**IN THE INCOME TAX APPELLATE TRIBUNAL**
**"C" BENCH: BANGALORE**

**BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER**
**AND**
**SHRI KESHAV DUBEY, JUDICIAL MEMBER**

| ITA No.562/Bang/2024 |
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| Assessment Year: 2020-21 |

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| Karnataka Bank Ltd.<br>Regd & Head Office PB No.599<br>Mahaveera Circle<br>Kankanady<br>Karnataka 575 002<br><br>**PAN NO : AABCT5589K** | **Vs.** | ACIT<br>Circle-1(1) & TPS<br>Mangaluru |
| **APPELLANT** | | **RESPONDENT** |

| ITA No.555/Bang/2024 |
|---|
| Assessment Year: 2020-21 |

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| ACIT<br>Circle-1(1) & TPS<br>Mangaluru | **Vs.** | Karnataka Bank Ltd.<br>Regd & Head Office PB No.599<br>Mahaveera Circle<br>Kankanady<br>Karnataka 575 002<br><br>**PAN NO : AABCT5589K** |
| **APPELLANT** | | **RESPONDENT** |

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| **Appellant by** | : | Sri S. Ananthan & Smt. Lalitha Rameswaran, A.Rs |
| **Respondent by** | : | Ms. Neera Malhotra, D.R. |

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| **Date of Hearing** | : | 13.06.2024 |
| **Date of Pronouncement** | : | 31.07.2024 |

**O R D E R**

**PER KESHAV DUBEY, JUDICIAL MEMBER:**

These are cross appeals filed by assessee and revenue directed against order of NFAC for the assessment year 2020-21 dated 8.2.2024 passed u/s 250 of the Income Tax Act, 1961 (in short "The Act").

**2.** The assessee has raised following grounds of appeal:

*1. The order of the learned Commissioner of Income Tax Appeals) is bad in law, arbitrary, perverse and legally unsustainable.*

*2. The learned Commissioner of Income Tax (Appeals) erred in upholding the disallowance u/s 14A to the extent of 1% of tax exempt securities.*

*3. The learned Commissioner of Income Tax (Appeals) erred in upholding the disallowance of Rs.1073,95,04,388/- u/s 36(1)(vii) being the bad debts written off by the non-rural branches of the Appellant bank.*

*4. Without prejudice to ground no. 3, the learned Assessing Officer be directed not to tax the recovery from written off accounts if the ground no. 3 is not allowed.*

*5. The learned Commissioner of Income Tax (Appeals) erred in upholding the disallowance of Rs. 1,20,77,150/- being the Penalty paid to RBI.*

*6. The learned Commissioner of Income Tax (Appeals) erred in upholding the disallowance of Rs 44,660/- being club expenses incurred by the bank.*
*Total Tax Effect 3,51,83,47,070/-*

**3.** The revenue has raised following grounds of appeal:

*1. The order of the ld. CIT(A) is opposed to law and facts of the case.*

*2. The ld. CIT(A) has erred in considering the loss from securitization trust as an allowable expense even when the underlying assets have been written off the books and deduction has been claimed on account of bad and doubtful debts.*

*3. The ld. CIT(A) has erred in considering the loss from securitization trust as an allowable expense u/s 115TCA of the Income Tax Act, even when there is no specific provision u/s 115TCA of the Income Tax Act for sharing of expenses of Securitization trust.*

*4. The appellant craves leave to add, to amend, to alter/or to delete all or an of the above grounds of appeal.*

**4.** First, we will take up the assessee's appeal in ITA No.562/Bang/2024 (AY 2020-21).

**5.** Ground No.1 is general which do not require any adjudication.

**6.** Ground No.2 is with regard to disallowance u/s 14A of the Act of Rs.1,80,37,124/-.

**6.1** Facts of the case are that during the assessment proceedings, ld. AO found that the assessee had earned exempt income of Rs. 1,8139,849/- and made suo-moto disallowance of expenditure of Rs. 1,02,825/- relating to the exempt income. After examination of the submission and details, the AO made the addition u/s14A r.w.r. 8D stating that certain expenses relating to treasury section and brokerage paid for trading are directly linked to the investment. Further, it is stated that the every rupee spent or invested has an inherent opportunity cost and assessee bank didn't have any fund without cost. Also, the exempt income can't be earned without utilising the resources and existing establishment of the assessee bank.

