IN THE INCOME TAX APPELLATE TRIBUNAL "C" BENCH : KOLKATA

[Before Hon'ble Shri J. Sudhakar Reddy, AM & Shri S.S. Viswanethra Ravi, JM ]

I.T.A No. 524/Kol/2017

Assessment Year : 2012-13

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| M/s Landis + Gyr Ltd.<br>[PAN: AAACV 9922 B]<br>(Appellant) | -vs- | DCIT, Circle-1(1), Kolkata<br><br>(Respondent) |

For the Appellant : Shri Kamal Sawhney, AR

For the Respondent : Shri G. Mallikarjuna, CIT, DR

Date of Hearing : 25.07.2018
Date of Pronouncement : 17.10.2018

**ORDER**

**Per S.S. Viswanethra Ravi, JM**

This appeal by the assessee Asst Years 2012-13 of the Learned Dispute Resolution Panel (DRP) dated 08.12.2016 in which directions are given to the Learned AO u/s 144C(5) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act').

2. Ground No. 1 to 5 are relating to confirmation of transaction of payment of management services fees amounting to Rs. 5,03,65,604/-.

3. Heard both and perused the material available on record. It is noted that the issue raised in Ground No. 1 to 5 was decided by this Tribunal in assessee's own case by its consolidated order dated 03.08.2016 for A.Y.'s 2007-08 and 2008-09. The relevant portion of which is reproduced herein below:

***"6.3.4. Payment of Management Service fees – Manufacturing (Domestic) Segment***

*The assessee submitted that it had received varied nature of management services under a Service Agreement entered into with its AE. For the purpose of compliance with the transfer pricing documentation requirements, the assessee documented in its transfer pricing study report and submitted in the course of assessment, the management services framework wherein the description of services received, payment terms, details of cost allocation mechanism, evidences of benefits received from such services etc were explained to the revenue. These are enclosed in Page 39 and Pages 294 to 295 of the Paper Book. We find that the assessee had considered payment of management service fee to be a different class of transaction, distinct from other international transactions. Accordingly, based on functional analysis, AE was determined as the least complex party and accordingly determined to be the tested party for the purpose of the analysis. Further , TNMM was determined to be the MAM. We find that the assessee undertook to identify comparable companies rendering similar services and the international transaction was determined to be at Arm's Length. These are enclosed in Pages 295 -303 of the Paper Book. The ld TPO while passing the order u/s 92CA(3) of the Act ignored the separate transaction level analysis undertaken by the assessee for justifying the Arm's Length nature of the international transaction and instead went ahead and clubbed the transaction under the TNMM analysis undertaken by ld TPO with respect to manufacturing segment. Moreover, when the ld DRP remanded back the case to the file of the ld TPO for analysis of the separate transaction level analysis and providing ground wise observations for arguments raised by the assessee before the ld DRP, the ld TPO did not offer any adverse comments with respect to economic analysis carried out by the assessee for transaction pertaining to the payment of management service fees. These are enclosed in pages 307-311 and Pages 294-303 of the Paper Book. The ld AR submitted that in the course of TP assessment for subsequent years i.e AYs 2009-10, 2010-11 & 2011-12 , the said transaction has been considered to be at Arm's Length by the ld TPO (for AY 2009-10) and also confirmed by the ld DRP (for AY 2010-11 and AY 2011-12) wherein, same economic analysis has been adopted by the assessee to determine the Arm's Length Price of the transaction.* ***We hold that the study made by the assessee with regard to payment of management service fees which has been accepted by the revenue in the subsequent years, should be applied for the Asst Year 2008-09 also to put an end to this controversy. Hence in order to meet the ends of justice, we direct the ld TPO/ ld AO accordingly."***

4. In view of the above, we direct TPO/AO accordingly. Ground No. 1 to 5 raised by the assessee are allowed.

5. Ground No. 6 is relating to depreciation on intellectual property assets.

6. Heard both and perused the material available on record. It is noted that the issue raised in Ground No. 6 was decided by this Tribunal in assessee's own case by its consolidated order dated 03.08.2016 for A.Y.'s 2007-08 and 2008-09. The relevant portion of which is reproduced herein below:

*"3.3. We have heard the rival submissions and perused the materials available on record including the paper book filed by the assessee comprising of relevant extracts of Central Electricity Authority (Installation and operation of meters) Regulations, 2006 (pages 47 to 66 of paper book) with regard to this issue. We find that the assessee had capitalized the following assets under intellectual properties:-*

*a. Low cost single phase static meter IP for domestic segment.*
*b. Low cost single phase static meter IP for South Asian market like Vietnam, etc.*
*c. RF AMR Radio frequency accelerated meter reading IP*
*d. Salem 3T Metering Module IP*
*e. Salem 1G HVDS IP*
*f. PL Comm Evaluation Modem IP*

