BEFORE THE AUTHORITY FOR ADVANCE RULINGS
(INCOME TAX) NEW DELHI

==========

Monday, the 31st Day of March, 2009

P R E S E N T

Mr. Justice P.V.Reddi (Chairman)
Mr. A.Sinha (Member)
Mr.Rao Ranvijay Singh (Member)

A.A.R. NO. 759 OF 2007

Name & address of the applicant	M/s.Rural Electrification Corporation Ltd. Core-4, Scope Complex,7 Lodhi Road, New Delhi-110003.
Commissioner concerned	Commissioner of Income Tax (LTU), New Delhi.
Present for the Applicant	Mr. Pradeep Dinodia, FCA Mr. D.S.Ahluwalia, GM, REC Mr. Rakesh Sareen, DGM(Finance)REC Mr. Murlidharan, CM(F&A), REC
Present for the Department	Mr. S.D.Kapila, Advocate

R U L I N G

(By Mr. Rao Ranvijay Singh)

The applicant, a Government company, has filed an application before us under section 245Q(1) of the Income Tax Act, 1961 (in short the Act) in the prescribed Form No. 34E i.e. the form prescribed for specified categories of resident applicants under section 245N(b)(ii) of the Act and has sought advance ruling in respect of the following two questions:-

"1. Whether the Income-tax Authorities are justified in making/confirming the disallowance u/s 36(1)(viii) of the Income-tax Act, amounting to

Rs.34,57,00,000/- as per provisions of that section as it stood at the material point of time.

2. Whether the Income-tax Authorities are justified in making/confirming the disallowance of Rs.26,50,00,00/- u/s 36(1)(viia) of the Income-tax Act pertaining to the provision for bad and doubtful debts in spite of the fact that reserve for the same has also been created."

2. The applicant, M/s. Rural Electrification Corporation Ltd. is a public sector undertaking and is engaged in the business of providing long term finance primarily to State Electricity Boards for the purpose of transmission, distribution and generation of electricity so that the society at large is benefited in respect of industrial, agricultural and infrastructural development. It has been stated that the Revenue had, all along in the past, accepted the applicant to be an eligible financial corporation for requisite deduction under section 36(1)(viii) of the Act and had accordingly allowed the deduction under the aforesaid section on the profits derived from the business of long-term finance for rural electrification.

1ST Question :

3. Facts:- In the Assessment Year (in short A.Y.) 1997-98 i.e. the year in question, the applicant furnished return of income on 30th November 1997, declaring an income of Rs.24,71,21,413/- under section 115JA of the Act. The said return was processed under section 143(1) of the Act on 16.6.1998 and the regular assessment order under section 143(3) of the Act was, after due scrutiny, passed on 24.3.2000 accepting the returned income. Requisite deduction under section 36(1)(viii) of the Act aggregating to Rs.34,57,00,000/- was also allowed.

Subsequently, as records bear out, the assessment proceedings were re-opened under section 147 of the Act on the ground that deduction already allowed under section 36(1)(viii) of the Act was erroneous and prejudicial to the interest of Revenue. Re-assessment proceedings were completed on 11.3.2005 under section 143(3) / 148. In appeal, the A.O.'s order was confirmed. Thereafter, the present application was filed after obtaining clearance from COD set up by the Govt. of India.

4. In course of the re-assessment proceedings, the Assessing Officer (in short A.O.) called upon the applicant to explain as to why the deductions already allowed under section 36(1)(viii) of the Act be not set aside in view of the fact that the special reserve created for the purpose of availing deduction under section 36(1)(viii) of the Act was subsequently withdrawn and transferred to General Reserve. To be more detailed, as per provisions of section 36(1)(viii), an assessee is required to create a special reserve for being eligible for deduction under Section 36(1)(viii) of the Act, of an amount not exceeding 40% of the profits derived from such business of providing long-term finance. The A.O. was of the view that even in the relevant assessment year, the creation of special reserve and the maintenance thereof constituted an essential ingredient for availing deduction under the aforesaid section. Scrutinizing the case, it transpired that in the return filed, the applicant claimed deduction of Rs.34.57 crores after creating a special reserve of Rs.36 crores. The A.O. examined the balance sheet and found that the applicant had an opening balance of Rs.272.79 crores by way of carried forward special reserve and had, in addition, created a special reserve out of the current year's

