. However, the assessing officer issued notice under Section 143(2) of the Act to the assessee, after which the assessment was completed. *Inter alia*, the assessing officer, while dealing, under Section 143(3) of the Act, with the claim of the assessee for bad debts of Rs. 12,65,95,770/-, noticed that the argument put forward on behalf of the assessee, that the deduction allowable under Section 36(1)(vii) of the Act is independent of deduction under Section 36(1)(viia) of the Act, could not be accepted. Consequently, he observed that the assessee having a provision of Rs. 15,01,29,990/- for bad and doubtful debts under Section 36(1)(viia) of the Act could not claim the amount of Rs. 12,65,95,770/- as deduction on account of bad debts because the bad debts did not exceed the credit balance in the provision for bad and doubtful debts account and also, the

requirements of clause (v) of Sub-section (2) of Section 36 of the Act were not satisfied. Therefore, the assessee's claim for deduction of bad debts written off from the account books was disallowed. This amount was added back to the taxable income of the assessee, for which a demand notice and challan was accordingly issued. This order of the assessing officer dated 24th January, 2005, was challenged in appeal by the assessee on various grounds.

2. The Commissioner of Income Tax (Appeals) [hereafter referred to as 'the CIT(A)'], vide its order dated 7th April, 2006, partly allowed the appeal, particularly in relation to the claim of the appellant Bank for bad debts. Relying upon the judgment of a Division Bench of the Kerala High Court in the case of *South Indian Bank Ltd. v. CIT* [(2003) 262 ITR 579], the CIT(A) held that the claim of the appellant was fully supported by the said decision and since the entire bad debts written off by the bank under Section 36(1)(vii) were pertaining to urban branches only and not to the provision made for rural branches under Section 36(1)(viia), it was entitled to the deduction of the full claimed amount of Rs. 12,65,95,770/-. Consequently, he directed deletion of the said amount.

3. For the years of assessment in question and being

aggrieved from the order of the CIT(A), the Revenue as well as the assessee filed appeals before the Income Tax Appellate Tribunal, Cochin (for short, the 'ITAT'). All the appeals were heard together and vide its order dated 16th April, 2007, while relying upon the judgment of the jurisdictional High Court in the case of *South Indian Bank Ltd.* (supra), the ITAT dismissed the appeal of the Revenue on this issue and also granted certain other benefits to the assessee in relation to other items.

4. We consider it appropriate to notice at this stage the fate of the orders passed for the previous assessment years in relation to the appellant and other banks.

5. M/s. Dhanalakshmi Bank Ltd., one of the appellants before us, had also raised the same issue before the ITAT in Income Tax Appeal Nos.602-605 (Coch.) of 1994 and 190 (Coch.) of 1995, in relation to earlier assessment years. A view had been expressed that there was no distinction made by the Legislature in the proviso to Section 36(1)(vii) between rural and non-rural advances and, therefore, its application cannot be limited to rural advances. Under clause (viia) also, a bank was held to be entitled to deduction in respect of the provisions made for rural and non-rural advances, subject to

limitations contained therein. Thus, the contention of the assessee in that case, for deduction of bad debts from urban branches under Section 36(1)(vii), was rejected. The earlier view taken by the Tribunal in the case of *Federal Bank* in ITA Nos. 505, 854(Coch.) of 1993, 376(Coch.) of 1995 and 284(Coch.) of 1995 held that the proviso to clause (vii) only bars the deduction of bad debts arising out of rural advances, the actual right to set off bad debts in respect of non-rural and urban advances cannot be controlled or restricted by application of the proviso and the same would be allowed without making adjustment *vis-a-vis* the provision for bad and doubtful debts. This view was obviously favourable to the assessee. Noticing these contrary views in the cases of *Dhanalakshmi Bank* and *Federal Bank*, the matter in the case of the appellant-Bank, for assessment years 1991-92 to 1993-1994 was referred to a Special Bench of the ITAT for resolving the issue. The Special Bench, vide its judgment dated 9th August, 2002, had answered the question of law in the affirmative, holding that debts actually written off, which do not arise out of the rural advances, are not affected by the proviso to clause (vii) and that only those bad debts which arise out of rural advances are to be deducted under Section

36(1)(viia) in accordance with the proviso to clause (vii). Finally, the matter, in respect of the appellant-Bank, was ordered to be placed before the assessing officer and with respect to other banks, before the concerned benches of the ITAT. The order of the Special Bench of the ITAT was implemented by the Department and was never called in question. It may be noticed here that in relation to earlier assessments, i.e. right from 1985-1986 to 1987-1988 in a similar case, different banks came up for hearing in appeal before a Division Bench of the Kerala High Court in the case of *South Indian Bank Ltd.* (supra) wherein, as mentioned above, while discussing the scope of Section 36(1)(viia) and 36(2)(v) of the Act, the High Court set aside the order of the Tribunal in that case and held that the assessee was entitled to the deduction under clause (vii) irrespective of the difference between the credit balance in the provision account made under clause (viia) and the bad debts written off in the books of accounts in respect of bad debts relating to urban or non-rural advances. It accepted the contention of the assessee and referred the matter to the assessing officer. This judgment of the High Court is subject matter of Civil Appeal Nos. 1190-1193 of 2011 before us.