**6.2** During the assessee proceeding the assessee contented before the ld. CIT(A) that the assessee had earned exempt income of Rs.l,39,849/- and the A.O. made a disallowance of Rs.1,80,37,124/- . The assessee submitted that it's total investment portfolio stood at Rs17,545.34 crores and the exempt investment is only Rs.90.57 crores, which forms just 0.52% of total investments. In this regard, the assessee has further submitted that even without the tax exempt investments, it would have incurred the expenditure to maintain the huge amount of investment portfolio. Therefore, no expenditure can be said to be incurred for earning the tax free income. Also, it hasnet surplus interest income over and above interest expenditure. Further, the exempt income is only incidental income and the investment activity doesn't require any human agency and no expenditure was involved. The assessee also contended that the disallowance was made almost of the same ground as in the earlier

year ignoring the decision of the jurisdictional tribunal I TAT, Bangalore and Karnataka High Court in assessee's own case and the Hon'ble Supreme Court in the case of South India Bank [2021] 438 ITR 1 (SC). The matter has been examined in detail by the ld. CIT(A) and he found that the then ld. CIT(A) and thereafter, the ITAT in assessee's own case had decided the issue in favour of the assessee primarily on the reason for non-recording of dis-satisfaction of AO about correctness of the claim of the expenditure. The ld. CIT(A) referred the relevant section and rule relating to this issue, which are as under:-

*14A. (2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.*

*8D. (1) Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with—*

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| *(a)* | *the correctness of the claim of expenditure made by the assessee; or* |
| *(b)* | *the claim made by the assessee that no expenditure has been incurred,* |

*in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).*

**6.3** The ld. CIT(A) observed that a plain reading of the above provisions reveals that the dis-satisfaction of the AO has been further elaborated in the rule 8D(1), wherein two conditions are prescribed for non-satisfaction of the AO and the Rule 8D(1) prescribes fulfilment of any one of the two conditions precedent to the calculation of disallowance as per the method prescribed in rule 8D(2). The first condition may be about the dis-satisfaction of correctness of the claim of expenditure and the second condition may be about the dis-satisfaction of the claim made by the assessee that

no expenditure was incurred. So fulfilment of any condition shall be sufficient to hold that the AO was not satisfied about the correctness of the claim of the assessee. In the present case, it is seen from the assessment order that the AO had issued specific queries intimating that the assessee's submission that there is no expenditure involve in earning exempt income does not appear to be correct and thereafter, made several findings before rejecting the submission of the assessee. Further, the AO had examined the issue in details and made his/her view on each & every submission of the assessee. This shows that the AO not satisfied with the arguments of the assessee in support of claim that no expenditure was incurred to earn exempt income and fulfil the second condition prescribed at clause (b) of rule 8D(1). Also, the Act/Rule doesn't prescribe any specific method of recording the dis-satisfaction of the AO. This view is duly supported by the decision of the Hon'ble High Court of Gujarat in the case of Devarsons Industries (P.) Ltd. Vs. ACIT (OSD) [2017] 84 taxmann.com 244 (Gujarat) wherein it was held that where Assessing Officer gave detailed reasons for making disallowance under section 14A in respect of exempt dividend income and LTCG earned by assessee discarding assessee's theory that to earn assessable income assessee incurred no expenditure whatsoever, mere fact that Assessing Officer did not arrive at satisfaction in a particular manner while making said disallowance, would not per se destroy mandate of section 14A. In fact, the jurisdictional ITAT in assessee's own case for AY 2012-13 had categorically stated that there is no particular method/manner to record satisfaction or dissatisfaction and the same has to be inferred from the discussion made by the AO as held in the MAK Data (P) Ltd Vs CIT[2013](358 1 TR 593) (SC). Thus, the assessee's contention on this count was rejected by ld. CIT(A).

**6.4** The assessee had further submitted that the Hon'ble Supreme Court in the case of South Indian Bank (2021) 438 ITR 1 (SC) has held that no disallowance can be made in case of bank because the

investment made by a banking concern is part of their banking business and income from such investment shall be business income. On examination of the aforesaid decision, it is seen that the Hon'ble Court had referred the CBDT's Circular No. 18 of 2015 wherein the issue relates to interest from non-slr securities of bank and not the tax free securities. Further, Hon'ble Supreme Court had decided the disallowance for interest expenditure and not the direct or administrative expenses. The assessee also relied on ITAT decision on the issue on it's own case but the same is not applicable because these decisions were made on a/c of non-recording of dis-satisfaction of AO only and not on a/c of other administrative & general expenses under rule 8D(2). During the appellate proceedings also, the assessee didn't make any submission with respect to disallowance made under rule 8D(2)(ii) on merit but only taken technical ground, which has already been discussed in preceding paras. Further, it is a matter of fact that investment in tax-free securities was placed to earn some dividend income on surplus fund and one has to monitor the requirement of fund for the business and investment and therefore, it can't be denied that no power, establishment and administration is required to deploy the surplus fund in tax-free securities.