profit, to the tune of Rs.36 crores during the year in question. It was further noticed that the applicant had, as the records bear out, reduced an amount of Rs.257.05 crores from the opening balance of special reserve by way of transferring the same to general reserve account, thereby leaving a special reserve as on 31.3.1997 to the tune of Rs.51 crores only. The A.O. did not agree to the explanation furnished by the applicant and came to the conclusion that it was mandatory for the applicant during the year in question also to 'maintain' the special reserve already created and the applicant should not have transferred the same to the General Reserve. The A.O. has also stated in the assessment order that once the applicant has made a withdrawal from the Special Reserve created, it can be safely inferred that no special reserve was created by the applicant. The. A.O. accordingly, concluded that the applicant forfeits the claim for the deduction under Section 36(1)(viii) of the Act. Dealing with the contention based on the amendment brought out by Finance Act, 1997, the assessing officer observed:-

> *"… The assessee has referred to the amendment in clause (viii) of sub-section (1) of section 36 effected by Finance Act, 1997 with effect from 1.4.1998. The amendment has the effect of substituting the words in clause (viii) "in respect of any Special Reserve created", with the words "in respect of any Special Reserve created and maintained".*
>
> *xxx xxx xxx*
>
> *It can be seen from the above that the amendment has the effect of withdrawing the deduction already allowed under section 36(1)(viii) in a subsequent year in which the amount is withdrawn from the Special Reserve Account. In other words the amendment is not concerned with a case in which the withdrawal from the reserve is made in the same previous year in which the reserve is created. The amendment in clause (viii) should be read along with the amendment in section 41, with the introduction of sub-section (4A). If the amount is*

withdrawn from the Special Reserve in the same year, there would no question of applying section 41(4A) to withdraw the deduction already allowed. The amendment makes it all the more clear that at least as on the last day of the previous year the Special Reserve Account should remain in tact to make the assessee eligible for the deduction under section 36(1)(viii). The amendment is of curative effect as held by the Supreme Court in the case of Allied Motors reported in 224 ITR 667(SC). The addition of the phrase "maintained" in the amendment is clarificatory in nature as is evident from the proviso to section 36(1)(viii) which lays down the condition that where aggregate of the amount to such reserve exceeds twice the paid up capital and general reserve, no allowance is available on the excess. In other words, if withdrawal from special reserve is presumed to be permitted prior to 1.4.98, then in such situation this proviso will be rendered redundant and otiose. The intention of the legislature, therefore, has to be understood as providing for a situation where if the assessee creates a special reserve for the purposes of deduction u/s 36(1)(viii), it has to maintain the same.

In view of the discussion as above, the assessee is not eligible for deduction u/s 36(1)(viii). Accordingly, the deduction claimed by the assessee u/s 36(1)(vii) of Rs.34.57 crores is disallowed and added to the income of the assessee."

5. It would be appropriate to reproduce section 36(1)(viii) of the Act as it stood in the relevant assessment years i.e. A.Y.1997-98 in the following terms: -

Section 36(1)(viii) : as it stood in the statute during the A.Y.(1997-98)

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

xxx xxx xxx

(viii) …. In respect of any special reserve created by a financial corporation[@] which is engaged in providing long-term finance for [industrial or agricultural development or development of infrastructure facility in India or by a public company formed and

[@] emphasis supplied.

registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes, an amount not exceeding forty per cent of the profits[@] derived from such business of providing long-term finance computed under the head "Profits and gains of business or profession" **[**before making any deduction under this clause **]** carried to such reserve account[@]:]

Provided that the corporation [or, as the case may be, the company] is for the time being approved by the Central Government for the purposes of this clause:

Provided further that where the aggregate of the amounts carried to such reserve account from time to time exceeds [twice the amount of] the paid-up share capital **[**(excluding the amounts capitalized from reserves)**]** of the corporation [or, as the case may be, the company], no allowance under this clause shall be made in respect of such excess."

