

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'F' NEW DELHI**

**BEFORE SHRI PRASHANT MAHARISHI, ACCOUNTANT
MEMBER**

&

SHRI K.NARASIMHA CHARY, JUDICIAL MEMBER

**ITA No.5744/Del/2015
Assessment Year: 2001-02**

Nokia India P. Ltd.,
C/o TEC Level 18,
DLF Cyber City, Phase-III
Building No.5, Tower A,
Gurgaon.
PAN: AAACN2170R
(Appellant)

vs DCIT, Circle 13(1),
New Delhi.

(Respondent)

Appellant by: Shri Vikas Srivastava , Advocate
Shri Sumit Mangal, Advocate
Respondent by: Shri Surender Pal, Sr. DR

Date of hearing: 29.11.2018

Date of Pronouncement: 09 .01.2019

ORDER

PER K. NARASIMHA CHARY, JM

Challenging the order dated 17/08/2015 in appeal No. 168/13-14 passed by the learned Commissioner of Income Tax (Appeals)-6, Delhi ("Ld. CIT(A)") assessee preferred this appeal.

2. Brief facts of the case are that the Nokia India private limited (assessee) is a wholly-owned subsidiary of Nokia Corporation, Finland. They have filed their return of income for the assessment year 2001-02 on 31/10/2001 declaring nil income, after setting off the unabsorbed business losses and depreciation.

The assessee had the book profits and, therefore, liable to pay tax of Rs.3,499,284 as per section 115 JB of the Income Tax Act, 1961 (“the Act”). Assessment was completed under section 143(3) of the Act at a total income of Rs.12,20,00,470/-by order dated 29/03/2004 and the appeal against the said order was partly allowed by the 1st appellate authority.

3. The assessee claimed Rs.7,48,62,367/- as marketing expenses during the Financial Year 2000-01 which included Rs.59,38,347/- incurred on account of FOC handsets issued to employees, dealers and AMSCs. Details of such FOC handsets issued during the year is as under:

| S No. | FOC handsets issued to | Amount in Rs. |
|-------|---|---------------|
| 1. | Dealers | 41,20,881 |
| 2. | Employees | 17,51,235 |
| 3. | AMSCs | 66,231 |
| | Total | 59,38,347 |
| | Less: Depreciation @25% on Sr. 1,2 and 3 | 14,84,586 |
| | Addition | 44,53,700 |

4. Ld. AO in his assessment order dated March 29, 2004 i.e., original order u/s 143 (3) of the Act held that these handsets were capital assets of the appellant and disallowed aforementioned expenditure after allowing depreciation @ 25%. Such an addition of the AO was upheld by the Ld. CIT(A) in his order. In the Second Appeal, a coordinate Bench of this Tribunal in its order dated December 5, 2008 summarily rejected the contentions of the appellant and upheld the order of the CIT(A). Matter was carried to the Hon’ble Delhi High Court and Hon’ble High Court, by order dated July 14, 2009, remanded the matter to the Tribunal for fresh consideration on the ground

that ITAT summarily dismissed the arguments of the appellant. Subsequently, ITAT in its order dated 22/09/2011 remitted back the matter to the AO to consider the issues relating to the addition of Rs.44,53,700/- on account of disallowance of marketing expenses and Rs.80,03,258/-on account of closing stock afresh after providing an opportunity of being heard to the appellant. Ld. AO, however, in its order dated 31/03/2013 passed under section 143(3) of the Act and 254 of the Act repeated the following additions:

- (i) Disallowance on account of handsets issued on FOC basis to employees, dealers and After Market Service Centers (“AMSCs”) amounting to INR 44,53,700 [INR 59,38,347 - 25% depreciation].
- (ii) Addition to closing stock amounting to INR 80,03,258 on account of FOC handsets issued to employees, dealers and AMSC’s as also damaged handsets, thus leading to double addition of INR 59,38,347, already disallowed at Sr. No. 1.

5. When the assessee preferred an appeal against the above additions before the Ld. CIT(A), the Ld. CIT(A) vide impugned order confirmed the additions and dismissed all the grounds of appeal. The assessee, therefore, is in this appeal before us challenging those two additions.

