

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'C': NEW DELHI
(Through Video Conferencing)**

**BEFORE,
SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER
AND
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER**

**ITA No.1126/Del/2018
(ASSESSMENT YEAR 2014-15)**

Add. CIT, Special Range-4, New Delhi.	Vs.	M/s Infres Methodex Pvt. Limited, Block B-1, Plot No.D-7, Mohan Co-op Industrial Estate, Mathura Road, New Delhi-110 044. PAN -AABCI 1964R
(Appellant)		(Respondent)

Appellant By	Ms. Anima, Sr. DR
Respondent by	Dr. Rakesh Gupta, Adv.
Date of Hearing	13.07.2021
Date of Pronouncement	30.09.2021

ORDER

PER SUDHANSHU SRIVASTAVA, JM:

This appeal is preferred by the Department against order dated 14.11. 20217 passed by the Learned Commissioner of Income Tax (Appeals)-35, New Delhi {CIT(A)} and pertains to Assessment Year 2014-15.

2.0 The brief facts of the case are that the assessee company is engaged in the business of production, sales and maintenance of office automation equipment. The return of income was filed declaring an income of Rs.16,41,93,722/-. The case was selected for scrutiny and during the course of assessment proceedings, the Assessing Officer (AO) observed that the assessee had debited an amount of Rs.4,69,39,754/- on account of 'post sales customers support and warranties' in the Profit and Loss account. The Assessing Officer observed that these expenses were debited on provisional and estimated basis and, therefore, the assessee was required to explain the basis for creating these provisions with the help of supporting documents. Thereafter, considering the submissions of the assessee, the Assessing Officer came to the conclusion that the estimates made by the assessee were not reliable for the reason, that as per the Assessing Officer, the assessee had no consistent basis for making the provision for warranty. The Assessing Officer proceeded to disallow the entire amount of Rs.4,69,39,754/-. The Assessing Officer also made certain other additions pertaining to (i) claim of depreciation

amounting to Rs.60,557/- (ii) disallowance U/s 14A of the Income Tax Act, 1961 (hereinafter called 'the Act') amounting to Rs.2,73,665/- (iii) disallowance of Club expenses amounting to Rs.55,226/- and completed the assessment at an income of Rs.21,15,22,960/-.

2.1 Aggrieved, the assessee preferred an appeal before the Ld. CIT(A) challenging the additions/disallowances and the Ld. CIT(A) was pleased to delete the addition of Rs.4,69,39,754/- on account of provision for warranty. The Ld. CIT(A) also restricted the disallowance made u/s 14A from Rs.2,73,665/- to Rs.1,01,352/-.

2.2 Now, aggrieved, the Department has approached the Tribunal and has challenged the deletion made by the Ld. CIT(A) by raising the following grounds of appeal:-

"1. On the facts and in the circumstances of the case the Ld CIT(A) erred in law in deleting the disallowance of Rs. Rs. 4,69,39,754/- made by the Assessing officer on account of warranty provision made by the assessee in the profit and loss account, which is not proved to be computed on any scientific basis on past records. The CIT(A) has not dealt at all the

inconsistencies in creation of provision from year to year pointed out in detail in the Assessment order in para 8 of the order.

2. *On the facts and in the circumstances of the case the Ld CIT(A) erred in law in restricting the disallowance from Rs. 2,73,665/- to Rs. 1,01,352/- made by the Assessing officer u/s 14A in accordance with the Rule 8D of Income Tax Rules, 1962.*

3. *On the facts and in the circumstances of the case, the Ld CIT(A) erred in law as Ld CIT(A) has not given any basis for deleting the disallowance of interest expenses and changing the computation of disallowance of interest u/s 14A r.w.r 8 D(2)(iii) of Income Tax Rules, 1962.*

4. *Whether for Application of Section 14A(1) of the Income Tax Act, 1961 the purpose for making investment and earning tax exempt income thereon is an essential legal requirement.*

5. *Whether the term “in relation to” as used in section 14A of the Act contemplates a direct and proximate nexus between “expenditure incurred” and “earning of exempt income”*

