

OFFICE OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

New Delhi

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**CAG Audit Report on Direct Taxes Exemptions and Deductions to Banks and Non-Banking Financial Companies Presented in Parliament**

Audit Report No. 40 of 2025 on Direct Taxes Exemptions and Deductions to Banks and Non-Banking Financial Companies was laid on the floor of the Parliament here today. The Comptroller & Auditor General of India (C&AG) carried out a Performance Audit on 'Exemptions and Deductions to Banks and Non-Banking Financial Companies' by the Income Tax Department. This audit report not only reviewed the follow-up actions taken by the Department based on earlier audit recommendations made in earlier CAG's Performance Audit Report No. 7 of 2008, but also examined compliance with RBI norms on asset classification, income recognition, and provisioning.

The Performance Audit covered the assessments of Scheduled Commercial Banks and NBFCs. A sample comprising 2,463 cases was selected for audit examination based on various parameters out of which 2,378 cases were examined during the audit till June 2023.

The report includes 1,847 audit observations: 671 systemic issues, 118 related-party observations, 525 internal control issues, and 533 compliance issues, with a probable tax implication of ₹ 74,766.39 crore. Replies received from the Ministry and Department up to November 2025 have been suitably incorporated in the report.

Out of probable tax effect of ₹ 74,766.39 crore pertaining to 533 audit observations on compliance issues included in the Report, Ministry replied to 25 audit observations involving tax effect of ₹ 1,061.58 crore. Of these 25 audit observations, the Ministry accepted 21 audit observations involving a tax effect of ₹ 799.38 crore while partly accepting two audit observations involving a tax effect of ₹ 24.50 crore. Out of 25 audit observations, remedial action has been completed in 17 audit observations involving tax effect of ₹ 599.04 crore and remedial action has been initiated in six audit observations involving tax effect of ₹ 224.84 crore. The Ministry did not accept two audit observations involving the tax effect of ₹ 237.70 crore.

Income Tax Department (ITD), at field formations level, had furnished replies in 212 audit observations involving tax effect of ₹ 47,557.33 crore. Of these 212 audit observations, ITD accepted 88 audit observations involving tax effect of ₹ 28,639.13 crore, completed remedial action in 79 audit observations involving tax effect of ₹ 5,056.59 crore and initiated remedial action in 64 audit observations involving tax effect of ₹ 15,324.15 crore. ITD did not accept 41 audit observations involving the tax effect of ₹ 6,900.25 crore.

The audit identified persistent shortcomings, including incorrect deductions for bad-debt allowances, provisions for bad and doubtful debts, and deductions for special reserves, as

well as other deductions and exemptions. Some of these issues had already been flagged in the previous performance audit report, and the CBDT issued instructions on 26 November 2008 in response to CAG's Performance Audit Report No. 7 of 2008.

**Some of the key audit findings are given below:**

- Banks and NBFCs submit their Income Tax returns using Form ITR-6, as prescribed by the Income Tax Department, along with Tax Audit Reports in Form 3CD. Audit observed that these forms lack specific columns for claiming deductions under Sections 36(1)(vii), 36(1)(viiia), and 36(1)(viii), which makes it challenging for Assessing Officers to accurately calculate the allowable deductions. Audit observed irregular allowance of deductions related to bad debts written off, provisions for bad and doubtful debts, and transfer to special reserves, resulting in probable tax implications of ₹ 33,459.08 crore, ₹ 2,971.26 crore, and ₹ 531.18 crore, respectively.
- Audit noted that, under Rule 6EA of the Income Tax Rules, 1961, a loan is considered a Non Performing Asset (NPA) if it remains outstanding for more than six months, whereas under RBI guidelines, this period is only three months. The ambiguity has resulted in a plethora of tax disputes, in which the Department seeks to tax accrued interest on NPA if the outstanding amount is for a period of three to six months.
- The income by way of interest on NPA shall be chargeable to tax in the previous year in which it is credited to the Profit and Loss account for that year or when it is actually received by that institution or bank, whichever is earlier, as per Section 43D of the Income Tax Act. Income from interest on non-performing assets (NPAs) for NBFCs was required to be taxed for the period up to the assessment year (AY) 2019-20 as per the amendment made in Finance Act 2019. Audit noted that the provisions of Rule 6EA have not been amended to comply with Section 43D. Furthermore, Audit observed 36 cases of NBFCs where interest on NPA has not been taxed on an accrual basis.
- Section 139A read with Rule 114B of the Income Tax Rules specifies sixteen types of transactions that require quoting of PAN. Audit found 127 cases in which banks and NBFCs allowed write-offs of bad debts totalling ₹ 40,178.47 crore without the borrower's PAN. Additionally, there were 58 cases in which bad debts of ₹ 1,69,782.47 crore were allowed as a deduction without any borrower information, though not debited to the Profit and Loss account.
- A 360-degree analysis of assessments of 10 banks and 7 NBFCs for the assessment years (AYs) 2014-15 to 2019-20 revealed several instances of systemic deficiencies, inadequate internal control, and non-compliance with the prescribed rules and regulations.
- Audit analysed the data provided by the RBI vis-a-vis data furnished by tax auditors in Form 3CD, and identified discrepancies in 52 cases of banks in which the assessee had offered only ₹ 2,098.35 crore in tax, compared with the actual recovery of ₹ 14,303.00 crore reported to the RBI. Furthermore, analysis of the data provided by the NHB vis-a-vis furnished by tax auditors under clause 25 of Form 3CD revealed 15 instances where an amount of ₹ 137.89 crore reported as recovered to the NHB was not included in the Tax Audit Report.