**6.5** The assessee alternatively submitted before the ld. CIT(A) that the disallowance should be restricted on the tax-exempt investment of Rs. 90.57 crores only and not the portfolio of investments of Rs. 17,545.34 crores. This issue has been examined and it is found that the Hon'ble I TAT (Special Bench) of Delhi in the case of ACIT Vs Vireet Investment (P.) Ltd. [20171 82 taxmann.com 415 (Delhi - Trib.) (SB) has held that while computing disallowance u/s 14A r.w. Rule 8D, only those investments are to be considered for computing average value of investment, which yielded exempt income during year. In view of this finding of the Special Bench of ITAT, the AO is directed to restrict the disallowance u/s 14A r.w. Rule 8D(2)(ii) on average value of investment only which yielded exempt income

during the year. Nonetheless to say that the ld. CIT(A) directed the assessee that it shall furnish the details of investment, which yielded exempt income during the year under consideration and then the AOP shall verify and recompute the disallowance as directed above. Against this assessee is in appeal before us.

**7.** We have heard the rival submissions and perused the materials available on record. Similar issue came for consideration before this Tribunal in assessee's own case in ITA Nos.876 & 877, 963 & 964/Bang/2023 for the assessment years 2016-17 & 2017-18 the Tribunal vide order dated 19.2.2024 held as under:

*"11. After considering the rival submissions and perusing the material on record, we note that this issue was considered by this Tribunal in the case of Canara Bank (erstwhile Syndicate Bank) in ITA No. 501 & 390/Bang/2023for assessment years 2016-17 & 2017-18 dated 25.10.2023 and it was held as under:-*

> *"6. Considering rival submissions, we note that this issue has been settled by the Hon'ble jurisdictional High Court in assessee's own case for AY 2011-12 & 2012-13 in ITA No.258/2020 dated 8.2.2021 observing as under:-*
>
> *" 4. Even though four substantial questions of law are raised in the appeal Memorandum cited supra, among them, substantial question of law Nos.2 & 4 are covered by the judgment and are answered by the co-ordinate bench of this court vide judgment dated 31..01.2020 in ITA No.481/2014. Paras 8 to 10 of the said judgment dated 31.01.2020 passed in the aforesaid case, reads as under:*
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> *"8. We have considered the submissions made by learned counsel for the parties and have perused the record. Before proceeding further, it is apposite to take note of Section 14A of the Act:*
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> *Section 14A (1) For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.*
>
> (2) *The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assesee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.*

(3) *The provisions of sub-Section (2) shall also apply in relation to a case where an assesee claims that no expenditure has been incurred by him in rei-3tion to income which does not form part of the total income under this Act.*

*Provided that nothing contained in this Section shall empower the Assessing Officer either to reassess under Section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under Section 154, for any assessment year beginning on or before the 1st day of April 2001.*

9. *From perusal of Section 14A of the Act, it is evident that for the purposes of computing the total income under this chapter, no deduction shall be allowed in respect of the expenditure incurred by the assessee in relation of the income which does not form part of his total income under the Act. The expenditure, the return of investment and cost of requisition are distinct concepts. Therefore the word 'incurred' in Section 14A of the Act have to be read in the context of the scheme of the Act and if so read, it is clear that it disallows certain expenditures incurred to earn exempt income from being deducted from other incomes which is includable in the total income for the purposes of chargeability to the Lax. It i4 equally well settled that expenditure is a pay out. In order to attract applicability of section 14,4 of the Act, there has to be a pay out and return of investment or a pay back is not such a debit item. [See: WALFORT SHARE AND STOCK BROKERS (P) LTD SUPRA as well as M.4XOP INVESTMENTS LTD SUPRA]. In the instant case, the assessee has admittedly not incurred any expenditure. This case pertains to income on dividend, which by no stretch of imagination can be treated to be an expenditure to attract the provisions of Section 14A of the Act. In view of aforesaid enunciation of law by the Supreme Court, the first substantial question of law framed by this court is answered in favour of the assessee and against the revenue.*

10. *Learned counsel for parties, have fairly admitted that in case this court frames a substantial question of law that whether provisions of Section 115JA apply to the Banking Companies are not the remaining substantial questions of lay,/ would be reduced otiose. This court has already framed a substantial question of law in this regard today. This court by an order passed on 16.01.2020 passed in ITA No.13/2014 has already held that the provisions of Section 115JB do not apply to the banking companies. Therefore, the substantial questions of law Nos_3, 4 and 5 and substantial question of law framed in ITA 99/2010 are rendered academic and need not be answered. So far as substantial; question of law No.2 in ITA No.97/2010 is concerned, the same is squarely covered by the decision of the*
*Supreme Court in 'CIT VS. ESSAR TELEHOLOINGS LTD.',(2018) 401 ITR 445, wherein it has been held that provisions of Section 114A read with rule 8D of the Income Tax Rules are prospective in nature and can not be applied to any assessment year prior to Assessment Year 2008-09. Accordingly, the aforesaid substantial*

*question of law is answered against the revenue and in favour of the assessee."*

5. *In this regard, a memo is also filed by the learned counsel for the assessee, which reads as under:*

*"MEMO ON BEHALF OF THE APPELLANT*

*The appellant respectfully submits that in view of the substantial questions of law 2 and 4 having been covered in favour of the assessee in the earlier orders in assessee's own case, it is submitted that substantial questions of law 1 and 3 become academic and need not be answered by this Hon'ble Court.*

*Therefore, it is most humbly prayed that this Hon'ble Court may be pleased to take the memo on record and pass appropriate orders in the interests of justice and equity."*

6. *As per the Memo, question Nos.1 & 3 would only be treated as academic and hence, not answered. in view of the same, in terms of the order dated 31.01.2020, the substantial questions of law Nos.2 & 4 are answered in favour of the assessee and in terms of the aforesaid judgment."*

*6.1 Respectfully following the above judgment, we decide the issue in the above terms of the judgment. The ld. DR has submitted that the Hon'ble Apex court has admitted the SLP filed by the revenue but the status of the same could not be furnished by the ld. DR, accordingly, we are bound by the order of the Jurisdictional High Court."*

12. *Following the above decision of this Tribunal, we delete the disallowance sustained by the CIT(Appeals) u/s 14 r.w. Rule 8D. For AY 2017-18 also, on similar facts, we delete the disallowance u/s. 14A r.w. Rule 8D."*

**7.1** In view of the above order of the Tribunal, we delete the disallowance sustained by ld. CIT(A) u/s 14A of the Act r.w. Rule 8D of the I.T. Rules 1962. This ground of appeal of the assessee is allowed.

**8.** Next ground No.3 is with regard to upholding disallowance u/s 36(1)(vii) of the Act of Rs.1073,95,04,388/- being the bad debts written off by the non-rural branches of the assessee's bank.

**9.** Facts of the case are that The assessee claimed a sum of Rs.1073.95 crore as bad debts u/s 36(1 )(vii) of the Act related to non-rural branches in the computation of income. In the assessment

order, the A.O. held that the deduction is got allowable because the assessee bank has already been allowed provision for bad and doubtful debts u/s 36(1 and there was sufficient credit balance in the provision for doubtful debts accounts. The A.O. has taken this view by referring first proviso below section 36(1)(vii) and clause (v) of section 36(2) of the Act wherein it provides that no deduction u/s 36(1 )(vii) shall be allowable unless the assessee debited the bad debts to the provision for bad and doubtful debts account. The A.O. also referred Explanation 2 below section 36(1 )(vii) wherein it was clarified that provision for bad and doubtful debts u/s 36(1 shall relate to all types of advances including advances made by rural branches.

**10.** After hearing both the parties, we are of the opinion that similar issue came for consideration before this Bench in assessee's own case in ITA Nos.876 & 877 and 963 & 964/Bang/2023 for the assessment years 2016-17 & 2017-18 the Tribunal vide order dated 19.2.2024 held as under:

*"19. After hearing both the sides, we note that similar issue has been decided by the coordinate Bench of this Tribunal in assessee's own case for AY 2014-15 in ITA No.1907/BANG/2018 & 230/PAN/2018 dated 26.5.2022 in favour of the assessee after considering*
*Explanation 2 inserted in section 36(1)(vii) by Finance Act, 2013 (after the decision of the Supreme Court in the case of Catholic Syrian Bank) held as under:-*

> *"7.7 We heard the Ld D.R and perused the record. Now the core question that arises is whether the bad debts relating to non-rural branches are also required to be first debited to PBDD a/c and then the excess amount over and above the balance available in PBDD alone could be allowed as bad debts u/s 36(1)(vii) of the Act. 7.8 The provisions of sec. 36(1)(vii) allows deduction as under:-*
>
> *"36(1)(vii) Subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year. Provided that in the case of an assessee to which clause (viia) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account under that clause.*
>
> ……..

*Explanation 2 – For the removal of doubts, it is hereby clarified that for the purposes of the proviso to clause (vii) of this subsection and clause (v) of sub section (2), the account referred to therein shall be only one account in respect of provision for bad and doubtful debts under clause (via) and such account shall relate to all types of advances, including advances made by rural branches;"*

*The provisions of sec.36(2)(v) are relevant here and it reads as under:-*

*"(2) In making any deduction for a bad debt or part thereof, the following provisions shall apply----*

*…….*

*(v) where such debt or part of debt relates to advances made by an assessee to which clause (viia) of sub-section (1) applies, no such deduction shall be allowed unless the assessee has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debts' account made under that clause."*

*A combined reading of provisions of clause (vii) of sec.36(1), the proviso thereunder and clause (v) of sec.36(2) would show that (a) the bank should debit the actual bad debts written off by it to "PBDD a/c" (sec. 36(2)(v)) (b) the deduction u/s 36(2)(vii) shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the PBDD made under clause (viia) of sec.36(1).*

*7.9 The contention of the revenue is that the Explanation 2 has expanded the scope of the proviso to sec. 36(1)(vii) and hence the bad debts relating to non-rural branches are also required to be first debited to PBDD a/c and the excess amount alone can be allowed as deduction u/s 36(1)(vii) of the Act. According to revenue, the decision rendered by Hon'ble Supreme Court in the case of Catholic Syrian Bank (2012)( 343 ITR 270). In the above said case, the Hon'ble Supreme Court has expressed the view that the provisions of sec. 36(1)(vii) and 36(1)(viia) allow separate deduction and they are independent provisions. The Supreme Court further held that the clause (viia)(a) applies only to rural advances. So the bad debts relating to non-rural advances need not be deducted against the PBDD allowed under clause (a) of sec.36(1)(viia) of the Act. The Hon'ble Supreme Court, inter alia, also observed as under:-*

*"31 It was neither in dispute earlier nor is it disputed before us, that the assessee-bank is maintaining two separate accounts, one being a provision for bad and doubtful debts other than provision for bad debts in rural branches and another provision account for bad debts in rural branches for which separate accounts are maintained…."*

*Referring to the above said observations, the revenue has taken the view that the Hon'ble Supreme Court has rendered its decision on the assumption that the banks would be maintaining two separate PBDD a/c, viz., one for rural branches and another one for non-rural branches.*

*7.10 It is possible that all banks may not be maintaining two separate accounts, as observed by the Hon'ble Supreme Court. Hence there was an apprehension in the minds of revenue with regard to the effect of the decision rendered by Hon'ble Supreme Court. For instance, if a particular bank is maintaining only a single PBDD a/c for the provision created u/s 36(1)(viia) of the Act and even if that bank is not having any rural branches, then it may try to avail the benefit of decision rendered by Hon'ble Supreme Court and may possibly contend that*

(i) *the provision allowed u/s 36(1)(viia) shall apply only to rural branches.*

(ii) *since it does not maintain two separate PBDD a/c for rural and non-rural advances, the bad debts relating non-rural branches need not be reduced from the PBDD a/c allowed u/s 36(1)(viia) in terms of sec. 36(2)(v) and the proviso to sec. 36(1)(vii) of the Act.*

*However, the Ld A.R submitted before us that the Explanation 2 has been inserted in sec. 36(1)(vii) by Finance Act, 2013 (after the decision of Catholic Syrian Bank) to debar certain assessees to avail the interpretation given by Hon'ble Supreme Court in the case of Catholic Syrian Bank (supra).*

*7.11 We have considered the arguments advanced by Ld A.R on this point. According to Ld A.R, if we closely analyse the provisions of sec. 36(1)(viia) of the Act, the intention of the Parliament in inserting Explanation -2 shall become clear. Accordingly, we analysed the provisions of sec.36(1)(viia) and notice that the said section allows deduction of PBDD to various types of assessees, viz.,*

(i) *Clause (a) of sec. 36(1)(viia) shall be applicable to a Scheduled bank (not being a bank incorporated by or under the laws of a country outside India) or non-scheduled bank or a cooperative bank other than a primary agricultural credit society or a primary cooperative agricultural and rural development bank.*

*The quantum of deduction is 7.50% of Total income (computed before making any deduction under this clause and Chapter VIA) and an amount not exceeding 10% of aggregate average advances made by the rural branches of such bank.*

(ii) *Clause (b) of sec. 36(1)(viia) shall be applicable to a bank incorporated by or under the laws of a country outside India. The quantum of deduction is 5% of the total income (computed before making any deduction under this clause and Chapter VIA).*

(iii) *Clause (c) is applicable to a public financial institution or a State financial corporation or a State industrial investment corporation. The quantum of deduction is 5% of total income (computed before making any deduction under this clause and Chapter VIA).*

(iv) *Clause (d) is applicable to Non-banking financial company from AY 2017-18.*

*The Hon'ble Supreme Court in the case of Catholic Syrian Bank (supra) has held that the PBDD allowed under clause (a) of Sec. 36(1)(viia) refers to 'rural advances' only. In fact the expression "rural branches" finds place in clause (a) only. It can be noticed that the reference to "rural branches" is not there in clause (b) to (d). Generally, the foreign banks may not have rural branches. However, such kind of banks, financial institutions, NBFC etc. are also eligible to claim deduction towards PBDD u/s 36(1)(viia) of the Act under clauses (b) to (d). In view of the decision rendered in the case of Catholic Syrian bank, it is possible that the assessees covered by clause (b) to (d) may contend that the bad debts written off by them need not be adjusted against PBDD allowed u/s 36(1)(viia) of the Act, since the bad debts relate to "non-rural debts". Accordingly, we are of the view that the Explanation 2 has been inserted in order to bring the assesses covered by clauses (b) to (d) within the ambit of the proviso to sec. 36(1)(vii) and sec. 36(2)(v) of the Act. Hence, in our view, advances given by rural and non-rural branches mentioned in Explanation 2 shall apply to the assesses covered by clause (b) to (d) of sec. 36(1)(viia) of the Act.*

*7.12 At this juncture, we may gainfully refer to the "MEMORANDUM EXPLAINING FINANCE BILL 2013", which brings out the intention of the Parliament in inserting Explanation-2 in sec. 36(1)(vii) of the Act. It is extracted below:-*

*"**Clarification for amount to be eligible for deduction as bad debts in case of banks**:-*

*Under the existing provisions of section 36(1)(viia) of the Income-tax Act, in computing the business income of certain banks and financial institutions, deduction is allowable in respect of any provision for bad and doubtful debts made by such entities subject to certain limits specified therein. The limit specified under section 36(1)(viia)(a) of the Act restrict the claim of deduction for provision for bad and doubtful debts for certain banks (not incorporated outside India) and certain cooperative banks to 7.5% of gross total income (before deduction under this clause) of such banks and 10% of the aggregate average advance made by the rural branches of such banks. This limit is 5% of gross total income (before deduction under this clause) under sections 36(1)(viia)(b) and 36(1)(viia)(c) for a bank incorporated outside India and certain financial institutions.*

*Provisions of clause (vii) of section 36(1) of the Act provides for deduction for bad debt actually written off as irrecoverable in the books of account of the assessee. The proviso to this clause provides that for an assessee, to which section 36(1)(viia) of the Act applies, deduction under said clause (vii) shall be limited to the amount by which the bad debt written off exceeds the credit balance in the provision for bad and*

*doubtful debts account made under section 36(1) (viia) of the Act. The provisions of section 36(1)(vii) of the Act are subject to the provisions of section 36(2) of the Act. The clause (v) of section 36(2) of the Act provides that the assessee, to which section 36(1)(viia) of the Act applies, should debit the amount of bad debt written off to the provision for bad and doubtful debts account made under section 36(1) (viia) of the Act. Therefore, the banks or financial institutions are entitled to claim deduction for bad debt actually written off under section 36(1)(vii) of the Act only to the extent it is in excess of the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) of the Act.*

*However, certain judicial pronouncements have created doubts about the scope and applicability of proviso to section 36(1)(vii) and held that the proviso to section 36(1)(vii) applies only to provision made for bad and doubtful debts relating to rural advances. Section 36(1)(viia) of the Act contains three subclauses, i.e. sub-clause (a), sub-clause (b) and sub-clause (c) and only one of the sub-clauses i.e. sub-clause (a) refers to rural advances whereas other sub-clauses do not refer to the rural advances. In fact, foreign banks generally do not have rural branches. Therefore, the provision for bad and doubtful debts account made under clause (viia) of section 36(1) and referred to in proviso to clause (vii) of section 36(1) and section 36(2)(v) applies to all types of advances, whether rural or other advances. It has also been interpreted that there are separate accounts in respect of provision for bad and doubtful debt under clause (viia) for rural advances and urban advances and if the actual write off of debt relates to urban advances, then, it should not be set off against provision for bad and doubtful debts made for rural advances.* ***There is no such distinction made in clause (viia) of section 36(1)****. In order to clarify the scope and applicability of provision of clause (vii), (viia) of sub-section (1) and sub-section (2), it is proposed* ***to insert an Explanation in clause (vii) of section 36(1) stating that for the purposes of the proviso to section 36(1)(vii) and section 36(2)(v), only one account as referred to therein is made in respect of provision for bad and doubtful debts under section 36(1)(viia) and such account relates to all types of advances, including advances made by rural branches.*** *Therefore, for an assessee to which clause (viia) of section 36(1) applies, the amount of deduction in respect of the bad debts actually written off under section 36(1)(vii) shall be limited to the amount by which such bad debts exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) without any distinction between rural advances and other advances. This amendment will take effect from 1st April, 2014 and will, accordingly, apply in relation to the assessment year 2014-15 and subsequent assessment years."*

*The CBDT has issued an Explanatory note to the Provisions of Finance Act, 2013 on 24.01.2014 in F No.142/24/2013 – TPC, wherein also the very same explanations have been given for introducing Explanation – 2*

*in Sec. 36(1)(vii) of the Act. The above said Memorandum and the Explanatory Note issued by the Government/CBDT supports our view.*

*7.13 Our view is further fortified by certain observations made by Hon'ble Supreme Court in the case of Catholic Syrian Bank (supra). We may refer to paragraph 27 of the decision now:-*

*"27. As per this proviso to clause (vii), the deduction on account of the actual write off of bad debts would be limited to the excess of the amount written off over the amount of the provision which had already been allowed under clause (viia). The proviso by and large protects the interests of the Revenue. In case of rural advances which are covered by clause (viia), there would be no such double deduction. The proviso, in its terms, limits its application to the case of a bank to which clause (viia) applies.* ***Indisputably, clause (viia)(a) applies only to rural advances****."*

*It is pertinent to note that the Hon'ble Supreme Court has categorically held that clause (a) of sec. 36(1)(viia) applies to rural advances only. If the Parliament wanted to undo the above said interpretation given by the Hon'ble Supreme Court, it should have brought amendment in clause (a) to sec. 36(1)(viia) to make its intention clear that the clause (a) shall apply to both rural and non-rural advances. Since there is no such amendment, the interpretation given by Hon'ble Supreme Court that "clause (viia)(a) applies to rural advances only" shall remain intact. Explanation 2 inserted in sec. 36(1)(vii), in our view, does not override the above said interpretation given by Hon'ble Supreme Court.*

*7.14 In the Memorandum explaining the purpose of introducing Explanation -2 in Sec. 36(1)(vii), it has been acknowledged that only the clause (a) refers to "rural branches". It has also been stated that the foreign banks do not have rural branches. The assesses covered by clause (b) to (d) may not be having rural branches. Hence, the memorandum explains as under with regard to the decision rendered by Hon'ble Supreme Court in the case of Catholic Syrian Bank (supra):-*

*"However, certain judicial pronouncements have created doubts about the scope and applicability of proviso to section 36(1)(vii) and held that the proviso to section 36(1)(vii) applies only to provision made for bad and doubtful debts relating to rural advances."*

*Because of the interpretation so given by Hon'ble Supreme Court, as discussed earlier, there arose a necessity for the Parliament to clarify that the PBDD allowed u/s 36(1)(viia) shall apply to all types of advances including advances made by rural branches. However, as stated earlier, the clause (a) to sec.36(1)(viia) has been held to be applicable to rural advances only and this interpretation has not been overridden by any amendment.*

*7.15 As noticed earlier, the assessees covered by clauses (b) to (d) may not be having rural branches, but they would be getting the benefit of deduction of PBDD u/s 36(1)(viia) of the Act. Hence, in order to bring*

*those assessees within the ambit of the proviso to sec. 36(1)(vii) and sec. 36(2)(v), it was imperative for the Parliament to clarify the legal position and accordingly Explanation-2 has been inserted in sec. 36(1)(vii) of the Act. Accordingly, on the analysis of the provisions discussed above, we are of the view that the above said Explanation-2 shall operate*

(a) *in respect of clause (a) of sec. 36(1)(viia) of the Act only to rural advances and*

(b) *in respect of clauses (b) to (d), for advances given by both rural and non-rural branches.*

7.16 *In the instant case, the assessee has claimed deduction towards PBDD under clause (a) to sec. 36(1)(viia) of the Act, meaning thereby, the clause (a) is applicable to rural advances only as per the decision given by Hon'ble Supreme Court in the case of Catholic Syrian Bank. Hence the bad debts relating to non-rural branches are not required to be adjusted against PBDD allowed under clause (a) of sec. 36(1)(viia) of the Act in terms of the proviso to sec. 36(1)(vii) and sec. 36(2)(v) of the Act.*

7.17 *In view of the foregoing discussions, we are unable to agree with the view expressed by Ld CIT(A) on this issue. Accordingly, we set aside the order passed by Ld CIT(A) on this issue and direct the AO to allow the bad debts relating to nonrural branches u/s 36(1)(vii) of the Act without adjusting the same against the PBDD a/c, since the said PBDD a/c relates to rural advances only."*

20. *Respectfully following the above decision, we delete the addition u/s. 36(1)(vii) of the Act for both the AYs 2016-17. This issue for AY 2017-18 is on the same facts and there is only difference in quantum and hence applying the decision for AY 2016-17 we delete the addition on this issue for this AY 2017-18 also.*

**10.1** In view of the above order of the Tribunal, taking a consistent view, we allow the ground taken by the assessee.

**11.** With regard to next ground Nos.4 & 5 of the assessee's appeal, after hearing both the parties, we are of the opinion that similar issue came for consideration in the case of Canara Bank in ITA Nos.391 & 392/Bang/2023 for the assessment year 2019-20 dated 22.12.2023 wherein held as under:

*"21.2 We note that this Tribunal in case of Union Bank of India vs. DCIT (supra) observed and held as under:*

*"16.4 We heard rival submissions and perused the materials on record. We notice that the Mumbai Tribunal in IDBI Bank Ltd., case (Supra) while considering a similar penalty payment to RBI has held that the amount*

*paid by the assessee is not in the nature of penalty. The Hon'ble Mumbai Tribunal in this case has held that —*

> *12.1 In the instant case, as recorded by the AO the assessee has claimed expenses on account of penalty of 15,00,000/- imposed by the RBI u/s 47A of the Banking Regulation Act, 1949 and 94,200/- for noncompliance of guidelines on customer service, guidelines in respect of exchange of coins and small de-nomination notes and mutilated notes. The ratio laid down in the decisions mentioned at para 12 is squarely applicable to the instant case instead of the decision in ANZ Grindlays Bank (supra) relied on by the Ld. DR. Therefore, following the decisions mentioned at para 12 above, we delete the disallowance of 15,94,200/- levied by the AO. Accordingly, the 2nd ground of appeal is allowed."*