Explanation - *xxx* *xxx* *xxx*

6. In section 36(1)(viii) the amendment was made by the Finance Act, 1997 with effect from 1.4.1998, by inserting the word 'and maintained' after the word 'created'. The provision after the amendment, to the extent it is relevant, is quoted hereunder:-

Section 36(1)(viii) …." In respect of any special reserve created **[**and maintained**]**[@] by a financial corporation, which is engaged in providing long-term finance for [industrial or agricultural development or development of infrastructure facility in India or by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes, an amount not exceeding forty per cent of the profits derived from such business of providing long-term finance computed under the head "Profits and gains of business or profession" **[**before making any deduction under this clause) carried to such reserve account:]

[@] emphasis supplied.

Provided that the corporation [or, as the case may be, the company] is for the time being approved by the Central Government for the purposes of this clause:

Provided further that where the aggregate of the amounts carried to such reserve account from time to time exceeds [twice the amount of] the paid-up share capital **[**(excluding the amounts capitalized from reserves)**]** of the corporation [or, as the case may be, the company], no allowance under this clause shall be made in respect of such excess."

xxx ***xxx*** ***xxx***

7. Along with the amendment in section 36(1)(viii) as referred to in preceding Para, there has been simultaneous amendment w.e.f. 1.4.1998 in section 41 by way of insertion of clause (4A) in the following terms: -

Profits chargeable to tax.

Section 41.(1) xxx xxx xxx

(4A) "Where a deduction has been allowed in respect of any special reserve created and maintained under clause (vii) of sub-section (1) of section 36, <u>any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession</u>[@] and accordingly be chargeable to income-tax as the income of the previous year in which such amount is withdrawn."

Explanation. – Where any amount is withdrawn from the special reserve in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year."

8. From the above, it can be seen that while the Legislature had amended section 36(1)(viii) and intended to confer the benefit under that section only if that special reserve created is maintained, the consequence of withdrawing the amount from the special reserve in the previous year is taken care of by sub-section (4A) of section 41. In other words, if any deduction has been allowed in respect of any

[@] emphasis supplied.

special reserve under section 36(1)(viii) of the Income-tax Act and it is subsequently withdrawn, then it shall be deemed to have been profits and gains of the business and are chargeable to income-tax. Thus, the creation and maintenance of the reserve funds has been made a condition with effect from 1.4.98 for availing the benefit under section 36(1)(viii) and the consequence of withdrawing any such amount after deduction is made, by fiction of law, deemed to be the profit and gains of business chargeable to tax as the income of the previous year in which the amount is withdrawn.

9. Further, a comparative analysis of the provisions for two respective assessment years, as extracted above, shows that under section 36(1)(viii) of the Act, subject to certain conditions, a deduction is provided in respect of a special reserve created by a financial corporation of an amount not exceeding 40 per cent of the total income, carried to such reserve account. We think that crucial words in these provisions are 'special reserve created', '40 per cent of the total income' and 'carried to such reserve account'. With these crucial words, the section contemplates the creation of reserve out of the total income of the relevant previous year and it contemplates that the Profits should be carried to such reserve account. At this juncture, the following observations of Madras High Court in the case of CIT vs. Tamilnadu Industrial Investment Corporation, reported in 240 ITR 573, can be usefully referred to: -

> "Unless the assessee creates a special reserve out of the income of the previous year, the assessee is not entitled to claim the deduction under section 36(1)(viii) of the Act. The statutory condition is that the reserve must be out of the profit of the relevant previous

> year…….. may point out that under section 36(1)(viii) of the Act, the special reserve should not only be created but must be carried to reserve account".

We find that between the provisions as they stood in A.Y. 1997-98 and A.Y. 1998-99, the material variation is that of insertion of the word 'and maintained' with effect from 1.4.1998 i.e. applicable from the A.Y. 1998-99. The amendment has been effected primarily to incorporate the condition regarding maintenance of reserve and seems to have been necessitated to overcome some deficiencies in the Act such as likely misuse of the provision. An amendment to section 41 i.e. insertion of clause (4A) has also simultaneously been made in order to bring to tax any amount withdrawn from such special reserve in the year in which the amount is withdrawn.

