IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "B", HYDERABAD

BEFORE SHRI P.M. JAGTAP, ACCOUNTANT MEMBER
AND SHRI SAKTIJIT DEY, JUDICIAL MEMBER

ITA No. 450/Hyd/2015
Assessment Year: 2012-13

State Bank of Hyderabad, Hyderabad.	vs.	Dy. Commissioner of Income-tax, Circle – 3(2), Hyderabad
PAN – AAADCS 4009 H (Appellant)		(Respondent)

ITA Nos. 498 and 499/Hyd/2015
Assessment Years: 2007-08 & 2012-13

Dy. Commissioner of Income-tax, Circle – 3(2), Hyderabad	vs.	State Bank of Hyderabad, Hyderabad.
(Appellant)		PAN – AAADCS 4009 H (Respondent)

Assessee by	:	Mrs. Lalitha Rameswaran
Revenue by	:	Shri J. Siri Kumar
Date of hearing		13-07-2015
Date of pronouncement		14-08-2015

O R D E R

PER SAKTIJIT DEY, J.M.:

Out of these three appeals, two by the department and one by assessee are against two separate orders of ld. CIT(A)-III, Hyderabad for the AYs 2007-08 and 2012-13. While appeal for AY 2007-08 being ITA No. 498/Hyd/2015 is by the department, there are cross appeals for the AY 2012-13. As the issues more or less are common and

assessee is same in these appeals, they were clubbed and heard together, and therefore, we find it convenient to dispose of these appeals by way of a common order.

ITA No. 498/Hyd/2015 for AY 2007-08 by revenue

2. Solitary issue raised by revenue in this appeal is in relation to deletion by CIT(A) of addition made u/s 14A of the Act by AO.

3. Briefly the facts are, assessee is a banking company and subsidiary of SBI. For the AY under consideration, assessee had filed its return of income on 31/10/07 declaring total income of Rs. 495,28,37,146. Assessment in case of assessee was originally completed u/s 143(3) of the Act vide order dated 30/09/08 by disallowing expenditure of Rs. 5,83,68,430 u/s 14A of the Act. Against such assessment order assessee preferred appeal before ld. CIT(A). Ld. CIT(A), however, directed AO to disallow the expenditure in terms with rule 8D of the IT Rules. Assessee carried further appeal to ITAT. ITAT disposed of the appeal of assessee vide order dated 07/09/2012 holding that rule 8D of IT Rules will not be applicable for the impugned AY. Further ITAT directed AO to estimate the disallowance of expenditure u/s 14A at a reasonable rate. Though, the department challenged the order of ITAT before the Hon'ble high Court, but, the department's appeal was dismissed by the Hon'ble High Court vide order dated 07/08/2013 in ITTA No. 323 of 2013.

4. Thus, in terms with the direction of ITAT to reasonably estimate the disallowance of expenditure u/s 14A of the Act, AO passed impugned assessment order on 29/11/2013 quantifying the disallowance u/s 14A at Rs. 5,83,68,430. While doing so, AO observed that assessee has incurred operating expenditure of Rs. 808 crores and interest expenditure of Rs. 2134 crores for earning total income of Rs. 3946 crores. According to AO, interest and

operating expenditure incurred by assessee works out to 74% of the total income. He, therefore, inferred that assessee would have spent the same percentage as expenditure for earning the exempt income also. As assessee had itself disallowed an amount of Rs. 7,03,500 u/s 14A, AO treated the balance amount of Rs. 5,76,64,930 as expenditure incurred towards earning of exempt income and added it to the income of assessee. Being aggrieved of such disallowance, assessee preferred appeal before ld. CIT(A).

5. In course of hearing of appeal before ld CIT(A), assessee relying upon the decisions of ITAT in its own case submitted, it has already made disallowance u/s 14A an amount equal to establishment charges in the form of salary to officers and staff working in the investment division incurred for a period of two months. It was also submitted by assessee, since tax free investments are in the nature of stock-in-trade of assessee, exempt income earned by assessee on such investment, which are exempt from taxation should also be incidental to the assessee's business, hence, no disallowance u/s 14A could be made. In this context, assessee relied upon a decision of the Hon'ble Karnataka high Court in case of CCI Vs. JCIT, 250 CTR 291.

6. Ld. CIT(A) after considering the submissions of assessee, deleted the addition made by AO by holding as under:

> *"6. I have considered the facts on record and the submissions of the AR in this regard. In my appellate orders for AY 2010-11 and 2011-12 dated 18.2.2014, it was held on identical facts, relying on the decision in the case of CCI Ltd Vs. JCIT (Kar) 250 CTR 291 that since the tax free bonds and other investments had been held to be in the nature of stock in trade of the appellant, it would be logical to hold that the interest and dividend earned by the appellant, which are exempt from taxation, State Bank of Hyderabad were incidental to the appellant's business and that no disallowance u/s 14A, other than that already made*

by the appellant in its computation of income as its returns, was warranted with regard to such investments.

7. Following my decision in the appellant's own case, as cited above, the disallowance of Rs. 5,76,64,930 is directed to be deleted and the appeal Is allowed."

7. We have considered the submissions of the parties and perused the materials on record. While DR relied upon the reasoning of AO, ld. AR submitted before us, Tribunal in assessee's own case for the preceding AYs has held that reasonable expenditure which could be disallowed u/s 14A would be an amount equal to expenditure incurred by assessee towards two months salary of officers and staff of investment division. In this context, ld. AR placed on record order passed by ITAT in assessee's own case for AYs 1996-97 to 1998-99 in ITA No. 661,662 & 663/Hyd/2003 dated 19/03/10 passed in ITA No. 584/Hyd/08 for AY 2005-06 and order dated 06/08/2010 passed in ITA No. 827/H/09 for AY 2006-07.

