



By CA Nitin Bhuta Mumbai

Mobile Number :9820295319

E-mail: [nitin.bhuta@gmail.com](mailto:nitin.bhuta@gmail.com)

## **Light!! Camera!! Action!! – Bad Debts Dichotomy**

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In this article, I have invoked the concept of “**Light!! Camera!! Action !!**” which is the catchy “call-phrase” used in the Entertainment Industry to get everyone ready before action takes place. Here, the call for action is to resolve and clear the dichotomous inequality in the treatment of Bad Debts under the provisions of Income Tax Law as compared to the GST Law – so that the principles of Equality of Law and Equal Protection to all within the territory as contemplated under Article 14 of the Constitution of India are upheld.

### **Contextual reference of Words **Light!! Camera!! Action!!****

#### **Light !! means**

*something that makes vision possible or*

*to cause something to start burning or*

*the brightness that comes from Sun every day on the surface of world canvas without default*

**(“Light” here provides illuminating clarity on the provisions relating to tax treatment of Bad Debts)**

**Camera !! means**

*a device that consists of light proof chamber with aperture fitted with a lens and a shutter which the image of an object is projected onto a surface for recording (as on a photosensitive film or electronic sensor) or for translation into electrical impulses (as for television broadcast*

**(“Camera” here with its telescopic lens conveys that the stakeholders can see an image of what are the remedial measures required for the fair Tax Treatment of Bad Debts)**

**Action !! means**

*the fact or process of doing something to achieve an aim or the state or process of doing something or being active operation, something done such as act or deed, movement or posture during some physical activity, force or energy man of action or the accomplishment of a thing usually over a period of time, in stages, or with the possibility of repetition.*

**(Action!! here conveys what a stakeholder anticipates in stages or in a swift manner to address and resolve the disparity in tax treatment of Bad Debts considering generally accepted international law practices)**

## **Article 14 of Constitution of India**

*It reads as under: “The State **shall not deny to any person equality before the law** or the **equal protection of the laws within the territory of India.**”*

### **Meaning of Bad Debts**

*Bad Debts can be said to be **uncollectible debt** or **uncollectible accounts receivables** or **uncollectible sundry debtors** or any other nomenclature used in trade, business or commerce by the organisation. Such Debts often need to be written off in the books of account of seller or provider of services which hits detrimentally on the **bottom line** (Profits or Earnings or Surplus or Losses or Operating Margins or Deficits or Profitability Ratios) of such person. Such writing off also **disrupts the** working capital cycle of business enterprises, thus **eroding** the working capital ratios, **dampening current and future prospects**, sometimes resulting in **winding up** of the business enterprises due to **bankruptcy** or **infeasibility** or **non-viability of business**. **It some cases, it tends to have a profound impact on the application of principles of conservatism, going concern and prudence** while drawing up financial statements of the business enterprise/s. Bad Debts may pertain to total dues or partial dues depending on the facts of the matter.*

*In the undergoing paras, I have tried to explain in a nutshell the legal provisions of Bad Debts write off for the normal businesses and*

*Banking Sectors under Income Tax Act 1961 and Goods and Services Tax Act 2017.*

### ***Tax Treatment of Bad Debts under Income Tax Act 1961***

#### ***Normal Business Enterprises or Entities***

Reference is this regard invited towards the provisions of section 36 of The Income Tax Act, 1961 [hereinafter referred to as the 'Act']. The relevant extracts of the said section read as under:

##### ***“Other deductions.***

*(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 –*

....

*(vii) subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year*

....

*(2) In making any deduction for a bad debt or part thereof, the following provisions shall apply—*

*(i) no such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee;”*

***[Emphasis Added]***

On careful review of the above provision, it may be argued and inferred that while computing the business profit u/s 28 of the Income Tax Act 1961, an assessee is entitled to avail the deduction with respect to bad debts written off in the books if the following conditions are fulfilled:

1. The debt in question must be written off as irrecoverable in the books of account for the relevant previous year and

2. The amount of the debt must be taken into account while computing the income either during the previous year or during the earlier years.