10. The combined effect of the amendments made by the Finance Act 1997 in section 36(1)(viii) and section 41 of the IT Act have been aptly analyzed by a division bench of Kerala High Court in Kerala Finance Corporation vs. CIT (2003, 129 Taxman 365).

> "Thus, it can be seen that while the Legislature had amended section 36(1)(viii) and intended to confer the benefit under that section only if that special reserve created is maintained, the consequence of withdrawing the amount from the special reserve in the previous year is taken care of by sub-section (4A) of section 41. In other words, if any deduction has been allowed in respect of any special reserve under section 36(1)(viii) of the Income-tax Act and it is subsequently withdrawn, then it shall be deemed to have been profits and gains of the business and are chargeable to income-tax. Thus, the creation and maintenance of the reserve funds has been made a condition for availing the benefit under section 36(1)(viii) and the consequence of withdrawing any such amount after deduction is made, is also made by fiction of law, deemed to be the profit and gains of business chargeable to tax as the income of the previous year in which amount is withdrawn.

> Going by the plain language of the section as it stood at the relevant point of time, it can be seen that creation of a special reserve was sufficient to entitle the assessee to claim the benefit under section 36(1)(viii) of the Income-tax Act and that the word "and maintained" was inserted only with effect from 1.4.1998 and it is not given any retrospective effect either expressly or impliedly. The Circular issued by the Department as quoted above also clarifies the position that it was intended only to operate subsequent to assessment year in question, after the same was amended and not before."

11. Realising the fact that the amendment is not retrospective, the learned counsel for the Revenue has argued that even without taking resort to the amendment, the main provision in section 36(1)(viii) shall be construed in the light of the second proviso. It is pointed out that the main provision in sub clause (viii) shall be read in such a way that it is always subject to the restriction contained in the proviso. Otherwise, the second proviso will be practically rendered infructuous because an assessee could, just before the special reserve bloats up to the ceiling limit of 200 per cent of paid up capital, withdraw the amount from the special reserve and transfer the same to the general reserve. Such a situation could not have been contemplated by the legislature, contends the counsel for Revenue. Incidentally, stress is laid on the expression "from time to time" in the 2nd Proviso. In effect, the argument of the learned counsel is that even under the un-amended clause (viii), the special reserve shall not only be created but continue to be maintained so that the restriction under the second proviso could be effectively enforced. From another angle, it is submitted that the subsequent amendment adding the words 'and maintained' are to be treated as clarificatory of the pre-existing legal position. It is also submitted that the circular of CBDT referred to by the applicant is not really supportive of the applicant's contention.

12. It is the contention of the applicant's learned representative that the provision of maintaining special reserve created from time to time would only be applicable from A.Y. 1998-99 because the amendment did not have retrospective effect either expressly or impliedly. But for the subsequent amendment, there was no obligation to maintain the special reserve intact for the purpose of claiming the deduction under section 36(1)(viii). It is pointed out that the 2nd proviso which is a computation provision does not make any difference for the interpretation of the main provision in clause (viii). Further, it is submitted that the applicant, in the instant case, has not frittered away the special reserve created; on the other hand, the same has been transferred to the general reserve and the special reserve created during the year to the tune of 36 crores out of profit chargeable to tax, has remained intact and this in itself is sufficient to entitle the applicant to avail the deduction under section 36(1)(viii). It is further submitted that the amendment which was effected by the Finance Act, 1997 making the maintenance of reserve mandatory, cannot be construed as clarificatory in nature.