6. However, the Department of Income Tax, being dissatisfied with the order of the ITAT in assessment year 2002-2003, filed an appeal before the High Court under Section 260A of the Act.

7. The Division Bench of the High Court of Kerala at Ernakulam hearing the bunch of appeals against the order of the ITAT, expressed the view that the judgment of that Court in the case of *South Indian Bank* (supra) was not a correct exposition of law. While dissenting therefrom, the Bench directed the matter to be placed before a Full Bench of the High Court.

8. That is how the matter came up for hearing before a Full Bench of the High Court of Kerala at Ernakulam and vide its judgment dated 16th December, 2009, the Full Bench not only answered the question of law but even decided the case on merits. While setting aside the view taken by the Division Bench in *South Indian Bank* (supra) and also the concurrent view taken by the CIT(A) and the ITAT, the Full Bench of the High Court held as under:-

> "5…What is clear from the above is that provision for bad and doubtful debts normally is not an allowable deduction and what is allowable under main clause is bad debt actually written off.

However, so far as Banks to which clause (viia) applies are concerned, they are entitled to claim deduction of provision under sub-clause (viia), but at the same time when bad debt written is also claimed deduction under clause (vii), the same will be allowed as a deduction only to the extent it is in excess of the provision created and allowed as a deduction under clause (viia). It is worthwhile to note that deduction under Section 36 (1)(vii) is subject to sub-section (2) of Section 36 which in clause (v) specifically states that any bad debt written off should be claimed as a deduction only after debiting it to the provision created for bad and doubtful debts. Further, in order to qualify for deduction of the bad debt written off, the requirement of section 36 (2) (v) is that such amount should be debited to the provision created under clause (viia) of claim deduction of provision under sub-clause (viia), but at the same time when bad debt is written off is also claimed deduction under clause (vii), the same will be allowed as a deduction only to the extent it is in excess of the provision created and allowed as a deduction under clause (viia). It is worthwhile to note that deduction under section 36(1) (vii) is subject to sub section (2) of section 36 which in clause (v) specifically states that any bad debt written off should be claimed as a deduction only after debiting it to the provision created for bad and doubtful debts. What is clear from the above provisions is that though Respondent-Banks are entitled to claim deduction of provision for bad and doubtful debts in terms of clause (viia), such Banks are entitled to deduction of bad debt actually written off only to the extent it is in excess of the provision created and allowed as deduction under clause (viia). Further, in order to qualify for deduction of bad debt written off, the requirement of section 36 (2) (v) is that such amount should be debited to the provision created under clause (viia) of Section 36(1). Therefore, we are of the view that the distinction drawn by the Division Bench in SOUTH INDIAN BANK'S case

between the bad debts written off in respect of advances made by Rural Branches and bad debts pertaining to advances made by other Branches does not exist and is not visualized under proviso to Section 36(1)(vii). We, therefore, hold that the said decision of this Court does not lay down the correct interpretation of the provisions of the Act. Admittedly all the Respondent-assesses have claimed and have been allowed deduction of provision in terms of clause (viia) of the Act. Therefore, when they claim deduction of bad debt written off in the previous year by virtue of the proviso to section 36(1)(vii), they are entitled to claim deduction of such bad debt only to the extent it exceeds the provision created and allowed as deduction under clause (viia) of the Act.

6. In the normal course we should answer the question referred to us by the Division Bench and send back the appeals for the Division Bench to decide the appeals consistent with the Full Bench decision. However, since this is the only issue that arises in the appeals, we feel it would be only an empty formality to send back the matter to the Division Bench for disposal of appeals consistent with our judgment. In order to Avoid unnecessary posting of appeals before the Division Bench, we allow the appeals by setting aside the orders of the Tribunal and by restoring the assessments confirmed in first Appeals."

9. Dissatisfied from the judgment of the Full Bench of the Kerala High Court, the assessee has filed the present appeal purely on question of law.

10. The basic question of some significance, that arises for consideration in the present appeals, is regarding the scope and ambit of the proviso to clause (vii) of sub-section (1) of

Section 36 of the Act. According to the contention raised on behalf of the assessee, the view taken by the Full Bench of the Kerala High Court cannot be sustained in law as there are distinct and different items of account that are maintained by the bank in the normal course of its business and it is not permissible to interchange these items in accordance with the settled standards of accountancy or even in law. As such, the claim of doubtful and bad debts could not have been added back to taxable income as it was an additional liability of the bank being shown as an independent item.

11. To put it more precisely, the contentious questions of law that have been raised in the present appeals are as follows:-

> "(j) Whether the Full Bench of the High Court has grossly erred in reversing the finding of the earlier Division Bench that on a correct interpretation of the Proviso to clause (vii) of Section 36(1) and clause (v) to Section 36(2) is only to deny the deduction to the extent of bad debts written off in the books with respect to which provision was made under clause (viia) of the Income Tax Act?
>
> (k) Whether the Full Bench was correct in reversing the findings of the earlier Division Bench that if the bad debt written off relate to debt other than for which the provision is made under clause (viia), such debts will fall squarely within the main part of clause (vii) which is entitled to be deduction and in respect of that part of the debt with reference to which a provision is made under clause (viia), the proviso will operate to limit the deduction to the extent of the difference between that part of debt written off in the previous year and the

credit balance in the provision for bad and doubtful debts account made under clause (viia)?"