*3.3.1. It was argued that the intellectual property rights acquired by the assessee consisted of designs, software, data base, research and development material and facility , technical know how, process know how , confidential information, basic and detailed drawings, operation and maintenance manuals relating to the business carried out by TECRES. The valuation of the same was carried out by an independent expert and valuation report is enclosed in pages 25 to 82 of paper book. We find that the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations issued in July 2010 (enclosed in pages 67 to 73 of Part A of Paper Book) provides that the term 'intangible property' includes rights to use industrial assets such as patents, trademark, trade names, designs or models. It also includes literary and artistic property rights and intellectual property such as knowhow and trade secrets. These intangibles are assets that may have considerable value even though they may have no book value in the company's balance sheet. We find in Para 1.155 of the OECD / G20 Base Erosion and Profit Shifting (BEPS) Report on Actions 8-10 (2015) – Aligning Transfer Pricing Outcomes with Value Creation, issued in the year 2015, 'that in some situations, the transfer or secondment of one or more employees may, depending on the facts and circumstances, result in the transfer of valuable knowhow or other intangibles from one associated enterprise to another'. Even though in the instant case, the transaction is between two unrelated enterprises, the principles enunciated therein would squarely apply. Further para 6.20 of the said action plan, provide that 'knowhow and trade secrets are proprietary information or knowledge that assists or improve a commercial activity, but that are not registered for protection in the manner of patent or trademark. Knowhow and trade secrets generally consist of undisclosed information of an industrial, commercial or scientific nature arising from previous experience, which has practical application in the operation of an enterprise. Knowhow and trade secrets may relate to manufacturing , marketing, research and development, or any other commercial activity. The value of know- how and trade secrets is often dependent on the ability of the enterprise to preserve the confidentiality of the know how or trade secret. In certain industries the disclosure of information necessary to obtain patent protection could assist competitors in developing alternative solutions. Accordingly, an enterprise may, for sound business reasons, choose not to register patentable knowhow, which may nonetheless contribute substantially to the success of the enterprise. The confidential nature of knowhow and trade secrets may be protected to some degree by (i) unfair competition or similar laws, (ii) employment contracts, and (iii) economic and technological barriers to competition. Knowhow and trade secrets are intangibles.'*

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*Hence, it could be safely concluded that even OECD has laid down the principle that intellectual property in the form of knowhow is not required to be registered.*

*3.3.2. We find that the assessee had filed a copy of the Business Transfer Agreement (BTA) entered into with Mr. Gandhi as an additional evidence. It was submitted by the ld AR that the said agreement was never called for by the lower authorities and hence there was no occasion for the assessee to file the same and it was also submitted that the acquisition of business from Mr Gandhi by the assessee was never a subject matter of debate. In these circumstances, we*

*deem it fit and appropriate to admit the said additional evidence for better appreciation of the facts to resolve the issue under dispute before us.*

*3.3.3. We find force in the argument advanced by the ld AR that the transfer of employees would also result in transfer of knowhow also. We find that the Explanation 4 to section 32(1) of the Act defines 'knowhow' as any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil-well or other sources of mineral deposits (including searching for discovery or testing of deposits for the winning of access thereto). Section 32(1)(ii) of the act provides for depreciation on intangible assets including knowhow, patents, copyrights, trade marks, licences, franchises, or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1st day of April 1998. Hence from the combined reading of OECD, definition of knowhow and provisions of section 32 of the Act in respect of intangible assets, it could be safely concluded that depreciation is allowed on intellectual property being knowhow and such intellectual property is not required to be registered with any government authority. Know how is an intangible property, rights in respect of which can be bought and sold. As per the Law Lexicon dictionary, 'knowhow' indicates something essentially different from secret and confidential information. It indicates the way in which a skilled man does his job with his skill and experience. It was also stated that knowhow is a closely held unpatented inventions, formulae, design, drawings, procedures and methods together with accumulated skills and experience in the hands of a licensor firm's professional personnel.*

*3.3.4. It is not in dispute that assessee had acquired from TECRES six different IPs which were independently valued by the independent expert before the company was taken over by the assessee company. Admittedly TECRES was engaged in the research and development of metering related to software and communication technology which is useable in measurement of electrical and management of energy. It is not in dispute that the said company had been delivering service in the field of metering software development of static meters for major Indian manufacturers in the metering industry namely L & T , Genus, HPL Socomec etc apart from doing work for other overseas clients. We find that the assessee in order to migrate into the new lucrative business of manufacturing static meters was looking for partner which could help it out in its new venture. Therefore, after a detailed study and informed business decision, the assessee decided to buy out the entire unit of TECRES along with its specialized research engineers who had enormous experience and domain knowledge in respect of static meters which the assessee could leverage in developing new marketable products. Therefore, in essence what the assessee has acquired is knowhow in developing new type of meters which were digital meters with anti-tampering and other communication facilities. We find that the reliance placed by the ld AR on the Co-ordinate bench decision of Pune Tribunal in the case of Modular Infotech P Ltd vs DCIT reported in 131 TTJ 243 (Pune) is well founded. In the said case, the assessee company was engaged in the business of software development and also licensing of software. It had taken over the business of a firm namely M/s Modular Systems and claimed depreciation @ 25% on an amount of Rs. 4,27,00,000/- pertaining to the value of IPR paid to the firm. The AO disallowed the claim of depreciation on IPR against which assessee filed appeal before the ld CITA. During the appellate proceedings with the CITA, the assessee pointed out that the amount of Rs. 4.27 crores included composite consideration in respect of all the intangible assets of the firm namely IPRs and the goodwill and submitted a fresh valuation of the assets including that of the goodwill at Rs. 79,50,000/-. The CITA disallowed depreciation on goodwill of Rs. 79,50,000/- and allowed assessee's claim of depreciation in respect of balance IPR payment. On appeal filed before the Tribunal, it was held that where assessee company took over business of a firm at value assessed by professionals and value so determined was made part of agreement, it was wrong to presume that there was a notional amount which was transacted between parties, hence disallowance of depreciation on intellectual property rights on ground that value was assigned to an asset which was non-existent was not justified. We find that the facts of the assessee's case are also similar to the facts before the Pune Tribunal*

