

IN THE INCOME TAX APPELLATE TRIBUNAL, DELHI 'F' BENCH,  
NEW DELHI

BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER, AND  
MS. SUCHITRA KAMBLE, JUDICIAL MEMBER

ITA Nos. 2723/DEL/2017 [A.Y 2011-12]  
ITA Nos. 749/DEL/2018 [A.Y 2012-13]

Rohde & Schwarz India Pvt Ltd  
A-27, First Floor, Mohan Cooperative  
Industrial Area, Mathura Road  
New Delhi

Vs. The Dy. C.I.T  
Circle - 21(2)  
New Delhi

PAN: AAACR 3267 P

(Applicant)

(Respondent)

Assessee By : Shri S. Srinivasan, CA

Department By : Shri Surendra Pal, Sr. DR

Date of Hearing : 06.11.2019

Date of Pronouncement : 07.11.2019

**ORDER**

**PER N.K. BILLAIYA, ACCOUNTANT MEMBER,**

The above two separate appeals by the assessee are preferred against two separate orders of the Commissioner of Income Tax [Appeals] - 7, New Delhi dated 17.02.2017 and 28.12.2107 pertaining

to assessment years 2011-12 and 2012-13. Since both these appeals were heard together, these are being disposed of by this common order for the sake of convenience and brevity.

2. The common grievance in both these appeals relates to the disallowance made for the provision for warranty, though the quantum may differ.

3. Briefly stated, the facts of the case are that the assessee received commission income and as per the Sales Representation Agreement, the assessee's activity involves the sale of equipments and at the same time, attends to the warranty services for free warranty for the warranty period. The assessee gets income from its Associated Enterprise Rhode & Schwarz GmbH, Germany and other for services rendered. The services include all activities culminating in the sale of their equipments and free warranty services for 2-5 years, depending upon the equipments, which start after the equipment has been sold to the parties in India.

4. During the course of assessment proceedings, the assessee was asked to furnish the details of commission income and creation of provision. In A.Y 2011-12, the assessee filed the following details:

Commission as actual received	27,94,34,315
Add: commission of earlier year considered as income	36,06,987
Less - Commission of previous years offered to tax in earlier year	5,12,51,599
Less: Provision for warranty	74,45,364
Commission for the year	22,44,44,339

5. In A.Y 2012-13, the assessee filed the following details:

Balance as at 31 <sup>st</sup> March, 2011	<b>Rs. 3,34,39,187/-</b>
Add: Addition during the year	<b>Rs. 2,55,27,748/-</b>
Less: amount used during the year	<b>Rs. 2,00,88,611/-</b>
Balance as at 31 <sup>st</sup> March, 2012	<b>Rs. 3,88,78,324/-</b>

6. The assessee was required to justify its claim of creation of provision for warranty. On receiving no plausible reply, the Assessing Officer made an addition of Rs. 74,45,364/- in A.Y 2011-12 and Rs. 2,55,27,748/- in A.Y 2012-13.

7. The assessee carried the matter before the Id. CIT(A) and the Id. CIT(A), after considering the facts and submissions, found that a similar addition was confirmed by his predecessor in A.Y 2010-11. The relevant findings of the Id. CIT(A) read as under:

*"5.3. I have carefully considered the assessment order and the submissions filed by the AR. This issue was adjudicated by me in appeal for A.Y. 2011-12 in Appeal No: 625/CIT(A)-7/Del/14-15 dated 22.04.2016 and the addition made by the AO was confirmed. Operative part of the order is reproduced as under:*

"3.4. I have carefully considered the assessment order and the submissions filed by the Aft. The appellant company during the year has created a provisions of warranty at Rs.36,06,987/- which is reduced from the commission income instead of separately debiting into the P & L A/c. The Ld. AR has relied on the judgement of the Hon 'ble Apex Court in the case of M/s Rotork Controls India (P) Ltd. vs. CIT (2009) 314 ITR 62. The AO has recorded that the appellant failed to submit details of warranty expenses and how it was linked to the commission. Further, during appellate proceedings a simple chart disclosing invoices against which provisions of warranty is tabulated was furnished. No basis as to how the warranty provision was worked out was available. The Hon 'ble Supreme

Court in the case of *M/s Rotork Controls India (P) Ltd. vs. CIT (supra)* held as under:

"A provision is a liability which can be measured only by using a substantial degree of estimation, A provision is recognized when : (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the obligation, and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognized."