12. The appellant has contended that as the similar claims had been decided in favour of the banks for the assessment years 1991-1992 to 1993-1994, by Special Bench of the ITAT, which had not been challenged by the Department. As such, the issue had attained finality and could not be disturbed in the subsequent years.

13. The above contention of the appellant banks does not impress us at all. Merely because the orders of the Special Bench of the ITAT were not assailed in appeal by the Department itself, this would not take away the right of the Revenue to question the correctness of the orders of assessment, particularly when a question of law is involved. There is no doubt that the earlier order of the CIT(A) had merged into the judgment of the Special Bench of the ITAT and attained finality for that relevant year. Equally, it is true that though the Full Bench of the Kerala High Court specifically overruled the Division Bench judgment of that very Court in the case of *South Indian Bank* (supra), it did not notice any of the contentions before and principles stated by the Special Bench of the ITAT in its impugned judgment. As already

noticed, the question raised in the present appeal go to the very root of the matter and are questions of law in relation to interpretation of Sections 36(1)(vii) and 36(1)(viia) read with Section 36(2) of the Act. Thus, without any hesitation, we reject the contention of the appellant banks that the findings recorded in the earlier assessment years 1991-1992 to 1993-1994 would be binding on the Department for subsequent years as well.

14. Now, we would proceed to examine the provisions of Sections 36(1)(vii), 36(1)(viia) and 36(2) of the Act and their scope. It would be appropriate for this Court to notice the relevant provisions of the Sections at this stage itself.

> "Section 36 (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28 –
> (i) to (vi).....
> (vii) Subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year:
>
> Provided that in the case of an assessee to which clause (viia) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause;
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> Explanation – For the purposes of this clause, any

bad debt or part thereof written off as irrecoverable in the accounts of the assess shall not include any provision for bad and doubtful debts made in the accounts of the assessee.

(viia) 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.

Provided further that for the relevant assessment years commencing on or after the 1st day of April, 2003 and ending before the 1st day of April, 2005, the provisions of the first proviso shall have effect as if for the words “five per cent”, the words “ten per cent” had been substituted :

Provided also that a scheduled bank or a non-scheduled bank referred to in this sub-clause shall, at its option, be allowed a further deduction in excess of the limits specified in the foregoing provisions, for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the Central Government.

Explanation. - For the purposes of this sub-clause, "relevant assessment years" means the five consecutive assessment years commencing on or after the 1st day of April, 2000 and ending before the 1st day of April, 2005.

Section 36 (2) In making any deduction for a bad debt or part thereof, the following provisions shall apply –

(i) No such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off 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;

(ii) If the amount ultimately recovered on any such debt or part of debt is less than the difference between the debt or part and the amount so deducted, the deficiency shall be deductible in the previous year in which the ultimate recovery is made;

(iii) Any such debt or part of debt may be deducted if it has already been written off as irrecoverable in the accounts of an earlier previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year), but the Assessing Officer had not allowed it to be deducted on the ground that it had not been established to have become a bad debt in that year;

(iv) Where any such debt or part of debt is written off as irrecoverable in the accounts of the previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year) and the Assessing Officer is satisfied that such debt or

> part became a bad debt in any earlier previous year not falling beyond a period of four previous years immediately preceding the previous year in which such debt or part is written off, provisions of sub-section (6) of section 155 shall apply;
>
> (v) Where such debt or part of debt relates to advances made by an assessee to which clause (viia) of sub-section (1) applies, no such deduction shall be allowed unless the assessee has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debts account made under that clause."

15. The income of an assessee carrying on a business or profession has to be assessed in accordance with the scheme contained in Part 'D' of Chapter IV dealing with heads of income. Section 28 of the Act deals with the chargeability of income to tax under the head 'profits and gains of business or profession'. All 'other deductions' available to an assessee under this head of income are dealt with under Section 36 of the Act which opens with the words 'the deduction provided for in the following clauses shall be allowed in respect of matters dealt with therein, in computing the income referred to in Section 28'. In other words for the purposes of computing the income chargeable to tax, beside specific deductions, 'other deductions' postulated in different clauses of Section 36 are to be allowed by the assessing officer, in accordance with law.

16. Sections 36(1)(vii) and 36(1)(viia) provide for such

deductions, which are to be permitted, in accordance with the language of these provisions. A bare reading of these provisions show that Sections 36(1)(vii) and 36(1)(viia) are separate items of deduction. These are independent provisions and, therefore, cannot be intermingled or read into each other. It is a settled canon of interpretation of fiscal statutes that they need to be construed strictly and on their plain reading.