6. Coming to the disallowance of marketing expenses incurred by way of issuance of handsets on Free of cost (“FOC”) basis to employees, dealers and AMSC’s - INR 44,53,700 (INR 59,38,347-25% depreciation) covered by Ground No. 2, 4,5 and 6, it is argued by the Ld. AR that the phones issued on a free of cost basis form part of the stock-in-trade of the appellant and cannot be considered as a capital asset. He submitted that the handsets issued on FOC basis by the appellant include the Handsets issued to employees for interaction with dealers and other service organizations; Handsets issued to AMSC’s for issuing new handsets to customers in the event handsets sold to customers are

defective and cannot be repaired during the warranty period; that the assessee is required to provide new cellular hand-sets to the AMSCs in case of defective Nokia cellular handsets, which cannot be repaired during the warranty period and therefore cannot be accounted for under the provision for warranty; that these handsets given as a replacement within the warranty period constitute a contractual obligation for the company and the expenditure is necessarily business expenditure allowable under section 37(1) of the Act.

7. Ld. AR further submits that the Display and Promotional Handsets issued to the dealers are the sample cellular handsets provided to such dealers for display and promotional purposes and these handsets are never received back by the appellant and the ownership is transferred to employees, dealers and AMSCs without any intention of repossessing them. The appellant vide CIT(A) submission dated June 3, 2015 (second round) submitted confirmations from its employees on a sample basis that they received phones free of cost to support the business of the appellant.

8. He further submitted that the disallowance should be deleted on grounds of materiality but in view of the fact that the marketing expenses incurred by the appellant during the relevant year pertaining to handsets issued free of cost were Rs.59,38,347/- which is only 0.89% of the appellant's turnover for the year of Rs.66,56,99,042/-, the disallowance needs to be deleted on grounds of materiality also.

9. Lastly, he brought it to our notice that by Order dated 30/01/2018, a coordinate bench of this tribunal in assessee's own case in AY 2003-04 in M/s Nokia India (P) Ltd. vs. DC1T, Circle 13(1) [ITA No. 2445/Del/2010] allowed the entire marketing expenditure on account of FOC handsets with the following observation that,-

“9.8. We have perused the submissions advanced by both the sides and the light of the records placed before us and the orders of this Tribunal in

assessee's own case relied upon by both the sides. Ld.AR while contestin s the issue had categorically submittedthat assessee do not have bills of havine been issued to its employees/dealers etc freeof cost. He thus submitted that settins aside the issue back to Ld.AO for verificationwould not serve any purpose.

9.9 Under such circumstances in our considered opinion we find it fit and proper todecide the issue in the lihht of the records placed before us. orders passed bvauthorities below as well as the submissions advanced by both the sides.

9.10 It is observed that assessee has shown marketing expenses to the tune of Rs. 53, 31, 919/-on account of mobile phone handsets issued to AM SC, dealers and employees etc. Ld.AR has submitted in his written submission dated 04/12/2017 that the handset given on free of cost basis to AM SC, dealers and employees are no longer owned by assessee. He it has been submitted that the title in the mobile phones is also transferred. Undisputedly assessee is a company which is eneased in import and sale of mobilehandsets. It has a wide team of dealers and sales personnel. Assessee has siven freeof cost Mobile to all these persons for communication amonstt themselves for thebusiness of assessee. Assessee has therefore debited the cost of these phones as own any of these phones and as it has been reduced from the stock and no bill isrequired to be prepared. Apparently the mobile phones will not be returned toassessee as they would be used by the recipients effective useful life. Thereforenaturally the expenditure of giving phones to sales team is an expenditure incurredby assessee wholly and exclusively for the purpose of business of assessee. Assesseehas also not capitalised these phones for the obvious reasons that phones are notowned by assessee and therefore there is no requirement of claim of depreciationthereon. In our view as expenditure is revenue in nature, assessee is eligible fordeduction under section 37 (1) only. Hence the ground raised by assessee stands allowed. ”

And that the said order of the Tribunal was upheld by the Hon'ble High Court and the Tax Department's appeal on this issue has been dismissed. Relevant extracts from the order of the Hon'ble High Court are reproduced below:

“8. Second issue raised by the Revenue relates to capitalization of marketing expenses to the extent of Rs. 39.98 lakhs. Assessing Officer had observed that the respondent- assessee had provided mobile handsets to their dealers, employees and after-sale- service centres. He held that these mobile handsets should be considered as capital assets used by the respondent- assessee for its business and accordingly the respondent- assessee was entitled to claim deprecation on these mobile handsets. This addition was upheld by the Commissioner of Income Tax (Appeals) holding his

predecessors in the Assessment Years 2000-01, 2001-02 and 2002-03 had upheld the said decision, though appeals were pending before the Tribunal.