*supra. It is not in dispute that the turnover of the assessee had substantially increased from the year under appeal on account of activities of the R&D Centre which the assessee had acquired from Mr Gandhi. The element of know how is inherent in the static meters manufactured by the assessee pursuant to acquisition of TECRES. It is not in dispute that the entire Research & Development team of TECRES along with their developed codes and domain depository have joined the assessee. Hence it cannot be said that the assessee had not acquired any intellectual properties from Mr Gandhi. The total consideration paid by the assessee in the sum of Rs. 6,07,89,093/- to Mr. Gandhi has not been disputed. Out of this total consideration, the assessee had bifurcated the value towards IP rights to the tune of Rs. 4.92 crores based on an independent valuation from an expert. The main emphasis for disallowance is only on the point that the intellectual properties is not approved by any government or any competent authority. Nowhere the income tax act mandates the registration of the intellectual properties for the purpose of granting depreciation u/s 32 of the Act. Getting the intellectual properties registered is within the domain of the assessee and it only offers protection to the assessee from preventing other parties to use the same. The revenue cannot thrust the mandate of registration of the same and mere non-registration of the same does not make the transaction ingenuine or sham. Hence the version of the revenue that IP should be certified by the government authority and it does not fall within the assets specified in IT Rules is without any basis and not tenable.*

*3.3.5.* ***In view of the aforesaid findings and respectfully following the judicial precedent relied upon hereinabove, we allow the grounds 2(a) to 2(d) raised by the assessee for the Asst Year 2007-08 and grounds 12(1) to 12(c ) raised for the Asst Year 2008-09. The ld AO is also directed to rework the opening WDV of this asset in the subsequent year and rework the allowability of depreciation on the same pursuant to this order. In view of this decision, we are not inclined to entertain the alternative claim of the assessee vide ground no. 1(a) that the consideration so paid in the sum of Rs. 4,92,00,000/- has to be construed as Goodwill and depreciation has to be granted accordingly.***

7. In view of the above, we direct TPO/AO accordingly. Ground No. 6 raised by the assessee are allowed.

8. Ground No. 7 is relating to disallowance of provision for stock obsolescence under normal provisions.

9. Heard both and perused the material available on record. It is noted that the issue raised in Ground No. 7 was decided by this Tribunal in assessee's own case by its consolidated order dated 13.09.2017 for A.Y.'s 2010-11 and 2011-12. The relevant portion of which is reproduced herein below:

*33.3. We have heard the rival submissions. From the perusal of the materials available on record, we find that the assessee has created a provision for obsolete inventories amounting to Rs 10,00,472/- during the year following the mandate provided in Accounting Standard (AS) 2 issued by Institute of Chartered Accountants of India (ICAI) on 'Valuation of Inventories' ,*

*wherein, while creating such provision, i.e the method of valuation of stock should be cost or net realizable value whichever is lower. The ld AR stated that the items of obsolete stock are identified from the system maintained by the assessee . The system captures the slow moving inventories nad thereafter the realizable value of the stock is considered vis a vis the cost of those items. The items of inventory identified are those items which have lost their consumer acceptability over a period of time and hence are considered obsolete. The realizable market value considered for comparison is determined based upon prevalent prices and is the only practical method for comparison and subsequent evaluation whether an item of inventory has become obsolete or not. He stated that the method for determining the item of obsolete inventory being a scientific and commercially acceptable method and the provision created based thereupon indicate that the loss has actually incurred in the current period and it is only its actual quantification which is not possible and hence the provision is recorded in the books. We find from the workings of provision for obsolete stocks furnished before the lower authorities by the assessee (enclosed in pages 1185 to 1189 of Part 3 of Paper Book) that the assessee had adopted different percentage of provision for obsolete stocks depending upon the different time periods from the date of sale as under:-*

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| *Upto 180 days* | *- 0% provision* |
| *181-360 days* | *- 25% provision – Rs 2,83,815.18* |
| *361-540 days* | *- 50% provision – Rs 7,970.69* |
| *541-720 days* | *- 75% provision – Rs 1,75,572.98* |
| *> 720 days* | *- 100% provision –Rs 5,33,113.50* |
| ***Total Provision*** | ***Rs 10,00,472.35*** |

*We find from the said workings , the assessee had clearly mentioned the item code, description of item available in the inventories, date of last transaction, quantity, rate per unit and the value together with the time periods from the date of sale to decide the relevant provision percentage. Hence it could be safely concluded that the assessee had made a scientific calculation for making provisions based on commercially acceptable method. We find that the valuation of the stocks in accordance with AS-2 issued by the ICAI is one of the standards recognized u/s 145(2) of the Act, wherein the closing stock is to be valued at lower of cost or net realizable value.*

*33.3.1. We find that this issue is directly covered in favour of the assessee by the decision of the Hon'ble Delhi High Court in the case of CIT vs Hotline Teletube & Components Ltd reported in (2008) 175 Taxman 286 (Delhi) . The facts before the Hon'ble Delhi High Court and the decision rendered thereon are as under:-*

***3.1*** *The assessee had filed a return on 20-10-2002 declaring a loss of Rs. 51,031. The case of the assessee was picked up for scrutiny and a notice under section 143(2) of the Act was issued. During the course of the assessment, it came to light that the assessee is in the business of manufacture of picture tubes of black and white television sets, as well as, glass shells for black and white picture tubes, electron gun and glass stems.*

***3.2*** *During the course of the assessment proceedings, the Assessing Officer sought explanation from the assessee with regard to provision in respect of diminution in value of stock. The Assessing Officer also sought the assessee's explanation as to why the provision be not added back while computing the profit from business under section 115JB of the said Act.*