17. The provisions of Section 36(1)(vii) would come into play in the grant of deductions, subject to the limitation contained in Section 36(2) of the Act. Any bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year is the deduction which the assessee would be entitled to get, provided he satisfies the requirements of Section 36(2) of the Act. Allowing of deduction of bad debts is controlled by the provisions of Section 36(2). The argument advanced on behalf of the Revenue is that it would amount to allowing a double deduction if the provisions of Sections 36(1)(vii) and 36(1)(viia) are permitted to operate independently. There is no doubt that a statute is normally not construed to provide for a double

benefit unless it is specifically so stipulated or is clear from the scheme of the Act. As far as the question of double benefit is concerned, the Legislature in its wisdom introduced Section 36(2)(v) by the Finance Act, 1985 with effect from 01.04.1985. Section 36(2)(v) concerns itself as a check for claim of any double deduction and has to be read in conjunction with Section 36(1)(viia) of the Act. It requires the assessee to debit the amount of such debt or part thereof in the previous year to the provision made for that purpose.

Effect of Circulars

18. Now, we shall proceed to examine the effect of the circulars which are in force and are issued by the Central Board of Direct Taxes (for short, 'the Board') in exercise of the power vested in it under Section 119 of the Act. Circulars can be issued by the Board to explain or tone down the rigours of law and to ensure fair enforcement of its provisions. These circulars have the force of law and are binding on the income tax authorities, though they cannot be enforced adversely against the assessee. Normally, these circulars cannot be ignored. A circular may not override or detract from the provisions of the Act but it can seek to mitigate the rigour of a particular provision for the benefit of the assessee in certain

specified circumstances. So long as the circular is in force, it aids the uniform and proper administration and application of the provisions of the Act. {Refer to *UCO Bank, Calcutta* v. *Commissioner of Income Tax, W.B.* (1999) 4 SCC 599]}.

19. In the present case, after introduction of Section 36(1)(viia) by the Finance Act, 1979, [(1981) 131 ITR (St.) 88], with effect from 1st April, 1980, Circular No. 258 dated 14th June, 1979 was issued by the Board to clarify the application of the new provisions. The provisions were introduced in order to promote rural banking and assist the scheduled commercial banks in making adequate provision from their current profits to provide for risks in relation to their rural advances. The deductions were to be limited as specified in the Section. A 'rural branch' for the purpose of the Act had meant a branch of a scheduled bank, situated in a place with a population not exceeding 10,000, according to the last preceding census of which the relevant figures have been published. Under clause 13.3, the Circular found it relevant to mention that the provisions of new clause (viia) of Section 36(1), relating to the deduction on account of provisions for bad and doubtful debts, is distinct and independent of the provisions of Section

36(1)(vii) relating to allowance of deduction of the bad debts. In other words, the scheduled commercial banks would continue to get the benefit of the write-off of the irrecoverable debts under Section 36(1)(vii) in addition to the benefit of deduction of the provision for bad and doubtful debts under Section 36(1)(viia).

20. The Finance Act, 1985, which was given effect from 1st April, 1985, added the proviso to Section 36(1)(vii), amended Section 36(1)(viia) and also introduced clause (v) to Section 36(2) of the Act. To complete the history of amendments to these clauses, we may also notice that proviso to Section 36(1)(viia)(a) was introduced by Finance Act, 1999 with effect from 1st April, 2000 and explanation to Section 36(1)(vii) was introduced by Finance Act, 2001 with effect from 1st April, 2001.

21. A Circular No.421 dated 12th June, 1985 [(1985) 156 ITR (St.) 130] attempted to explain the amendments made to Section 36 and also explained the provisions of clause (viia) of Section 36(1). It reads as under :

> "*Deduction in respect of provisions made by banking companies for bad and doubtful debts.*
>
> 17.1 Section 36(1)(vii) of the Income-tax Act provides for a deduction in the computation of

taxable profits of the amount of any debt or part thereof which is established to have become a bad debt in the previous year. This allowance is subject to the fulfilment of the conditions specified in sub-section (2) of section 36.

17.2 Section 36(1)(viia) of the Income-tax Act provides for a deduction in respect of any provision for bad and doubtful debts made by a scheduled bank or a non-scheduled bank in relation to advances made by its rural branches, of any amount not exceeding 1½ per cent of the aggregate average advances made by such branches.

17.3 Having regard to the increasing social commitments of banks, section 36(1)(viia) has been amended to provide that in respect of any provision for bad and doubtful debts made by a scheduled bank [not being a bank approved by the Central Government for the purposes of section 36(1)(viiia) or a bank incorporated by or under the laws of a country outside India] or a non-scheduled bank, an amount not exceeding ten per cent of the total income (computed before making any deduction under the proposed new provision) or two per cent of the aggregate average advances made by rural branches of such banks, whichever is higher, shall be allowed as a deduction in computing the taxable profits.

17.4 Section 36(1)(vii) of the Act has also been amended to provide that in the case of a bank to which section 36(1)(viia) applies, the amount of bad and doubtful debts shall be debited to the provision for bad and doubtful debts account and that the deduction admissible under section 36(1)(vii) shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account.

