IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "D" New Delhi

BEFORE SHRI G.D. AGRAWAL, HON'BLE PRESIDENT
&
SHRI AMIT SHUKLA, JUDICIAL MEMBER

I.T.A. No.841/DEL/2013
Assessment Year: 2007-08

Asst. CIT, Circle-16(1), New Delhi.	vs.	M/s. Thomson Holdings (India)Ltd., 302 (3B), World Trade Tower, Barakhamba Lane, New Delhi.
		TAN/PAN: AACCT 0862G
(Appellant)		(Respondent)

I.T.A. No.1093/DEL/2013
Assessment Year: 2007-08

M/s. Thomson Holdings (India) Ltd., 302 (3B), World Trade Tower, Barakhamba Lane, New Delhi.	vs.	Dy.CIT, Circle-16(1), New Delhi.
TAN/PAN: AACCT 0862G		
(Appellant)		(Respondent)

Appellant by:	Shri Amit Jain, Sr. D.R.		
Respondent by:	S/Shri Vishal Kalra & S.S. Tomar, Adv.		
Date of hearing:	12	06	2018
Date of pronouncement:	07	09	2018

O R D E R

PER AMIT SHUKLA, J.M.:

The aforesaid cross appeals have been filed by the assessee as well as by the Revenue against the impugned order dated 16.11.2012, passed by the CIT(Appeals)-XII, New Delhi for the quantum of assessment passed u/s.143(3) for

the Assessment Year 2007-08. We will first take up the assessee's appeal wherein the assessee has raised the following grounds: -

> *"1. That on the facts and circumstances of the case and in law, the CIT(A) has erred in upholding the disallowance on account of provision made during the year for price reduction amounting to Rs.1,43,00,205/- holding that the liability had not accrued during the relevant financial year.*
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> *2. Notwithstanding and without prejudice to the above, the CIT(A) erred in not directing the Assessing Officer to allow the claim for deduction in relation to price reduction amounting to Rs. 1,43,00,205/- in the previous year relevant to assessment year 2008- 09 i.e. the year in which, the price reduction was admittedly passed on to the purchaser."*

2. The facts in brief *qua* the aforesaid issue are that the assessee-company is engaged in the business of wholesale trading of set top boxes, providing market support and warranty support services for its associated enterprises and in research and development activities for broadband and broadcast related equipments and products systems. During the relevant Assessment Year, assessee had sold 'set top boxes' to M/s. Tata Sky Ltd. It has been stated that set top boxes kit comprised of three components, namely, the basic unit, the remote control unit and the master carton plus batteries. As per the MOU between the assessee and Tata Sky Ltd. dated 17.01.2006 read with Addendum dated 15.06.2006, the parties agreed on the price of each of these components. However, the assessee eventually ended up

charging M/s. Tata Sky Ltd a price higher than the agreed price on two of the components, namely, remote control unit and the master carton plus batteries. As a result, the parties agreed that the assessee would retrospectively provide the discount in respect of extra price charged on the set top box kits. Accordingly, the assessee issued relevant debit notes amounting to Rs.14,300,205/- which pertained to sale affected during the year 2007-08; and accordingly, claimed the provision for price reduction of that amount out of sales made during the year under consideration. Before the Assessing Officer in response to the show cause notice, the assessee submitted that the provision for price reduction pertains to the sale made during the financial year 2006-07 and since it follows the mercantile system of accounting, therefore, the said provision is to be allowed, because as per the mercantile system of accounting, costs directly associated with the revenue recognized during the relevant period irrespective of the money has been paid or not are considered as expenses and charged to the income for the relevant period. The assessee also submitted revised letter/agreement between the parties dated 16.08.2007, wherein the assessee to such post facto price reduction. The content of the letter has been reproduced in the impugned assessment order. Thus, it was submitted that such an understanding of price reduction was in accordance with Addendum to MOU agreed between the parties. However, the learned Assessing Officer held that the 'set top boxes' sold to M/s. Tata Sky Ltd. and

