

IN THE INCOME TAX APPELLATE TRIBUNAL  
BANGALORE BENCH 'A', BANGALORE

BEFORE SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

AND

SHRI. ABRAHAM P. GEORGE, ACCOUNTANT MEMBER

I.T.A No.1136/Bang/2014  
(Assessment Year : 2002-03)

Joint Commissioner of Income-tax (LTU),  
Bangalore

..Appellant

v.

M/s. Hewlett Packard India Sales P. Ltd,  
(Erstwhile Hewlett Packard India P. Ltd),  
24, Salarpuria Arena,  
Hosur Main Road, Bangalore  
PAN : AAACC9862F

..Respondent

I.T.A No.1134/Bang/2014  
(Assessment Year : 2002-03)  
(By the Assessee)

Assessee by : Shri. K. P. Kumar, Sr. Counsel  
Revenue by : Shri. I. P. S. Bindra, CIT-DR-I

Heard on : 13.10.2015

Pronounced on : 30.10.2015

**ORDER**

**PER ABRAHAM P. GEORGE, ACCOUNTANT MEMBER :**

These are appeals filed by Revenue and Assessee respectively,  
directed against an order dt.30.06.2014 of CIT (A)-LTU,  
Bengaluru.

02. Appeal of the Revenue is taken up first for disposal. Revenue has altogether raised four grounds. Vide ground number 1 grievance raised is that disallowance of expenditure incurred by the assessee on repairs, maintenance and miscellaneous expenditure was scaled down to 15%.

03. Facts apropos are that assessee manufacturing and trading computer equipment and accessories had claimed repairs and maintenance expenditure of Rs.3,09,46,505/-, break-up of which was as under :

Machinery	Rs. 40,64,233
Others	<u>Rs.2,68,82,282</u>
	<u>Rs.3,09,46,505</u>

Assessee has also claimed miscellaneous expenditure of Rs.1,34,54,426/-. It seems during the course of assessment proceedings, assessee was unable to produce evidence in support of the above claim. He disallowed the above claim of expenditure totalling to Rs.4,44,00,931/-. Aggrieved, assessee moved in appeal before the CIT (A).

04. Argument of the assessee before the CIT (A) was that it had all supporting evidence for the claim of maintenance and

miscellaneous expenditure. CIT (A) sought a remand report from the AO. In such remand report, AO stated that assessee had produced the ledger accounts and certain bills / invoices in support of the transactions. As per the AO, every entry in the ledger reflected transactions arising out of a bunch of bills / invoices. AO tested one of such entries and found that in relation to a claim for plant and machinery repairs, assessee could produce bills only to the extent of Rs.1,56,122/-, whereas the relevant entry was for Rs.2,01,524/-. Similarly for other repairs also, there was an entry for Rs.2,49,166/-, but the primary documents were available only for Rs.2,48,142/-. Further, as per the AO, there were a number of bills / invoices which related to the preceding accounting year. CIT (A) after considering the submissions of the assessee and the remand report of the AO held that there were some gaps in evidence produced by the assessee in support of the expenditure recorded in its books of accounts. Considering the gaps to be ranging between 1 to 23% of the test checked items, CIT (A) held that a disallowance of 15% would suffice. He ordered accordingly.

05. Now before us, Ld. DR submitted that assessee could not justify the entries in the ledger. Supporting bills never tallied with the amount shown in the ledger entries. Assessee had also

accounted for bills and invoices relating to preceding accounting year. Thus as per the Ld. DR assessee was unable to discharge the onus resting on it to prove the expenditure. Ld. DR submitted that disallowance made by the AO had to be reinstated.

06. Per contra, Ld. AR supported the orders of CIT (A).

07. We have perused the orders and heard the rival contentions.

Remand report furnished by the AO to the CIT (A), is reproduced here under :

*“2. In this case the assessment was completed under section 143(3) r.w.s 147 on 31.12.2007. The additions/ disallowances made were inter alia, repair charges [plant & machinery and others] and miscellaneous expenses. In the letter referred to above, a report was called for, on the evidences furnished by the assessee in this regard. The disallowances in question were repair charges of plant & machinery and others and also miscellaneous expenses. As the disallowance was for the reason that the assessee did not produce necessary evidence, the assessee was given an opportunity of producing the same and being heard. On verification, following facts emerge.*

