IN THE INCOME TAX APPELLATE TRIBUNAL
BENCH : COCHIN

BEFORE SHRI GEORGE GEORGE K., JUDICIAL MEMBER
AND
Ms. PADMAVATHY S., ACCOUNTANT MEMBER

ITA No.838/Coch/2022
Assessment Year : 2017-18

Fedbank Financial Services Ltd., A-Wing, 5th Floor, Unit No.511 & 512, Kanakia Wall Street, Andheri Kurla Road, Andheri East, Mumbai – 400 093. **PAN : AAACF 8662J**	Vs.	The Deputy Commissioner of Income Tax, Circle 1(1), Kochi.
APPELLANT		RESPONDENT

Assessee by	:	Ms. K. Parvathy Ammal, CA
Revenue by	:	Shri Prashanth V.K., CIT(DR)

Date of hearing	:	01.03.2023
Date of Pronouncement	:	08.03.2023

O R D E R

Per Padmavathy S, Accountant Member:

This appeal is against the order of the Principal Commissioner of Income Tax (PCIT) passed u/s. 263 of the Income Tax Act (the Act) dated 30.03.2022 for the assessment year 2017-18.

2. The appellant is a non-banking financial company with registered office at Mumbai. The appellant is a wholly owned subsidiary of Federal Bank Ltd. The assessee filed the return of income for AY 2017-18 on 27.10.2017 declaring a total income of

Rs.37,50,77,620. The case was selected for scrutiny and the assessment was completed u/s.143(3) assessing the income of the assessee at Rs.37,77,62,220. Subsequently the PCIT issued a show cause notice by stating that –

> "the assesse had debited Rs. 3,38,000 towards 'provision/(Excess reversal) for Loss Assets" and Rs.2,45,000/- towards 'provision for Doubtful Debts' in the P&L account. The above amounts totalling Rs.5,83,000/- being 'provisions' is not an allowable expenditure u/s.37 of the IT Act. In the absence of any detail/explanation justifying the allow ability of the above sum of Rs.5.,83,000, this amount ought to have been disallowed by the A.O. However he has failed to do so.
> Thus, it is clear that the AO has mistakenly and erroneously omitted to consider the above facts, while completing the assessment, thereby causing prejudice to the interests of revenue".

3. The assessee filed a reply stating that –

> "`...Fedbank Financial Services Ltd. is a Non Banking Finance Company... we have made provisions for Debts by classification in accordance with NPA Provisioning Norms as stipulated in RBI guidelines... to bring parity with the banking sector, the benefit of claiming deduction with respect to provisions for bad and doubtful debts/advances was extended to NBFCs by the Finance Act, 2016...the necessary amendment was made in section 36(1)(viia) of the IT Act with effect from the AY 2017-18 onwards... however there is a view that no deduction is allowable under the said section for provision on standard debts...accordingly, we have added back Rs.1,53,44,773/ - being the Provision on standard debts... this add back is included in the amount of Rs.1,62,16,125 under any other disallowance in the ITR filed for AY 2017-18... as such amount claimed under section 36(1)(viia) is only Rs.5,83,000/ - (Rs.3,38,000/- towards Provision for Loss assets and Rs.2,45,000/ - towards Provision for Doubtful debts as per the NPA norms... as per section 36(1)(viia) up to 5% of total income is allowable which works out to be Rs.1.88 crores...since amount claimed is less than the 5% allowable, no addition is made at Sl. No. 6 (Amounts debited

to the profit and loss account, to the extent disallowable under section 36 due to non-fulfilment of condition specified in relevant clauses) against sub-item M (Provision for bad and doubtful debts)... hence no disallowance is warranted"

4. The PCIT did not accept the submissions of the assessee and proceeded to set aside the order passed u/s.143(3) by holding that –

"6.1 It is a fact that for the FY 2016-17 relevant to the AY 2017-18, the assessee had debited Rs.5.83 lakhs towards 'Provisions' (Rs.3.38 lakhs towards Provision for Loss Assets and Rs.2.45 lakhs towards Provision for doubtful debts) in the Profit and Loss account. Provisions are not an allowable expenditure u/s 37 of the IT Act and in the absence of any detail / justification from the assessee, the AO ought to have disallowed the same during the course of assessment proceedings before him.