17.5 Section 36(2) has been amended by insertion of a new clause (v) to provide that where a debt or

> a part of a debt considered bad or doubtful relates to advances made by a bank to which section 36(1)(*viia*) applies, no such deduction shall be allowed unless the bank has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debt account made under clause (*viia*) of section 36(1)."

22. Still another circular being Circular No.464, dated 18th July, 1986 [(1986) 161 ITR(St.) 66] was issued with the intention to explain the amendments made by the Income Tax (Amendment) Act, 1986. Clause 5 of the Circular dealt with the modifications introduced in respect of the deductions on provisions for bad and doubtful debts made by the banks and it stated as follows :

> "5. Modification in respect of deduction on provisions for bad and doubtful debts made by the banks
>
> 5.1 Under the existing provisions of clause (*viia*) of sub-section (1) of section 36 of the Income-tax Act inserted by the Finance Act, 1979, provision for bad and doubtful debts made by scheduled or a non-scheduled Indian bank is allowed as deduction within the prescribed limits. The limit prescribed is 10% of the total income or 2% of the aggregate average advances made by the rural branches of such banks, whichever is higher. It had been represented to the Government that the foreign banks were not entitled to any deduction under this provision and to that extent, they were being discriminated against. Further, it was felt that the existing ceiling in this regard, *i.e.*, 10% of the total income or 2% of the aggregate average advances made by the rural branches of Indian banks, whichever is higher, should be modified.

> Accordingly, by the Amending Act, the deduction presently available under clause (viia) of sub-section (1) of section 36 of the Income-tax Act has been split into two separate provisions. One of these limits the deduction to an amount not exceeding 2% of the aggregate average advances made by the rural branches of the banks concerned. It may be clarified that foreign banks do not have rural branches and hence this amendment will not be relevant in the case of the foreign banks. The other provisions secure that a further deduction shall be allowed in respect of the provision for bad and doubtful debts *made by all banks, not just the banks incorporated in India*, limited to 5% of the total income (computed before making any deduction under this clause and Chapter VI-A). This will imply that all scheduled or non-scheduled banks having rural branches would be allowed the deduction up to 2% of the aggregate average advances made by such branches and a further deduction up to 5% of their total income in respect of provision for bad and doubtful debts."

23. Reference usefully can also be made to the Statement of Objects and Reasons for the Finance Act, 1986, wherein, *inter alia*, it was stated that the amendments were intended to provide a deduction on the provisions for bad debts made by all banks upto 5 per cent of their total income and an additional 2 per cent of the aggregate average advances made by the rural branches of the banks. These percentages stood altered by subsequent amendments in 1993 and 2001.

24. Clear legislative intent of the relevant provisions and unambiguous language of the circulars with reference to the

amendments to Section 36 of the Act demonstrate that the deduction on account of provisions for bad and doubtful debts under Section 36(1)(viia) is distinct and independent of the provisions of Section 36(1)(vii) relating to allowance of the bad debts. The legislative intent was to encourage rural advances and the making of provisions for bad debts in relation to such rural branches. Another material aspect of the functioning of such banks is that their rural branches were practically treated as a distinct business, though ultimately these advances would form part of the books of accounts of the principal or head office branch. Thus, this Court would be more inclined to give an interpretation to these provisions which would serve the legislative object and intent, rather than to subvert the same. The Circulars in question show a trend of encouraging rural business and for providing greater deductions. The purpose of granting such deductions would stand frustrated if these deductions are implicitly neutralized against other independent deductions specifically provided under the provisions of the Act. To put it simply, the deductions permissible under Section 36(1)(vii) should not be negated by reading into this provision, limitations of Section 36(1)(viia) on the reasoning that it will form a check against

double deduction. To our mind, such approach would be erroneous and not applicable on the facts of the case in hand.

Interpretation and Construction of Relevant Sections

25. The language of Section 36(1)(vii) of the Act is unambiguous and does not admit of two interpretations. It applies to all banks, commercial or rural, scheduled or unscheduled. It gives a benefit to the assessee to claim a deduction on any bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year. This benefit is subject only to Section 36(2) of the Act. It is obligatory upon the assessee to prove to the assessing officer that the case satisfies the ingredients of Section 36(1)(vii) on the one hand and that it satisfies the requirements stated in Section 36(2) of the Act on the other. The proviso to Section 36(1)(vii) does not, in absolute terms, control the application of this provision as it comes into operation only when the case of the assessee is one which falls squarely under Section 36(1)(viia) of the Act. We may also notice that the explanation to Section 36(1)(vii), introduced by the Finance Act, 2001, has to be examined in conjunction with the principal section. The explanation specifically excluded any provision for bad and doubtful debts made in the account

of the assessee from the ambit and scope of 'any bad debt, or part thereof, written off as irrecoverable in the accounts of the assessee'. Thus, the concept of making a provision for bad and doubtful debts will fall outside the scope of Section 36(1)(vii) simplicitor. The proviso, as already noticed, will have to be read with the provisions of Section 36(1)(viia) of the Act. Once the bad debt is actually written off as irrecoverable and the requirements of Section 36(2) satisfied, then, it will not be permissible to deny such deduction on the apprehension of double deduction under the provisions of Section 36(1)(viia) and proviso to Section 36(1)(vii). This does not appear to be the intention of the framers of law. The scheduled and non-scheduled commercial banks would continue to get the full benefit of write off of the irrecoverable debts under Section 36(1)(vii) in addition to the benefit of deduction of bad and doubtful debts under Section 36(1)(viia). Mere provision for bad and doubtful debts may not be allowable, but in the case of a rural advance, the same, in terms of Section 36(1)(viia)(a), may be allowable without insisting on an actual write off.