*Repair Charges:*

*3. Plant and Machinery: As mentioned above, entire amount of expenditure under this head amounting to Rs.40,64,233/- was disallowed. As the number of items totaling to this: amount was substantial, the evidence, was verified on a test check basis. Perusal of the records also showed that in the ledger, ledger, each line entry in turn relates to a bunch of bills/invoices involving several transactions.*

*Therefore the assessee was again asked to match the line entries in the ledger with bills / invoices on a test check basis [This pattern is applicable to the remaining expenses covered in this report also]. The entry on 14.05.2001 for Rs.2,01,524/- under the head "Supra computers/labour ch/aprOl" was selected. Copies of bills / invoices in respect of this entry were filed on 14.03.2011. In its letter dated 09.03.2011, the assessee admits that it is able to furnish the copies of bills only to the extent of Rs. 1,56,122/-. During the course of the hearing, it was argued for the assessee that it is due to the efflux of time that it is not possible to furnish copies of all the bills/invoices. Thus to the extent of verification made and subject to the difference as mentioned above, the assessee's claim appears to be in order.*

*3.1 Other Repairs: The amount disallowed under this head is Rs.2,68,82,282/- As in the case of plant and machinery, there was a small gap in the bills / invoices produced. In respect of electricity maintenance charges dated 20.04.2001 amounting to Rs.2,49,166/- the assessee could produce bills / invoices to the extent of Rs.2,48,142/-. Similarly, with regard to "Natraj / corrugated boxes" dated 25.06.2001 amounting to Rs.2,01,958/-, copies of bills / invoices produced were for Rs.1,88,043/-. Even here the time gap is stated to be the reason for the difference. Therefore to the extent of verification made and subject to the difference as mentioned above, the assessee's claim appears to be in order.*

*3.2 Miscellaneous Expenses : Rs.1,34,54,426/- was disallowed under this head. The details of "Foreign currency tt charges & commission" dated 28.06.2001 were called for. Against the amount debited, Rs.2,02,200/-, the assessee produced copies of bills/invoices amounting to Rs.1,99,250/- Explanation for the*

*difference was same as in the case of other expenses. Therefore to the extent of verification made and subject to the difference as mentioned above, the assessee's claim appears to be in order.*

4. *Another important fact that needs to be mentioned here is that copies of the bills/invoices filed by the assessee contain several bills/invoices, which relate to the previous accounting year, i.e., 2000-01 (assessment year 2001- 02). The assessee's explanation was that in view of the fact that individual value of these bills/invoices is no great and considering the large number of such bills/invoices, they are bunched together and the expenditures are booked on a later, convenient date. As the assessee follows mercantile system of accounting, these expenditures should have been booked in the earlier year itself. The assessee argues that this is the practice consistently followed by it.*

5. *Considering the facts of the case as narrated above, especially in Para 4, the assessee's appeal may kindly be decided on merits."*

08. What we find from the remand report is that AO with regard to the repair charges stated that assessee's claim appeared to be in order except for the differences mentioned by him at para 3 of the remand report. Same opinion has been given by him with respect to other repairs also. Very same view has been taken by him with regard to the miscellaneous expenditure also. Only major lacuna that has been pointed out by the AO is that some of the bills / invoices relate to preceding assessment year. CIT

(A) worked out the percentage of difference between figures shown in the ledger entries and the supporting bills and found that difference varied between 1 to 23%. He therefore considered that an addition of 15% would be sufficient to address the deficiencies pointed out by the AO. In the face of the remand report of the AO, reproduced by us above, and the quantum of variation pointed out therein, we are of the opinion that the disallowance of 15% sustained by the CIT (A) was reasonable. We do not find any reason to interfere in the order of CIT (A) in this regard. Ground 1 of the Revenue stands dismissed.

09. Vide its ground 2 grievance of the Revenue is that CIT (A) directed allowance of depreciation on assets given by assessee under finance lease. AO had denied the claim of depreciation on assets which were leased out by the assessee on financial lease.

