

**IN THE INCOME TAX APPELLATE TRIBUNAL "E" BENCH, MUMBAI  
BEFORE SRI MAHAVIR SINGH, JM AND SRI RAJESH KUMAR, AM**

**ITA No. 6949/Mum/2013**

(A.Y. 2009-10)

Stovec Industries Ltd. NIDC, Nr. Lambha Village Post Narol, Ahmedabad- 382405	Vs.	Asst. Commissioner of Income Tax (OSD), Range - 2(3), Mumbai
<b>Appellant</b>	..	<b>Respondent</b>
<b>PAN No. AABCS7223D</b>		

**ITA No. 6643/Mum/2013**

(A.Y. 2009-10)

Asst. Commissioner of Income Tax (OSD), Range -2(3), Mumbai	Vs.	Stovec Industries Ltd. NIDC, Nr. Lambha Village Post Narol, Ahmedabad- 382405
<b>Appellant</b>	..	<b>Respondent</b>

**Assessee by** : Dhanesh Bafna, Ravi Sawana,  
AR

**Revenue by** : V Justin, DR

**Date of hearing:** 04-04-2018 **Date of pronouncement :** 11-04-2018

**ORDER**

**PER MAHAVIR SINGH, JM:**

These cross appeals are arising out of the order of Commissioner of Income Tax (Appeals)-6, Mumbai [in short CIT(A)], in appeal No. CIT(A)-6/IT.178/Rg.2(3)/11-12 dated 20.08.2013. The Assessment was framed by the Asst. Commissioner of Income Tax (OSD), Circle-2(3), Mumbai (in



short 'ACIT') for the A.Y. 2009-10 vide order dated 29.12.2011 under section 143(3) of the Income Tax Act, 1961(hereinafter 'the Act').

2. The first issue in this appeal of Revenue is as regards to the order of CIT(A) deleting the disallowance of claim by the AO of warranty provisions. For this Revenue has raised the following ground No. 1:-

*"1. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in allowing the claim of the warranty provision without appreciating that the same was contingent and has been made on estimate basis and the assessee has not been able to discharge the onus to prove that it is a reliable estimate which has been worked out on a scientific basis according to the previous experience in the product and therefore Apex Court decision in the case of Rotork Controls India Pvt. Ltd. 314 ITR 62 is not applicable in this case."*

3. Brief facts are that the assessee has debited a sum of ₹ 21,10,038/- as provisions for warranty and claim the same as deduction. The assessee explained before AO vide submission letter dated 20-12-2011 that the warranty provisions is credited on the basis of past experience and on estimate computed amount for warranty. The AO noted that the assessee has not brought on record the expenses incurred on account of warranty given on sale of its products, nature of warranty and provision how arrived. According to AO, the provision credited on ad hoc basis without any scientific estimate is not allowable. Aggrieved, assessee preferred the appeal before CIT(A). The CIT(A) after considering the submissions of the assessee deleted the disallowance of warranty provisions by observing in Para 4.7 and 4.8 as under:-



*“4.7 I have considered the above submissions of the Appellant as well as the facts of the case. In view of the appellant’s explanation in Para 4.6 above, the additional evidence is admitted. It is seen that the Appellant has fairly demonstrated that the warranty is embedded in the sale price of the products sold by it and this fact has been accepted by the AO in his remand report. Thus, warranty is an ascertained liability and it arises as soon as a product is sold to any customer. The chart submitted by the Appellant and reproduced in Para 4.2 above clearly demonstrates that the provision is created on a reasonable basis and the same is reversed as and when liability gets crystallized. The Apex court in the case of Rotork Controls India Private Limited vs. CIT has laid down following conditions for allowing claim of provision for warranty:*

- a. an enterprise has a present obligation as a result of a past event;*
- b. it is probable that an outflow of resources will be required to settle the obligation; and*
- c. a reliable estimate can be made of the amount of the obligation.*

*4.8 Since in the present case, the Appellant has satisfied all the conditions, the claim of the appellant for provision for warranty is required to be allowed. The AO is directed to accordingly allow the claim in respect of provision for warranty.”*

Aggrieved, now Revenue is in appeal before us.



4. Before us, the learned Sr. Departmental Representative argued that that even now the assessee could not explain to scientific basis on which the warranty provision was paid. He argued that the sample sale voucher could not prove the basis of computation of warranty. Even the assessee could not establish the past experience of warranty claimed on purchases made by customers on the basis of which the warranty provision was credited. The learned Sr. Departmental Representative argued that even the Hon'ble Supreme Court in the case of Bharat Earth Movers Vs CIT 2000 (245) ITR 428 (SC) has recognized the provision for warranty, which should be based on experience and historical trends regarding the claim of warranty expenses. According to him, the working must be robust and it should be determined on historical trend basis of proper accounting system for keeping relationship between nature of sales, warranty provisions made and actual expense incurred against its subsequent sale.