26. The Special Bench of the ITAT had rejected the contention of the Revenue that proviso to Section 36(1)(vii)

applies to all banks and with reference to the circulars issued by the Board, held that a bank would be entitled to both deductions, one under clause (vii) of Section 36(1) of the Act on the basis of actual write off and the other on the basis of clause (viia) of Section 36(1) of the Act on the mere making of provision for bad debts. This, according to the Revenue, would lead to double deduction and the proviso to Section 36(1)(vii) was introduced with the intention to prevent this mischief. The contention of the Revenue, in our opinion, was rightly rejected by the Special Bench of the ITAT and it correctly held that the Board itself had recognized the position that a bank would be entitled to both the deductions. Further, it concluded that the proviso had been introduced to protect the Revenue, but it would be meaningless to invoke the same where there was no threat of double deduction.

27. As per this proviso to clause (vii), the deduction on account of the actual write off of bad debts would be limited to excess of the amount written off over the amount of the provision which had already been allowed under clause (viia). The proviso by and large protects the interests of the Revenue. In case of rural advances which are covered by clause (viia), there would be no such double deduction. The proviso, in its

terms, limits its application to the case of a bank to which clause (viia) applies. Indisputably, clause (viia)(a) applies only to rural advances.

28. As far as foreign banks are concerned, under Section 36(1)(viia)(b) and as far as public financial institutions or State financial corporations or State industrial investment corporations are concerned, under Section 36(1)(viia)(c), they do not have rural branches. Thus, it can safely be inferred that the proviso is self indicative that its application is to bad debts arising out of rural advances.

29. In a recent judgment of this Court, in *Southern Technologies Ltd. v. Joint Commissioner of Income Tax, Coimbatore* [(2010) 2 SCC 548] (authored by one of us, Kapadia, J., as he then was), both Sections 36(1)(vii) and 36(1)(viia) were discussed. Then, this Court went on to state how these provisions operate in the case of a Non Banking Financial Corporations (NBFC) *vis-à-vis* bank covered under Section 36(1)(viia). The Court held as under:

> "37. To understand the above dichotomy, one must understand "how to write off". If an assessee debits an amount of doubtful debt to the P&L 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 P&L 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 1-4-1989.

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58. Section 36(1)(vii) provides for a deduction in the computation of taxable profits for the debt established to be a bad debt. Section 36(1)(vii-a) provides for a deduction in respect of any provision for bad and doubtful debt made by a scheduled bank or non-scheduled bank in relation to advances made by its rural branches, of a sum not exceeding a specified percentage of the aggregate average advances by such branches.

59. Having regard to the increasing social commitment, Section 36(1)(vii-a) has been amended to provide that in respect of provision for bad and doubtful debt made by a scheduled bank or a non-scheduled bank, an amount not exceeding a specified per cent of the total income or a specified per cent of the aggregate average advances made by rural branches, whichever is higher, shall be allowed as deduction in computing the taxable profits. Even Section 36(1)(vii) has been amended to provide that in the case of a bank to which Section 36(1)(vii-a) applies, the amount of bad and doubtful debt shall be debited to the provision for bad and doubtful debt account and that the deduction shall be limited to the amount by which such debt exceeds the credit balance in the provision for bad and doubtful debt account.

60. The point to be highlighted is that in case of banks, by way of incentive, a provision for bad and doubtful debt is given the benefit of deduction, however, subject to the ceiling prescribed as stated above. Lastly, the provision for NPA created by a scheduled bank is added back and only thereafter deduction is made permissible under Section 36(1)(vii-a) as claimed."

30. The scope of the proviso to clause (vii) of Section 36(1) has to be ascertained from a cumulative reading of the provisions of clauses (vii), (viia) of Section 36(1) and clause (v) of Section 36(2) and only shows that a double benefit in respect of the same debt is not given to a scheduled bank. A scheduled bank may have both urban and rural branches. It may give advances from both branches with separate provision accounts for each.

31. It was neither in dispute earlier, nor dispute before us, that the assessee bank is maintaining two separate accounts, one being a provision for bad and doubtful debts other than provisions for bad debts in rural branches and another provision account for bad debts in rural branches for which separate accounts are maintained. This fact is evinced by the entries in the profit and loss account, balance sheet and break up details. We need not deliberate this aspect with reference to records at any greater length as this is not a matter in issue before us. It was contended on behalf of the Revenue that the Revenue is only concerned with the assessee as a single unit and not with how many separate accounts are being maintained by the assessee and under what items. The

Department, therefore, would assess an assessee with reference to a single account maintained in the head office of the concerned bank. This, according to the learned counsel appearing for the Department, would further substantiate the argument of the Department that the interpretation given by the Full Bench of the High Court is the correct interpretation of Section 36(1)(vii). This argument has to be rejected, being without merit.