8. Having considered the submissions of the parties, the only issue which arises for consideration, in our view, is whether the disallowance of expenditure u/s 14A of the Act is valid or not. As can be seen, in assessee's own case for preceding AY, the Tribunal has held that before introduction of Rule 8D, disallowance u/s 14A of the Act has to be made at a reasonable rate. In this context, Tribunal in assessee's own case has held that expenditure incurred towards two months salary for officers and staff in investment division could be considered as disallowance to be made u/s 14A of the Act. As it appears, assessee in terms with the aforesaid direction of Tribunal has disallowed expenditure of Rs. 7,03,500 u/s 14A of the Act. In the aforesaid view of the matter, we do not find any infirmity in the order of ld. CIT(A) in deleting addition made by AO. Accordingly grounds raised are dismissed.

9. In the result, department's appeal is dismissed.

ITA No. 450/Hyd/15 for AY 2012-13 by assessee

10. In this appeal, assessee has raised two issues.

11. In Ground No.2 assessee has challenged the disallowance of deduction claimed u/s 36(1)(viia) for the amount of Rs. 43,95,77,953.

12. Briefly the facts relating to this issue are, during the assessment proceeding, AO while examining assessee's claim on account of provision for bad and doubtful debts, noticed that assessee has computed the provision for bad and doubtful debts allowable as under:

a. Bad and doubtful debts @ 7.5% of total income	156,55,18,082
b. Rural branch advances @ 10% of the aggregate average rural advances based on census published in 2011	503,95,59,872
Total	660,50,77,954

He noticed that in the computation of taxable income assessee has claimed the total amount of Rs. 6,60,50,77,954 towards provision for bad and doubtful debts u/s 36(1)(viia). In addition, assessee has also claimed deduction of Rs. 209,07,50,831 as bad debts written off u/s 36(1)(vii) in respect of non rural advances. AO observed that as per the proviso to section 36(1)(vii), the amount of deduction relating to any 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. He observed that assessee bank had opening balance of provisions for NPAs at Rs. 475.83 crores and made fresh provision of Rs. 580.46 crores during the year and against the same, assessee has written off Rs. 210.74 in its books of account. However, in the computation of total

income, assessee has claimed deduction of Rs. 209.08 crore in stead of setting off against provision of Rs. 616.55 crores. He further noted that during the year, assessee has claimed deduction of Rs. 660,50,77,954 u/s 36(1)(viia), which is worked out as per the limit prescribed by the Act. However, as per the books of account, assessee has created provision for an amount of Rs. 616.55 for NPAs, which also includes Rs. 596.57 for non-rural branch advances and Rs. 19.98 crores for rural branches advances. Thus, it was inferred by AO that assessee has claimed deduction u/s 36(1)(viia) to the maximum limit prescribed even though the actual provision made in books is less. AO thereafter relying upon number of decisions including the decision of Hon'ble Supreme Court in case of Catholic Syrian Bank Ltd. Vs. CIT, 343 ITR 270 as well as referring to the provisions of section 36(1)(viia) and section 36(1)(vii) held that since assessee has created provision for rural debts at Rs. 19.98 crores in the books of account for the year ending 31/03/2012, deduction u/s 36(1)(viia) has to be restricted to that amount only and the balance amount of Rs. 640,52,77,954 has to be disallowed. Accordingly, he added back the amount of Rs. 640,52,77,594. Being aggrieved of such disallowance, assessee preferred appeal before ld. CIT(A).

13. Before ld. CIT(A), assessee submitted that section 36(1)(viia) provides for a special deduction which has to be calculated as per the said provision and not with reference to the provision made in the books of account. Alternatively, it was submitted by assessee that after the amendment to section 36(1)(viia) in the year 1985, its scope has been enlarged and the condition that the provision should relate only to rural debts has been removed. It was submitted by assessee as per the provision u/s 36(1)(viia) as it stands now there is no requirement that provision should relate to rural advances alone. Thus, it was submitted, assessee had made provision of Rs. 616.55 crores and claimed deduction of Rs. 660.50 crores.

14. Ld. CIT(A) after considering the submissions of assessee noted that as per the decisions of ITAT in assessee's own case in the preceding AYs deduction u/s 36(1)(viia) is allowable to the extent of provision actually made. She, therefore, directed that deduction u/s 36(1)(viia) should be allowed to the extent of provision made in the books of account. Being aggrieved of the aforesaid decision of ld. CIT(A), assessee preferred appeal before us.

15. We have considered the submissions of the parties and perused the material on record. At the outset, ld. AR fairly conceded that the decision of ld. CIT(A) to restrict the deduction claimed u/s 36(1)(viia) to the extent of provision actually made in the books of account is fair and reasonable. Considering such submissions of ld. AR, we uphold the order of ld. CIT(A) on this issue and dismiss the ground raised.

14. The next issue as raised in ground No. 3 is in relation to disallowance of an amount of Rs. 209,07,50,831 claimed as deduction u/s 36(1)(vii) of the Act.