6.2 During the course of present revisionary proceedings, the assessee has submitted that being a Non Banking Finance Company (NBFC), it is eligible for claiming deduction with respect to provisions for bad and doubtful debts as this benefit was extended to NBFCs by the Finance Act, 2016 making it effective from AY 2017-18 onwards. The assessee has further stated that as the above benefit does not extend to 'Provision on standard debts', it has added back Rs.1.53 crores being the 'Provision on standard debts' and has included the same in the amount of Rs.1.62 crores under 'any other disallowance' in its return of income for AY 2017-18. Thus, according to the assessee, it has correctly claimed the amount of Rs.5.83 lakhs towards 'provision for loss assets and doubtful debts' for AY 2017-18 and this amount is also less than 5% of its total income as stipulated in the Act. However, the AO has failed to enquire into this aspect of the case during the course of assessment proceedings before her.

6.3 From the brief discussion as narrated above, it is evident that the AO has failed to enquire into the factual aspects of the issue in this case. She has incorrectly assumed the facts of the case and has passed the impugned assessment order without application of mind. In my view, the AO has passed the

impugned assessment order in an erroneous fashion which is also prejudicial to the interests of revenue. ”

5. The assessee is in appeal before the Tribunal by raising various grounds against the order of the PCIT passed u/s.263.

6. The ld AR made the following submissions –

“1. Banking and Non-Banking Financial Companies are governed by the provisions of Reserve Bank of India.

2. The main object of the company is to grant loans. Invariably when loans are extended there are irrecoverable loans - bad debts. Section 36(1)(vi) provides for deduction in computing the income under Profit and Gains of business. Section 36(1)(vii) provides that “the amount of any bad debt or part thereof which is written off as irrecoverable in the books of accounts of the assesse for that previous year is an allowable deduction”. The said section is subject to provisions of sub section (2). Section 36(2) provides that “no 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 business of banking or money lending which is carried on by the assesse. Therefore any amount representing bad debt in respect of an assessee which is in the ordinary course of business of banking or money lending even the principal amount which is written off as bad debt is an allowable deduction. The condition was that the amount should be written off as irrecoverable in the accounts of the assessee for the previous year.

3. It was in 1979 that section 36(1) (viia) was introduced which provided for a deduction in respect of any provision for bad and doubtful debts. Initially the benefit of deduction in respect of provision for bad and doubtful debts was allowed only in respect of rural advance made by scheduled bank. However during the course of time the scope of the section was expanded, initially the benefit of deduction of provision for bad and doubtful was extended only to scheduled banks. However with effect from A.Y.2017-18 section 36(1)(viia)(d) provides that “deduction shall be allowed to

a non banking financial companies of an amount not exceeding 5% of the total income". Section 36(1) (viia) (d) provides that deduction in respect of any provision for bad and doubtful debts made by Non-Banking Financial Company can be allowed to an extent of an amount not exceeding 5% of the total amount computed before making any deduction under this clause and Chapter VIA. A non-banking financial company shall have the meaning assigned to it in clause 45(1) (f) of the Reserve Bank of India of 1934. It was based on this provision of deduction u/s.36(viia)(d) that the appellant made the claim of deduction. The total income of the appellant is 37.58 crores and 5% thereof was Rs.1.88 Crore and the claim of the appellant was only to an extent of Rs.1.83 lacs.

4. At this juncture it will also be useful to look at the classification in respect of loans and advances directed to be made by Reserve Bank of India. The loans extended by a NBFC are bifurcated into two i) standard assets and ii) non-performing assets. Non-performing assets further classified as.

Substandard assets

ii. Doubtful assets and

iii. Loss assets

5. Every Non-Banking Financial Company is required to provide for in its account a certain percentage towards provisions for bad debt and doubtful debt as per the guidelines of the Reserve Bank of India. Provision for bad debt and doubtful debt is mandatory in the accounts of a non-banking financial company. The Income tax Act in turn also permit deduction upto 5% of the income u/s.36(1) (viia) (viid) of the Act. Since the amount of provision for bad and doubtful debt did not exceed the amount specified in the section and provision is an allowable expenditure deduction was claimed. Incidentally it is submitted that in respect of standard assets also a provision to the extent Rs.1.53 crores was made which was however disallowed while computing the income since there were dissenting decisions as to whether the provisions for standard assets were allowable or not , since the standard assets did not as a matter of carry any risk of recovery. Hence to be on the conservative side the appellant while filing the return added back disallowed the claim of provisions on standard assets and confined its provisions only to an extent of bad and doubtful debts on the

non-performing assets. Hence there is no error in the assessment order passed by the assessing authority.

6. Section 263 is to be invoked when the twin conditions of order being erroneous and prejudicial to the revenue are to be satisfied."