> *16.5. We notice that the Hon'ble Mumbai Tribunal in the above case has analysed the provisions of the Banking Regulation Act to understand the nature of fine / penalty paid before coming to the conclusion that the amount claimed are routine fines or penalties and that they are compensatory' in nature not punitive. We further notice as observed by the CIT(A) in the order, the assessee has not furnished the full details of the nature of payment made to RBI. We are of the considered view that the provisions under which these payments are done need to be looked into in detail and it will not be correct to conclude without analyzing the same. We therefore remand the case back to the AO to look into the details of payments made to RBI to see if these are routine payments for a procedural noncompliance or whether they are punitive. We allow the appeal of the assessee for statistical purposes."*

*Considering submissions of both sides, we remand this matter to file of AO to look into the details/nature of payments made by assessee to RBI in order to verify whether these are routine payments for procedural non-compliances or were punitive in nature. The Ld. AO is then directed to consider this issue in accordance with law.*

*Based on the above observation we remand this issue to the Ld.AO for necessary verification and consideration of the issue in accordance with law.*

***Accordingly Ground no.8 raised by the assessee stands partly allowed for statistical purposes."***

**11.1** Accordingly, in view of the above order of the Tribunal, this issue is remitted to the file of ld. AO on similar direction as discussed above. This ground of appeal is partly allowed for statistical purposes.

**12.** Ground No.6 is with regard to disallowance of club expenses. This ground is not pressed before us at the time of hearing. Accordingly, this ground is dismissed as not pressed.

**13.** In the result, appeal of the assessee in ITA No.562/Bang/2024 is partly allowed for statistical purposes.

**14.** Now we will take up revenue's appeal in ITA No.555/Bang/2024 (AY 2020-21).

**15.** Facts of the case are that the assessee has claimed a loss of Rs.4,96,33,514/- as per section 115TCA for AY 2020-21. The assessee submitted that this loss is a share of administrative expenses incurred by the securitization trust in recovering the bad debts, which was passed on to the assessee bank. The ld. AO disallowed the claim by noting that the assessee had been claiming deduction u/s 36(1)(viia) & 36(1)(vii) of the Act on account of NPA and bad & doubtful debts provision. The ld. AO has held that since the NPA has already been written off from the assessee's books, the loss derived from the investment of NPAs did not qualify for the claim.

**16.** The ld. CIT(A) observed that the main issue in this ground of appeal is whether the loss incurred by the securitization trust on behalf of the investor in connection with any investment, recovery of bad debt/NPA is an allowable expenditure in the hand of the investor or not. On plain reading of set 115TCA of the Act, it is inferred that any income accruing or arising to, or received by, person, being an investor of a securitization trust shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person, had the investments by the securitization trust been made directly by the person. In this regard, it is observed that income includes loss. This is held by the Hon'ble Supreme Court in the case of CIT vs. J. H. Gotla (1985) 156 ITR 323 (SC) wherein it was held that the expression 'income' shall include loss because the loss is nothing but negative income. In the instant case, the securitization trust is doing the NPA recovery work and thereby

incurred the expenditures arising out of which was passed on to all the investors including the assessee proportionately. In the light of sec 115TCA of the Act, it is considered that in case the securitization trust recovers from NPA and the same shall be allocated to all the investors including the assessee proportionately, which would amount to an income of the assessee. Therefore, expenditure incurred by the securitization trust to recover the NPA and proportionate allocation to all the investors is an allowable expense.

**16.1** Considering the facts and circumstances of the case, ld. CIT(A) observed that the allocation of loss on a/c of expenditure incurred by the securitization trust on behalf of the investors including the assessee is an allowable expenditure u/s 115TCA of the Act as income includes loss. Therefore, the AO was directed by the ld. CIT(A) to delete the disallowance made on this issue and allowed the ground of the assessee. Against this revenue is in appeal before us.

**17.** We have heard the rival submissions and perused the materials available on record. The ld. D.R. submitted that the quantification made by assessee towards this expenditure is not proper and while quantifying the expenditure on this count, one has to consider section 115TCA(4) of the Act which is missing in this case.

**17.1** In our opinion, we find force in the argument of ld. D.R. Accordingly, we remit this issue to the file of ld. AO to examine the disallowance after considering the provisions of section 115TCA(4) of the Act. Ordered accordingly.

**18.** In the result, appeal of the revenue is partly allowed for statistical purposes.

Order pronounced in the open court on 31st July, 2024

| | |
|---|---|
| **Sd/-** | **Sd/-** |
| **(Chandra Poojari)** | **(Keshav Dubey)** |
| **Accountant Member** | **Judicial Member** |

Bangalore,
Dated 31st July, 2024.
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The DR, ITAT, Bangalore.
5 Guard file

By order

**Asst. Registrar,**
**ITAT, Bangalore.**