6. *Whether the CIT(A) is legally justified in not upholding disallowance u/s 14A of the Income Tax Act, 1961 without considering legislative intent of introducing section 14A by the Finance Act, 2001 as clarified by CBDT Circular No. 5/2014 dated 10.02.2014.*

7. *Whether the CIT(A) is legally justified in not upholding disallowance u/s 14A of the Income Tax Act, 1961 without considering a legal principle that allowability/disallowability of expenditure under the Act is not conditional upon the earning of*

income as upheld by Hon'ble Supreme Court in the case of CIT vs. Rajendra Prasad Moody (1978) 115 ITR 519.

8. The appellant craves leave to add, amend, vary, omit or substitute any of the aforesaid grounds of appeal at any time before or at the time of hearing of appeal.”

3.0 The Ld. Sr. Departmental Representative (DR) submitted that the provision of warranty had been wrongly deleted by the Ld. CIT(A) because the assessee had no consistent basis for making the provision for warranty. While referring to para-8 of the assessment order, the Ld. SR. DR submitted that the provision for warranty as percentage of sales had increased to 12.84% in the assessment year under consideration as compared to 6.60% in the immediately preceding assessment year. She also referred to the observations of the Assessing Officer that during the Financial Year 2012-13, there had been a reversal of provision for warranty amounting to Rs.3,60,03,317/- indicating that the estimates made by the assessee were not reliable. The Ld. Sr. DR argued that the estimates made by the assessee for making the impugned provision were

neither on a scientific basis nor reliable and, therefore, the Assessing Officer had rightly made the disallowance.

3.1 With reference to the disallowance U/s 14A of the Act, she supported the order of the Assessing Officer.

4.0 Per contra, the Ld. Authorized Representative (AR) placed reliance on the findings of the Ld. CIT(A) and while vehemently supporting them submitted that the Ld. CIT(A) had rightly deleted the additions/disallowances.

5.0 We have heard rival submissions and have also perused the records. As far as the issue of disallowance of provision for warranty is concerned, it is seen that the Assessing Officer has made the addition after observing that the estimates made by the assessee for making the impugned provisions were neither on a scientific basis nor were reliable. The Assessing Officer, while making the disallowance, has placed reliance on the judgment of the Hon'ble Apex Court in Rotork Controls India Pvt. Ltd. reported

in 314 ITR 62(SC) on the ground that the assessee company did not fulfill the following conditions:-

- (i) An obligation to incur expenses should have been arisen;
- (ii) The estimate should be on scientific basis; and
- (iii) The estimate should be on reliable based on experience and historical trend.

5.1 It was the assessee's submissions before the Lower Authorities that the provision created as a percentage of sales were different in Financial Years 2011-12, 2012-13 and 2013-14 for the reason that the warranty period ranged between one year to three years depending on the model of the machine and, therefore, the provision made for the machine whose warranty extended for 2 to 3 years is to be carried forward and is to be added to the provision of the current year and, therefore, because of this reason, the provision to sales ratio was not consistent and that it was not because of any change in the basis of principles on which the provision is made. It was also submitted before the Lower Authorities that the assessee company provided free replacement of

parts against the manufacturing defects and also provided preventive maintenance checks for the equipment sold during the period ranging from 1 to 3 years and, accordingly, provision was made for the costs likely to be incurred during the warranty period on a consistent basis that is material cost being estimated at 1 to 3% of sale value for each year and labour cost at 75% of the standard labour cost. It was also the assessee submissions before the Lower Authorities that the provision is estimated on past trends and experience and is worked out every year. It was also submitted before the Lower Authorities that if the provision made in earlier year is more or less, difference in the amount is accounted through Profit & Loss Account and that this practice is being followed consistently by the company since the past many years. The assessee had also submitted an illustrative calculation sheet for the provision made along with purchase orders before the Lower Authorities in support of its working and claim.

