

## ITAT slams AO for not allowing bad debts claim in case co-operative bank didn't have any rural branches

**Summary – The Pune ITAT in a recent case of Bhagini Nivedita Sahakari Bank Ltd., (the Assessee) held that A co-operative bank is entitled to claim deduction of bad debts provided in first part of section 36(1)(vii)(a) being 7.5 per cent of total income even in absence of rural branches**

### Facts

- The assessee co-operative society was engaged in the business of banking. It had no rural branches though it had several branches in non-rural areas. For the year under consideration, the assessee had claimed deduction for doubtful debts under section 36(1)(vii) which was 7.5 per cent of the total income.
- The Assessing Officer noted that the assessee was not having any rural branches. He held that deduction under section 36(1)(vii) was available in respect of rural advances and since the bank was not having any rural advances, was not eligible for deduction under said section. Hence, deduction claimed under section 36(1)(vii) was disallowed.
- On appeal, the Commissioner (Appeals) also upheld the order passed by the Assessing Officer.
- In instant appeal the assessee contended that the assessee was co-operative bank, which admittedly, had no rural branches. Referring to the provisions of section 36(1)(vii), it was stressed that the said section had two limbs, wherein the deduction could be computed either on the basis of 7.5 per cent of total income or 10 per cent of aggregate average advances made by rural branches and since all the branches of assessee were urban branches, so percentage of rural branches would be zero and hence, first limb of section 36(1)(vii) was to be applied.

### Held

- The issue which arises in the present appeal is against claim of deduction under section 36(1)(vii). Under the said section, deduction is allowable on account of provision for bad and doubtful debts. In other words, deduction could be claimed in respect of bad and doubtful debts subject to the terms and conditions which are provided in the Act itself. *Explanation* to section 36 defines the terms used in sub-clause (a) of clause (vii), wherein it was defined as non-scheduled banks, rural branches, co-operative banks and scheduled banks. The assessee is a co-operative bank. In the initial years, co-operative banks were entitled to the benefit of deduction under section 80P. However, the said deduction has been withdrawn by the Finance Act, 2007 with effect from 1-4-2007. Thereafter, the Legislature has extended the benefit of section 36(1)(vii) co-operative banks also. Initially, only scheduled banks were entitled to the deduction under section 36(1)(vii) in respect of doubtful debts but with effect from 1-4-2007, the benefit has been extended to co-operative banks and they are entitled to claim the deduction on account of provision for bad and doubtful debts, subject to the condition that provision to that extent is made in the books of account. Sub-clause (a) refers to

deduction of an amount not exceeding 7.5 per cent of total income, before allowing any deduction under the chapter VI-A and secondly, it also refers to a deduction of an amount not exceeding 10 per cent of aggregate average advances made by rural branches of such banks, which have been computed in prescribed manner.

- The CBDT *vide* Circular No. 464, dated 18-7-1986 had clarified the position for bad and doubtful debts made by the banks that under the existing provisions inserted by Finance Act, 1979 provision for bad and doubtful debts made by scheduled or non-scheduled Indian bank was allowed as deduction within prescribed limits. The limit prescribed at the relevant time was 10 per cent of total income or 2 per cent of aggregate average advances made by the rural branches of such banks, whichever was higher. There was representation to the Government that foreign banks were not entitled to any such deduction and further it was also felt that existing ceiling at the relevant time, should be modified. Accordingly, by Amending Act, the deduction presently available under section 36(1)(vii) was split into two separate provisions. One of these limbs was the deduction to an amount not exceeding 2 per cent of aggregate average advances made to by rural branches of the bank concerned; in this regard, it was clarified that foreign banks do not have rural branches, hence this amendment would not be relevant in the case of foreign banks. The circular further provided that the other provisions secure that a further deduction shall be allowed in respect of provision for bad and doubtful debts made by all banks, not just the banks incorporated in India, limited to 5 per cent of total income. The circular then concluded by saying that this will imply that all scheduled or non-scheduled banks having rural branches would be allowed the deduction upto 2 per cent of the aggregate average advances made by such branches and a further deduction upto 5 per cent of their total income in respect of provision for bad and doubtful debts. In other words, the circular very clearly provided that two types of deductions have to be allowed to scheduled or non-scheduled banks *i.e.* in case they had rural branches, then deduction of 2 per cent of aggregate average advances was to be allowed and in addition to that deduction upto 5 per cent of their total income in respect of provision for bad and doubtful debts was to be allowed. The second part of deduction was also made available to foreign banks, which admittedly would never have rural branches in India. In such scenario, the intent of the Legislature was to provide deduction to the scheduled or non-scheduled banks; first on account of rural advances and second on account of total income other than the rural advances and two different types of deductions were provided. It may be clarified herein itself that the circular which is dated 18-7-1986 was in respect of scheduled or non-scheduled banks and extending to the foreign banks but the co-operative banks were not included at that relevant point for the aforesaid deduction. It was only with effect from 1-4-2007, amendment was made to section 36(1)(viii) in respect of any provision for bad and doubtful debts. It was provided that scheduled banks or non-scheduled banks, all co-operative banks other than primary agricultural credit society or primary co-operative agricultural and rural development banks, deduction was allowable to the extent of an amount not exceeding 7.5 per cent of total income computed before making any deduction under chapter VI-A and an amount not exceeding 10 per

cent of aggregate average advances made by rural branches of such banks, computed in the prescribed manner. The scope of said section has thus been enlarged with effect from 1-4-2007 and deduction is available not only to the scheduled or non-scheduled banks but to the co-operative banks also *i.e.* the assessee.

- The issue which arises is in relation to co-operative banks which do not have any rural branches. The question which is to be addressed is whether even in the absence of any rural branches, benefit of deduction could be allowed under section 36(1)(viii) to a co-operative bank and that also to the extent of 7.5 per cent of total income.
- The assessee is entitled to the claim of deduction under section 36(1)(viii) to the extent of 7.5 per cent of total income. The assessee co-operative bank do not have any rural branches, hence is not entitled to the second part claim of 10 per cent of advances made by rural branches. The deduction is allowable with a rider to satisfy the provisions of said section *i.e.* making a provision to that extent in the books of account.