13. We find it difficult to accept the contention of the Revenue's counsel that clause (viii) of Section 36(1) as it stood before amendment has to be so construed as to imply an obligation to maintain the special reserve intact. It would amount to reading words which were not there in the pre-amended provision. The importance of difference between the expressions 'created' and 'maintained' cannot be understated. But for the amendment, the restriction against withdrawal of special reserve cannot be read into the main clause (viii). The legislature having noticed the need for amendment so as to prevent its misuse or to carry out the objective in

a more effective manner, thought it fit to introduce the word ‘maintain’ while at the same time amending section 41 in order to ensure that the amount withdrawn from the special reserve is subjected to tax. Thus, the Finance Act, 1997 has brought into existence a new scheme of taxation. It cannot be said to be just a reiteration of the old provision. True, the main provision as well as the proviso should be read together and if possible be so construed as to promote the objective of the proviso; but, it cannot be done, in the absence of clear words and in the absence of ambiguity in the pre-existing provision. The apprehension expressed by the learned counsel for Revenue that unless the requirement of maintenance of special reserve created is implied, the second proviso will be a dead letter does not appeal to us. The diversion from special reserve need not always be there to circumvent the second proviso. Various business exigencies or considerations may weigh with the assessee in deciding upon withdrawal from special reserve. It need not always be viewed from taxation angle. For instance, in the present case, the applicant has still maintained a substantial part of the special reserve even after transferring a part of it to general reserve, as seen earlier. Assuming that the effective working of the second proviso is impaired if the special reserve is not required to be maintained intact, the remedy lay in legislative amendment and that is why the legislature stepped in to introduce the amendment without giving retrospective effect to the same. Merely because the objective of the provision will be better served, it is not permissible to read words into a provision which is otherwise clear. We have, therefore, no hesitation in rejecting the contention advanced on behalf of the Revenue.

14. It is well-settled that an amending provision is regarded as clarificatory or declaratory when the same is introduced to clear the doubts or ambiguity as regards its meaning in order to avoid unintended consequences. In the instant case, there is no ambiguity in the earlier provision of section 36(1)(viii) as the only requirement for claiming the deduction was the creation of the special reserve and the proviso was there to take care of the computational aspect. This very scheme had been existing right from the inception of the Act. Moreover, in the absence of clear words indicating that the amendment was clarificatory, it would not be so construed when the pre amended provision was clear and unambiguous (Ref.Sakuru vs. Tanoji, AIR 1985 1277). Where a new provision impairs an existing right or creates a new obligation, retrospectivity cannot be inferred (vide Govinddas vs. I.T.O.)[@]. Another observation therein relevant to the present case is that 'if the enactment is expressed in language which is fairly capable of either interpretation, it ought to be construed as prospective only."

15. There is no doubt that the purpose of the expression 'and maintained' is obviously to impose an additional obligation and it is not merely declaratory of the existing legal provision as discussed earlier. The legislature, by the present amendment, seeks to restrict the benefit which the statute hitherto provided to the assessee. The scope and effect of the aforesaid amendment, as also the insertion of section 41(4A) have been elaborated in the following portion of the departmental circular No.763, dated 18th February,1998 :-

> "Amendment of section 36(1)(viii) to incorporate the condition of maintenance of special reserve. **21.1** Clause (viii) of sub-section (1) of section 36 permits the deduction of an

[@] 103 I.T.R. 123 (SC)

amount not exceeding forty per cent of the profits derived from the business of providing long-term finance carried to any special reserve, created by a financial corporation or a public company. The deduction is admissible provided that the corporation or the company is approved by the Central Government for this clause and the aggregate of the amounts carried over to the special reserve from time to time does not exceed twice the amount of paid up share capital and general reserves. While this clause imposes a condition of creation of a special reserve, it does not impose any condition on the maintenance of the reserve.

21.2 In order to incorporate the condition regarding maintenance of the reserve, clause (viii) has been amended by substituting the words "special reserve created" with the words "special reserve created and maintained". An amendment has been made in section 41 in order to bring to tax any amount withdrawn from such special reserve in the year in which the amount is withdrawn. For this purpose, a new sub-section (4A) has been introduced in this section, and a reference to this sub-section is also made in sub-section (5) of this section.

21.3 This amendment will take effect from the 1st April, 1998, and will, accordingly, apply in relation to the assessment year 1998-99 and subsequent years."

