Deloitte.

Tax Alert | Delivering clarity

31 August 2020

Deduction allowed for diminution in value of government securities ‘Held till Maturity’ and disallowed in excess of provision in respect of rural advances

The Pune Bench of the Income-tax Appellate Tribunal rendered its decision that diminution in value of government securities, ‘Held till Maturity’ by the bank is deductible. Further, deduction for bad and doubtful debts in respect of advances made by rural branches under section 36(1)(viia) of the Income-tax Act, 1961, is not allowable in excess of the provision made.

Background:

Issue 1 – Deduction for diminution in value of securities

- The taxpayer[1] a co-operative bank, had purchased certain government securities, ‘Held till Maturity’ (securities) at a premium.
  - The taxpayer amortised the premium on securities in the profit and loss account (P&L).
- During the Financial Year (FY) 2011-12, corresponding to Assessment Year (AY) 2012-13, the taxpayer claimed deduction with respect to diminution in value of such securities (being the difference between face value of such securities and their market value at the end of the year) without routing it through the P&L.
- During audit, the Assessing Officer (AO) disallowed the deduction for diminution in value of securities on the following basis:
  - The securities were in the nature of investments; and
  - The taxpayer had not debited the amount of diminution to the P&L account.

Issue 2 – Deduction in excess of provision made for advances by rural branches

- The taxpayer had made a provision for bad and doubtful debts with respect to advances by rural branches. However, the taxpayer relying on a Delhi ITAT case[2] claimed a higher deduction under section 36(1)(viia) of the Income-tax Act, 1961 (ITA), being 10% of the aggregate average advances made by its rural branches.

  Section 36(1)(viia) allows deduction of provision made for bad and doubtful debts in respect of advances made by rural branches, subject to a maximum of 10% average of such advances.
- During audit, the AO allowed the taxpayer a deduction only to the extent of provision made and disallowed the excess deduction claimed.

[1] Vishwas Co-operative Bank Ltd. v. DCIT ITA No. 1060 / Pun / 2017

[2] ACIT v. Prathma Bank ITA No. 4090 / Del / 2013

On appeal, the Commissioner of Income-tax Appeals [CIT(A)] upheld the AO's order on both the issues. The taxpayer filed an appeal before the Pune Bench of the Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

Issue 1 – Deduction for diminution in value of securities

- The ITAT noted the following key points:
  - The taxpayer did not record the diminution in value of securities in its books of account in order to comply with the Reserve Bank of India (RBI) norms, as per which securities need to be valued at the year-end without any diminution.
  - The Revenue did not bring any contrary case on record to that of the Bombay High Court[3] relied upon by the taxpayer in which it was held that the securities held by the taxpayer bank as 'Held till Maturity' would not be treated as investment.
  - On sale of securities, the taxpayer had deducted the reduced market value (i.e. diminished value) of the securities for calculating income from sale of such securities.
  - The taxpayer had reflected the income / profit from sale of such securities as business income and not as capital gains.
  - The diminution of the value of the securities was determined without considering the amount of premium.
- The ITAT held that:
  - If a particular amount was deductible under the Income-tax Act, 1961 (ITA), then the same was to be allowed as deduction even if not recorded in the books of account.
  - The securities were stock-in-trade and not investments.

  Accordingly, the ITAT held that the taxpayer was eligible to claim deduction of the diminution in value of such securities.

Issue 2 – Deduction in excess of provision made for advances by rural branches

- The ITAT noted the following:
  - The Pune ITAT in a similar case[4] did not allow deduction under section 36(1)(viia) of the ITA in respect of the provision which was not made in the books of account (i.e. the Pune ITAT disallowed the deduction in excess of provision made). The Pune ITAT had relied on the decision of the Punjab and Haryana High Court[5] and another case of the Pune ITAT[6] while arriving at the said conclusion.

---

[3] Pr.CIT v. Bank of Maharashtra [2019] 410 ITR 413 (Bom HC)

[4] ACIT v. Bank of Maharashtra [2014] 41 CCH 108 (Pune ITAT)

[5] State Bank of Patiala v. CIT [2005] 272 ITR 54 (P&H)

[6] Shri Mahalakshmi Cooperative Bank Ltd. ITA No. 1658 / PN / 2011

- The case of Delhi ITAT[7] relied upon by the taxpayer, was given based on an earlier case in the context of section 263 of the ITA (pertaining to revision of orders prejudicial to the Revenue) in the said taxpayer's own case.

- Considering the above, the ITAT disallowed the claim of deduction in excess of provision.

Comments:

- This ruling affirms the following principles:
  - Diminution in value of securities 'Held till Maturity' held by banks is an allowable expense, even if the same is not routed through the P&L.
  - Deduction under section 36(1)(viia) of the ITA for bad and doubtful debts (in respect of advances made by rural branches of a bank) cannot exceed the actual provision made by the taxpayer in this regard.

[7] ACIT v. Prathma Bank ITA No. 4090 / Del / 2013