the bills and vouchers regarding the same has been raised during the relevant financial year 2006-07 and the entries in the books of account and the payments have been received and duly entered into books of account which have been finalized after the end of the financial year as on 31st March, 2007. The assessee has entered *post facto* change on the sale price after the closure of the books of account and has adjusted the sale receipts which cannot be accepted once the books are closed. Even the agreement with the purchaser by way of Addendum has been entered on 01.06.2007, and whereby it has modified the sale price which cannot be accepted in the impugned financial year. Accordingly, he disallowed the entire provision for price reduction of Rs.1,43,00,205/-.

3. Ld. CIT (A) after incorporating the assessee's detailed submission has affirmed the finding of the Assessing Officer and the addition holding that liability did not accrue/crystallized by 31st march, 2007.

4. Before us, the ld. counsel for the assessee after explaining the entire facts submitted that the actual liability existed at the end of the year in respect of sales made during the year to pass on the benefit of price reduction to the Tata Sky. It was only that the quantum of price was crystallized in the next financial year. The amount was crystallized on 21st August, 2007 which was much before the finalization of the financial statement on 18th October, 2007 and was also

approved by the Board of Directors on that date. He also referred to Accounting Standard AS-4 and submitted that the said provision was in accordance with the said standards because assets and liabilities as existing on the balance sheet date needs to be adjusted for the significant events occurring between the balance sheet and the dates on which financial statements were approved. The existence or absence of an accounting entry for the provision would not affect the deductibility of the amount as tax implication depends upon the legal position and not the manner in which accounting entries are passed. Without prejudice, he submitted that in the event the disallowance is upheld, then the directions may be given to allow such deduction in respect of price reduction in Assessment Year 2008-09; and he also drew our attention to the order of ld. CIT(A) for Assessment Year 2008-09 whereby the ld. CIT(A) held that since this issue is pending for disposal before the Tribunal in Assessment Year 2007-08, therefore, the Assessing Officer was directed to follow the direction in this regard and in case this matter is decided in favour of the assessee for Assessment Year 2007-08, Assessing Officer was directed to allow the claim in Assessment Year 2008-09.

5. On the other hand, learned Department Representative has relied upon the order of the Assessing Officer as well as ld. CIT (A) and submitted that, since the entire event by which price deduction was agreed happened in subsequent year and

was crystallized in the next financial year, therefore, the same cannot be allowed in this year.

6. We have heard the rival submissions and also perused the relevant findings given in the impugned orders as well as the material placed on record. As per MOU dated 17th January, 2006 the assessee and Tata Sky Ltd. to whom assessee had sold 'set top boxes' agreed on price of each of the components. However, the price of the various components were revisited on account of changes in the Union Budget whereby there was a deduction of duty in the components of the set top boxes which had an impact by w.e.f. 1st March, 2007. The price reduction was in principle agreed before 31st March, 2007. However, the exact price of reduction happened post 31st March, 2007 which is evident from the letter dated 16.08.2007, whereby the price reduction was to be given retrospective effect to the Tata Sky Ltd. It is an undisputed fact that provision for price reduction pertains to the 'set top boxes' sold to Tata Sky during the financial year 2006-07 and the sales were made pursuant to the MOU entered between the parties on 17th January, 2006, i.e., during the financial year 2005-06. While entering into MOU, there was a clear cut clause, (the relevant extract of which has been incorporated in the impugned appellate order) which stipulated and agreed between the parties that the assessee will pass on all the benefits received in relation to any change in taxes and duties to the Tata Sky Ltd. This is evident from the following clauses.