5. On the other hand, the learned Counsel for the assessee explained that the assessee gives post sales warranty against the performance of its product and manufacturing defects therein. This can be observed in the terms of delivery and payment mentioned in the sample copies of the order confirmation document. The order confirmation includes warranty as a part of the contracted sales price and warranty is a simultaneous obligation incurred by the assessee in the year of sale. Also, the sales price is inclusive of the estimated warranty cost. The assessee is bound by a contractual obligation to repair the defects or replace the defective parts and materials arising within the warranty period. Thus, the provision for warranty is an ascertained liability (and not an ad-hoc liability) which arises at the time of sale and may have to be discharged at any time within the warranty period. This view is further supported by point 15.1 of 'Significant Accounting Policies' mentioned in Schedule 'U' to the audited



financials of the FY 2008-09 (enclosed in the paper book), which states as follows:

*“Provisions are recognized when the company has a legal and constructive obligation as a result of past event for which it is probable that a cash outflow will be required and a reliable estimate can be made of the amount of the obligation.”*

Thus, sales (attached with warranty) are past event resulting into present obligation, the obligation being the warranty expense. He also explained that it has been following the ‘reversal’ concept of accounting since inception on a consistent basis. Further, the warranty provision is made in the accounts on the basis of a specific percentage of sale which is derived on the basis of nature of item sold and past experience as can be seen from the warranty calculation field along with this submission.

6. We have gone through the facts and circumstances of the case. We have also gone through the bills and vouchers submitted by assessee in respect of warranty provisions and details of computation of warranty which is enclosed at pages 158 of the assessee’s paper book. Even the assessee has enclosed the details of the provision for warranty, sales and provision created for warranty sales in term of percentage for AY 2006-07, 2007-08, 2008-09 and for the relevant AY 2009-10, which is as under:-

Particulars	Assessment Year			
	2006-07	2007-08	2008-09	2009-10
Provision for Warranty	835,000	386,718	1,284,311	4,514,683
Sales	595,132,245	351,150,959	408,290,144	429,296,197
Provisions for Warranty as a % of Sales	0.14%	0.11%	0.31%	1.05%

7. We find that the provision for warranty claimed by assessee during the relevant AY is ₹ 21,10,038/- which is net of the provision utilized during the year. Further it is also a fact that the provision for warranty has



never been disallowed in any of the earlier assessment year even though the assessment proceedings were conducted under section 143(3) of the Act. The learned counsel for the assessee informed the Bench that during AY 2010-11, warranty provision was disallowed by the AO but subsequently allowed by the CIT(A) and Tribunal dismissed the appeal of Revenue on account of low tax effect. We also find that the assessee also follows reversal method of accounting wherein, the provision utilized is reduced from the provision for warranty lying in the books of accounts assessee. In such circumstances, we have to go through the decision of Hon'ble Supreme Court in the case of Rotork Controls India Private Limited vs. CIT (314 ITR 62) (SC), wherein Hon'ble Supreme Court has observed as under:-

*“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. “*

8. Further, the learned Counsel for the assessee also relied on Bharat Earth Movers (supra), which has been relied on by the learned Sr. Departmental Representative and he referred to the particular observations of Hon'ble Supreme Court which reads as under:-



*“4. The law is settled: if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied, the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain.”*

9. In view of the above factual and legal position, we are of the view that this provision for warranty is estimated by the assessee on scientific basis and assessee has claimed net of provision utilized during the year as per reversal method of accounting and hence we find no infirmity in the claim of the assessee. Accordingly, we reverse the orders of the lower authorities and allow the claim of the assessee. This issue of assessee's appeal is allowed.

10. The next issue in this appeal of Revenue is against the order of CIT(A) directing the AO to assessee that the gain arising on land building as a separate long term capital gain and short term capital gain. For this Revenue has raised the following ground No. 2 and 3:-

*“2. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing that the gain arising on land and building has to be given separate treatment without appreciating that the land and buildings have been sold by the assessee company through a transfer deed and the*



*first schedule to the deed of transfer which contains the details of transfer, has land and the buildings and structures mentioned therein.*

3. *On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing that the gain arising oil and building has to be given separate treatment without appreciating that the AD had correctly treated the transfer under the head short term capital gain as the land and buildings were sold by the assessee company as a package through a transfer deed and the land and building comprised part of block of assets of the assessee company.”*

11. Briefly stated facts are that the assessee has sold its factory building situated at NIDC, Narol, Dist-Ahmedabad to Trumac Engineering Company P. Ltd as on 10-12-2008 at a total consideration of 5,75,00,000/-. The assessee in its fixed asset schedule attach along with balance sheets disclosed the land and buildings separately as on 31-03-2008 and 31-03-2009 and while taking the value as on 31-03-2009 the assessee had deducted the value at ₹ 1,22,690/- and for building at ₹ 84,53,034/-. The assessee while filing its return of income declared long term capital gain on sale of this property. However, the AO noted that this property is depreciable asset and assessee has shown the land and building as one asset and therefore the same was assessed under short term capital gain under section 50(1) of the Act and therefore the AO computed the short term capital gain at ₹ 4,89,24,276/-. Aggrieved assessee preferred the appeal before CIT(A).

12. The CIT(A) after going through the factual position assessed the sale proceeds of land as long term capital gain at ₹ 3,82,85,944/- and balance of building amount of ₹ 50,46,966/- (1,35,00,000- 84,53,034/-)

treated the being difference of ₹ 1.35 crore minus the WDV value of the property at ₹ 84,53,034/- as short term capital gain. The CIT(A) for treating the short term capital gain observed in Para 5.9 and 5.10 as under:

*“ 5.9 In the case of the appellant, the moneys paid in respect of the factory building, being a depreciable asset, exceed the written down value by an amount of ₹ 50,46,966/- (₹ 1,35,00,000/- - ₹ 84,53,034/-). This shall be added to the business income of the appellant, if the same (i.e. Rs.50.4649661-) does not exceed the difference between the actual cost and the written down value of such asset (which means the depreciation availed by the appellant in respect of the asset). The actual cost of the building is therefore required to be ascertained by the AO. If the said amount (of Rs.50,146,966/-) is in excess of the difference between the actual cost and the written down value of the asset (i.e. the factory building), the addition in this regard shall be restricted to the difference between the actual cost and the written down value. Therefore, the AO is directed to ascertain the difference between the actual cost and the written down value of these depreciable assets sold and accordingly, re-compute the business income of the appellant. The computation of business income shall therefore be as under:*

<i>Income from business or profession (as per e-return)</i>	<i>3,94,88,108/-</i>
---	----------------------

*Add: as discussed above*



*[Rs. 50,46,966/-] or [cost of depreciable asset sold – ₹ 84,53,034], whichever is lower to be ascertained.*

*5.10 Coming to the computation of capital gain on sale of building, as per the provisions of section 50, the sale value of Rs.1,3500000/- shall be adopted as the sale consideration and from this consideration, the written down value of the building at Rs.84,53,034/- shall be reduced to arrive at the short term capital gain in respect of the factory building sold. The short term capital gain to be assessed shall therefore be Rs.50,46,966/-.*

Aggrieved, now Revenue is in second appeal before Tribunal.

13. The assessee also raised the issue that the WDV of the building should be taken as per the Income Tax Act instead of the value as per companies Act, as directed by CIT(A). For this assessee raised the following ground:-

*“On the facts and circumstances of the case the learned CIT(A) has erred in directing the Assessing Officer to consider the written down value (WDV) of building as per Companies Act, 1956 at Rs 84,53,034 instead of WDV as per the Act of Rs 1,39.52.126 and thereby assessing short-term capital gain at Rs 50,46,966 without considering the fact that the WDV of block of building is in excess of the consideration received on sale of building.”*

14. We have heard the rival contentions and gone through the facts and circumstances. We find that the CIT(A) has rightly treated the sale consideration arising out of land as long term capital gain and sale consideration attributable to building as short term capital gain. Hence,



**ITA No. 6643 & 6949/Mum/2013**

we find no infirmity in the order of CIT(A) and hence the same is confirmed. The issue of Revenue's appeal is dismissed.

15. As regards to the issue of assessee's appeal, the learned counsel for the assessee stated that he has no grievance on the issue because the CIT(A) has already passed the rectification order Under section 54 of the Act, vide order dated 30.03.2015 and hence, he is not interested in prosecuting this ground. Accordingly, the same is dismissed as not pressed.

**16. In the result, the appeal assessee is partly allowed and that of the Revenue is dismissed.**

Order pronounced in the open court on 11-04-2018.

Sd/-  
(RAJESH KUMAR)  
ACCOUNTANT MEMBER

Sd/-  
(MAHAVIR SINGH)  
JUDICIAL MEMBER

Mumbai, Dated: 11-04-2018  
*Sudip Sarkar /Sr.PS*

**Copy of the Order forwarded to:**

1. The Appellant
2. The Respondent.
3. The CIT (A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.  
//True Copy//

BY ORDER,

Assistant Registrar  
**ITAT, MUMBAI**