32. In the normal course of its business, an assessee bank is to maintain different accounts for the rural debts for non-rural/urban debts. It is obvious that the branches in the rural areas would primarily be dealing with rural debts while the urban branches would deal with commercial debts. Maintenance of such separate accounts would not only be a matter of mere convenience but would be the requirement of accounting standards.

33. It is contended, and rightly so, on behalf of the assessee bank that under law, it is obliged to maintain accounts which would correctly depict its statement of affairs. This obligation arises implicitly from the requirements of the Act and certainly under the mandate of accounting standards.

34. *Inter alia*, following are the reasons that would fully

support the view that a bank should maintain the accounts with separate items for actual bad and irrecoverable debts as well as provision for such debts. It could, for valid reasons, have rural accounts more distinct from the urban, commercial accounts.

(a) It is obligatory upon each bank to ensure that the accounts represent the correct statement of affairs of the bank.

(b) Maintaining the common account may result in over stating the profits or the profits will shoot up which would result in accruing of liabilities not due.

(c) Accounting Standard (AS) 29, issued in 2003, which concerns treatment of 'provisions, contingent liabilities and contingent assets'. Under the head 'Use of Provisions', clauses 53 and 54 state as under:-

> "53. A provision should be used only for expenditures for which the provision was originally recognised.
>
> 54. Only expenditures that relate to the original provision are adjusted against it. Adjusting expenditures against a provision that was originally recognised for another purpose would conceal the impact of two different events."

35. The above clauses justify maintenance of distinct and

different accounts.

36. Merely because the Department has some apprehension of the possibility of double benefit to the assessee, this would not by itself be a sufficient ground for accepting its interpretation. Furthermore, the provisions of a section have to be interpreted on their plain language and could not be interpreted on the basis of apprehension of the Department. This Court, in the case of *Vijaya Bank v. Commissioner of Income Tax & Anr.* [(2010) 5 SCC 416], held 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 what ultimately matters, then there would be a mismatch between the rural branch accounts and the head office accounts. Therefore, in order to prevent such mismatch and to be in conformity with the accounting practice, the banks should maintain separate accounts. Of course, all accounts would ultimately get merged into the account of the head office, which will ultimately reflect one account (balance sheet), though containing different items.

37. Another example that would support this view is that, a bank can write off a loan against the account of 'A' alone where

it has advanced the loan to party 'A'. It cannot write off such loan against the account of 'B'. Similarly, a loan advanced under the rural schemes cannot be written off against an urban or a commercial loan by the bank in the normal course of its business.

38. The Full Bench of the Kerala High Court expressed the view that the Legislature did not make any distinction between provisions created in respect of advances by rural branches and advances by other branches of the bank. It also returned a finding while placing emphasis on the proviso to Section 36(1)(vii), read with clause (v) of Section 36(2) of the Act that the interpretation given by a Division Bench of that Courts in the case of *South Indian Bank* (supra) was not a correct enunciation of law, inasmuch as the same would lead to double deduction. It took the view that in a claim of deduction of bad debts written off in non-rural/urban branches in the previous year, by virtue of proviso to Section 36(1)(vii), the banks are entitled to claim deduction of such bad debts only to the extent it exceeds the provision created for bad or doubtful rural advances under clause (viia) of Section 36(1) of the Act. We are unable to persuade ourselves to contribute to this reasoning and statement of law.

39. Firstly, the Full Bench ignored the significant expression appearing in both the proviso to Section 36(1)(vii) and clause (v) of Section 36(2), i.e., 'assessee to which clause (viia) of sub-section (1) applies'. In other words, if the case of the assessee does not fall under Section 36(1)(viia), the proviso/limitation would not come into play.

40. It is useful to notice that in the proviso to Section 36(1)(vii), the explanation to that Section, Section 36(1)(viia) and 36(2)(v), the words used are 'provision for bad and doubtful debts' while in the main part of Section 36(1)(vii), the Legislature has intentionally not used such language. The proviso to Section 36(1)(vii) and Sections 36(1)(viia) and 36(2)(v) have to be read and construed together. They form a complete scheme for deductions and prescribe the extent to which such deductions are available to a scheduled bank in relation to rural loans etc., whereas Section 36(1)(vii) deals with general deductions available to a bank and even non-banking businesses upon their showing that an account had become bad and written off as irrecoverable in the accounts of the assessee for the previous year, satisfying the requirements contemplated in that behalf under Section 36(2). The provisions of Section 36(1)(vii) operate in their own field and

are not restricted by the limitations of Section 36(1)(viia) of the Act. In addition to the reasons afore-stated, we also approve the view taken by the Special Bench of ITAT and the Division Bench of the Kerala High Court in the case of *South Indian Bank* (supra).

41. 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).