***3.3*** *The assessee sought to explain the provision made in respect of diminution in value of stock by submitting that a sum of Rs. 12,02,973 debited to the profit and loss account was on account of obsolete and old picture tubes. It was the assessee's say that since the demand for black and white television picture tubes had diminished, the inventory with respect to the same which it had been carrying for more than three years had become obsolete and hence, it was unable to sell the same which, prompted the assessee to write off the same as a loss.*

***5.*** *In the instant case we find that the principle for valuing stock at cost or realizable market price whichever is lower is applicable. The assessee has demonstrated that the stock being obsolete did not move for over three years and also the fact that it could only be sold if at all as scrap. As a matter of fact, the assessee also established that in the event it is sold as scrap the burden of excise duty would be much more than what it could realize on sale of the said stock as scrap. The Tribunal has returned this as a finding of fact. In view of these findings, it is quite clear that, all that, the assessee has done by making the provision for diminution in value of stock is to anticipate the loss in the value of stock.*

***6.*** *In the circumstances, we are of the view that no substantial question of law arises for our consideration.*

***7.*** *Accordingly, the appeal is dismissed.*

*33.3.2. In view of our aforesaid findings and respectfully following the judicial precedent relied upon hereinabove, we hold that the provison made for obsolete stocks in the sum of Rs 10,00,472/- is squarely allowable as deduction as a business loss under normal provisions of the Act.* ***Accordingly, the Ground No. 10 raised by the assessee for the Asst Year 2011-12 is allowed.***

10. In view of the above, we direct TPO/AO accordingly. Ground No. 7 raised by the assessee are allowed.

11. Ground No. 8 relating to disallowance of provision for warranty and allowability of actual warranty expenditure under normal provisions.

12 Heard both and perused the material available on record. It is noted that the issue raised in Ground No. 8 was decided by this Tribunal in assessee's own case by its consolidated order dated 13.09.2017 for A.Y.'s 2010-11 and 2011-12. The relevant portion of which is reproduced herein below:

*"32.2.4. When the assessee sells his goods, the warranty clause is part of the sale transaction and therefore it is a committed liability by the assessee at the very initial stage of sale. But for prescription of such a warranty clause, the customer may not even buy the product of the assessee. In the instant case, the assessee had given the figures of actual warranty liability incurred and paid in the previous years which forms the basis of existence of warranty liability in the past. Now it would be pertinent to get into Clause 19 of the Purchase Order dated 16.2.2010 issued by WBSEDCL to the assessee defining the terms and conditions of contract. The ld DR vehemently relied on this clause as it only mentioned about 'Guarantee' and there was no clause for 'warranty' in the terms and conditions. Accordingly the ld DR objected to the allowability of provision for warranty in the sum of Rs 1,85,85,000/-. For the sake of convenience, the relevant clause 19 under the caption 'Guarantee' is reproduced hereunder:-*

*19.* ***Guarantee:***

*a) The Meters and Pilfer Proof Meter Boxes shall be guaranteed arising out faulty design, materials, bad workmanship for a period of 5-1/2 years from the date of supply. The meters / Pilfer Proof Meter Boxes found defective within the above guarantee period should be replaced by the supplier free of cost within one month on receipt of intimation. If the defective meters / Pilfer Proof Meter Boxes are not replaced within the above specified period, WBSEDCL will recover twice the cost of meters /Pilfer Proof Meter Boxes from the supplier.*

***b) Name plate of the meter is to be marked with 'Guarantee of the Meter' : 5-1/2 years from the date of supply.***

*We find from the above clause, the warranty clause is inbuilt in the Guarantee Clause itself. As it could be seen that the assessee in the event of any defective supply within a period of 5-1/2 years had to replace the meters to WBSEDCL and in the event of meters not getting replaced, then the assessee has to pay twice the cost of meters to WBSEDCL. Hence it could be safely concluded that the assessee had agreed for both warranty (i.e replacement of defective meters) as well as guarantee ( of paying twice the cost of meters if meters are not replaced). Hence we hold that the reliance placed by the ld DR does not advance the case of the revenue and actually it favours the assessee. We also find that the Hon'ble Supreme Court in the case of Rotork Controls India (P) Ltd vs CIT reported in 314 ITR 62 (SC) had held as under:-*

***11.*** *Liability is defined as a present obligation arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.*

***12.*** *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 is 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 assessment years 1983-84 onwards. Valve Actuators are sophisticated goods. Over the years appellant has been manufacturing Valve Actuators in 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, warranty became integral part of the sale price of the Valve Actuator(s). In other words, 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, 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 three conditions for recognition of a provision are satisfied in this case.*

*Hence we hold that the provision for warrant in the sum of Rs 1,85,85,000/- is an ascertained liability based on the claims made by WBSEDCL during the year under appeal for which the liability to incur the same had definitely arisen during the year under appeal and accordingly eligible for deduction in the year of arising of liability.*

*32.2.5. There is no dispute with regard to the actual warranty cost incurred by the assessee in the sum of Rs 8,04,000/- and hence the same represents crystallized liability during the year which is allowable as deduction.*

*32.2.6. With regard to the remaining provision for warranty of Rs 12,79,000/-, we find from page 1380 of Part 3 of Paper Book, that the assessee had arrived at this figure based on scientific method on a very conservative approach by taking the average of actual warranty liability incurred in the past 10 years . The said workings were very much filed before the lower authorities. Hence we hold that the said sum represents ascertained liability during the year under appeal, although the actual quantification of the same would arise in future. It is well settled that if the assessee is following mercantile system of accounting, if the business liability has definitely arisen in accounting year, deduction should be allowed although liability may have to be quantified and discharged at a future date but what should be definite is incurring of liability. It is not in dispute that the assessee is following mercantile system of accounting. This principle has been endorsed by the Hon'ble Supreme Court in the case of Bharat Earth Movers vs CIT reported in 245 ITR 428 (SC). Hence we hold that this liability of Rs 12,79,000/- is an ascertained liability in the year under appeal based on the systematic historical data of the past wherein warranty liabilities had occurred to the assessee. Reliance in this regard is again placed on yet another finding of the Hon'ble Supreme Court in the case of Rotork Controls India (P) Ltd vs CIT reported in 314 ITR 62 (SC) wherein it was held as under:-*

***17.** At this stage, we once again reiterate that a liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow of resources and in respect of which a reliable estimate is possible of the amount of obligation. As stated above, the case of Indian Molasses Co. (P.) Ltd. (supra) is different from the present case. As stated above, in the present case we are concerned with an army of items of sophisticated (specialised) goods manufactured and sold by the assessee whereas the case of Indian Molasses Co. Ltd. (supra) was restricted to an individual retiree. On the other hand, the case of Metal Box Co. of India Ltd. (supra) pertained to an army of employees who were due to retire in future. In that case the company had estimated its liability under two gratuity schemes and the amount of liability was deducted from the gross receipts in the profit and loss account. The company had worked out its estimated liability on actuarial valuation. It had made provision for such liability spread over to a number of years. In such a case it was held by this Court that the provision made by the assessee-company for meeting the liability incurred by it under the gratuity scheme would be entitled to deduction out of the gross receipts for the accounting year during which the provision is made for the liability. The same principle is laid down in the judgment of this Court in the case of Bharat Earth Movers (supra). In that case the assessee-company had formulated leave encashment scheme. It was held, following the judgment in Metal Box Co. of India Ltd.'s case (supra), that the provision made by the assessee for meeting the liability incurred under leave encashment scheme proportionate with the entitlement earned by the employees, was entitled to deduction out of gross receipts for the accounting year during which the provision is made for that liability. <u>The principle which emerges from these decisions is that if the historical trend indicates that large number of sophisticated goods were being manufactured in the past and in the past if the facts established show that defects existed in some of the items manufactured and sold then the provision made for warranty in respect of the army of such sophisticated goods would be entitled to deduction from the gross receipts under section 37 of the 1961 Act. It would all depend on the data systematically maintained by the assessee.</u> It may be noted that in all the impugned judgments before us the assessee(s) has succeeded except in the case of Civil Appeal Nos. 3506-3524 of 2009 - Arising out of S.L.P.(C) Nos. 14178-14182 of 2007 - Rotork Controls India (P.) Ltd. v. CIT, in which the Madras High*

*Court has overruled the decision of the Tribunal allowing deduction under section 37 of the 1961 Act. However, the High Court has failed to notice the "reversal" which constituted part of the data systematically maintained by the assessee over last decade.*

*(UNDERLINING IS PROVIDED BY US)*

*32.2.7. Accordingly we hold that the entire provision for warranty in the sum of Rs 206.68 lakhs would be squarely allowed as deduction in the year under appeal under the normal provisions of the Act.*

13. In view of the above, we direct TPO/AO accordingly. Ground No. 8 raised by the assessee are allowed.

14. Ground No. 9 is relating to disallowance of provision for leave encashment.

15. Heard both and perused the material available on record. It is noted that the issue raised in Ground No. 9 was decided by this Tribunal in assessee's own case by its consolidated order dated 03.08.2016 for A.Y.'s 2007-08 and 2008-09. The relevant portion of which is reproduced herein below:

*"2.1. We have heard the rival submissions. At the outset, we find that the CIT(A) confirmed the disallowance as made by the Ld. AO on account of claim for provision for leave encashment. Ld. counsel for the assessee stated that the deduction on account of provision for leave encashment was made on the basis of the judgment of Hon'ble jurisdictional High Court in the case of Exide Industries Ltd. Vs. Union of India (2007) 292 ITR 470 (Cal) but he fairly conceded that subsequently Hon'ble Supreme Court has stayed this judgment of Hon'ble jurisdictional High Court vide order 08-05-2009 by following observations:-*
*"Pending hearing and final disposal of the Civil Appeals, Department is restrained from recovering penalty and interest which has accrued till date. It is made clear that as far as the outstanding interest demand as of date is concerned, it would be open to the Department to recover that amount in case Civil Appeal of the Department is allowed.*

*We further make it clear that the assessee would, during the pendency of this Civil Appeal, pay tax as if section 43B(f) is on the Statue Book but at the same time it would be entitled to make a claim in its returns."*

*In view of the above, Ld. counsel for the assessee fairly stated that let Hon'ble Supreme Court decide the issue and by that time the matter can be remitted back to the file of ld AO for fresh adjudication in terms of the decision of Hon'ble Supreme Court. On this, Ld. CIT DR has not objected to the same. Accordingly, we set aside this issue to the file of the AO to await the decision of Hon'ble Supreme Court and decide the issue accordingly. This issue of assessee's appeal is remitted back to the file of AO and accordingly* ***ground no. 1 in ITA No. 37/Kol/2012 raised by assessee is allowed for statistical purposes.***

16. In view of the above, we direct TPO/AO accordingly. Ground No. 9 raised by the assessee is allowed for statistical purposes.

