

**Note relating to write-off of bad debt in the books of account of an assessee  
under the provisions of section 36(1)(vii) of the I.T.Act, 1961.**

Recently the Apex Court has rendered two very significant judgements in relation of the write-off of bad debt in the books of account of an assessee for the purpose of deduction thereof, under the provisions of section 36(1)(vii) of the Income-Tax Act, 1961 (the Act), r.w.s.36(2) of the Act. The aforesaid judgements are as follows :

- (i) *T.R.F. Ltd. Vs. CIT [2010] 323 ITR 397 (SC)*, and
- (ii) *Vijaya Bank Vs. CIT [2010] 323 ITR 166 (SC)*.

Earlier, the provisions of section 36(1)(vii) were also considered by the Apex Court, in the case of *Southern Technologies Ltd. Vs. JCIT [2010] 320 ITR 577 (SC)*.

Section 36(1)(vii) was amended by the Direct Tax Laws (Amendment) Act, 1987, with effect from 1.4.1989. Before the aforesaid amendment, section 36(1)(vii) read as follows :

**“36. Other deductions.**

- (1) *The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28-*
- (vii) *subject to the provisions of sub-section (2), the amount of any debt, or part thereof, which is established to have become a bad debt in the previous year.”*

After the aforesaid amendment, section 36(1)(vii) reads as follows :

**“36. Other deductions.**

- (1) *The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28-*
- (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”*

From the aforesaid provisions of section 36(1)(vii), it may be seen that after 1.4.1989, it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable. It is enough if the bad debt is written off as irrecoverable in the accounts of the assessee.

As per the present provisions of section 36(1)(vii), however, it will also be necessary to take into consideration the *Explanation* to section 36(1)(vii), as also the provisions of section 36(2) of the Act. For the sake of ready reference, section 36(1)(vii), along with the **proviso** and the *Explanation* thereto are reproduced as follows :

-----  
**Other deductions.**

**36. (1)** *The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—*

*(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 (vii) 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 made under that clause.*

*Explanation.—For the purposes of this clause, any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee;*

-----  
 In this context, it is relevant to note that the aforesaid *Explanation* to section 36(1)(vii) was inserted by the Finance Act, 2001, with effect from 1.4.1989, retrospectively. The aforesaid *Explanation* has made a lot of difference regarding the claim of deduction in respect of bad debt, under section 36(1)(vii) of the Act.

In this context, it will also be necessary to reproduce the provisions of 36(2) of the Act. The same are reproduced as follows :

-----  
**Other deductions.**

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

*(i) no such 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 the business of banking or money-lending which is carried on by the assessee;]*

*(ii) if the amount ultimately recovered on any such debt or part of debt is less than the difference between the debt or part and the amount so deducted, the deficiency shall be deductible in the previous year in which the ultimate recovery is made;*

*(iii) any such debt or part of debt may be deducted if it has already been written off as irrecoverable in the accounts of an earlier previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment*

- year), but the Assessing Officer had not allowed it to be deducted on the ground that it had not been established to have become a bad debt in that year;
- (iv) where any such debt or part of debt is written off as irrecoverable in the accounts of the previous year (being a previous year relevant to the assessment year commencing on the 1st day of April, 1988, or any earlier assessment year)] and the Assessing Officer is satisfied that such debt or part became a bad debt in any earlier previous year not falling beyond a period of four previous years immediately preceding the previous year in which such debt or part is written off, the provisions of sub-section (6) of section 155 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.

-----

It is in the light of the aforesaid provisions of section 36(1)(vii), r.w.s.36(2), that the aforesaid judgements of the Supreme Court are to be understood. Both the aforesaid judgements are discussed in detail as follows :

1. *T.R.F. Ltd. Vs. CIT [2010] 323 ITR 397 (SC)*

It was held in this case that after the amendment of section 36(1)(vii) of the Income-Tax Act, 1961, with effect from 1.4.1989, in order to obtain a deduction in relation to bad debts, it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable. It is enough if the bad debt is written off as irrecoverable in the accounts of the assessee.

2. *Vijaya Bank Vs. CIT [2010] 323 ITR 166 (SC)*

In this case, reliance has been placed on the earlier judgement of the Apex Court, in the case of *Southern Technologies Ltd. Vs. JCIT [2010] 320 ITR 577 (SC)*. In the judgement in the case of *Vijaya Bank*, the observations of the Apex Court, in the case of *Southern Technologies Ltd.*, have been referred to. The aforesaid observations are to be found on page 604 of the Report, in the case of *Southern Technologies Ltd.* For the sake of ready reference, the aforesaid observations are reproduced as follows :

-----

*Prior to April 1, 1989, the law, as it then stood, took the view that even in cases in which the assessee(s) makes only a provision in its accounts for bad debts and interest thereon and even though the amount is not actually written off by debiting the profit and loss account of the assessee and crediting the amount to the account of the debtor, the assessee was still entitled to deduction under section 36(1)(vii). (See VIT Vs. Jwala Prasad Tiwari [1953] 24 ITR 537 (Bom.) and Vithaldas H. Dhanjibhai Bardanwala Vs. CIT [1981] 130 ITR 95 (Guj.)). Such state of law*

prevailed up to and including the assessment year 1988-89. However, by insertion (with effect from April 1, 1989) of a new Explanation in section 36(1)(vii), it has been clarified that any bad debt written off as irrecoverable in the account of the assessee will not include any provision for bad and doubtful debt made in the accounts of the assessee. The said amendment indicates that before April 1, 1989, even a provision could be treated as a write off. However, after April 1, 1989, a distinct dichotomy is brought in by way of the said Explanation to section 36(1)(vii). Consequently, after April 1, 1989, a mere provision for bad debt would not be entitled to deduction under section 36(1)(vii). To understand the above dichotomy, one must understand “how to write off”. If an assessee debits an amount of doubtful debt to the profit and loss account and credits the asset account like sundry debtor’s account, it would constitute a write off of an actual debt. However, if an assessee debits “provision for doubtful debt” to the profit and loss account and makes a corresponding credit to the “current liabilities and provisions” on the liabilities side of the balance-sheet, then it would constitute a provision for doubtful debt. In the latter case, the assessee would not be entitled to deduction after April 1, 1989.

-----

In the light of the aforesaid observations of the Apex Court, in the case of *Southern Technologies Ltd.*, it was held in the case of *Vijaya Bank*, that after 1.4.1989, a mere provision for bad debt will not be entitled to deduction under section 36(1)(vii). If an assessee debits an amount of doubtful debt to the profit and loss account and credits the assets account like sundry debtors account, that would constitute a write off of an actual debt. However, if an assessee debits provision for doubtful debts to the profit and loss account and makes a corresponding credit to the “*current liabilities and provisions*” on the liabilities side of the balance-sheet, then it would constitute a provision for doubtful debt and in such a case, the assessee would not be entitled to deduction after April 1, 1989.

It was further held that though a mere debit to the profit and loss account would constitute a provision for a bad and doubtful debt, yet that would not constitute actual write-off. But where besides debiting the profit and loss account and creating a provision for bad and doubtful debt, the assessee has correspondingly / simultaneously obliterated the said provision from its accounts by reducing the corresponding amount from loans and advances / debtors on the assets side of the balance-sheet, and, consequently at the end of the year, the figure in the loans and advances or the debtors on the assets side of the balance-sheet is shown as net of the provision for “*impugned bad debt*”, the assessee will be entitled to the benefit of deduction under section 36(1)(vii), as there is an actual write-off by the assessee in his books. Disallowance cannot be made on an apprehension that if the assessee failed to close each and every individual account of its debtor, it may result in the assessee claiming deduction twice over.

*It was also held in the aforesaid judgement, in the case of Vijaya Bank that section 36(1)(vii) of the Act, dealing with deduction of bad debts written off by the assessee covers banking as well as non-banking assessees.*

In the present context, provisions of section 36(2)(v) are also relevant. According to section 36(2)(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 the previous year to the provision for bad and doubtful debts account made under that clause. It may be clarified here that clause (viia) of section 36(1) relates to deduction in respect of any provision for bad and doubtful debts made by a scheduled bank or a non-scheduled bank or a co-operative bank, etc.

### **Conclusion**

In the light of the aforesaid discussion, it may be concluded that –

- (i) In order to claim the deduction in respect of bad debt, the bad debt must be debited to the profit and loss account and correspondingly / simultaneously the aforesaid bad debt should be obliterated or reduced from loans and advances / debtors on the assets side of the balance-sheet and consequently at the end of the year, the figure of the loans and advances or the debtors on the assets side of the balance sheet is shown as net of the provision for the impugned bad debt.
  
- (ii) For the deduction in relation to bad debts under section 36(1)(vii) of the Act, it is not necessary for the assessee to establish that the debt has, in fact, become irrecoverable; it is enough if the bad debt is written off as irrecoverable in the accounts of the assessee.

Place : Pune

Date : 8.6.2010

(S.K.Tyagi)

jm