

EY Tax Alert

ITAT Special Bench allows deduction for provisioning made by banks on 'standard assets'

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Executive summary

This Tax Alert summarizes a Special Bench ruling of the Chandigarh Income-tax Appellate Tribunal (ITAT) in the case of Malwa Gramin Bank¹ on the allowability of deduction under Section 36(1)(viiia) of the Income-tax Act, 1961 (Act) in respect of provisions created on "standard assets". The ruling assumes significance in light of divergent judicial precedents on the issue.

The Special Bench has ruled in favor of the assessee, holding that provision on standard assets, made in accordance with RBI norms qualifies for deduction under Section 36(1)(viiia) of the Act, subject to the overall ceiling limit as prescribed therein.

The key observations of the Special Bench are:

- The classification as a standard asset merely indicates that either the advances are regular or the period of default has not yet crossed the regulatory threshold period as prescribed by the RBI. Therefore, all the 'standard assets' are not inherently completely free from credit risk and always bear the risk of going bad in the future, which necessitates provisioning against these assets also to safeguard the bank from potential losses.
- The provision has been made as per the mandatory guidelines of RBI, which mandate the creation of general provisions against 'standard assets' as well.
- Drawing reference from the legislative history in relation to the provisions of Section 36(1)(viiia) of the Act, the ITAT observed that the said provision supports banks in maintaining prudential provisioning norms and provide a

¹ TS-687-ITAT-2026(CHANDI)

tax incentive for provisioning which is essential in managing credit risk. It also helps banks align their financial reporting with RBI regulations without adverse tax consequences.

- The expression used is 'provision for bad and doubtful debts' and the prudential norms of RBI require the taxpayer to mitigate potential losses though the same may be remote and may arise on 'standard assets' as well.

Background

- Section 36(1)(viiia) of the Income-tax Act, 1961 ('Act') provides for deduction to banks in respect of provisions created for bad and doubtful debts, subject to prescribed limits linked to total income and rural advances².
- The provision was introduced to incentivize banks to make adequate provisioning and expand rural credit by recognizing anticipated credit losses, even before actual write-off.
- A key area of controversy has been whether provisions created on 'standard assets' (i.e., performing assets) fall within the scope of deduction under the said provision, particularly in light of divergent judicial precedents.

Facts of the case

- The Taxpayer, a regional rural bank, had created provisions in its books towards:
 - non-performing assets ('NPAs'); and
 - standard assetsin accordance with RBI prudential norms.
- It claimed deduction under section 36(1)(viiia) towards provisions for bad and doubtful debts which includes provisions created on NPAs and standard assets.
- During assessment, the Assessing Officer (AO) allowed deduction with respect to provisions for NPAs but disallowed the deduction relating to provision towards 'standard assets'.
- The first appellate authority [CIT(A)] upheld the disallowance, holding that the provision applies only to doubtful or loss assets and not to standard assets.
- Aggrieved by the CIT(A)'s order, the Taxpayer filed an appeal before Tribunal and in view of conflicting judicial precedents, the matter was referred to a Special Bench for adjudication.

Taxpayer's contentions

- Section 36(1)(viiia) of the Act does not make any distinction between "standard", "sub-standard", "doubtful" or "loss" assets while granting deduction. The provision refers broadly to "provision for bad and doubtful debts" and the computation mechanism is based on aggregate advances, thereby indicating that the benefit is not asset-class specific.
- The Taxpayer is obligated to follow RBI prudential norms requiring provisioning even for standard assets. Since such provisioning is not discretionary but regulatory, tax deductibility should align with such statutory obligation, subject to prescribed limits.
- It was highlighted that classification as "standard" only indicates that the account has not crossed the

NPA recognition threshold. Even performing assets may subsequently become non-performing and therefore involve credit risk requiring provisioning.

- The term "doubtful" should be interpreted in a wider sense to be understood in the context of assessment of credit risk, which includes standard assets.
- Relied on the legislative history of the said section, which was introduced to encourage rural banking and enabling banks to create adequate buffers against credit risk.
- The Taxpayer also relied on various Tribunal decisions allowing deduction on standard assets and also placed reliance on judicial observations emphasizing that RBI norms must be considered while allowing such deductions.
- Similar deduction was allowed in earlier years in the Taxpayer's own case, and no further appeal was filed by the Revenue, indicating acceptance of the position.

Tax Authority's contentions

- Section 36(1)(viiia) explicitly allows deduction only for "bad and doubtful debts", which implies a clear nexus with assets that are impaired or exhibit recovery uncertainty.
- Standard assets are performing assets generating income and do not present recovery issues; therefore, provisions on such assets cannot be regarded as bad or doubtful debts for the purpose of section 36(1)(viiia).
- The proviso to the section refers specifically to assets classified as doubtful or loss assets, indicating legislative intent to limit deduction to such categories and not to extend it to 'standard assets'.
- The provisioning under RBI norms is driven by prudential/ regulatory considerations and cannot override the specific language of the Income-tax Act. Thus, compliance with RBI norms does not automatically entitle the Taxpayer to deduction.

Special Bench's Ruling

- The allowability of deduction under section 36(1)(viiia) of the Act is subject only to:
 - Creation of provision in the books of account; and
 - Adherence to prescribed monetary ceilings (percentage of total income and rural advances).

No further condition regarding asset classification is prescribed in the statutory framework.

- The classification as standard asset merely indicates that either the advances are regular or the period of default has not yet crossed the regulatory threshold period as prescribed by RBI. Therefore, all the 'standard assets' are not inherently completely free from credit risk and always bear risk of going bad in future which necessitate provisioning against these assets also to safeguard the bank from potential

² Only in case of Indian banks

losses.

- The expression used is 'provision for bad and doubtful debts' and the prudential norms of RBI require the taxpayer to mitigate potential losses though the same may be remote one and may arise on 'standard assets' also.
- The provision against 'standard assets' is to be made by banks as mandated by the prudential norms issued by the RBI and therefore, the same is covered by eligible deduction under section 36(1)(viii) subject to the maximum limits as laid down there-under.
- It was noted that certain judgments relied upon by the Revenue were not directly applicable to the issue under consideration, as they pertained to different statutory contexts.
- The Special Bench relied on the case of *Bellad Bagewadi Urban Souhard Sahakari Bank Niyamit v. CIT (2018 (3) TMI)* whereby the Karnataka HC held that banks are bound to follow RBI guidelines and that disallowance contrary to such guidelines would not be justified.
- The Special Bench noted that there are no jurisdictional High Court decisions which were brought to notice apart from the fact that a similar issue is pending before Telangana HC in the case of Andhra Bank³.

Comments

- a) The Special Bench ruling takes favorable view on the interpretation of Section 36(1)(viii) of the Act in the context of RBI-mandated provisioning on standard assets.
- b) However, given that different benches of the Tribunal have taken divergent views and the issue is pending for consideration before higher judicial forums in certain cases, the matter remains debatable.
- c) It is a settled legal position that rulings of the Tribunal are binding only within their respective territorial jurisdiction, though such rulings may carry persuasive value in other jurisdictions. In light of the existence of divergent judicial precedents on this issue, taxpayers may consider evaluating the judicial position on the matter.

³ ITA No. 1592/H/2008 dated 18.4.2013 of ITAT Hyderabad

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