42. Consequently, while answering the question in favour of the assessee, we allow the appeals of the assessees and dismiss the appeals preferred by the Revenue. Further, we direct that all matters be remanded to the assessing officer for computation in accordance with law, in light of the law enunciated in this judgment.

.....J.
(A.K. Patnaik)

.....J.
(Swatanter Kumar)

New Delhi;
February 17, 2012

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 1143 OF 2011

Catholic Syrian Bank Ltd. ...Appellant(s)

Versus

Commissioner of Income Tax, Thrissur ...Respondent(s)

with

Civil Appeal Nos. 1147/11, 1151/11, 1155/11, 1156-1160/11, 1170/11, 1171/11, 1172/11, 1173/11, 1174/11, 1175/11, 1176/11, 1177/11, 1178/11, 1179/11, 1180/11, 1181/11, 1182/11, 1183/11, 1184/11, 1185/11, 1186/11, 1187/11, 1188/11, 1189/11, 1190-1193/11, 1194/11, 1396/11, and 1397/11.

J U D G M E N T

S. H. KAPADIA, CJI

1. I have gone through the judgment of my esteemed brother Swatanter Kumar, J. and I agree with the conclusions contained therein. However, I would like to give my own reasons.

> The question for our consideration is - whether on the facts and circumstances of the case, the assessee(s) is eligible for deduction of the bad and doubtful debts actually written off in view of Section 36(1)(vii) which limits the deduction allowable under the proviso to

the excess over the credit balance made under clause (viia) of Section 36(1) of Income Tax Act, 1961 ("ITA" for short)?

2. Under Section 36(1)(vii) of the ITA 1961, the tax payer carrying on business is entitled to a deduction, in the computation of taxable profits, of the amount of any debt which is established to have become a bad debt during the previous year, subject to certain conditions. However, a mere provision for bad and doubtful debt(s) is not allowed as a deduction in the computation of taxable profits. In order to promote rural banking and in order to assist the scheduled commercial banks in making adequate provisions from their current profits to provide for risks in relation to their rural advances, the Finance Act, inserted clause (viia) in sub-section (1) of Section 36 to provide for a deduction, in the computation of taxable profits of all scheduled commercial banks, in respect of provisions made by them for bad and doubtful debt(s) relating to advances made by their rural branches. The deduction is limited to a specified percentage of the aggregate average advances made by the rural branches computed in the manner prescribed by the IT Rules, 1962. Thus, the provisions of clause (viia) of Section 36(1) relating to

the deduction on account of the provision for bad and doubtful debt(s) is distinct and independent of the provisions of Section 36(1)(vii) relating to allowance of the bad debt(s). In other words, the scheduled commercial banks would continue to get the full benefit of the write off of the irrecoverable debt(s) under Section 36(1)(vii) in addition to the benefit of deduction for the provision made for bad and doubtful debt(s) under Section 36(1)(viia). A reading of the Circulars issued by CBDT indicates that normally a deduction for bad debt(s) can be allowed only if the debt is written off in the books as bad debt(s). No deduction is allowable in respect of a mere provision for bad and doubtful debt(s). But in the case of rural advances, a deduction would be allowed even in respect of a mere provision without insisting on an actual write off. However, this may result in double allowance in the sense that in respect of same rural advance the bank may get allowance on the basis of clause (viia) and also on the basis of actual write off under clause (vii). This situation is taken care of by the proviso to clause (vii) which limits the allowance on the basis of the actual write off to the excess, if any, of the write off over the amount standing to the credit of the account created under clause (viia). However, the Revenue disputes the

position that the proviso to clause (vii) refers only to rural advances. It says that there are no such words in the proviso which indicates that the proviso apply only to rural advances. We find no merit in the objection raised by the Revenue. Firstly, CBDT itself has recognized the position that a bank would be entitled to both the deduction, one under clause (vii) on the basis of actual write off and another, on the basis of clause (viia) in respect of a mere provision. Further, to prevent double deduction, the proviso to clause (vii) was inserted which says that in respect of bad debt(s) arising out of rural advances, the deduction on account of actual write off would be limited to the excess of the amount written off over the amount of the provision allowed under clause (viia). Thus, the proviso to clause (vii) stood introduced in order to protect the Revenue. It would be meaningless to invoke the said proviso where there is no threat of double deduction. In case of rural advances, which are covered by the provisions of clause (viia), there would be no such double deduction. The proviso limits its application to the case of a bank to which clause (viia) applies. Clause (viia) applies only to rural advances. This has been explained by the Circulars issued by CBDT. Thus, the proviso indicates that it is limited in its application to bad

debt(s) arising out of rural advances of a bank. It follows that if the amount of bad debt(s) actually written off in the accounts of the bank represents only debt(s) arising out of urban advances, the allowance thereof in the assessment is not affected, controlled or limited in any way by the proviso to clause (vii).

3. Accordingly, the above question is answered in the affirmative, i.e., in favour of the assessee(s). For the above reasons, I agree that the appeals filed by the assessees stand allowed and the appeals filed by the Revenue stand dismissed with no order as to costs.

.....C.J.I.
(S.H. Kapadia)

New Delhi;
February 17, 2012