16. The following observations of the Kerala High Court in Kerala Financial Corporation case, in the penultimate para, are quite relevant and are extracted below:-

"As we have seen, the condition for availing the benefit under section 36(1)(viii) of the Income-tax Act, as it stood at the relevant time, is that a reserve fund should be created and that there is no dispute that such a fund was created. In the absence of any condition that it should be continued to be maintained, there is no warrant to think that the Legislature intended to confer the benefit of the provision only if it continued to maintain the reserve. In the absence of any condition that it should be continued to be maintained, there is no warrant to think that the Legislature intended to confer the benefit of the provision only if it continued to maintain the reserve. In the absence of any expression indicating such a

requirement by the assessee and in view of the fact that such a requirement was made expressly clear by an amendment brought about by the Finance Act, 1997, we have no hesitation to hold that such a requirement made explicitly clear both by the amendment to section 36(1)(viii) as well as by the insertion of sub-section (4A) of section 41 of the Income-tax Act, any retrospective effect cannot be presumed to be a condition for granting the benefit as per the provisions which stood prior to the amendment in question."

17. In Birla Cement Works vs. CBDT (248 ITR 216) the question arose whether Explanation III to Section 194C of the Income-tax Act, 1961 which was inserted by the Finance Act of 1995 was clarificatory. The Supreme Court held that there were no compelling reasons to hold that Explanation III was clarificatory or retrospective in operation. Although, there were conflicting views on the interpretation of expression "carrying out any work", it was held that section 194C before the insertion of Explanation III was not applicable to transport contracts. By Explanation III, an inclusive definition of 'work' was introduced so as to cover carriage of goods and passengers by any mode of transport other than by Railways.

18. In the case of Allied Motors (P) Ltd. vs. CIT[@] which was cited by the A.O., the Supreme Court took the view that the first proviso to Section 43B was retrospective in nature. The Supreme Court observed: "*a proviso which is inserted to remedy unintended consequences and to make the provision workable, a proviso which supplies an obvious omission in the section and is required to be read into the section to give the section a reasonable interpretation, requires to be treated as retrospective in operation, so that a reasonable interpretation can be given to the section as a whole".* The reasons for adopting the view that the first proviso to Section 43B was retrospective are found at page 684-685 of ITR. Explanation 2

[@] 224 I.T.R. 667

which was added subsequently was given retrospective effect. Having noticed that Explanation 2 and the first proviso cannot be read in isolation, their Lordships held that if the Explanation is retrospective, the first proviso is equally so. Hence, it was held that the proviso has to be read into Section 43B from its inception along with Explanation 2. This legal position was reinforced by a departmental circular referred to by the Supreme Court. The ratio of that judgment cannot be pressed into service here.

19. The Income Tax Appellate Tribunal (I.T.A.T.) Chandigarh Bench in the case of Delhi Financial Corporation vs. JCIT, A.Y. 1997-98, reported in [2007] 13 SOT 170 observed as under:-

> "At bare perusal of section 36(1)(viii), as extracted above, itself shows that the amount of deduction is not to exceed 40 per cent of profits derived from the eligible business. Such amount is required to be carried to a special reserve account. So, however, there is no condition prescribed as to the maintenance of such special reserve, in fact, the only requirement with respect to the special reserve can be found in the second proviso to section 36(1)(viii). The said proviso requires that where the aggregate of the amounts carried to such accounts from time to time exceeded twice the amount paid share capital, no allowance under this clause shall be made in respect of such excess. Ostensibly, there is no condition prescribed which requires the maintenance of such reserve so created for the purposes of determining deduction under the sub-clause for the instant assessment year. .. …. .. A plea has been taken by the revenue that the amendment so made is only clarificatory in nature and is, therefore, to be considered as applying even to the assessment year under consideration which is 1997-98. The CIT(Appeals) has also taken this line of reasoning while rejecting the plea of the assessee. We are unable to subscribe to the aforesaid interpretive exercise adopted by the CIT (Appeals). Firstly, for the reason that the Finance Act, 1997 as we have seen earlier clearly prescribes that the amendments are to

take effect from 1.4.1998 and shall apply in relation to the assessment year 1998-99 and subsequent years. A specific reference by the Legislature itself rules out the scenario of the said amendment being considered as having retrospective effect.