15. Briefly the facts are, as already stated in the preceding paragraphs, assessee during the year had opening balance of provision for NPAs at Rs. 428.83 crore and made fresh provision of Rs. 580.46 crore during the year. Against the aforesaid provision made assessee had written off Rs. 210.74 crore in its books of account. However, in the computation of income, assessee claimed deduction of Rs. 209.08 crore u/s 36(1)(vii). AO while completing assessment observed that out of the total provision of Rs. 616.55 crores made in the books of account, an amount of Rs. 596.57 was for non-rural advancess and Rs. 19.98 crores for rural advances. AO observed that bad debts written off in the books of account is not controlled or limited by the proviso to clause 36(1)(vii). In other words, bad debts written off in the accounts of assessee representing urban advances is an allowable deduction. He, therefore, accepted

assessee's claim of deduction u/s 36(1)(vii) for an amount of Rs. 209,07,50,831 as the same was less than the provision made in the books of account at Rs. 596.57 crores. Having held so, AO observed that if it is ultimately held that assessee is entitled to make provision for both urban and rural advances u/s 36(1)(viia), the, proviso u/s 36(1)(vii) will operate and assessee will not be entitled to write off bad debts claimed u/s 36(1)(vii) for the amount of Rs. 209,07,50,831. Being aggrieved of such decision of AO, assessee challenged the same before ld. CIT(A). Ld. CIT(A), however, upheld the decision of AO by observing as under:

> *"9.2 This alternative disallowance by the Assessing Officer is a natural corollary to the rejection of the disallowance u/s 36(1)(viia). A debt cannot be claimed both on the basis of its being written off and its being part of the provision. The appellant admittedly had made a provision of only Rs. 19.98 crores in its books for rural bad debts. The balance Provision admittedly related to urban debts. The disallowance of Rs. 209,07,50,831 u/s 36(l)(vii) is, therefore, upheld."*

16. Ld. AR submitted before us, assessee can claim deduction both u/s 36(1)(vii) and 36(1)(viia) subject to restrictions put under the proviso to section 36(1)(vii) of the Act, which only applies to rural debts. It was submitted by ld. AR, as the amount of Rs. 209,07,50,831 represents the debts actually written off relating to non-rural advances claim of deduction u/s 36(1)(vii) cannot be disallowed. He submitted, the Hon'ble Supreme Court in case of Catholic Syrian Bank Vs., CIT (supra) has clearly laid down the law that proviso to section 36(1)(vii) is applicable only in respect of rural advances and not non-rural advances. Therefore, the debts relating non-rural advances actually written off in the books of account cannot be disallowed by applying proviso to section 36(1)(vii). In this context, he specifically referred to the observations made in para 2 of the judgment delivered by Hon'ble Supreme Court. Ld. AR submitted, as far as the provision for bad and doubtful debt to be made u/s 36(1)(viia) is concerned, it will include both rural advances and non-

rural advances. In this context, he referred to the decision of the ITAT Bangalore Bench in case **of** DCIT Vs. Ing Vysya Bank Ltd., ITA No. 53 & 54/Bang./13, dated 25/10/2013. Thus, ld. AR submitted, assessee having actually written off bad debts relating to non-rural advances, no disallowance can be made by applying proviso to section 36(1)(vii).

17. Ld. DR, on the other hand, referring to explanation 2 to section 36(1)(vii)submitted before us, as per the said explanation, it has been clarified that for the purpose of proviso to section 36(1)(vii) assessee has to maintain only one account in respect of provision for bad and doubtful debts and as such account will relate to all types of advances including the advances made by rural branches, no differentiation can be made between rural advances and non-rural advances while applying the proviso to section 36(1)(vii).

18. In the rejoinder, ld. AR submitted, explanation 2 to section 36(1)(vii) was introduced into the statute by the Finance Act, 2013 with effect from 01/04/2014, hence, it will have prospective application and will not apply to the AY under consideration. In this context, he relied upon following decision:-

1. ITAT Mumbai Bench in case of Bank of India Vs. Addl. CIT-14, [2014] (5) TMI 929

19. We have considered the rival submissions and perused the materials on record as well as the orders of revenue authorities. As could be seen from the finding of AO as well as ld. CIT(A), only reason for which claim of deduction for Rs. 209,07,50,831 representing actual write off of bad debts relating to non-rural advances u/s 36(1)(vii) was denied is, assessee having already availed deduction u/s 36(1)(viia), it is not eligible to claim deduction u/s 36(1)(vii) as it will amount to double deduction. In our view, both AO as well as ld. CIT(A) have committed fundamental error by mixing up provisions of sections 36(1)(vii) and 36(1)(viia). While 36(1)(vii)

speaks of actual write off of bad debts in the books of account, section 36(1)(viia) even allows provision made towards bad and doubtful debts in respect of rural advances to the extent of provision made in the books of account subject to the ceiling fixed under clause (viia) of section 36(1). Proviso to section 36(1)(vii) operates only in a case where deduction is also claimed under section 36(1)(viia). In other words, proviso to section 36(1)(vii) applies to write off of bad debts relating to rural advances to the extent it exceeds the provision made u/s 36(1)(viia). If we examine the facts of the present case in the context of aforesaid statutory provision, it will be evident that assessee, though, has written off in the books of account an amount of Rs. 210.74 crore, but, in the computation of total income, the actual deduction claimed u/s 36(1)(vii) is Rs. 209.08 crore representing bad debts written off relating to non-rural/urban advances. The balance amount of bad debts relating to rural advances was not claimed as deduction by assessee in terms with the proviso to section 36(1)(vii) as it has not exceeded the provision for bad and doubtful debts relating to rural advances created u/s 36(1)(viia). Both AO and ld. CIT(A) have misconstrued the statutory provisions while observing that proviso to section 36(1)(vii) would also apply in case of bad debts relating to non-rural advances. The Hon'ble Supreme Court in case of Catholic Syrian Bank Vs. CIT (supra) while analyzing provisions of section 36(1)(vii) and 36(1)(viia) have observed that section 36(1)(viia) applies only to rural advances. The observations made by Hon'ble Apex Court in this regard in paras 26 & 27 of the judgment is extracted hereunder for convenience.

> **"26.** *The Special Bench of the Tribunal had rejected the contention of the Revenue that proviso to s. 36(1)(vii) applies to all banks and with reference to the circulars issued by the Board, held that a bank would be entitled to both deductions, one under cl. (vii) of s. 36(1) of the Act on the basis of actual write off and the other on the basis of cl. (viia) of s. 36(1) of the Act on the mere making of provision for bad debts. This, according to the Revenue, would lead to double deduction and the proviso to s. 36(1)(vii) was introduced with the intention to prevent this mischief. The contention of the Revenue, in our opinion, was rightly rejected by the Special Bench of the Tribunal and it correctly held that the Board itself had recognized the position that a bank would be entitled to both the deductions. Further, it*

concluded that the proviso had been introduced to protect the Revenue, but it would be meaningless to invoke the same where there was no threat of double deduction.

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

Concurring with the aforesaid majority view, Hon'ble CJI, S.H. Kapadia, as the then he was, held as under:

"2. Under Section 36(1)(vii) of the ITA 1961, the tax payer carrying on business is entitled to a deduction, in the computation or taxable profits, of the amount of any debt which is established to have become a bad debt during the previous year, subject to certain conditions. However, a mere provision for bad and doubtful debt(s) is not allowed as a deduction in the computation of taxable profits. In order to promote rural banking and in order to assist the scheduled commercial banks in making adequate provisions from their current profits to provide for risks in relation to their rural advances, the Finance Act, inserted clause (viia) in subsection (1) of Section 36 to provide for a deduction, in the computation of taxable profits of all scheduled commercial banks, in respect of provisions made by them for bad and doubtful debts relating to advances made by their rural branches. The deduction is limited to a specified percentage of the aggregate average advances made by the rural branches computed in the manner prescribed by the IT Rules, 1962. Thus, the provisions of clause (viia) of Section 36(1) relating to the deduction on account of the provision for bad and doubtful debt(s) is distinct and independent of the provisions of Section 36(11(vii) relating to allowance of the bad debt(s). In other words, the scheduled commercial banks continue to get the full benefit of the write off of the irrecoverable debt(s) under Section 36(1)(vii) in addition to the benefit of deduction for the provision made for bad and doubtful debt(s) under section 36(1)(viia). A reading of the Circulars issued by CBDT indicates that normally a deduction for bad debt(s) can be allowed only if the debt is written off in the books as bad debt(s). No deduction is allowable in respect of a mere provision for bad and doubtful debt(s). But in the case of rural advances, a deduction would be allowed even in respect of a mere provision without insisting on an actual write off However, this may result in double allowance in the sense that in respect of same rural advance the bank may get allowance on the basis

of clause (viia) and also on the basis of actual write off under clause (vii). This situation is taken care of by the proviso to clause (vii) which limits the allowance on the basis of the actual write off to the excess, if any, of the write off over the amount standing to the credit of the account created under clause (viia). However, the Revenue disputes the position that the proviso to clause (vii) refers only to rural advances. It says that there are no such words in the proviso which indicates that the proviso apply only to rural advances. We find no merit in the objection raised by the Revenue. Firstly, CBDT itself has recognized the position that a bank would be entitled to both the deduction, one under clause (vii) on the basis of actual write off and another, on the basis of clause (viia) in respect of a mere provision. Further, to prevent double deduction, the proviso to clause (vii) was inserted which says that in respect of bad debt(s) arising out of rural advances, the deduction on account of actual write off would be limited to the excess of the amount written off over the amount of the provision allowed under clause (viia). Thus, the proviso to clause (vii) stood introduced in order to protect the Revenue. It would be meaningless to invoke the said 1 proviso where there is no threat of double deduction. In case of rural advances, which are covered by the provisions of clause (viia), there would be no such double deduction. The proviso limits its application to the case of a bank to which clause (viia) applies. Clause (viia) applies only to rural advances. This has been explained by the Circulars issued by CBDT. Thus, the proviso indicates that it is limited in its application to bad debt(s) arising out of rural advances of a bank. It follows that if the amount of bad debt(s) actually written off in the accounts of the bank represents only debt(s) arising out of urban advances, the allowance thereof in the assessment is not affected, controlled or limited in any way by the proviso to clause (vii).”

Thus, considered in light of principle laid down as referred to above, when the proviso to section 36(1)(vii) applies to bad debts written off relating to rural advances, the same cannot be applied for disallowing deduction claimed on account of write off of bad and doubtful debts relating to non-rural/urban advances. As far as application of explanation to section 36(1)(vii) is concerned, we agree with the ld. AR that its operation will be prospective and will not apply to the impugned AY. For this proposition, we rely upon the decision of the ITAT Mumbai in case of Bank of India Vs. Addl. CIT (supra). Even otherwise also, careful reading of explanation to section 36(1)(vii)

would indicate that nowhere it suggests that the proviso to section 36(1)(vii) would apply in respect of bad debt written off relating to non-rural advances. In the aforesaid view of the matter, we hold that assessee would be eligible to avail deduction of an amount of Rs. 209.94 crore representing actual write off in the books of account of bad debts relating to non-rural/urban advances in terms with section 36(1)(vii), as proviso to the said section would not apply to non-rural advances. Accordingly, we delete the addition made by AO and confirmed by ld. CIT(A).

20. In the result, assessee's appeal is partly allowed.

ITA No. 499/Hyd/2015 for 2012-13 by revenue

21. In this appeal, the department has raised six grounds. Ground Nos. 1 & 6 being general in nature, do not require any specific adjudication.

22. The first issue as raised in Ground No. 2 relates to disallowance of depreciation relating to Held to Maturity (HTM) investments.

23. Briefly the facts are, while verifying the computation of income for the AY under consideration, AO noticed that assessee has claimed deduction for an amount of Rs. 507,05,30,372 on account of depreciation on investment in HTM securities and in Held for Trading (HFT)/approved for sale (AFS) securities, the details of which are as under:

i) Depreciation of investments in HTM securities	Rs. 249,92,95,750
ii) Depreciation of investments in AFS & HFT securities (being held in stock in trade)	Rs. 257,12,34,622
	Rs. 507,05,30,372

==========

AO while completing assessment held that assessee is not eligible to claim depreciation on HTM securities as it cannot be treated as stock-in-trade. He, therefore, disallowed the claim of depreciation for an amount of Rs. 249,92,95,750 on HTM securities. Similarly, AO observing that depreciation on HFT and AFS securities is to be allowed to the extent provided in the books of account, restricted deduction to Rs. 79,01,00,000 and added back the balance amount of Rs. 178,11,34,622. Being aggrieved of such disallowance, assessee challenged the same before ld. CIT(A).

24. Ld. CIT(A) following the decision of ITAT, Hyderabad in assessee's own case for AY 2003-04 in ITA No. 1232/Hyd/06, dated 28/11/08 and the decision of the Hon'ble AP High Court in assessee's own case reported in 151 ITR 203 deleted the addition by holding that as HTM category of securities as well as HFT and AFS securities are held as stock-in-trade, claim of depreciation has to be allowed. Being aggrieved, department is before us.

25. We have heard the parties and perused the materials on record. At the outset, learned counsels of both the parties have agreed that the issue in dispute is squarely covered by the decisions of the coordinate benches in assessee's own case for different assessment years. On perusal of materials on record, we find that this particular issue has been subject matter of dispute from AY 2003-04 onwards. In AY 2003-04, ITAT while deciding the issue in dispute in ITA No. 1232/hyd/06 dated 28/11/08 allowed assessee's claim of depreciation on HTM securities by holding that they are in the nature of stock-in-trade. The Hon'ble AP High Court also affirmed the view expressed by the Tribunal in the judgment reported in 151 ITR 203. The Hon'ble High Court held securities of all categories held by a bank are in the nature of stock-in-trade. The coordinate bench in its latest order

passed for AY 2009-10 in ITA No. 666/Hyd/2013 dated 29/11/13 held as under:

> 5. Having considered the submissions of the parties and perused the materials on record, we are of the view that the issue is squarely covered in favour of the assessee not only by virtue of decision of the jurisdictional High Court in assessee's own case reported in 151 ITR 703 but by atleast three separate orders of the ITAT, Hyderabad Bench in assessee's own case for different assessment years. The Coordinate Bench in its latest order passed in ITA.No.847/Hyd/2012 and 1002/Hyd/2012 dated 28.03.2013 relating to assessment year 2008-2009 while deciding the issue held as under :
>
> > "28. We have considered the rival submissions and perused the material on record. The Hon'ble jurisdictional High Court in assessee's own case (151 ITR 703) held that main business of the banking company being to accept deposits to advance loans to appropriate persons, money constitutes its stock in trade. The amount required 4 ITA.No.584 & 666/Hyd/2013 State Bank of Hyderabad, Hyd. to kept in India as per section 24 of the Banking Regulation Act, 1949 in the form of cash, gold and unencumbered securities is part of stock in trade of the assessee. While identical issue of claim of depreciation on HTM securities came up before the Income-tax Appellate Tribunal in assessee's own case for the assessment year 2003-04 in ITA No.1232/Hyd/2006 dated 28-11-2008, the Incometax Appellate Tribunal following the ratio laid down by the jurisdictional High Court in 151 ITR 703 and Hon'ble Kerala High Court in case of CIT V/s. Nedungadi Bank Ltd (264 ITR 545) held that when there is no distinction between the three categories of securities viz.,HTM, AFS and HFT. The assessee can provide for depreciation in all the securities on the same footing. In view of the ratio laid down by the co-ordinate bench of this Tribunal, we do not find any reason to interfere with the finding of the CIT (A) on this issue. Accordingly, the ground raised by the department is dismissed".

Since the issue in dispute is squarely covered by the decisions of the coordinate benches in assessee's own case for previous AYs, following the view expressed by the Tribunal, we uphold the order of ld. CIT(A) by dismissing the ground raised.

26. The next issue as raised in Ground No. 3 relates to decision of ld. CIT(A) in deleting the addition made by AO on account of broken period interest.

27. Briefly the facts are, AO observed that every bank is required to maintain prescribed percentage of liquid asset for maintaining statutory liquidity ratio (SLR) as per the Banking Regulation Act, 1949. For this purpose, bank subscribes/buys govt. securities. Banks also deal in govt. securities by buying and selling in the open market

to comply with the above norm. He observed that RBI pays half yearly interest on the due dates of such securities to the holders of the securities whose name appear in the ledger maintained by RBI. Banks are free to transfer such securities for consideration to other banks and consequently RBI pays interest to such holder on the date for payment of interest. While bank appearing in the RBI ledger is entitled to receive interest for the entire period, bank which buys securities in the intervening period has to make payment to the seller an amount which includes the traded value of the security and a portion of interest for the period covering between commencement of due date and upto the date of purchase. The proportionate interest relatable to the above intervening period is known as broken period interest. On perusal of the financial statements of assessee for the year under consideration, AO noticed that assessee has paid broken period interest on purchase of securities amounting to Rs. 263,58,94,093 during the relevant PY which has been claimed as deduction. AO, however, disallowed the expenditure claimed by observing that the nature of expenditure being capital is not allowable. Being aggrieved of such disallowance made by AO, assessee challenged the same before ld. CIT(A).

28. Ld. CIT(A) having found that ITAT in assessee's own case for AY 2007-08 has allowed the expenditure claimed on account of broken period interest , followed the same and deleted the addition made by AO. Aggrieved, department is before us.

29. We have considered the submissions of the parties and perused the materials on record. Ld. counsels for both the parties agreed that the issue is covered by the decision of ITAT in assessee's own case. On perusal of the orders of coordinate bench, it is seen that this issue relating to deduction claimed on account of broken period interest has permeated through preceding AYs in assessee's own case. In the latest order passed for the AY 2009-10 by the coordinate bench in ITA

No. 666/Hyd/13 dated 29/11/13, the bench following its earlier order for AY 2008-09 held as under:

"9. We have heard the parties and perused the material on record. As can be seen from the Order of the Coordinate Bench of this Tribunal while considering this issue in assessee's own case for the A.Y. 2008-09 in ITA. No. 847 & 1002/Hyd/2012 dated 28.03.2012 held as under :

"30. We have considered the submissions of the parties. On perusal of the orders of the revenue authorities and materials on record we find that the issue is squarely covered in favour of the assessee by the orders of co-ordinate bench passed in assessee's own for the assessment years 1999- 2000 and 2007-08. The Tribunal in the order for the assessment year 2007-08 in ITA No.578 and 779/Hyd/10 dated 7-9-2012 have held as under:-

"The first issue in the appeal is regarding disallowance of broken period interest of Rs.58.51 Crores. The bank which have purchased government securities have paid 6 ITA.No.584 & 666/Hyd/2013 State Bank of Hyderabad, Hyd. Rs.58.51 Crores towards interest in respect of securities purchased for the broken period from the preceding due date for payment of interest upto the date of purchase. The bank had also received interest of Rs.36.84 Crores in respect of securities sold by them for the broken period from the preceding due date for payment of interest upto the date of the sale. The assessee claimed the amount of interest paid for the broken period upto the date of purchase as deduction on the ground that the securities were held stock in trade. The AO however rejected the appellant's claim holding that the appellant's contention that the securities constituted stock in trade. It has not been accepted since it was found that the securities held in the category of HTM (held to maturity) did not form part of the stock. However, the CIT(A) allowed the claim on the ground that the same was in stock in trade and hence the interest for the broken period is an allowable deduction, following the decision of ITAT Hyderabad dated 18/03/05. Aggrieved Revenue is on appeal. We find that the issue is covered by the decision of the Mumbai Bench in the case of JCIT Vs. Dena Bank 139 TTJ 81 (Mum). They had followed the decision of Special Bench in the Mumbai in JCIT Bank of Beharain, 132 TTJ 505 and the 7 ITA.No.584 & 666/Hyd/2013 State Bank of Hyderabad, Hyd. decision of Mumbai High Court in the case of American Express International Banking Corporation Vs. CIT 258 ITR 601, we find that Kerala High Court., CIT Vs. Nedungadi Bank 264 ITR 545 has held that the broken period interest is an allowable deduction. Respectfully following the above decisions, we uphold the order of CIT(A) and reject the Revenue's appeal on this ground." 31. Though it is a fact that in case of CIT V/s. Bank of Rajasthan Ltd (316 ITR 391), relied upon by the learned Departmental Representative, the Hon'ble Rajasthan High Court has taken a contrary view by holding that the payment towards broken period interest is a capital expenditure. However, as the co-ordinate bench has decided the issue after following the view expressed by the Hon'ble Bombay High Court in case of American Express International Banking Corporation (supra) and Hon'ble Kerala High Court in case of CIT V/s. Nedungadi Bank (supra), we respectfully follow the same and uphold the order of the CIT (A). The ground raised by the department is dismissed."

Facts being materially same, respectfully following the decision of the coordinate bench on the issue, we uphold the order of ld. CIT(A) by dismissing the ground raised by the department.

30. The next issue as raised in Ground No. 4 relates to addition made on account of disallowance u/s 14A of the Act, but, deleted by ld. CIT(A).

31. Briefly, the facts are, during the assessment proceeding, AO noticed that assessee had earned exempt income of Rs. 5,10,91,194 on which it has admitted expenditure of Rs. 11,91,090. AO called upon assessee to explain the basis for quantifying the expenditure at Rs. 11,91,090. In response to the query raised by AO, it was submitted by assessee that in terms with the decision of ITAT in assessee's own case for AY 2000-01, assessee has quantified the expenditure relating to exempt income by taking into consideration two months salary of treasury/investment department. Alternatively, it was submitted by assessee that provisions of section 14A are not applicable to the dividend earned out of the shares held as stock-in-trade. For this proposition, assessee relied upon a decision of the Hon'ble Karnataka High Court in case of M/s CCI Ltd. Vs. JCIT, 250 CTR 291. AO, however, was not convinced with the explanation of assessee. AO noticed that as per the financial statement, assessee has incurred operating expenditure of Rs. 1735.81 and interest expenditure of Rs. 782.17 for earning total income of Rs. 11670.97. Thus, total expenditure incurred by assessee for earning income of Rs. 1667.97 is Rs. 9107.98, which works out to 77.26% of the total income. AO opined that assessee must have incurred same percentage of expenditure for earning exempt income also. He, therefore, applying the rate of 77.26% to the exempt income earned by assessee of Rs. 5,10,91,194 quantified the expenditure at Rs.

3,94,73,056. Being aggrieved of such disallowance assessee challenged the same before ld. CIT(A).

32. Ld. CIT(A) after considering the submissions of assessee in the light of decision in case of CCI Vs. JCIT (supra) held that as the tax free bonds and other investments are in the nature of security of assessee, it will be logical to hold that interest and dividend earned by assessee which are exempt from taxation are merely incidental to assessee's business, hence, no disallowance u/s 14A can be made other than the disallowance already made by assessee in its computation of income. Accordingly, she deleted the addition made by AO.

