

## **Deduction of provision for bad debts couldn't be disallowed by issuing sec. 143(1) intimation: HC**

**Summary – The High Court of Bombay in a recent case of Bajaj Auto Finance Ltd., (the Assessee) held that Issue as to whether claim of a provision for bad debts is deductible under section 36(1)(viii) or not, is debatable, and such a debatable claim cannot be disallowed by way of an intimation under section 143(1)(a)**

### **Facts**

- The assessee was an auto finance company. It debited in its profit and loss account certain amount, representing provision for doubtful overdue under hire purchase finance agreements. The assessee claimed said amount as bad debts under section 36(1)(vii) mentioning in the computation sheet that it was relying on the decision of *Vithaldas Dhanjibhai v. CIT* [\[1981\] 6 Taxman 105/130 ITR 95 \(Guj.\)](#) where claim of deduction of provision of bad debts was allowed by the High Court.
- The Assessing Officer took a view different from the said High Court decision and disallowed claim by issuing intimation and made addition to the assessee's income.
- The assessee filed application under section 154 for deletion of adjustment, but same was rejected by the Assessing Officer.
- On appeal, the Commissioner (Appeals) concurred with the findings of the Assessing Officer and dismissed the appeal.
- On further appeal, the Tribunal held, on the basis of the return of the income itself and the accounts and documents accompanying it, that the claim of provision for doubtful over due instalments under the hire purchase finance agreements was clearly distinct and separate form one of the claim of bad debts and was *prima facie* inadmissible on its own. The Tribunal, therefore, dismissed the assessee's appeal.
- On appeal to High Court:

### **Held**

- In *Vithaldas H. Dhanjibhai Bardanwala (supra)*, even a provision debited to the profit and loss account was allowed as bad debts, where corresponding credit entries are posted in the bad debts reserve account. It was held that it was not necessary to post credit entries in the ledger account of the concerned parties. It was on the basis of the aforesaid decision of the Gujarat High Court that the claim in respect of the provision for bad debts was made by the assessee. Once, reliance is placed upon a decision of a Court and/or Tribunal to make a claim, then even if the Assessing Officer has a different view and does not accept the view, yet the claim itself becomes debatable. This is so laid down in Instruction No. 1814, dated 4-4-1989 issued by the CBDT in respect of the scope of *prima facie* disallowance under section 143(1)(a). In fact, paragraph No.9 thereof provides that where a claim for deduction has been made on the basis of a decision of a High Court/Tribunal, then

even if there is contrary view expressed by another High Court and/or Tribunal or an appellate Authority, the issue itself becomes debatable. In such cases, no adjustment under section 143(1)(a) is permissible. Thus, disallowance of a claim can be made only after hearing the assessee who has made the claim.

- Further, Court in *Khatau Junkar Ltd. v. K.S. Pathania* [\[1992\] 196 ITR 157/61 Taxman 157 \(Bom.\)](#) had, while dealing with the word '*prima facie* inadmissible' in clause (iii) of section 143(1)(a), has held that the word '*prima facie*' means 'on the face of it the claim is not admissible'. It means the claim does not require any further inquiry before disallowing the claim. The Court observed that where a claim has been made which requires further inquiry, it cannot be disallowed without hearing the parties and/or giving the party an opportunity to submit proof in support of its claim. In the absence of section 143(1)(a) being read in the above manner *i.e.* debatable issues cannot be adjusted by way of intimation under section 143(1)(a), would lead to arbitrary and unreasonable intimations being issued, leading to chaos.
- In the present facts, it is undisputed that the decision of Gujarat High Court was referred to in the computation of income. Thus, the Assessing Officer could not have disallowed the claim on a *prima facie* view that the same is inadmissible. In fact, there can be no dispute that even according to the Assessing Officer, the issue was debatable. This is evident from the fact that, when the applicant assessee had filed an application under section 154 for deletion of the adjustment made of provision of bad debts by intimation under section 143(1)(a), it was disallowed on the ground that it is a debatable issue. This itself would indicate that whether the claim of a provision for bad debts is deductible under section 36(1)(vii) or not is debatable. Further, the above claim for deductions as made by the applicant was by following the decision of the Gujarat High Court in *Vithaldas H. Dhanjibhai Bardanwala (supra)*. Thus, it was a debatable issue. Therefore, the same could not have been disallowed by way of an intimation under section 143(1)(a).
- Section 36(1)(vii) was amended by the Finance Act, 2001 by insertion of Explanation to section 36(1)(vii) with effect from 1-4-1989. While disposing of a reference under section 256(1), the question proposed shall be answered taking into account the subsequent amendment to the law with retrospective effect, as they are clarificatory in nature.
- In the aforesaid background, it was found that the insertion done by Explanation to section 36(1)(vii) (with effect from 1989) would arise for consideration while answering the proposed question in respect of assessment year 1993-94. The above amendment by addition of Explanation to section 36(1)(vii) was a subject matter of consideration by the Supreme Court in *Vijaya Bank v. CIT* [\[2010\] 323 ITR 166/190 Taxman 257](#). In the above decision, the Court, while applying the amended law, held that mere debit of a provision to the profit and loss account will not by itself be sufficient to constitute bad debts (write off). This must be accompanied by simultaneously also reducing the loans and advances from the asset side of the balance sheet. This would ensure that the amount shown as loans and advances (debtors) is net of the provisions made for bad debts.

- Therefore, in the present facts, while mere making of provision for bad debts will not by itself (on application of amended law) entitle the party to deduction, yet it would be a matter where the assessee should be given an opportunity to establish its claim. This by producing its evidence of the manner in which it treated the provision of bad debts written off in accounts as well as in its balance sheet. Therefore, the disallowance cannot be made by intimation under section 143(1)(a), as it requires that a party be given an opportunity to establish its claim before disallowing it. It would have been a completely different matter if the Apex Court had ruled that in no case can provision for bad debts be allowed as a bad debt under section 36(1)(vii). The allowance of the claim of provision for bad debt is entirely dependent upon how it is reflected in the balance sheet and its accounts. Therefore, for the above purpose it is necessary that the party to be given an opportunity to establish its claim. Therefore, in the present facts, adjustment by way of disallowing deduction by intimation under section 143(1)(a) is not proper.