IN THE HIGH COURT OF SINDH AT KARACHI

I.T.A No.829, 831 & 832 of 1999

Present:
Mr. Justice Irfan Saadat Khan
Mr. Justice Zulfiqar Ahmad Khan

Dates of hearing	:	19.02.2022 and 03.03.2022.
Appellant	:	M/s. National Development Finance Corporation through Mr. Mazhar Elahi Jafri, Advocate.
Respondents	:	Commissioner of Income Tax and another through Mr. Muhammad Zubair Qureshi, Advocate.

J U D G M E N T

IRFAN SAADAT KHAN, J: These Income Tax Appeal **(ITAs)** were admitted for regularly hearing, vide order dated 18.12.2002, to consider the following question of law:

> *"Whether on the facts and in the circumstances of the case, the assessing officer /respondent No.2 was lawfully justified in disallowing admissibility of appellant's claim of provision for bad debts as an allowance /deduction under Section 23(1)(x) of the Income Tax Ordinance, 1979."*

The assessment years under discussion are 1994-1995, 1995-1996 and 1996-1997.

2. Briefly stated, the fact of the case are that the appellant is a financial institution which, in the years under consideration, has derived income from business, interest on securities and from

dividends. The return for the assessment year 1994 – 1995 was filed by declaring a loss of Rs.75,035,699/-; for the assessment year 1995 – 1996 the original return was filed at a loss of Rs.1,257,083,766/-, which subsequently was revised by declaring a loss of Rs.2,156,941,474/- and for the assessment year 1996 – 1997 the return was filed by declaring a loss of Rs.251,298,539/-. The assessments for all the three years under consideration were finalized under Section 62 of the Income Tax Ordinance, 1979 **(the repealed Ordinance)** on 29.02.1996, 29.12.1997 and 02.01.1998 respectively. The Assessing Officer **(AO)** while making the assessments found out that the appellant has made a provision for bad debts, which in his view was not allowable thus he added Rs.23,565,625/- in the assessment year 1994 – 1995, Rs.47,698,359/- in the assessment year 1995 – 1996 and Rs.71,908,136/- in the assessment year 1996 – 1997 respectively, under the provisions of Section 23(1)(x) of the repealed Ordinance. Appeals thereafter were preferred before the Commissioner of Income Tax (Appeals) **[CIT(A)]** by the appellant and the CIT(A) vide order dated 17.07.1996 pertaining to the assessment year 1994 – 1995 set aside the addition made by the AO by giving directions to re-adjudicate the matter, while for the assessment years 1995 – 1996 and 1996 – 1997 the additions made by the AO were confirmed. Being aggrieved with the orders of the CIT(A), appeals were preferred before the Income Tax Appellate Tribunal **(ITAT)**. For the assessment year 1994 -1995 appeal was preferred by the department, whereas appeals for the assessment years 1995 – 1996 and 1996 – 1997 were preferred by the appellant. All the three appeals were then

heard by the ITAT on 09.06.1999 and vide consolidated order dated 19.06.1999 the action of the AO was upheld and the additions made under Section 23(1)(x) of the repealed Ordinance were confirmed. It was then the present ITAs were filed by the present appellant.

3. Mr. Mazhar Elahi Jafri, Advocate has appeared on behalf of the appellant and stated that the appellant was a Development Financial Institution **(DFI)** and was maintaining Mercantile System of Accounting and the provision of the bad debt was made as per the accounting method employed by it. He stated that though the claim was a provision but same is allowable under Section 23(1)(x) of the repealed Ordinance. He, while elaborating his viewpoint, submitted that the requirement of Section 23(1)(x) of the repealed Ordinance is that the amount claimed should be a bad debt which has become irrecoverable. He stated that since the appellant was of the view that the amounts given in loan to certain persons have become irrecoverable, therefore, the said amounts were shown as bad debt.

4. Mr. Jafri stated the DCIT was not justified in disallowing the claim on the grounds that firstly the claim was premature secondly the amount was not written off and thirdly the claim was a mere provision only, which was not allowable. He stated that for claiming bad debt it is not necessary that amount should be actually written off, as in his view, showing an irrecoverable amount as bad debt is sufficient to claim an amount as bad debt. He stated that a DFI, strictly speaking is not a bank; therefore, the parameters as prescribed by the State Bank of Pakistan **(SBP)** in its Prudential Regulations are not applicable to

the appellant, though all banks and DFIs are under the control of the SBP. He stated that the Central Board of Revenue **(CBR)**, now Federal Board of Revenue **(FBR)**, has issued certain circulars which support his viewpoint and has invited our attention to CBR Circular letter of 02.07.1975 and CBR Circular dated 17.04.1996. He, therefore, in the end stated that the amounts claimed by the appellant as irrecoverable /bad debt may be allowed as a deduction under Section 23(1)(x) of the repealed Ordinance and the answer to the above question may be given in "Negative" i.e. in favour of the appellant and against the department/respondent. In support of his above contentions, the learned counsel has placed reliance on the following decisions:

1) *Commissioner of Income Tax Vs. National Bank of Pakistan, Karachi [(1976) 34 Tax 158 (Kar.)]*

2) *Vithaldas H. Dhanjibhat Bardanwala Vs. Commissioner of Income-Tax, Gujarat-V. [(1981) 130 ITR 95]*

3) *Begg Dunlop and Co., Ltd. Vs. Commissioner of Excess Profits Tax, West Bengal [(1954) 25 ITR 276]*

5. Mr. Muhammad Zubair Qureshi Advocate has appeared on behalf of the respondent and stated that the claim made by the appellant was a mere provision and hence was not allowable. He explained that only the amounts which were irrecoverable and have become bad could only be allowed to be written off under Section 23(1)(x) of the repealed Ordinance. He stated that the amounts under discussion were mere provisions and not actually write off amounts of the DFI hence by no stretch of imagination could be considered as bad

debt, therefore, these were rightly disallowed by the DCIT and confirmed by the ITAT.

6. The learned counsel stated that for all practical purposes the appellant (DFI) is to be considered as a bank and all the Prudential Regulations issued by the SBP, as applicable upon a bank, are applicable on the appellant and these Regulations duly provide a mechanism for the DFIs, with regard to claiming any amount as bad debt for the purpose of writing off the same. He stated that the two circulars relied upon by the learned counsel for the appellant in fact support his viewpoint rather than the stance of the appellant. He stated that the decisions relied upon by the learned counsel for the appellant also support the viewpoint of the department that it is only the irrecoverable amounts which are to be claimed as bad debt and written off and not the amounts which are mere provision only or premature in nature. He stated that from the wordings of Section 23(1)(x) of the repealed Ordinance, which is in parimateria to Section 10(2)(xi) of the repealed Income Tax Act 1922, it is evident that it is only the amounts which were irrecoverable were to be claimed as bad debts. According to the learned counsel proper mechanism for claiming the amounts as bad debts has not been followed by the appellant, therefore, the claim was premature and was rightly disallowed by the two authorities below. He next stated that from the assessment orders it is evident that the appellant has failed to furnish the required details to the AO and even has failed to produce certificate from the SBP showing the actual written off amounts but has made the claims on the basis of mere provision only which was premature in nature and not allowable under

the law. He lastly stated that the answer to the question involved in the present ITAs may be given in "Affirmative" i.e. in favour of the department /respondent and against the appellant.

7. We have heard both the learned counsel at some length and have also perused the record and the decisions relied upon by the learned counsel for the appellant and have also made some research on the subject on our own.

8. Before proceeding any further, we deem it expedient to reproduce herein below Section 23(1)(x) of the repealed Ordinance:

> ***23. Deductions****: (1) In computing the income under the head "Income from business or profession", the following allowances and deductions shall be made, namely:-*
> *(i)* .. ..
> *(ii)* .. ..
> *(iii)* .. ..
> *(iv)* .. ..
> *(v)* .. ..
> *(vi)* .. ..
> *(vii)* .. ..
> *(viii)* .. ..
> *(ix)* .. ..
> *(x) in respect of bad debts, such amount (not exceeding the amount actually written-off by the assessee) as may be determined by the Deputy Commissioner to be irrecoverable;*

9. Perusal of the law reveals that while claiming any income from any business and profession, under Section 22 of the repealed Ordinance, certain expenditures under Section 23 of the repealed Ordinance are allowable. Section 23(1)(x) of the repealed Ordinance however deals with the claim made in respect of the bad debts claimed by an assessee. The bad debts are generally those accounts /amounts which due to any reason have become irrecoverable and all possible efforts with regard to their recovery including the hope of recovery

had vanished which amounts are claimed as bad debts by an assessee. However, the legislature has put a bar upon an assessee that only such amounts would be allowed as bad debts which are determined by the Deputy Commissioner to be irrecoverable. It was not a matter of discretion of an assessee to decide what is a bad debt, rather the assessee has to establish with cogent material and on reasonable grounds that such and such accounts /amounts since have become irrecoverable, therefore, the same were declared as bad debts. However the discretion to allow or not to allow the same has not been given to the assessee rather the said power is given to the concerned DCIT to determine the amounts which actually have become irrecoverable as bad debts and the onus in this regard for claiming any accounts /amounts as irrecoverable as bad debts lies squarely on an assessee.

10. Now if the facts of the instant cases are examined, it would be noted that in the present cases the appellant had made a mere provision in its accounts with regard to the claim of the bad debts made by it. No doubt the accounts of the appellant were being maintained on Mercantile System of Accounting but the law clearly provides that for claiming any amount as irrecoverable as bad debt such amount would be determined by the DCIT and a mere provision with regard to irrecoverable amount shown as bad debt definitely is not allowable under the law. If the facts of the instant case are examined it would be seen that in respect of the claim made by the appellant for bad debts, which is a mere provision, details were required by the AO, as simply on the basis of mere provision an

expenditure cannot be allowed and for allowing the claim of the appellant the AO is duty bound to call the record, necessary explanations /clarifications from the appellant and thereafter to allow or to disallow any claim. However, in the instant matters it is seen that in spite of calling details from the appellant no detail of such claim was given by the appellant; hence, even if it is presumed for argument's sake that the claim was not a provision but actually written off, however since no details were provided, therefore, the AO was left with no option but to disallow the same on the basis of for want of necessary required details.

11. The learned counsel appearing for the appellant has candidly conceded that the appellant strictly speaking is not a bank, however has admitted that the Prudential Regulations as issued by the SBP are applicable upon the present appellant. The circular letter of April 17, 1996, issued by the FBR clearly stipulates that in computing business income of a bank deduction is admissible to the extent of the amount, as determined by the DCIT, which was found to be irrecoverable and which is actually written off, whereas the facts of the present cases reveals that the claim was a mere provision and not that of actually written off amounts. It may also be observed that the SBP in its Prudential Regulations of April 27, 2000, which is based on its previous Prudential Regulations, has categorized four classes, i.e. 1) the amounts which are outstanding for more than 90 days, 2) the amounts which are outstanding for more than 180 days, 3) the amounts which are outstanding for more than one year and 4) the amounts which are overdue for more than two years or more and it is

only the fourth category to which a provision of 100% outstanding balance is allowable as written off bad debt amount. However, in the present matters no such detail was provided by the appellant so as to show that the irrecoverable amounts claimed by them as provision for bad debts were outstanding since which time so as to enable the DCIT to determine the actual bad debts to allow write off to the appellant.

12. Attention may also be made to CBR circular letter dated 21.09.1992 which categorically provides that an assessee is required to give the names of the accountholders and amounts considered as bad debt in each case, as may be indicated in a certificate issued by the SBP. Admittedly no such occasion took place in the present matters as it could be seen from the assessment orders that in spite of calling the record /details the appellant has failed to produce the same to the DCIT. The AO has the authority under the law to enquire into genuineness of the claim and the assessee has no arbitrary or irrational authority to write off any amount as bad debt until and unless the parameters, as provided under the law have been fulfilled or met out, as simply making a provision for doubtful debt is not sufficient to claim deduction under Section 23(1)(x) of the repealed Ordinance.

13. Attention may also be made to CBR letter dated May 9, 1994, which clearly stipulates that the directions issued by the CBR from time to time in respect of banks are duly applicable on financial institutions, which included present appellant. Hence, the assertion of the learned counsel appearing for the appellant that the Prudential Regulations issued by the SBP for banks are not applicable in strict

sense on the present appellant is found to be contrary to the record. It would also be not out of place to mention that the instructions of the CBR, now FBR, issued from time to time are binding upon the departmental authorities under Section 8 of the repealed Ordinance.

14. So far as the reliance of the learned counsel for the appellant on certain decisions are concerned, the same are found to be quite distinguishable from the facts obtaining in the instant matter and these decisions clearly stipulate that it is only those irrecoverable amounts which have become bad in every aspect which could be written off as bad debt, in accordance with law. The upshot of the above discussion is that for making any allowance two conditions are necessary that the debt in fact has become bad and the said debt is irrecoverable for allowing a claim under Section 23(1)(x) of the repealed Ordinance, which aspect in our view is totally lacking in these ITAs.

15. In view of what has been discussed above, the answer to the above question is given in “Affirmative” i.e. in favour of the department /respondent and against the appellant. The instant ITAs stand disposed of in the above terms.

Let a copy of this judgment be sent to the Registrar of the ITAT for doing the needful in accordance with law.

JUDGE

JUDGE

Karachi:

Dated: .03.2022.