7. The ld DR supported the order of the PCIT.

8. We heard the parties and perused the material on record. Before proceeding further, it is apposite to take note of the relevant extract of section 263 and the Explanation (2) to section 263 of the Act which is invoked in the present case, which read as under :-

> "Revision of orders prejudicial to revenue.
> 263. (1) The [Principal Chief Commissioner or Chief Commissioner or Principal Commissioner] or Commissioner may call for and examine the record of any proceeding under this Act, and if he considers that any order passed therein by the Assessing Officer 89[or the Transfer Pricing Officer, as the case may be,] is erroneous in so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making or causing to be made such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, 90[including,—
> ****
> Explanation 2.—For the purposes of this section, it is hereby declared that an order passed by the Assessing Officer 94[or the Transfer Pricing Officer, as the case may be,] shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if, in the opinion of the Principal 95[Chief Commissioner or Chief Commissioner or Principal] Commissioner or Commissioner,—
> (a) the order is passed without making inquiries or verification which should have been made;
> (b) the order is passed allowing any relief without inquiring into the claim;
> (c) the order has not been made in accordance with any order, direction or instruction issued by the Board under section 119; or
> (d) the order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional

> High Court or Supreme Court in the case of the assessee or any other person."

9. Thus, from close scrutiny of the provisions of section 263, it is evident that twin conditions are required to be satisfied for exercise of revisional jurisdiction under section 263 of the Act i.e., firstly, the order of the Assessing Officer is erroneous; and secondly, it is prejudicial to the interests of the revenue on account of error in the order of assessment. The Bombay High Court in the case of Gabriel India Ltd. (1993) 203 ITR 108 has explained as to when an order can be termed as erroneous as follows:-

> "From the aforesaid definitions it is clear that an order cannot be termed as erroneous unless it is not in accordance with law. If an income tax officer acting in accordance with the law makes a certain assessment, the same cannot be branded as erroneous by the Commissioner simply because, according to him, the order should have been written more elaborately. This section does not visualise a case of substitution of the judgment of the Commissioner for that of the Income-tax Officer, who passed the order, unless the decision is held to be erroneous. Cases may be visualised where the Income tax officer while making an assessment examines the accounts, makes enquiries, applies his mind to the facts and circumstances of the case and determines the income either by accepting the accounts or by making some estimate himself. The Commissioner, on perusal of records, may be of the opinion that the estimate made by the officer concerned was on the lower side and left to the Commissioner he would have estimated the income at a figure higher than the one determined by the Income tax officer. That would not vest the Commissioner with power to examine the accounts and determine the income himself at a higher figure. It is because the Income tax officer has exercised the quasi judicial power vested in him in accordance with law and arrived at a conclusion and such a conclusion cannot be termed to be erroneous simply because the Commissioner does not feel satisfied with the conclusion …….. There must be some prima facie material on record to show that the tax which was lawfully exigible has not been imposed or that by the application of the

relevant statute on an incorrect or incomplete interpretation a lesser tax than what was just has been imposed."

10. There is no dispute that u/s. 263 of the Act, the PCIT does have the power to set aside the assessment order and send the matter for a fresh assessment if he is satisfied that further enquiry is necessary and the assessment order is prejudicial to the interests of the Revenue. However, in doing so, the PCIT must have some material which would enable to form a prima facie opinion that the order passed by the AO is erroneous, insofar as it is prejudicial to the interests of the Revenue. In the given case post the amendment which is effective from AY 2017-18 wherein section 36(1)(viia)(d) is amended to provide that in respect of any provision for bad and doubtful debts made by a non-banking financial company, an amount not exceeding five per cent of the total income (computed before making any deduction under this clause and Chapter VI-A). From the perusal of records, it is noticed that the provision for doubtful debts as has been provided for by the assessee for the year under consideration does not exceed the limit as prescribed u/s.36(1)(viia)(d) and therefore there is no error in the order of assessment passed by the AO since no disallowance in this regard is warranted.

11. In view of the facts as discussed above and relying on the decision of Bombay High Court in the case of Gabriel India Ltd (supra), we are of the considered view that the PCIT is not justified in setting aside the order of the AO and accordingly we hold that the

order of the PCIT u/s. 263 is without jurisdiction and liable to be quashed.

12. In the result, the appeal of the assessee is allowed

Pronounced in the open court on this 8th day of March, 2023.

Sd/-	Sd/-
(GEORGE GEORGE K)	(PADMAVATHY S)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Bangalore,
Dated, the 8th March, 2023.

/*Desai S Murthy /*

Copy to:

1. Appellant 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar,
ITAT, Bangalore/Cochin.