- Audit noted that the Department lacked an institutional mechanism to verify the genuineness of assessee's claims for rural advances reported in their Income Tax Returns. Audit observed irregularities in 21 cases in which deductions for provisions for bad and doubtful debts were allowed without verification of eligibility, due to inconsistencies in allowing deductions for rural advances based on census data for the same assessee across different assessment years (AYs).
- CBDT also needs to formulate a Standard Operating Procedure (SOP) for Assessing Officers to use during the assessment of banks, to ensure consistency in allowing exemptions and deductions for Banks/NBFCs across all assessment charges and to improve the quality of assessments.

The impact of the Audit is evident in the recovery actions taken by the Department, which reflect its acceptance of the audit findings. Notably, an aggregate amount of ₹ 3,503.44 crore was recovered from five assesseees as a result of these observations.

**Some of the key recommendations out of the total 37 Audit Recommendations are as below:-**

- CBDT may consider amending the provisions of Rule 6EA to include two categories of NBFCs: deposit-taking non-banking financial companies and systemically important non-deposit-taking non-banking financial companies, in accordance with the provisions of Section 43D of the Act and in line with the categorisation of NBFCs as per RBI, for clarity and to obviate the possibility of litigation.
- The Department of Revenue (DoR) may consider amending the provisions of the Income Tax Act to tax income arising out of the cessation of liability on account of the settlement of the principal portion of the loan in the hands of the borrower.
- CBDT may have a suitable mechanism to ensure that write offs are allowed after bad debt is crystallised to prevent assesseees from using the provisions of Section 36(1)(vii) as a modus operandi to reduce the tax liability under the guise of bad debts.
- CBDT may examine and issue clarification on the taxability of interest on NPA until the provisions of Section 43D were made applicable to NBFCs to avoid inconsistency in the tax treatment of interest income on NPA and possible litigation.
- CBDT may consider bringing a suitable amendment to Section 41(4A) of the Income Tax Act, as there is no provision regarding the tax treatment of the retained money in the Special Reserve by the entity after the discontinuance of the business of long-term finance.
- CBDT may amend ITR-6 to capture details of bad debts of the borrowers, including their PAN whose loan exceeds a threshold limit to be prescribed by the CBDT and were written off, irrespective of whether the bad debts are debited to the profit and loss account or not, for verifying the correctness of deduction allowed towards bad debts in the assessment.
- CBDT may consider clarifying the allowability of CSR expenses as deduction under Section 80G or under any other Section of the Income Tax Act to ensure that the provisions are interpreted uniformly by AOs and also ensure compliance to its instructions to minimize tax disputes and possible litigation.

- CBDT may clarify its stance on the issue of allowing deductions for bad debts written off as adjustments while computing book profit under Section 115JB when the bad debts written off are not debited to the Profit and Loss account, considering the significant amount of revenues foregone and to avoid protracted litigation on the issue.
- CBDT may issue instructions to the AOs regarding the amended provision of the Act after insertion of Explanation 2 to Section 36(1)(vii), which clearly specifies that there shall be only one PBDD account under Section 36(1)(viiia) for all types of advances to prevent incorrect disallowance of deductions towards PBDD under Section 36(1)(viiia).
- CBDT may examine the discrepancies in the amounts of recovery reported to the RBI compared to the Form 3CD to identify the reasons for the mismatch and take remedial action in such cases where underreporting of the taxable amount to the ITD is noticed.
- CBDT may formulate a Standard Operating Procedure (SOP) for use by Assessing Officers during the assessment of banks, to ensure consistency in allowing exemptions and deductions to banks across all assessment charges and to improve the quality of assessments.

Income Tax Act, 2025 was passed by the Parliament in August 2025 during the finalisation of this audit report, the Audit tried to examine the Income Tax Act, 1961 vis-à-vis the provisions of the Income Tax Act, 2025. The implications of the Income Tax Act, 2025, will be examined during the subsequent compliance audit and the follow-up Performance Audit on this subject.

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