Furthermore, in our view the said amendment brings on the Statute a further condition which is required to be fulfilled by an assessee before claiming the benefit under section 36(1)(viii). The Legislature, by the present amendment, seeks to restrict the benefit which the Statute hitherto provided to the assessee, unless such restriction is specifically made retrospective under normal circumstances, such provisions cannot be read as retrospective in nature. ……. amendments which create a higher obligation on the assessee shall be deemed to be prospective unless otherwise specifically provided."

20. In view of the above, it emerges that the amendment takes effect from 1.4.1998 and shall apply in relation to the assessment year 1998-99 and subsequent years.

21. The reliance of Revenue on the case of Indian Overseas Bank Ltd., reported in 77 ITR 512 SC, seems to be factually misplaced because in that case no separate reserve fund for development rebate, as required by proviso (b) to section 10(2)(vib) of the Income Tax Act 1922, had been created and the transfer of sum was to a reserve fund to meet the requirements of section 17 of the Banking Companies Act, 1949. In other words, where there is only one special reserve created, the assessee cannot claim the benefit of proviso (b) to section 10(2)(vib) of the 1922 Act without any such reserve created for that specific purpose, whereas in the instant case, the applicant has created Special Reserve out of the current year's profit chargeable to tax for a specific purpose of availing allowance under section 36(1)(viii) of the Act.

22. In the light of the discussion in preceding paras, we answer the 1st question in the negative i.e. in favour of the applicant.

2nd Question

23. Facts:- The applicant claimed deduction for A.Y.1997-98 under section 36(1)(viia)(c) of the Act of Rs.2.65 crores by creating a reserve for bad and doubtful debts in its balance sheet as on 31.3.97. The reserve for bad and doubtful debts was created in the balance sheet to the tune of Rs.8. 09 crores captioned as Reserve for 'bad and doubtful debts under section 36(1)(viia)' and a sum of Rs.4.5 crores was simultaneously appropriated/debited to the Profit and Loss Appropriation Account. The deduction claimed by the applicant was @ 5(five) per cent of the total income as computed before making any deduction under this clause i.e. section 36 (1)(viia)(c) and chapter VIA of the Act.

24. Section 36(1)(viia)(c) permits the deduction allowable @5% of the total income in respect of the notified financial institutions if a provision of bad and doubtful debts are made by an assessee. The A.O. considered the applicant's plea and came to the conclusion that since the applicant has not made a provision for bad and doubtful debts, as required by section 36(1)(viia)(c) of the Act, the deduction under the said section is not merited. For coming to this conclusion, the A.O. has observed that there is clear distinction between the words 'Reserve' and 'Provision'.

25. Before us the counsel for the applicant has contended that no adverse inference should be drawn even if the applicant has, instead of making a provision, created a 'reserve' by debiting the same to Profit and Loss Appropriation Account

because the creation of 'reserve' has been for the specific purpose of claiming deduction under section 36(1)(viia)(c) of the Act. It has also been emphasized that all along in the past the applicant has been making a provision for bad and doubtful debts and had accordingly been allowed deduction under the said section from A.Y. 1990-91 to 1995-96. It was during the year in question only when the applicant debited it to Profit and Loss appropriation account nomenclatured as 'Reserve for deduction under section 36(1)(viia)(c)', the applicant has been denied the benefit of deduction, submits the counsel. It has also been contended that nature and character of the reserve remains the same as envisaged under section 36(1)(viia) of the Act and, accordingly, the applicant should not be penalized for the technical lapse, if any. In course of arguments, the learned counsel also stated that as per the advice/opinion of the Expert Advisory Committee of Institute of Chartered Accountants of India (in short ICAI), the applicant had shown the provision as 'reserve'. Further, the counsel for the applicant has relied on the decision of Income Tax Appellate Tribunal in the case of Power Finance Corporation Ltd. vs. JCIT, 10 SOT 190 (Del) wherein identical issue has been decided in favour of the assessee.