1.1. For the avoidance of doubt, the above STB prices are, or comprise of (as the case may be):

(a) ex factory for product manufactured as CKD (Complete Knock-Down) in India at Excise duty @ 0% in which case pricing as stated in Scenario (a) above to apply or Excise duty @ 16% in which case pricing as stated in Scenario (b) above to apply. If modification in prevailing duties and taxes occurs, Thomson agrees to provide a detailed analysis of the effect of the change on the price of the STB including, but not limited to, substantiating detailed documentation which will allow TATA Sky to assess the modification and resulting price effect on STB's. Where the imposition of excise duty on STB's is re-established, Thomson must give TATA Sky the full benefit of any offsets available due to any duties or taxes paid in the provision of the STB's.

(b .....

(c).....

(d) inclusive of all known state levies like customs and excise duties as currently applicable but exclusive of local sales tax, VAT, octroi & entry tax. These will be payable additionally cost wherever applicable in respective states. Any change in these levies will be charged to the account of TATA Sky.

(e) .....

(f) are applicable for deliveries in all states across India on a local sales tax or VAT billing basis, as may be applicable."

6.1 Thereafter, the parties signed an Addendum to MOU on 15th January, 2006 wherein the price stipulated were to be revisited if the input costs and duties in respect of various components of the 'set top boxes' got changed and any reduction in such costs/taxes and duties were to be passed on to Tata Sky. After the series of discussion and negotiation,

vide letter dated 16th August, 2007, assessee and Tata Sky agreed on the dates from which revised price would take effect. The break-up of which is summarized hereunder:-

Particulars	*Amount (in US dollars)*	*Effective date*
Basic price (inclusive of 16.48% Excise)	*59.00*	
Remote Control Unit	*2.91*	*January 1, 2007*
Master Carton + 2 batteries	*0.42*	*June 30, 2006*
Impact of change in specification	*(1.00)*	*May 21, 2007*
Impact of budget changes	*(0.17)*	*March 1, 2007*
Total	*61.16*	

6.2 The detailed working of the price reduction has been provided in the paper book and also the debit notes issued after the agreement between the assessee and the Tata Sky. It is also not in dispute that the said amount has actually been passed on to the Tata Sky. Since, there was a retrospective reduction in the price of the set top box agreed in the month of June, i.e., much prior to the finalization of assessee's financial statement for the financial year 2006-07 which was finalized on 18th October, 2007, the assessee made the provision for the said price reduction in the financial statement for the year ending 31st March, 2007 itself. The department has disallowed the said claim for the provision on the ground that;

- *firstly*, the assessee was not aware of any liability on the last date of financial year, i.e., 31st March, 2007 and;

- *secondly*, assessee has made a provision after the end of this year and thereby revising its account which is not permitted.

6.3 If the assessee is following mercantile system of accounting, then as per the accounting standard-4, contingencies and events occurring after the balance sheet date has been permitted to be adjusted which is evident from the relevant portions of the AS-4 which reads as under:-

> *"13. Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that fundamental accounting assumption of going concern (i.e. the continuance of existence or substratum of the enterprise) is not appropriate."*

6.4 The balance sheet was drawn on 31st March, 2007 and the financial statement was approved by the Board of Directors on 18th October, 2007 and there was an actual liability as on 31st March, 2007 to pass on the benefit of reduction in prices to Tata Sky in respect of sales made during the financial year 2006-07; and the subsequent agreement was only to reaffirm the existence of the liability and crystallization of the exact amount as on 31st March, 2007. Thus, the provision is based on actual quantification of the amount of liability rather than based on some estimate basis or contingent value. Otherwise also Section 211 of the 'Companies Act' requires that every profit and loss account of a company should give a true and fair view of the profit and

