

## **SC breather to banks on tax dispute**

The Supreme Court has allowed the appeals of major banks in Kerala and dismissed the appeals by the Income Tax department in a dispute over the calculation of tax. The bench headed by Chief Justice S H Kapadia has asked the tax authorities to compute tax according to the principles laid down in the judgment.

The question involved in the case was whether the assessee banks were eligible for deduction of 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 (viiia) of Section 36(1) of Income Tax Act. The issue was answered in favour of the banks, which have made rural advances.

As a result of the judgment, the South Indian Bank is now entitled to get a refund of Rs 116 crore from the I-Tax department, while Federal Bank and Dhanlaxmi Bank would get Rs 30 crore each and the Catholic Syrian Bank Rs 15 crore.

The court said sections 36(1)(vii) and 36[1] (vii)(a) of the Income Tax Act [ITA] should be considered separately and deductions in tax assessment should be made independently.

Under Section 36(1)(vii) of the ITA, the tax payer is entitled to a deduction in the computation of taxable profits, equal to the amount of any debt established to have become a bad debt during the previous year, subject to certain conditions. However, a mere provision for doubtful debt is not allowed as a deduction in the computation of taxable profits.

To promote rural banking and to assist scheduled commercial banks make adequate provisions from their current profits to provide for risks in relation to their rural advances, the Finance Act inserted a clause to provide for a deduction in the computation of taxable profits of all scheduled commercial banks, in respect of provisions made by these for bad debts 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. This is subject to a limit of 10 per cent of the advances and 7.5 per cent of the taxable income of the bank. Thus, the provisions of Clause (viiia) of Section 36(1) relating to the deduction on account of the provision for bad and doubtful debts is distinct and independent of the provisions of Section 36(1)(vii) relating to allowance of the bad debt, the court said.

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

This order has a nation-wide impact, as all the commercial banks can now claim a refund of tax.

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