17. Ground No. 10 is relating to addition made on account of interest on MSMED under book profit.

18. Heard both and perused the material available on record. It is noted that the issue raised in Ground No. 10 was decided by this Tribunal in assessee's own case by its consolidated order dated 13.09.2017 for A.Y.'s 2010-11 and 2011-12. The relevant portion of which is reproduced herein below:

> *34. The last issue to be decided in this appeal is as to whether the ld DRP was justified in upholding the addition made on account of provision for interest on MSMED in the sum of Rs 29,21,911/- in the facts and circumstances of the case.*
>
> *34.1. The ld AO observed that assessee had made provision for interest to the tune of Rs 29,21,911/- for making delayed payment to its suppliers who are registered under The Micro , Small and Medium Enterprises Development Act, 2006 . This provision for interest in the sum of Rs 29,21,911/- was voluntarily disallowed by the assessee in the return of income under normal provisions of the Act but deduction was claimed under computation of book profits u/s 115JB of the Act. The ld AO treated the same as an unascertained liability and added back the same while computing the book profits u/s 115JB of the Act. This action of the ld AO was upheld by the ld DRP. Aggrieved, the assessee is in appeal before us vide Ground No. 14.*
>
> *34.2. We have heard the rival submissions. We find that as per the provisions of The Micro, Small and Medium Enterprises Development Act, 2006, any amount due to the supplier as defined in section 2(n) of the MSMED Act, should be paid on the date agreed upon between the buyer and the seller, which shall be before the appointed date as per section 15 of MSMED Act. Section 16 of the said Act provides that in case the buyer (i.e the assessee herein) fails to make the payment to the supplier , then the buyer shall be responsible to pay interest at monthly intervals on the amount due to the supplier from the appointed date at three times the bank rate notified by the Reserve Bank of India. Accordingly, the ld AR argued that the liability towards interest can in no way be termed as an unascertained liability as it gets crystallized pursuant to an independent statute. He stated that the term 'ascertained' as defined in the Oxford Dictionary means "find out, definite, certain". He stated that as per the method prescribed in the MSMED Act, 2006, there cannot be an iota of doubt that the interest calculated and due towards the suppliers is an ascertained liability. It is calculated as per a set formula and based on the number of days of payment overdue and hence it has to be construed as a certain liability and not as a contingent one and accordingly he prayed for allowance of the same as deduction while computing the book profits u/s 115JB of the Act.*
>
> *34.2.1. As per Section 23 of the said Act, the said provision for interest is not allowable as a deduction under the provisions of the Income Tax Act and accordingly, the assessee had rightly disallowed the same in the return of income under normal provisions of the Act. Now the short point of dispute in this regard is whether the said provision for interest would have to be disallowed even in the computation of book profits u/s 115JB of the Act. The ld DR stated that*

*the provisions of section 115JB of the Act are also part of the Income Tax Act, 1961 only and once section 23 of the MSMED Act, 2006 specifically states that the said interest shall not be allowed as deduction under Income Tax Act, it should not be allowed as deduction even in the computation of book profits u/s 115JB of the Act. The ld DR argued that only then the real intent of the provisions of section 23 of MSMED Act would get sanctified.*

*34.2.2. We find that though the provisions of section 115JB of the Act are self contained code in itself and starts with a non-obstante clause creating a legal fiction regarding the total income of the assessee. The provisions of section 115JB of the Act have been introduced in the statute book with effect from 1.4.2001. The MSMED Act, 2006 received the assent of the Hon'ble President of India on 16.6.2006. The Provisions of Section 23 of MSMED Act , 2006 are reproduced hereinbelow for the sake of convenience:-*

***23. Interest not to be allowed as deduction from income***

*Notwithstanding anything contained in the Income Tax Act, 1961 (43 of 1961), the amount of interest payable or paid by any buyer, under or in accordance with the provisions of this Act, shall not, for the purposes of computation of income under the Income-Tax Act, 1961, be allowed as deduction.*

*34.2.3. The Provisions of section 23 of MSMED Act, 2006 also starts with non-obstante clause by stating 'Notwithstanding anything contained in the Income Tax Act, 1961'. In this regard, it was argued by the ld DR that the wisdom of the legislators need to be accepted that the Parliament ought to have considered the provisions of the earlier Act while legislating the new Act. Obviously the MSMED Act was legislated and assent of the Hon'ble President of India obtained only on 16.6.2006 which is much after the Income Tax Act, 1961 and section 115JB of the Act contained therein. Going by the intention behind enacting the MSMED Act, i.e to protect the interests of the micro, small and medium enterprises that they get their dues in time for the supplies made by them and they don't get exploited by the big corporates or bigger players in the market, this payment of interest to those suppliers were provided in the MSMED Act. But we would like to state that the issue before us is to be decided as per the provisions contained in section 115JB of the Act. It is not in dispute that the revenue had sought to add back the provision for interest in the sum of Rs 29,21,911/- while computing the book profits u/s 115JB of the Act by treating the same only as an unascertained liability falling in clause (c ) of Explanation 1 to section 115JB(2) of the Act. For the sake of convenience, the said clause (c ) is reproduced below:-*

*Explanation 1 – For the purposes of this section, "book profit' means the net profit as shown in the profit and loss account for the relevant previous year prepared under sub-section (2) , as increased by –*

*(a) to (b) ……..*
*(c ) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities*

*34.2.4. Now the pertinent question would be whether the provision for interest of Rs 29,21,911/- would be ascertained or unascertained liability. We find that the said provision had been determined with reasonable certainty pursuant to the method of calculation provided under the MSMED Act, 2006 (which is an independent statute) . Moreover, the payment of this interest to the suppliers registered under MSMED Act, 2006 is mandatory in nature and no*