3.5. As the appellant company did not furnish any justification or any scientific basis to support the provision of warranty by reducing the same from the commission income, the AO cannot be faulted in effecting the disallowance of Rs.36,06,987/-. Moreover, the Hon'ble ITA T while adjudicating the issue in the case of the appellant for A.Y 2008-09 has held that estimation of the amount of warranty obligation has to be made on the basis of scientific method and not on the basis of any arithmetical calculation. The Hon'ble ITA T restored the matter to the AO to re-compute- the income received by the appellant on account of commission and service including warranty obligation. This also reinforces the view that the warranting provision made by the appellant was not based on any realistic estimation or scientific basis. In view of the facts of the case, the addition

of Rs.36,06,987/- for Assessment Year 2011-12 and 2,55,27,748/- in A.Y 2012-13 made by the AO on account of provision of warranty is held to be in order and is sustained. This ground of appeal is ruled against the appellant."

8. Before us, the ld. counsel for the assessee out rightly stated that the issue has been decided by the Tribunal in A.Ys 2007-08, 2008-09, 2009-10 and 200-11.

9. Per contra, the ld. DR could not bring any distinguishing decision in favour of the Revenue.

10. We have given thoughtful consideration to the orders of the authorities below and have also considered the orders of the coordinate bench in ITA No. 894/DEL/2012 and 520/DEL/2013 in A.Ys 2007-08 and 2008-09. The relevant findings of the coordinate bench read as under:

" Ground No.2 of ITA No.894/Del/2012 qua AY 2007-08 and Ground No.2 of ITA No. 520/Del/2013 qua for A Y: 2008-09.

16. Undisputedly the assessee company received commission to the tune of Rs. 17,46,97,141/- qua for Assessment Year 2007-08

and Rs.60,46,937/- qua for Assessment Year 2008-09. The AO noticed from the details filed by the assessee that out of aforesaid commission the assessee has taken Rs. 1,30,76,118/- as income accrued but not due for Assessment Year 2007- 08 and Rs. 1,27,85,642/- for Assessment Year 2008-09.

17. On the query raised by the AO that as to why the aforesaid amount received but deferred for warranty services be not taken as income in the relevant assessment year, the assessee filed the response as under:

*As regards the commission is concerned your Honour may note the following:*

- a) *The commission is received on the sale of equipments manufactured by the parent company.*
- b) *For other services including warranty which is provided by the assessee company for the next 2 years*

*Though for the purpose of transfer pricing certificate the entire amount has been reported, your Honour would rightly appreciate that for the services not rendered i.e. the warranty services which are to be rendered in the next 2 years, the income has not accrued to the assessee and so this has not been taken in the P & L A/c We would like to confirm that this has been considered as income in the next years and offered to tax (i.e. the year in which warranty services are*

*rendered.}*

*It is worthwhile to note that the assessee has not made any provision for warranty separately and has not debited any expenses pertaining to warranty to the P & L. The assessee instead of debiting P & L A/c has reduced from the income the provision for warranty and has been following the same accounting principle. Your Honour would appreciate that if this amount is added, this amounts to double taxation as these have been offered to income tax by the assessee in the next 2 assessment years. "*

Thereafter, the assessee was asked to file details of expenses incurred for the last four years prior to the relevant assessment year which the assessee filed. The AO by considering the past data arrived at the conclusion that the assessee has been incurring expenses on account of warranty services to the tune of 6.4% on the commission earned by him being the average as against 8% claimed by the assessee and thereby made an addition of Rs. 10,58,630/- qua for the Assessment Year 2007-08 and Rs. 14,17,054/- qua the assessment years 2008-09 to the income of the assessee. The learned Commissioner of Income-tax (Appeals) affirmed the finding returned by the AO on the ground that the commission income is not contingent on servicing of warranty claim and since the commission has accrued during the year under assessment it is taxable in the

said year.

19. Undisputedly the AO admitted the claim of the assessee by allowing of provision for warranty to the extent of 6.4% instead of 8% claim by the assessee by resorting to arithmetic calculation by taking average of the last four years prior to the assessment year under consideration. The learned Commissioner of Income-tax (Appeals) without bifurcating the commission income and provision for warranty income affirmed the addition only on accrual basis. The Id AR for the assessee contended that the identical issue has already been settled by the Hon'ble Jurisdictional High Court in the judgment cited as CIT Vs. Smt. Paramjeet Luthra (2014) 51 Taxmann. Com 571 (Del) in favour of the assessee. We have gone through the judgment CIT Vs. Paramjeet Luthra (supra) relied by the Id counsel for the assessee the ratio of which is that in case of provision for warranty services the entire income could not be offered for taxation for the year under assessment when the assessee had few obligations for providing after sales maintenance services and the necessary' expenses is required to be kept

for the same.

20. Hon'ble Apex Court in judgment cited as Rotork Controls India P. Ltd. Vs. CIT (2009) 314 ITR 62 settled the identical issue once for all by holding as under:-

*"The present value of a contingent liability, like the warranty*

*expense, if properly ascertained and discounted on accrual basis can be an item of deduction under section 37. The principle of estimation of the contingent liability is not normal rule. It would depend on the nature of the business, the nature of sales, the nature of the product manufactured and sold and the scientific method of accounting adopted by the assessee. It would also depend upon the historical trend and upon the number of articles produced.*

*A provision is a liability which can be measured only by using a substantial degree of estimation. A provision is recognized when : (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the obligation, and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognized.*

*The principle is that if the historical trend indicates that a large number of sophisticated goods were being manufactured in the past and the facts show that defects existed in some of the items manufactured and sold, then provision made for warranty in respect of such sophisticated goods would be entitled to deduction from the gross receipts under section 37.*

By applying the law laid by Hon'ble Apex Court and jurisdictional High Court in judgment cited in preceding paras we are of the considered view that AO as well as the learned

Commissioner of Income-tax (Appeals) have proceeded to make the addition purely by resorting to the arithmetic calculations by completely ignoring the fact that the assessee company is required to outsource the service to set off to settled its warranty obligation which can only be measured by using substantial degree of estimation. More particularly the reliable estimation of the amount of obligation has to be made on the basis of scientific method and not on the basis of arithmetic calculation as has been done by AO and affirmed by learned Commissioner of Income-tax (Appeals). Undisputedly the assessee company is to provide services including warranty for next two years after sales. The income accrued at the time of receiving commission has to be accounted for in the year of accrual and not in the year of receipt. So we are of the considered view that the matter is required to be restored to the AO to recompute the income received by the assessee on account commission and service including warranty obligation in pursuance of the findings returned herein after. Consequently ground No.2 of ITA No.894/Del/2012 qua AY 2007-08 and Ground No.2 of ITA No.520/Del/2013^jqfta for AY: 2008-09 are determined in favour of the assessee.

11. A similar view was taken by the coordinate bench in ITA Nos. 793/DEL/2015 and 3692/DEL/2016 for A.Ys 2009-10 and 2010-11.

Respectfully following the findings of the coordinate bench [supra] we restore the quarrel to the file of the Assessing Officer. The Assessing Officer is directed to decide the issue afresh in light of the directions by the coordinate bench given in earlier A.Ys.

13. In the result, both the appeals of the assessee in ITA Nos. 2723/DEL/2017 and 749/DEL/2018 are allowed for statistical purposes.

**The order is pronounced in the open court on 07.11.2019.**

Sd/-

**[SUCHITRA KAMBLE]  
JUDICIAL MEMBER**

Sd/-

**[N.K. BILLAIYA]  
ACCOUNTANT MEMBER**

Dated: 07<sup>th</sup> November, 2019

VL/

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar,  
ITAT, New Delhi

Date of dictation	
Date on which the typed draft is placed before the dictating Member	
Date on which the typed draft is placed before the Other Member	
Date on which the approved draft comes to the Sr.PS/PS	
Date on which the fair order is placed before the Dictating Member for pronouncement	
Date on which the fair order comes back to the Sr.PS/PS	
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