10. Facts apropos are that assessee had given certain assets on finance lease and following Accounting Standard 19 of ICAI did not capitalise the value of such assets in its books. However, the interest component received from lessees were credited to the profit and loss account. Nevertheless while filing its return, assessee relying on CBDT circular No.2, dt.09.02.2001, claimed depreciation. In other words, assessee capitalised the assets given on lease for tax purposes. AO was of the

opinion that the lease being financial in nature, depreciation could not be allowed to the assessee. As per the AO, after termination of the lease, ownership of the assets got transferred to the lessee. However, assessee pointed out the clauses in the lease agreement executed between the assessee and the lessee, wherein it was provided that on termination of the lease, lessee was to deliver the equipment to the lessor in good condition. Claim of the assessee was that title of the asset did not pass on to the assessee, and it remained with the assessee. As per the assessee, the transactions were classified as financial lease only to adhere to AS-19 (supra). However, AO was not impressed. According to him, owner of the asset was entitled to depreciation only if the asset was used in the business. As per the AO, there were certain features in the agreement which showed that the transactions were only financial lease. According to him, the period of the lease was almost on par with the life of the asset. At the end of the lease period there was an option with the lessee to continue the lease with a nominal rent. Thus according to the AO these were pure financial transactions and assessee could not claim depreciation. Disallowance of Rs.25,59,14,816/- was made.

11. Assessee's appeal before the CIT (A) was successful. CIT (A) held that where the lessor continued to be the owner, it was entitled to

depreciation. Reliance was placed on the decision of Hon'ble Apex Court in the case of I.C.D.S Ltd v. CIT [(2013) 350 ITR 527].

12. Ld. DR strongly assailing the order of CIT (A) submitted that at the end of the lease, assets were transferred to the lessee. Hence assessee could not have claimed depreciation on assets which were not in its business.

13. Per contra, Ld. AR supported the order of CIT (A).

14. We have perused the orders and heard the rival submissions. AO himself has stated in the assessment order that though assessee termed the lease as financial lease, the terms of the lease did not provide for transfer of ownership to the lessee automatically at the end of the lease. Only reason why the lease was considered to be financial in nature was that the lease period was more or less on par with the life of the assets which were leased out and the renewal of the lease was at the option of the lessee for a nominal rent. However, in our opinion none of these can substitute the clause in the lease agreement which specified that the ownership of the assets continued to be with the assessee. Insurance for the leased products were borne by the assessee. Assessee was the owner and held the title of the assets. Giving an equipment on lease by itself can be considered as a business. We are of the opinion that by virtue of the decision of Hon'ble Apex Court in I. C. D. S (supra), assessee having capitalised the assets in

its books was eligible for claiming depreciation thereon. We do not find any reason to interfere. Ground.2 of the Revenue stands dismissed.

15. Vide its ground 3, grievance is that CIT (A) directed the AO to allow the warranty provisioning done by the assessee.

16. Facts apropos are that assessee had debited a sum of Rs.74,54,02,531/- towards warranty expenditure. AO found that the said sum consisted of a provision of Rs. 23,72,84,914/-. AO put the assessee on notice why this should not be considered as an unascertained liability. Assessee explained that the products sold by it carried a warranty of one to three years and there was a necessity to make a provision in the books to meet the liability arising out of such warranty. As per the assessee, the provisions were made on a scientific basis, considering the actual warranty expenses incurred by it. AO was however not impressed. According to him, there was a sudden jump in the warranty provisioning from 0.85 crores to 23.75 crores. For this, assessee stated that it was following a new methodology for computing warranty costs. As per the assessee, earlier, only standard cost of parts consumed were considered for ascertaining the warranty, whereas for the impugned assessment year it had also considered other related costs like customs duty for calculation. AO after verifying the claim of the assessee was of the opinion that assessee's

sales were more or less identical for financial years 2000-01 and 2001-02. As per the AO assessee could not show how there would be a drastic increase in provisioning when sales volumes were similar. According to the AO this by itself showed that there was no scientific basis in estimating the warranty provisioning. In any case, as per the AO, warranty provisioning was not allowable since it was in the nature of contingent liability. Disallowance of Rs.23,72,84,914/- was made.

17. Aggrieved, assessee moved in appeal before the CIT (A). Argument of the assessee before the CIT (A) was that by virtue of judgment of Hon'ble Apex Court in the case of Rotork Controls India P. Ltd [314 ITR 62], claim had to be allowed. As per the assessee, it was also a party in the above case before the Hon'ble Apex Court and was tagged along with Rotork Controls India P. Ltd . CIT (A) was of the opinion that by virtue of the judgment of Hon'ble Apex Court in Rotork Controls India P. Ltd assessee had to succeed. He directed the AO to allow the claim.

18. Now before us strongly assailing the order of CIT (A), ld. DR submitted that judgment of Hon'ble Apex Court in the case of Rotork Controls India P. Ltd had only laid down the conditions under which the warranty provisioning can be allowed. According to him, the first and foremost condition was that provisioning should have been done on a

scientific basis. Though the assessee was reiterating that it was done on a scientific basis, it had never furnished the particulars before the AO. Therefore according to him the matter required a fresh look by the AO.

19. Per contra, Ld. AR strongly supporting the order of CIT (A) submitted that during the course of assessment proceedings, assessee had given a detailed work out of the provisioning done. According to him, the cost of spare parts and cost of labour involved in the warranty was scientifically estimated, based on historical and technical data. When assessee had furnished all scientific details, as per the Ld. AR there was no reason why the Revenue should be given another innings.

20. We have perused the orders and heard the rival contentions. Hon'ble Apex Court in the judgment in the case of Rotork Controls India P. Ltd (supra) had held as under at para 13 of its judgment :

*“13. A past event that leads to a present obligation is called as an obligating event. The obligating event is an event that creates an obligation which results in an outflow of resources. It is only those obligations arising from past events existing independently of the future conduct of the business of the enterprise that are recognized as provision. For a liability to qualify for recognition there must be not only present obligation but also the probability of an outflow of resources to settle that obligation. Where there are a number of obligations (e.g., product warranties or similar contracts) the probability that an outflow will be required in settlement, is determined by considering the said obligations as a whole. In this connection, it may be noted that in the case of a manufacture and sale of one single item, the provision for warranty could constitute a contingent liability not entitled to*

*deduction under section 37 of the said Act. However, when there is manufacture and sale of an army of items running into thousands of units of sophisticated goods, the past event of defects being detected in some of such items leads to a present obligation which results in an enterprise having no alternative to settling that obligation. In the present case, the appellant has been manufacturing and selling valve actuators. They are in the business from the assessment years 1983-84 onwards. Valve actuators are sophisticated goods. Over the years the appellant has been manufacturing valve actuators in a large numbers. The statistical data indicates that every year some of these manufactured actuators are found to be defective. The statistical data over the years also indicates that being sophisticated item no customer is prepared to buy valve actuator without a warranty. Therefore, the warranty became integral part of the sale price of the valve actuator(s). In other words, the warranty stood attached to the sale price of the product. These aspects are important. As stated above, obligations arising from past events have to be recognized as provisions. These past events are known as obligating events. In the present case, therefore, the warranty provision needs to be recognized because the appellant is an enterprise having a present obligation as a result of past events resulting in an outflow of resources. Lastly, a reliable estimate can be made of the amount of the obligation. In short, all the three conditions for recognition of a provision are satisfied in this case.”*

21. Three important aspects which are to be satisfied for a scientific warranty provisioning are (i) provisioning should be for present obligation, arising out of past obligating events, (ii) it should involve future outflow of resources and (iii) a reliable estimate of obligation can be made.

22. In the case before us, it is an admitted position that the warranty provisioning for the relevant previous year was much higher than that of the preceding year, though the sales of the assessee were more or less of

the same scale. Assessee itself in its letter dt.12.01.2005 to the AO had stated that there was change in methodology in computing the warranty cost. Relevant part of this letter is reproduced here under :

**5.4 Further, there has been a change in the methodology of computing the warranty cost, which has been explained below.**

- ✓ In the earlier years, warranty cost ratio was computed only on the basis of the standard cost of the spare parts consumed.
- ✓ In the current year, the cost component has been enlarged to include other elements of cost such as warranty related labour costs, customs duty, other logistic charges, etc.
- ✓ Based on such total cost, the ratio of Current Year Warranty Expense to Total Sales of the previous year has been determined for making a provision.
- ✓ This revised methodology has been applied for the computation of warranty cost to be provided.

*To summarise, the variance in the warranty provision in the current year, as compared to the previous year is on account of the following:*

- a) *Change in methodology of computation of warranty cost (as explained in Paragraph 5.4 above)*
- b) *Statistical /Scientific method of computation, as explained in paragraph 5.2 above*

*For the reasons stated in our earlier submissions, and relying on the specific judicial precedence on this issue, we wish to reiterate that the provision for warranty expenses computed, based on statistical information /scientific basis indicated in the earlier paragraphs, should be allowed as a deductible expenditure while computing the profits and gains derived by the assessee from its business in the year in which the products were sold.*

23. None of the lower authorities have verified whether the change in methodology was based on a scientific principle and whether the computation done by the assessee was in accordance with the law laid

down by the Hon'ble Apex Court in the case of Rotork Controls India P. Ltd (supra), where assessee was also a party. We are of the opinion that this issue requires a fresh look by the AO. We set aside the orders of authorities below and remit the issue back to the file of the AO for consideration in accordance with law declared by the Hon'ble Apex Court in the case of Rotork Controls India P. Ltd (supra). Ground 3 of the Revenue is treated as allowed for statistical purpose.

24. Vide its ground 4, grievance of the Revenue is that CIT (A) held assessee to be not liable for default in depositing the tax deducted at source.

25. Facts apropos are that AO from the audit report in Form 3CD filed by the assessee noted that tax deducted by the assessee on sums paid to non-residents were not remitted to the government till the date of the tax audit. Assessee was required to explain why Section 40(a)(i) of the Act should not be applied to it. In reply assessee stated that the TDS were deposited to government account on 28.11.2002 after the date of tax audit. AO relying on Section 40(a)(i) of the Act held that assessee could claim such deduction only in the year in which the deducted tax was paid. He held that Section 40(a)(i) was applicable on the payments made to non-residents and made a disallowance of Rs.5,26,17,446/-. In its appeal before the CIT (A) argument of the assessee was that Section 40(a)(i) was

amended w.e.f.01.04.2004. As per the assessee, prior to that date the requirement for both deduction and deposit of tax deducted was not there. According to the assessee, prior to 01.04.2004 it was sufficient if the deduction was effected before the due date. CIT (A) appreciated these contentions. Relying on the judgment of Hon'ble Delhi High Court in the case of CIT v. Oracle Software India Ltd [293 ITR 353], he held that assessee having deducted the tax though it had not remitted it before the date of the audit could not be subjected to the rigors of Section 40(a)(i) of the Act.

26. Now before us, Ld. DR strongly assailing the order of CIT (A) submitted that unless the deducted tax as remitted prior to the time prescribed in sub-section (1) of Section 200 of the Act, assessee could not claim deduction of the amount on which such tax was deducted, while computing its income under the head 'profit and gains of income or profession.'

27. Ld. AR supported the order of CIT (A).

28. We have perused the orders and heard the rival contentions. The impugned assessment year being 2002-03, the law as it stood prior to the substitution of the said sub-section through Finance (No.2) Act, 2004

applied. The said provision as it applied at the relevant point of time read as under :

*(a) in the case of any assessee--*

*(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act which is payable outside India, on which tax has not been paid or deducted under Chapter XVIIIB:*

*Provided that where in respect of any such sum, tax has been paid or deducted under Chapter XVII-B in any subsequent year, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid or deducted.*

29. Hon'ble Delhi High Court in the case of Oracle Software India Ltd (supra) had held that once tax was deducted at source within the relevant previous year, disallowance u/s.40(a)(i) of the Act could not be made on the ground that the remittance thereof was made in the next financial year. We are of the opinion that CIT (A) was justified in relying on the judgment of Hon'ble Delhi High Court in the case of Oracle Software India Ltd (supra) and giving relief to the assessee. Ground 4 of the Revenue stands dismissed.

30. Now we take up appeal of the assessee. Assessee has altogether raised eleven grounds of which grounds 1 and 2 are general in nature needing no specific adjudication. Ld. Counsel for the Assessee submitted

that he was not pressing any of the other grounds raised by the assessee.

Accordingly appeal of the Assessee is dismissed.

31. To summarise the result, appeal of the Revenue is partly allowed for statistical purpose, whereas that of the assessee stands dismissed.

Order pronounced in the open court on 30th day of October, 2015.

Sd/-

Sd/-

(SMT. ASHA VIJAYARAGHAVAN)  
JUDICIAL MEMBER

(ABRAHAM P GEORGE)  
ACCOUNTANT MEMBER

MCN\*

Copy to:

1. The assessee
2. The Assessing Officer
3. The Commissioner of Income-tax
4. Commissioner of Income-tax(A)
5. DR
6. GF, ITAT, Bangalore

By Order

Assistant Registrar