loss of the company for that financial year and Section 210 provides that every profit and loss and balance sheet should comply with the accounting standard issued by ICAI. The Hon'ble Supreme Court in the case of ***CIT vs. Woodward Governor India Pvt. Ltd., reported in (2009) 312 ITR 254*** has held that whereby financial statements have been drawn by the assessee as per the accepted accounting standards, then the same should be presumed to be correct unless the Assessing Officer on the basis of reasoning comes to a conclusion that financials prepared do not reflect true and correct profits. It is not an allegation of the Assessing Officer that such a price reduction did not pertain to the sales pertaining to financial year 2006-07, albeit such a price reduction has been crystallized post 31st March, 2007 which is much before the finalization of the financial statement approved by the Board of Directors. Under the mercantile system of accounting costs directly associated with the revenue recognized during the relevant period irrespective of the money has been paid or not have to be considered as expenses and charged to the income for the relevant period and same should be allowed in this year. In any case, if it is not allowed in this year, the same has to be allowed in Assessment Year 2008-09 for which ld. CIT (A) had already given direction to the Assessing Officer in case such an amount is not allowed in the impugned Assessment Year, thus, it does not impact the taxability. Accordingly, the grounds raised by the assessee are treated as allowed.

7. Now we will come to the Revenue's appeal wherein the Department has raised following three grounds.

1. *"On the facts and in the circumstances of the case and in law the learned C1T(A) erred in deleting the addition of Rs.31,95,131/- made by the AO by treating the recruitment expenses as capital in nature since this was initial year of the assessee company.."*
2. *"On the facts and in the circumstances of the case and in law the learned CIT(A) erred in deleting the addition of Rs.8,97,920/- made by the AO by treating the expenses incurred for software as capital in nature since as per income tax act read with appendix-1 of the income tax rules, 1962 software is a depreciable asset @ 60%."*
3. *"On the facts and in the circumstances of the case and in law the learned CIT(A) erred in deleting the addition of Rs.18,14,432/- made by the AO by disallowing the provision for warranty. The CIT(A) failed to appreciate that there was no basis for calculating this provision as this was the first working year of the assessee company.."*

8. In so far as the addition of Rs.31,95,131/- is concerned, the facts in brief are that the assessee has incurred an amount of Rs.31,95,131/- as professional charges representing recruitment charges/fees paid to 'Korn Ferry International Pvt. Ltd.' and 'Mafoi Consultants' for the recruitment of managerial secretarial staff. The said charges were claimed as deduction u/s. 37(1). However, the Assessing Officer disallowed the said amount on the ground that same is capital in nature relating to pre-commencement period and is going to give enduring benefit to the assessee. The main income which has been derived to the assessee is from that part of the business which was started from June, 2006 and assessee since has incurred most of his expenses for the first

time recruitment of the managerial secretarial staff therefore, needs to be capitalized, because it has been incurred prior to the commencement of the business.

9. Ld. CIT (A) deleted the said disallowance on the ground that no capital asset has been brought into existence and it is revenue in nature.

10. After hearing both the parties and on perusal of the relevant findings given in the impugned order, we find that it is not in dispute that the recruitment charges paid to the professional recruitment consultants for the recruitment of managerial and secretarial staff during carrying out its business. The assessee has set up its business in India way back in Assessment Year 2004-05 for trading in set top boxes and providing market support and warranty support services and in research and development activities for its group enterprises in India. During the year under consideration, assessee has provided market support services to its group entity in France for sale of its equipment in India and also performed research and development activities for its AEs. Hence, it cannot be presumed or held that assessee had not set up its business, and therefore, the recruitment charges will liable to be disallowed as pre-commencement expenses. The set top box business was merely an extension of its existing business which have commenced its operation much before; and moreover, if there is a common control and management and both the activities are under the ultimate

control and management of single Board of Directors and there is a common business organization under the same organization structure having common funds, then recruitment of such recruitment expenses cannot be said to be pre-commencement of some new business line in a different set up. Thus, such expenditure is clearly a revenue expenditure which needs to be allowed in the year in which it has been incurred. Thus, ground no.1 raised by the Revenue is dismissed.