Thus, once such debt is written off as a bad debt in its books of account during the relevant previous year, the assessee has fulfilled and complied with the condition (1) mentioned above.

Further, it needs to be ensured that such debts must have been taken into account while computing the total income for the earlier previous year – a fact which can be substantiated by way of appropriate documentation of such debts, thereby proving that the Assessee has fulfilled and complied with the cumulative condition (2) mentioned above.

Thereby, when the assessee has fulfilled and complied with both the above conditions simultaneously then the assessee is duly eligible to claim deduction under section 36(1)(vii) of the Act.

Further, Assessee is duty bound to report correct information in the Profit and Loss schedule of Income Tax Returns filed by him/her in the previous year in which debts are claimed as Bad Debts as per section 36(1) (vii) of the Income Tax Act 1961.

### **Tax Treatment of Bad Debts recovery in future**

In future, as and when such Bad debts are recovered by the Business Enterprises, then such recovery of Bad Debts would be termed as Profits and Gains of Business Or Profession in the previous year in which such recovery is made and it would be chargeable to income tax as per applicable rates notified as per the provisions of Income Tax Act 1961 every year by virtue of Finance

Bill passed by the Parliament and Assent given by the President of India.

### **Tax Treatment of Bad Debts written off and recovery - Banking Sector**

Section 36 (1) (viia) provides that a scheduled bank ( not being a Bank incorporated by or under the laws of a country outside India) or a non-scheduled bank or co-operative Bank other than a primary agricultural society or a primary co-operative agricultural and rural development bank , shall be allowed deduction in respect of provision for Bad and Doubtful Debts @ 8.5% of the amount of Total Income ( computed before making any deduction under the said clause and chapter VIA) and an amount not exceeding 10% of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner.

Thus, tax treatment for allowability of claim of Bad Debts is at par as far as normal business enterprises (write off) and banking sector (provision for Bad Debts instead of write off) is considered as per the principles of Equality and Equal Protection to all within the territory as contemplated under Article 14 of the Constitution of India.

### **Tax Treatment of Bad Debts under GST Act 2017.**

Now let us proceed to examine, whether tax treatment of Bad Debts under GST Act 2017 is at par or not and whether Principle of Equality before law and Equal protection to all as contemplated under Article 14 of Constitution of India is followed or not?

I assume all readers of this article are well versed with legal provisions of Section 34 of CGST Act ,2017. For ease of reference and understanding, I have explained it hereinbelow:

Section 34 can be termed as self-contained code for issue of Debit and Credit Notes by the Tax Payers which stipulates the time limits in the following scenarios viz.:

- *for supply of any goods or services or both*
- *in respect of taxable value of supply*
- *if the tax charged in the tax invoice is found to exceed the taxable value or tax payable in respect of such supply*
- *where the goods supplied are returned by the recipient*
- *where goods or services or both supplied are found to be deficient*
- The Supplier may issue to the Recipient one or more credit notes for supplies made in a financial year, containing such particulars as may be prescribed.

***Now let us examine, when debt is written off as Bad Debt in the books of account, whether above conditions are satisfied or not?***

*As we understand, debt is written off as a Bad Debt primarily because Recipient, who is receiving supply of such Goods or Services or both, defaults into honouring its business commitment*

*which is expected to be honoured in the normal course of business. In view of the Bad Debts write off, Seller who is providing supply of such Goods or Services or Both has to bear the brunt of the economic outflow, even though he is genuinely carrying on trade and commerce and following the due ethical practices of good business. Such Sellers are saddled with the burden even when there is no fault of theirs and when such situations are difficult to predict and are usually beyond their control. Of course, such situations are the learning fields which teach hard core business lessons to the businessman, to do business prudently and efficiently – making him understand the precarious implications of debts write off in the normal course of doing business.*

*As supplier of Goods or Services or Both, they have already deposited GST levies as applicable as per timelines provided under the provisions of GST Act 2017. But when trade dues are converted into Bad Debts and they are written off in the books of such Assessee or Taxable Person, the Supplier cannot take recourse to section 34 of CGST Act 2017 and try to claim reduction of his output tax liability - because no such beneficial or enabling provisions exist under the law. It appears that such a beneficial provision was not envisaged by the Sovereign while formulating the law – a stark inadequacy which calls for amending the law and providing much needed remedial measures in this regard.*