9. The Tribunal in the impugned order has held that the respondent-assessee was engaged in the manufacture, import and sale of mobile handsets. They had a large number of employees, a wide team of dealers and sales personnel. The respondent- assessee had transferred title or ownership of the mobile handsets to the employees, dealers, sales personnel etc., who were given mobile handsets free of cost and were no longer owned by the respondent-assessee. These mobile phones were not to be returned to the respondent-assessee. Accordingly, the cost of the mobile phones was business expenditure and was rightly reduced from the inventory. Thus, the respondent-assessee was justified in treating these mobile phones as expenditure incurred. The amount cannot be capitalized.

10. The aforesaid finding regarding capitalization or business expenditure is a finding of fact. Obviously, respondent-assessee could not have claimed title and depreciation, once the mobile phones etc. had been given and ownership had been transferred to the employees, dealers, sales personnel and after-sales-service centres. In the absence of any material and evidence to show that the findings of fact are perverse, we do not see any reason to interfere with the impugned order on the said aspect.”

10. Facts being similar, the findings of the tribunal and Hon’ble High Court in assessee’s own case on the above issue hold the field, and we do not find any reason to take a different view from the same. While respectfully following, we hold that the assessee could not have claim title and depreciation, once the mobile phones had been given and ownership had been transferred to the employees, dealers, sales personnel and after sales service centres, and consequently the addition made by the learned AO on this aspect needs to be deleted. We order accordingly.

11. Now coming to the addition to Closing Stock on account of handsets damaged in transit- Rs.80,03,258/- covered by Ground No. 3, 4 ,5 and 6, brief facts are that the closing stock of the appellant for the year ended 31st March, 2018 was arrived at after reducing the value of 990 handsets from the stock of the appellant on account of FOC handsets and handsets damaged during transit, amounting to Rs.80,03,258/- which is also captured in the Tax Report of the appellant, duly certified by their auditors.

12. Ld. AO vide assessment order dated March 29, 2004 held that aforesaid handsets cannot be written off in the books of the appellant and held that they are for business use and appellant can only claim depreciation on such handsets. The aforesaid addition of the AO was upheld by the Ld. CIT(A) in his order.

13. Ld. CIT(A), however, in his order noted that appellant has submitted the detailed breakup of Rs.80,03,258/-. A coordinate Bench of this Tribunal in its order dated 05/12/2008 summarily rejected the contentions of the appellant and upheld the order of the CIT(A). Hon'ble High Court, however, by order dated July 14, 2009 directed the appellant to move an application before ITAT as the said ground has not been discussed in the ITAT order. Subsequently the ITAT in its order dated September 22, 2011, in Miscellaneous Application No. 391/Del/09 filed by appellant in respect of said issue, referred back this issue to the AO as it was inter-connected to the other grounds of appellant related to marketing expenditure which had also been sent back to AO. Ld. AO, however, in the second round of proceedings also upheld the same additions as made in his original assessment order, and confirmed in the appeal by the Ld. CIT(A).

14. It is the argument of the Ld. AR that the Ld. AO has erred in making addition on account of FOC handsets twice, first by disallowing the marketing expenditure of Rs.59,38,347/- on account of FOC handsets by treating it as capital expenditure and again by making an addition to closing stock of Rs.80,03,258/- which also includes the aforesaid FOC handsets of Rs.59,38,347/-, and the double addition cannot be made by the AO in view of the decisions in CIT Vs, SAK Industries (P.) Ltd. (1994) 49 TTJ (Del) 457 (Delhi HC); Laxmipat Singhania vs. CIT (1969) 72 ITR 291 (SC).

15. He further submitted that without prejudice to the above, even if the handsets damaged in transit are treated as stock owned by the appellant, the same should be allowed to be written off and reduced from total income of the appellant in view of the provisions under Section 145-A of the Act. Therefore,

these handsets should be valued at lower of cost or net realizable value (“NRV”) in accordance with AS-2.