*option is given to the assessee in this regard. Hence it could be safely concluded that the said provision of interest would be clearly an ascertained liability. Moreover, we find that out of total provision of Rs 29,21,911/-, the assessee has paid a sum of Rs 10,71,467/- before the end of the previous year and the balance outstanding as on 31.3.2011 was only Rs 18,50,444/- which is quite evident from the annual report enclosed in the paper book of the assessee. This itself proves that the assessee had already discharged partial liability towards interest within the end of the previous year and unless the liability had crystallized, no assessee would come forward to make payment of the same. Hence we hold that it is only an ascertained liability as on 31.3.2011.*

*34.2.5. We find that the provisions of section 115JB of the Act stipulates that 'Book Profits' shall be deemed to be the total income of the assessee. The expression 'Book Profits' is defined in Explanation 1 to section 115JB of the Act which states as under:-*

*For the purposes of this section, "book profit' means the net profit as shown in the profit and loss account for the relevant previous year prepared under sub-section(2) , as increased by –*
*(a) to (k) ……*
*If any amount referred to in clauses (a) to (i) is debited to the profit and loss account or if any amount referred to in clause (j) is not credited to the profit and loss account, and as reduced by , -*
*……*

*Once the expression "Book Profits" is defined in section 115JB of the Act, we cannot travel beyond what is defined therein and we cannot impute any other words or provisions therein unless otherwise specified by the statute . Reliance in this regard is placed on the decision of the Hon'ble Apex Court in the case of Apollo Tyres Ltd reported in 255 ITR 273 (SC). Admittedly the interest payable to suppliers under MSMED Act, 2006 is not one of the item contemplated for addition to net profit for the purpose of computing book profits u/s 115JB of the Act. It is well settled that provisions of section 115JB of the Act creates a deeming fiction and there cannot be deeming fiction on an existing deeming fiction by imputing the provisions of section 23 of MSMED Act, 2006 into the expression "book profits" as defined in Explanation 1 to Section 115JB of the Act. We find that there is no other clause provided in Explanation (1) to section 115JB(2) of the Act for increasing the book profits of the assessee due to this provision for interest under MSMED Act, 2006. Moreover, we find that the provisions of section 23 of MSMED Act, 2006 specifies that interest payable to buyer shall not for the purposes of computation of income under the Income Tax Act, 1961, be allowed as deduction. In this regard, the expression ' computation of income' used therein , in our considered opinion, refers to the expression 'income' referred to in section 29 or in section 57 of the Income Tax Act. We find that Section 29 and Section 57 of the IT Act, 1961 talks about the manner in which the income referred to in section 28 (i.e business or professional income) and section 56 (i.e income from other sources) subject to grant of certain deductions under the respective heads. For the sake of convenience, the provisions of section 29 and section 57 are reproduced hereunder:-*

***Section 29 – Income from profits and gains of business or profession, how computed***

*The income referred to in section 28 shall be computed in accordance with the provisions contained in sections 30 to 43D.*

***Section 57-** The income chargeable under the head 'income from other sources' shall be computed after making the following deductions, namely –*
*……*

*34.2.6. In our considered opinion, what section 23 of MSMED Act, 2006 contemplates or refers to was the 'income' mentioned in section 29 and 57 of the Act i.e how the interest payable under MSMED Act, 2006 shall be treated while computing the income from business or profession u/s 29 or while computing the income from other sources u/s 57 of the Act. It cannot be stretched to extend to the provisions of section 115JB of the Act which is a deeming fiction, wherein the book profits shall be deemed to be the 'total income' of the assessee. The expression 'total income' as used in section 115JB of the Act cannot be equated with 'computation of income' used in section 23 of MSMED Act, 2006.. It can be appropriately used only in the context of provisions of section 29 and section 57 of the Act. Thus while computing the income under normal provisions under various heads alone, the provisions of section 23 of MSMED Act, 2006 would assume relevance and significance. Hence we hold that the interest payable under MSMED Act, 2006 need not be added back to the net profits while computing book profits u/s 115JB of the Act. Moreover, the ld AR also placed the scrutiny assessment orders of the assessee on record for the Asst Year 2014-15 u/s 143(3) of the Act dated 26.12.2016, wherein this aspect has been duly examined by the ld AO in the assessment and deduction was duly granted by him in the assessment. In view of these facts and findings, we hold that the provision for interest payable to suppliers registered under MSMED Act, 2006 in the sum of Rs 29,21,911/- is only an ascertained liability and need not be added back to the book profits computed u/s 115JB of the Act.* ***Accordingly, the Ground No. 15 raised by the assessee for Asst Year 2011-12 is allowed****.*

19. In view of the above, we direct TPO/AO accordingly. Ground No. 10 raised by the assessee is allowed.

20. Ground No. 11 is relating to addition made on account of provision for warranty and deduction of actual warranty expenditure under book profit.

21. Heard both and perused the material available on record. It is noted that the issue raised in Ground No. 11 was decided by this Tribunal in assessee's own case by its consolidated order dated 13.09.2017 for A.Y.'s 2010-11 and 2011-12. The relevant portion of which is reproduced herein below:

*32.2.8. The next dispute in this regard is as to whether the said provision for warranty would have to be construed as ascertained liability or unascertained liability for computing the book profits u/s 115JB of the Act. We have already held that all the three categories of provision for warranties (i.e 185.85 lakhs , 12.79 lakhs and 8.04 lakhs) are clearly ascertained liabilities and hence there is no question of adding back the same to the net profits as per profit and loss account for computing the book profits u/s 115JB of the Act. We have already held that the liability towards provision for warranty has been incurred by the assessee during the year under appeal although the actual quantification of the same arises in future date. Once it is held that there is a liability which is certain, the same automatically falls outside the ambit of unascertained liabilities contemplated in the Explanation to section 115JB of the Act and accordingly the same would be allowed as deduction while computing the book profits u/s*

*115JB of the Act. In our considered opinion, the said clause in provided in section 115JB of the Act only to prevent assessees from making some ad hoc provisions in the books , which would never crystallize , so as to reduce the net profits as per the books with consequential reduction in the tax payable u/s 115JB of the Act. That is not the case here and that is not the allegation also raised by the revenue in this case. The assessee herein had made provision for warranty based on a systematic and scientific working and method by taking into account the past history of incurrence product warranties and the said workings were also filed before the lower authorities. Hence it could be safely concluded that the said provision for warranty is not made based on ad hoc provision. Rather it has got a sound basis and judgment on the part of the assessee creating an obligating event on the assessee as a result of past events. We find that this provision would also not tantamount to provision made for diminution in value of assets.*

*32.2.9. We would like to place reliance on the decision of the Hon'ble Delhi High Court in the case of CIT vs Becton Dickinson India (P) Ltd reported in (2013) 29 taxmann.com 80 (Delhi) dated 19.11.2012 wherein it was held as under:-*
***6.** In the facts of the present case too this Court is of the opinion that the reasoning adopted by the Tribunal cannot be found fault with. The considerations which weighed with the Supreme Court in Rotork Controls India (P.) Ltd.'s case (supra) in concluding such warranty provisions were not contingent liabilities would apply with greater force to negate the claim by the revenue that such provisions are made for diminution in the value of any asset, so as to be covered by Explanation 1(i) to section 115JB of the Act. In these circumstances, the Court is satisfied that no substantial question of law arises for consideration.*

*Similar view was also taken by the co-ordinate bench decision of Mumbai Tribunal in the case of Anchor Electricals (P) Ltd vs DCIT reported in (2015) 81 taxmann.com 250 (Mumbai-Trib.) dated 26.4.2017 in the context of allowability of provision for warranty vis a vis computation of book profits u/s 115JB of the Act. It was held that :-*

***23.** With regard to the adjustment in book profit u/s115JB is concerned, it is noted that this issue is squarely covered in favour of the assessee by the judgment of Hon'ble Delhi High Court in the case of Becton Dickinson India (P) Ltd. (supra), wherein it has been held that the provision for warranty cannot be treated as provision for diminution in value of any assets so as to be covered by Explanation 1(i) to section 115JB (2) and thus no additions to book profit can be made. Further, Hon'ble Supreme Court in the case of Rotork Controls India (P) Ltd. (supra) held that amount of provision made on account of warranty expenses cannot be said to be unascertained liability. Thus, taking into account both these decisions, we find that no addition could have been made u/s 115JB for this amount. Therefore, addition to book profit is directed to be totally deleted.*

*32.3. In view of the aforesaid findings and respectfully following the judicial precedents relied upon hereinabove, we hold that the provision for warranty in the sum of Rs 206.68 lakhs would be allowed as deduction under normal provisions of the Act as well as while computing book profits u/s 115JB of the Act.* ***Accordingly, the Grounds 11 & 16 raised by the assessee for the Asst Year 2011-12 are allowed.***

22. In view of the above, we direct TPO/AO accordingly. Ground No. 11 raised by the assessee is allowed.

23. Ground No. 12 is relating to addition made on account of provision for stock obsolescence under book profit.

24. Heard both and perused the material available on record. It is noted that the issue raised in Ground No. 12 was decided by this Tribunal in assessee's own case by its consolidated order dated 13.09.2017 for A.Y.'s 2010-11 and 2011-12. The relevant portion of which is reproduced herein below:

> *33.3.3. With regard to the allowability of the provision for obsolete stock while computing the book profits u/s 115JB of the Act, the ld AO had disallowed the same on the ground that it is an unascertained liability and accordingly to be added back while computing book profits u/s 115JB of the Act. The ld DR argued that pursuant to the amendment brought in by the Finance (No.2) Act , 2009 with retrospective effect from 1.4.2001 , the said provision for obsolete stock represents provision made for diminution in value of asset and hence the same requires to be added back while computing the book profits u/s 115JB of the Act. When this was put to the ld AR, he fairly conceded for the addition u/s 115JB of the Act. Moreover, we find that the decision of the Hon'ble Delhi High Court supra was rendered on 11.8.2008 which was prior to the amendment brought in by Finance (No.2) Act, 2009 with retrospective effect from 1.4.2001.* ***Accordingly, the Ground No. 15 raised by the assessee for the Asst Year 2011-12 is dismissed.***

25. In view of the above, we direct TPO/AO accordingly. Ground No. 12 raised by the assessee is dismissed.

26. **In the result, the appeal of the assessee is partly allowed.**

**Order pronounced in the Court on 17.10.2018**

| | |
|---|---|
| Sd/- | Sd/- |
| J. Sudhakar Reddy | S.S. Viswanethra Ravi |
| Accountant Member | Judicial Member |

Dated : 17.10.2018
Biswajit, Sr. PS

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2. DCIT, Circle-1(1), Kolkata, P-7, Chowringhee Square, R. No. 20, 7th Floor, Kolkata-700069
3..C.I.T.(A)-4, Kolkata
4. C.I.T.- Kolkata.
5. CIT(DR), Kolkata Benches, Kolkata.

True copy

By Order

Senior Private Secretary
Head of Office/D.D.O., ITAT, Kolkata Benches