*Thus, considering Principle of Equality before Law and Equal Protection to all within the territory of India as contemplated under Article 14 of the Constitution of India, **can it be concluded that tax treatment as provided under Income Tax Act 1961 is fairer, more just and equitable for ease of doing***



*business in India as compared to tax treatment of GST provided under GST Act 2017? Is Sovereign not required to address such genuine disconnect, such disparity between two different laws? Food for thought for all .....*

*In my considered view, I would like to submit as under: -*

- Sovereign should immediately address and resolve such disparity in tax treatments across the two laws, so that it serves the genuine demand and need of all stakeholders who are contributing significantly towards nation building of the economy in view of implementation of Goods and Services Act 2017 w.e.f July 1,2017;*
- A study of the Tax Treatment of Bad Debts followed and implemented in some of the countries like Australia, Belgium, Hungary, France, Germany, Italy, Japan, Malta, Mexico, New Zealand, Norway, Singapore, Malaysia, USA, United Kingdom, Canada etc. reveals that almost all such countries permit the reduction of output tax liability in business scenarios where genuine bad debts have to be written off. Such an*

*interventional amendment will greatly help the business enterprises to tide over these testing and difficult times, when stress is rampant. At the same time, it needs to be mentioned that in the future when such bad debts are recovered, they are liable to pay the taxes on account of VAT/GST as applicable.*

- *As an anti-abuse safeguard, Sovereign can introduce stringent procedures for claiming reduction of output liability arising due to Bad Debts by adopting following suggestions: -*
  - *notifying appropriate rules and procedures under which beneficial provisions can be claimed by the Taxable persons;*
  - *Enabling clarificatory proviso can be inserted under section 34 of the CGST Act 2017, under section 16(4) of the CGST Act 2017, eligibility of Input Tax Credits under special circumstances under section 18 of the CGST Act, 2017 or by providing the option of Refunds under section 54 of the CGST Act 2017 and suitably amending the CGST Rules governing such enabling provisions;*

- **Further, such claim should be allowed to be processed only if it is duly certified by the Chartered Accountant or Cost Accountant or any other designated authority and after due process of verification of all the documentation of such claim.**
- **Further undertaking can be taken from Taxable Person that in future as and when such Bad Debts are recovered, they would pay the levies as applicable.**

To conclude, I would like to say that all stakeholders are eagerly waiting for the three magic “call” words **Light!! Camera!! Action** to be invoked - to address their genuine business concern arising out of the disadvantageous, and to that extent discriminative treatment in terms of benefits relating to Bad Debts. Such a redressal by the Sovereign will usher in the feeling that the Principle of Equality before law and Equality of protection to all within territory of India as contemplated by Article 14 of Constitution of India truly prevails without any disparity or bias under a particular statute. The Stakeholder wants to see “Light” at the end of the tunnel without waiting for “Light Years” to reach there. The Stakeholder has trained his telephoto lens of the **Camera !!** and can see vividly that the enabling beneficial provisions are the need of the hour. The Stakeholder prays for **Action!! to quickly and legislatively usher in the** enabling beneficial provisions in a swift, timely and systematic manner which reinforces stakeholder’s

*faith in the Sovereign – the Trust that the Sovereign will be fair and will take care of the stakeholders who do business in or with India.*

Principles of Equality before law and Equal protection to all within India as contemplated under Article 14 of Constitution of India can also be interpreted vis-à-vis other business laws applicable to any business situations. Viz. Corporate Law, FEMA Law, Indian Contract Act etc. All the readers of this article can do their independent research on such aspects and share their knowledge for the benefit of all by penning their thoughts.

(Note: Views expressed are my personal views and they may not be accepted by the Government. All readers are requested to take their considered views based on their own study and research to reach any suitable conclusions. There can be many other situations under the law/s but I have tried to establish the seed of thought by way of this article in the minds of readers. Suggestions to improve the article is always welcome with folded hands).