16. It is submitted by the Ld. AR that the sale of mobile handsets by the appellant was governed by high competition and constantly changing technology; that the value of damaged mobile handsets was also nil since it could not be sold further or utilized for the purpose of the business of the appellant; that, therefore, the value at which damaged handsets should be added back to closing stock is at their NRV, which is nil. Damaged handsets have been reduced from the stock of the appellant to arrive at its closing stock for the year; that the Closing stock has been disclosed in Annexure IX of the Tax Audit Report of the appellant, which is certified by their auditors and there cannot be a higher standard of proof in this regard; and that the Ld. AO was not justified in making additions to the closing stock of the appellant without rejection of books of accounts of the appellant.

17. He further submitted that the damaged handsets that have been reduced by the appellant from the closing stock in the AY 2001-02 are sold as scrap in the future years, the income from sale of scrap has been included in the taxable income of the appellant of that year. Hence, in case any damaged handsets reduced from the closing stock in AY 2001-02 are sold by the appellant in future years, the taxes are paid by the appellant at the time of sale of scrap.

18. He further submitted that the addition to closing stock would be revenue neutral in the long run as the addition made to the closing stock in one year will correspondingly lead to an increase in the opening stock of the next year and will not materially affect the profits of the appellant. Hence, such an adjustment should not be made when the appellant has consistently followed the same method for valuing its closing stock throughout the years.

19. Lastly, he submitted that such an adjustment was accepted by the Ld.

AO in AY 2003-04 and the Ld. AO while making the addition for AY 2003-04 gave relief of adjustment made in closing stock in AY 2002-03. The Ld. AO in his order for AY 2003-04, while making an addition in closing stock of appellant for damaged handsets, reduced the addition made in the closing stock of the appellant in the preceding AY i.e. AY 2002-03 from the total addition in closing stock in AY 2003-04.

20. Ld. DR places reliance on the orders of the authorities below. Insofar as the grievance of the assessee that this particular amount of Rs.80,03,258/- is concerned, it includes the amount of Rs.44,53,700/- on account of disallowance of marketing expenditure. On this aspect record speaks that it is a fact. Now turning to the issue whether the assessee shall be allowed the direction on account of the handsets damaged in transit. The meaning of the fact that the damaged handsets, reduced from the closing stock during the year, amounted to Rs.20,64,911/- and this constitutes only 0.31 % of the assessee's turnover for the assessment year 2001-02 where the total turnover for the year was Rs.66,56,99,042/-. At the outset, we are of the considered opinion that the addition of the amount of Rs.80,03,258/- includes the amount of Rs.44,53,700/- decided (supra) vide first issue.

21. Even in respect of the value of the handsets damaged in transit is concerned, it comes only to Rs.20,64,911/- which constitutes only 0.31% of appellant's total turnover for the year and while respectfully following the order dated 21st of February 2014 of a coordinate bench of this tribunal in ACIT vs. Grohe India private limited in ITA No.1441/Del/2013, we hold that it is not unlikely that some of the items may have been damaged or lost during transit, therefore, such a shortage due to damage or loss has to be considered reasonably keeping in view the magnitude of such short is being 0.31% of the total turnover and hence cannot be held as an unusual loss. Further, we are convinced with the argument that if valuation of closing stock is changed then the value of opening

stock should also be changed on the same basis or method and the closing stock of a particular year is the opening stock of the subsequent year as such it does not materially affected the accounts and profits disclosed by the assessee. As a matter of fact, the adjustment now sought to be made is revenue neutral and at best may result in requirement or postponement of revenue and in view of the concept of materiality which is well recognized both in accountancy and the law. Accounting standards notified by the CBDT under section 145(2) mandates that the concept of materiality be taken into consideration when finalizing the accounts of an assessee. Keeping in view all these things we are of the considered opinion that no addition on account of the closing stock due to the handsets damaged in transit is warranted in this matter. We accordingly direct the Ld. assessing officer to delete the addition on this score.

22. In the result appeal of the assessee is allowed.

Order pronounced in the Open Court on 9th January, 2019.

Sd/-

sd/-

**(PRASHANT MAHARISHI)
ACCOUNTANT MEMBER**

**(K. NARASIMHA CHARY)
JUDICIAL MEMBER**

Dated: 9th January, 2019
VJ

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR
ITAT NEW DELHI

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| Date on which file goes to the Head Clerk. | |
| Date of dispatch of Order. | |