26. Section 36(1)(viia)(c) as it stood in the relevant assessment year i.e. A.Y. 1997-98:-

Section 36(1)(viia)(c) : as it stood in the statute during the A.Y.(1997-98)

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(1) to vii

(viia) "in respect of any provision for bad and doubtful debts made by –

(a) xxx xxx xxx

(b) *xxx* *xxx* *xxx*

(c) a public financial institution or a State financial corporation or a State industrial investment corporation, an amount not exceeding five per cent of the total income (computed before making any deduction under this clause and Chapter VI-A)."

A look into the section 36(1)(viia)(c), as above, shows that this clause grants deduction up to the aggregate ceiling of 5 per cent of the total income, subject to the modalities of computation, to a public financial institution or state financial corporation or State Industrial Investment Corporation, if these entities make any 'provision for bad and doubtful debts'. Thus, the requirement of section is that of making a provision for bad and doubtful debts and it does not enjoin that the provision is to be debited to Profit and Loss Account. However, as per the decision in the case of Vazir Sultan, reported in 132 I.T.R. 559 (SC), the provision is a charge against the profits to be taken into account in the gross receipts as Profits and Loss account and 'reserve' is an appropriation of profits… When we look into entries in the accounts of the applicant, it emerges that in the P&L Appropriation Account the exact stipulation made reads:– "Reserve under Section 36(1)(viia) of the Income Tax Act for Bad and Doubtful debts[@]" and the amount debited on this score is 4.5 crores. It is thus clear that the intention of the applicant was for deduction under section 36(1)(viia) only though the 'provision' was nomenclatured as 'reserve'. It is the contention of the applicant that the entry under the caption 'reserve' in place of 'provision' was made in pursuance of the opinion expressed by the Expert Advisory Committee of the

[@] emphasis supplied

Institute of Chartered Accountants (ICAI). The first Appellate Authority, in his order dated 26.4.2005, has referred to such plea, but did not comment anything. Be that as it may, even if it is termed as reserve, which according to the applicant's counsel, was in pursuance of the ICAI's opinion, we are of the view that the nature and character of the entry remains the same as envisaged under clause (viia)(c) of Section 36(1) of the Act. In substance, we are of the opinion that it is a 'provision' though named as 'reserve'. In our view, the debit in the appropriation account would not by itself disentitle the applicant from claiming the deduction. We have to see the substance and real nature of the methodology adopted by the applicant. Here, the following observation of the ITAT Delhi in the case of Power Finance Corporation (supra) may be usefully extracted:-

> "mere debit in the appropriation account by the assessee would not disentitle the assessee from claiming deduction when the same is permissible to it under the provisions of section 36(1)(viia)(c) of the Act, more so, when the same has consistently been allowed by the department since 1990-91 to 1995-96 …."

27. We are, therefore, of the view that the applicant merits deduction under section 36((viia)(c) of the Act.

Ruling

28. In view of the above discussion, we rule as under:-

Question No.1 : It was not legally proper on the part of the Revenue to disallow the deduction claimed under section 36(1)(viii) of the Act.

Question No.2 : It was not legally proper on the part of the Revenue to disallow the deduction claimed under section 36(1)(viia)(c)) of the Act.

It is made clear that this ruling will not cover the aspect regarding computation of the deductible amount which is said to be pending before the I.T.A.T.

Pronounced by the Authority on this 31st day of March 2009.

Sd/-	**Sd/-**	**Sd/-**
(RAO RANVIJAY SINGH)	**(P.V.REDDI)**	**(A.SINHA)**
MEMBER	**CHAIRMAN**	**MEMBER**

F.No. AAR/759/2007 Dated ….

(A) This copy is certified to be a true copy of the advance ruling and is sent to:

1. The applicant.
2. The Commissioner of Income-tax (LTU), New Delhi.
3. The Joint Secretary (FT&TR-I), M/Finance, CBDT,Bhikaji Cama Place, New Delhi.
4. The Joint Secretary (FT&TR-II), M/Finance, CBDT,Bhikaji Cama Place, New Delhi
5. Guard file.

(B) In view of the provisions contained in Section 245S of the Act, this ruling should not be given for publication without obtaining prior permission of the Authority.

(Batsala Jha Yadav)
Addl. Commissioner of Income-tax(AAR-IT)