11. Coming to the issue of addition of Rs.8,97,920/- incurred for software which has been held to be capital in nature. The assessee has incurred sum of Rs.8,97,920/- as professional charges representing SAP fees paid to Seimens Information Pvt. Ltd. for onsite support of installation ERP. The Assessing Officer has disallowed the said payment of fees on the ground that its capital in nature as the expenditure incurred was in relation to initial installation of SAP software.

12. The ld. CIT (A) has deleted the said disallowance holding that expenses did not provide any enduring benefit to the assessee.

13. After considering the rival submissions and on perusal of the relevant material placed on record, it is seen that the expenditure pertains to consultancy charges paid to Seimens Information Systems Ltd. for additional support in relation to SAP software already installed and not towards purchase or initial installation of the software. Such charges paid for

additional support has been incurred during the normal course of business and for carrying out business operation more efficiently and in no way such expenditure bring into existence any capital asset of enduring nature. The nature of advantage is purely for the business operation and enabling the management to carry on more efficiently and more profitably leaving the fixed capital untouched and hence such expenditure is to be reckoned as revenue account. Even though the advantage made enduring for certain period of time. Thus such a disallowance has rightly been deleted by the ld. CIT (A).

14. Lastly, coming to the issue of provision for warranty amounting to Rs.18,14,432/-. The facts in brief are that the assessee has incurred warranty expenditure amounting to Rs.29,91,951/- in respect of set top boxes sold to Tata Sky during the year under consideration. Out of the said expenditure, an amount of Rs.11,77,519/- was actually paid to the vendor to whom warranty services were outsourced and the balance amount payable amounting to Rs.18,14,432/- was provided and was clubbed under the head 'sundry creditors'. The ld. Assessing Officer held that the provision made by the assessee is not based on its historical statistical data and valuation and accepted expenses. The estimate made by the assessee is not scientific and appears to be on higher side and accordingly disallowed the said provision.

15. Ld. CIT(A) following the order of the Hon'ble Supreme Court in the case of ***Rotork Controls India (P) Ltd. vs. CIT, reported in (2009) 314 ITR 62 (SC)*** held that the said provision is not in the nature of unascertained or contingent liability is deductible as business expenditure.

16. Before us, it is submitted by the learned counsel that the amount set aside on account of warrant expenses was not ascertained or contingent liability; rather it was entirely based on invoices/debit notes which have been received in the subsequent financial year, and therefore, the warranty expenditure which is based on actual bills and invoices should be allowed and also drew our attention to the debit notes appearing in the paper book from page 220 onwards he pointed out that this is not provision *per se* but actual warranty cost.

17. On the other hand, learned Department Representative has strongly relied upon the order of the Assessing Officer.

18. After considering the rival submissions and on perusal of the impugned order as well as the material referred to before us, it cannot be disputed that warranty is an expenditure which is to be incurred in future with respect to the sales made during the relevant previous year. The assessee has two account for such an expense in accordance with mercantile system of accounting regularly followed such a provision debited to the P & L account should not be in the nature of unascertained or contingent liability albeit should

be based on some scientific and historical basis. The assessee's case before us is that the provision made is actually based on the actual bills received in the subsequent year, and therefore, it cannot be held to be contingent at all. Once such a warranty expense has actually been incurred for which bills/debit notes have been raised, then it cannot be held that the amount debited under the head 'warranty expenses' is unascertained or contingent liability. Accordingly, Assessing Officer is directed to allow the provision for which the actual bills have been furnished whereby assessee has incurred such warranty expenses. Thus, grounds no.1 and 2 of the revenue is dismissed and ground no.3 is partly allowed for statistical purposes.

19. In the result, the appeal of the assessee is allowed and Revenue's appeal is partly allowed for statistical purposes.

Order pronounced in the open Court on 7th September, 2018.

Sd/-	Sd/-
[G.D. AGRAWAL]	**[AMIT SHUKLA]**
PRESIDENT	**JUDICIAL MEMBER**

DATED: 7th September, 2018
PKK: