

Provisions for standard assets of banks aren't provisions for bad and doubtful debts: ITAT

Summary – The Visakhapatnam ITAT in a recent case of Chaitanya Godavari Grameena Bank., (the Assessee) held that Provision for standard assets is purely contingent and could not be included in provision for bad and doubtful debts, thus, same could not be allowed as deduction under section 36(1)(viiia)

In order to allow assessee's claim under section 36(1)(viiia), what is to be seen by Assessing Officer is as to whether provision for bad and doubtful debts is created, irrespective of whether it is in respect of rural or non-rural advances by debiting profit and loss account and, to extent provision for doubtful debts so created, assessee is entitled for deduction subject to upper limit of deduction laid down in said section

Facts

- The assessee debited a sum under the head 'provision for bad and doubtful debts' which included provisions for standard assets.
- The Assessing Officer held that the provision made against the standard assets was contingent liability and could not constitute deductible expenditure for the purpose of Income-tax Act. Provision for standard assets was not against any debt which had become doubtful. Accordingly, the Assessing Officer made disallowance in respect of same.
- On appeal, the Commissioner (Appeals) held that the assessee was entitled for deduction on standard assets also and, accordingly, deleted the addition made by the Assessing Officer.
- On appeal :

Held

- The assessee's case is that the entire amount claimed as bad debts including the provision against standard assets is covered under section 36(1)(viiia). The assessee argued that the nomenclature is immaterial and as long as the assessee makes a provision within the limits prescribed under section 36(1)(viiia) read with rule 6ABA the assessee is entitled for deduction.
- Careful reading of section 36(1) and (viiia) shows that the word used in sections is bad debt and bad and doubtful debt but not the standard asset. Both the sections are interrelated and the allowance is subject to satisfactions of the terms and conditions specified in section 36(2). Deduction is allowed under section 36(1)(vii) if the debt is written off in the books of account subject to the condition that the same is offered as income in the earlier year or incurred in the ordinary course of business in the case of money lender. The same conditions required to be satisfied for the purpose of bad and doubtful debts also, *i.e.*, the debt should have been incurred in the ordinary course of business and classified as doubtful debt. The bad debt which is written off and claimed as deduction required to

be offered to income when it is recovered. Similarly the provision made for bad and doubtful debt recovered subsequently required to be offered to income as and when it is recovered. Therefore, the deduction of provision for bad and doubtful debts should be provided for on identification of each debt as per the conduct of the business but not lump sum deduction as argued by the assessee. For identification of Non-Performing Assets, bad and doubtful debts the bank has to identify each debt as per the norms prescribed by the Reserve Bank of India and classify the same as bad and doubtful debts.

- From the Master Circular of prudential norms of RBI it is clarified that the Non-Performing Assets and the doubtful debts constitute the debt in cases of non-recoveries of principal and interest or the interest or the principal for certain period of time. For this purpose the assessee has to identify each asset and classify the same in the correct head. Since the recovery is doubtful in the case of NPAs, bad and doubtful debts they are identified by asset wise and are covered under section 36(1)(vii) and allowable as deduction. Though prudential norms of the RBI are mandatory for classification of assets and to compile the financial statements of the assessee they are guidelines for the purpose of computation of profit and loss account and balance sheets of the assessee but not binding on the income tax for computing the income. Even if the aggregate amount of bad and doubtful debts exceed the limit, the maximum allowable deduction is limited to the amount computed in the manner prescribed under section 36(1)(vii) read with rule 6ABA. The provision for standard asset is purely contingent and cannot be equated with the provision for bad and doubtful debts.
- Prudential norms shows that it is a general provision which should not be reckoned for the purpose of reckoning the NPA, should not be netted from gross advances to be shown separately as contingent provision against standard assets. In the Income tax, the provisions are not allowable deduction and only the expenditure actually incurred or ascertained as per the system of accounting is the allowable expenditure except the provision for bad and doubtful debts discussed above. The asset classification of clearly shows that it was purely general and contingent in nature. There is no indication of non-recoverability of the debt. Therefore, the provision for standard assets cannot be equated with the provision for bad and doubtful debt and the assessee's argument that only the nomenclature is different is unacceptable. The provision is required only to meet the unexpected eventuality in the interest of the banking, but it is neither an allowable expenditure nor an ascertained liability.
- The provision for standard assets is not an allowable deduction and the order of the Commissioner (Appeals) is set aside and the order of the Assessing Officer. is restored