33. We have considered the submissions of the parties and perused the materials on record. There is no dispute to the fact that assessee itself has shown to have earned exempt income amounting to Rs. 5.10 crores and has also on its own disallowed expenditure relating to such income quantified at Rs. 11,91,090. Though for the year under consideration, disallowance u/s 14A, if any, should have been made as per Rule 8D of the IT Rules, but, AO for some strange reasons has made disallowance of expenditure worked out at 77.26% of the exempt income. In our view, such adhoc disallowance made by AO is not permissible in law. In our view disallowance u/s 14A, if any, should be strictly in compliance to rule 8D of IT rules. Further, if assessee has not incurred any interest expenditure for earning exempt income, no disallowance under rule 8D(2)(ii) of the Act, can be made. The only disallowance which could be made by AO is under rule 8D(2)(iii) i.e. 0.5% of the aggregate average value of investment. Further, we find merit in the contention of assessee that no disallowance u/s 14A can be made as assessee's investments in shares is as per the business needs of assessee, hence, earning of exempt income is incidental to assessee's business. As stated earlier, security held as HTM//AFS/HFT are in the nature of stock-in-trade of

assessee. Moreover, holding of such securities is ancillary and incidental to assessee's business. In the aforesaid view of the matter, shares/securities held by assessee cannot be treated as investment so as to attract provisions of section 14A. In the aforesaid view of the matter, we find no infirmity in the order of CIT(A) in deleting the addition made by AO. Accordingly, we uphold the same by dismissing ground raised by department.

34. The last issue which is raised by the department in ground No. 5 is in relation to allowance of deduction u/s 36(1)(viia) for an amount of Rs. 616.55 crores being the provision made for bad and doubtful debts.

35. Briefly the facts are, as stated earlier, in the computation of income for the assessment year under consideration, assessee has claimed deduction u/s 36(1)(viia) for an amount of Rs. 660,50,77,954 being the aggregate of 7.5% of total income and 10% of the aggregate average rural advances. However, actual provision made for bad and doubtful debts in the books of account was to the tune of Rs. 616.55 crores. During the assessment proceeding, AO noticed that out of the aforesaid provision for bad and doubtful debts made in the books of account an amount of Rs. 19.98 crores represents provision towards bad and doubtful debts of rural advances whereas the balance provision of Rs. 596.57 represents urban bad debts. AO on interpreting the provisions of section 36(1)(viia) was of the view that only provision relating to rural debts can be allowed as deduction u/s 36(1)(viia) thereby restricting the deduction to Rs. 19.98 crores. AO added back the balance amount of Rs. 640,52,77,954 to the income of assessee. Being aggrieved of such disallowance, assessee challenged the same before ld. CIT(A).

36. Ld. CIT(A) following the decision of ITAT in assessee's own case, though, held, that assessee is eligible for deduction u/s

36(1)(viia) for the provision made towards rural advances as well as non-rural advances, but, she held that deduction has to be restricted to actual provision made in the books of account. In other words, she allowed deduction u/s 36(1)(viia) to the extent of Rs. 616.55 crores being the provision actually made in the books of account. Being aggrieved of such decision of the ld. CIT(A), revenue is before us.

37. Ld. DR supporting the reasoning of AO submitted before us, as the deduction allowable u/s 36(1)(viia) is relatable to advances of rural branches, assessee cannot claim deduction towards provision made on account of doubtful debts relating to non-rural/urban advances.

38. Ld. AR, on the other hand, submitted before us, there is no restriction in the provisions of section 36(1)(viia) to infer that the provision made has to be confined to advances made by rural branches only. In this context, he reffered to a decision of the ITAT, Bangalore Bench in case of DCIT Vs. Ing Vysya Bank Ltd., in ITA No. 53 & 54/Bang./13, dated 25/10/2013.

39. We have considered the submissions of the parties and perused the orders of revenue authorities as well as other materials on record. On careful analysis of section u/s 36(1)(viia) of the Act, it is very much clear that assessee being a schedule bank can claim deduction in respect of provision for bad and doubtful debts made in its books of account, which does not exceed the aggregate of amount not exceeding 7.5% of the total income computed before making any deduction u/s 36(1)(viia) and Chapter-VIA and an amount not exceeding 10% of the aggregate average advances made by rural branches of such bank computed in terms with the prescribed rules. Thus, on reading of the aforesaid provision, it is very much clear that for claiming deduction under the said provision, assessee has to fulfill two conditions, firstly, it must have made a provision for bad and

doubtful debts in its books of account and secondly the maximum deduction allowable is to the extent of 7.5% of the total income and 10% of the aggregate average advances made by rural branches of such bank. On a reading of the provisions of section 36(1)(viia), as it stands now, it is very much clear that there is no restriction imposed under the said provision to indicate that assessee cannot make a provision for non-rural/urban advances. That being the case, department's argument that deduction u/s 36(1)(viia) has to be restricted only to the extent of provision for bad and doubtful debts relating to rural advances, in our view, is not acceptable. Provision contained u/s 36(1)(viia), was examined by the ITAT Bangalore Bench in case of CIT Vs. Ing Vysya Bank (supra). The ITAT after considering the legislative history of section u/s 36(1)(viia) from its inception has lucidly explained the true import of section u/s 36(1)(viia) as it stands in the present form. For better clarity, we thought it proper to reproduce the observations of the ITAT Bangalore Bench in extenso, which are as under:

> *34. It can be seen from the history of Sec.36(1)(viia) of the Act that at stage-I the deduction was allowed in respect of any provision for bad and doubtful debts made by a scheduled bank in relation to the advances made by its rural branches. At this stage the PBDD had to be linked to the advances made by Bank's rural branches. At stage-II of Sec.36(1)(viia), the deduction while computing the taxable profits was allowed of an amount not exceeding ten per cent of the total income (computed before making any deduction under the proposed new provision) or two per cent of the aggregate average advances made by rural branches of such banks, whichever is higher. At this stage also the PBDD had to be created and debited to the profit and loss account but was not required to be done in relation to advances made by Bank's rural branches and can be in relation to any debt. PBDD need not be in relation to rural advances but can be in relation to any advances both rural and non-rural advances. The two percent AAA made by rural branches of such banks had to be computed and the PBDD made in books has to be in relation to rural advances. The other eligible sum which can be considered for deduction u/s.36(1)(viia) of the Act viz., ten per cent of the total income (computed before making any deduction under the proposed new provision) does not require computation in relation to rural advances. Nevertheless the debit of PBDD to Profit and Loss account is necessary of the higher of the two sums to claim deduction u/s.36(1)(viia) of the Act. If the concerned bank does not have rural branches then they could not claim the deduction. Therefore the deduction was confined only to banks that had rural branches.*

35. At Stage-III of the provisions of Sec.36(1)(viia) of the Act, the deduction allowed earlier was enhanced. The enhancement of the deduction was consequent to representation to the Government that the existing ceiling in this regard i.e. 10% of the total income or 2% of the aggregate average advances made by the rural branches of Indian banks, whichever is higher, should be modified. Accordingly, by the Amending Act, the deduction presently available under cl. (viia) of sub-s. (1) of s. 36 of the IT Act has been split into two separate provisions. One of these limits the deduction to an amount not exceeding 2% (as it existed originally, now it is 10%) of the aggregate average advances made by rural branches of the banks concerned. This will imply that all scheduled or non-scheduled banks having rural branches would be allowed the deduction (a) upto 2% (now 10%) of the aggregate average advances made by such branches and (b) a further deduction upto 5% of their total income in respect of provision for bad and doubtful debts. The further deduction of 5% of total income was available to banks which did not have rural branches.

36. Therefore after 1.4.1987, scheduled or non-scheduled banks having rural branches were allowed deduction., (a) upto 2% (now 10%) of the aggregate average advances made by such branches and (b) Schedule or non-scheduled banks whether it had rural branches or not a deduction upto 5% of their total income in respect of provision for bad and doubtful debts. Even under the new provisions creating a PBDD in the books of accounts is necessary.

37. Though under Stage-II and Stage-III of the provisions of Sec.36(1)(viia) of the Act, PBDD has to be created by debiting the profit and loss account of the sum claimed as deduction, the condition that the provision should be in respect of rural advances is not necessary. At stage-II of the provisions of Sec.36(1)(viia) of the Act, this condition was done away with and it was only necessary to create PBDD in the books of accounts and debit to profit and loss account. The quantification of the maximum deduction permissible u/s.36(1)(viia) of the Act had to be done. Firstly it has to be ascertained as to what is 10% of the aggregate average advances made by rural branches, if the Bank has rural branches, otherwise that part of the deduction u/s.36(1)(viia) of the Act will not be available to the bank. The second part of the deduction u/s.36(1)(viia) has to be ascertained viz., 7.5% seven and one-half per cent of the total income (computed before making any deduction under this clause and Chapter VI-A). The above are the permissible upper limits of deductions u/s.36(1)(viia) of the Act. The actual provision made in the books by the Assessee on account of PBDD (irrespective of whether it is rural or nonrural) has to be seen. To the extent PBDD is so created, then subject to the permissible upper limits referred to above, the deduction has to be allowed to the Assessee. The question of bifurcating the PBDD as one relating to rural advances and other advances (Non-rural advances) does not arise for consideration."

As can be seen from the aforesaid observation of the Bangalore Bench, it has been held in clear terms that actual provision made by assessee on account of provision for bad and doubtful debt irrespective of the fact whether it is rural or non-rural, has to be seen while examining assessee's claim of deduction u/s 36(1)(viia). If the bank does not have rural branch, it will not get deduction relating to

10% of aggregate average advances made by rural branches. However, it will be eligible to claim deduction of 7.5% of total income. The Bench further held that bifurcating the provision for bad and doubtful debt as one relating to rural advances and other advances (non-rural) does not arise for consideration. Considered in the aforesaid perspective, reasoning of the AO in confining the deduction claimed u/s 36(1)(viia) only to the provision made towards rural advances, in our view, is not in accordance with the statutory provision. On the other hand, the view expressed by ld. CIT(A) while allowing assessee's claim of deduction is as per the statutory provision. Accordingly, we do not find any infirmity in the order of ld. CIT(A) in allowing assessee's claim of deduction for Rs. 616.55 crores u/s 36(1)(viia).

40. In the result, department's appeal is dismissed.

41. To sum up, assessee's appeal in ITA No. 450/Hyd/15 is partly allowed and department's appeals in ITA No. 498 & 499/Hyd/15 are dismissed.

Pronounced in the open court on 14th August, 2015.

Sd/-	**Sd/-**
(P.M. JAGTAP)	**(SAKTIJIT DEY)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Hyderabad, Dated: 14th August, 2015

kv

Copy to:-

1) DGM, State Bank of Hyderabad, Finance & Accounts Dept., Hybank Towers, Head Office, Gunfoundry, Hyd – 500 001.
2) DCIT, Circle – 3(2), IT Towers, AC Guards, Hyderabad
3) CIT(A)-3, Hyderabad
4) CIT-3, Hyderabad
5) The Departmental Representative, I.T.A.T., Hyderabad.