5.2 Although, the Assessing Officer did not find the explanation and submissions of the assessee satisfactory, the Ld.

CIT(A) accepted the assessee's submissions and working as being correct and allowed the claim of the assessee. However, a perusal of the order of the Ld. CIT(A) shows that he has accepted the submissions of the assessee without actually examining the weight of the submissions of the assessee. The Ld. CIT(A) has simply accepted the submissions provided by the assessee and after duly reproducing the submissions in the impugned order has noted that in view of the submissions made by the assessee and the case laws cited and in view of the facts and circumstances of the case, the impugned disallowance is deleted. However, while making the deletion, the Ld. CIT(A) has not given any reasoning as to why the submissions of the assessee were found to be satisfactory for the purpose of making provision of warranties. The Ld. CIT(A) has not adjudicated the issue before him by examining the various details and documents submitted by the assessee and has simply accepted the contentions of the assessee without returning a finding on fact. In such a situation, we deem it appropriate to restore this issue to the file of the Ld. CIT(A) for considering the issue afresh and, thereafter, adjudicate on the issue by passing a speaking order after

giving proper opportunity to the assessee. Accordingly, the Department succeeds on ground No.1 and the same stands allowed for statistical purpose.

5.3 As far as the issue of deletion of deletion u/s 14A of the Act is concerned, it is seen that during the year under consideration, the assessee had earned dividend income amounting to Rs.20,21,500/- from equity shares and mutual funds. The assessee had claimed exemption of this income u/s 10(34) & 10(35) of the Act and had *suo moto* made disallowance of Rs.12,000/- u/s 14A of the Act on estimate basis. The Assessing Officer had queried the assessee and the assessee was asked to show cause as to why disallowance should not be made u/s 14A in accordance with Rule 8D of the Income Tax Rules, 1962. It was the assessee's submission before the Assessing Officer that no borrowed funds had been utilized for the purposes of making the investments for earning of tax free income but the Assessing Officer was not satisfied with the assertion of the assessee and he proceeded to compute the total disallowance u/s 14A read with Rule 8D at Rs.2,85,665/- and after

giving benefit of the amount already suo moto disallowed by the assessee i.e. Rs.12,000/-, proceeded to make a further disallowance of Rs.2,73,665/-. The Ld. CIT(A), however, accepted the assessee's submission that the amount disallowable as per Rule 8D (2) (iii) of the Income Tax Rules should be an amount equal to $\frac{1}{2}$ % of the average of the value of investments as appearing in the balance sheet of the assessee on the first day and last day of the previous year. Accordingly, the Ld. CIT(A) accepted the assessee's contention that only Rs.1,01,352/- could be disallowed.

5.4 We have gone through the order of the Ld. CIT(A) as well as the findings of the Assessing Officer. It is seen that the Assessing Officer has simply applied the procedure prescribed in Rule 8D of the Income Tax Rules to compute the amount disallowable u/s 14A of the Act without appreciating that in the present case, no part of interest could have been said to have been incurred in relation to exempt income. In the assessment order, the Assessing Officer has not pointed out even a single expenditure having been incurred by the assessee during the year which was having proximate nexus

with the exempt dividend income earned during the year. It is very much apparent that the Assessing Officer, while computing the disallowance u/s 14A, considered the entire investments whereas the disallowance u/s 14A read with Rule 8D is in relation to the income which does not form part of the total income and this can only be done by taking into consideration the investment which has given rise to the income which does not form part of the total income. The Ld. CIT(A) has returned a categorical finding of fact on the issue and has computed the disallowance after excluding those investments which were not related to the earning of dividend income. Such is also the mandate of the Hon'ble Delhi High Court in the case of *ACB India Ltd. vs. ACIT reported in 374 ITR 108 (Delhi)* and plethora of other judgments. We also note that the assessee is not in appeal before this Tribunal against the amount of disallowance U/s 14A as confirmed by the Ld. CIT(A). Accordingly, we find no reason to interfere with the finding of the Ld. CIT(A) on the issue and we dismiss the grounds raised by the Department in this regard.

6.0 In the final result, the appeal of the Department stands partly allowed for statistical purpose.

Order pronounced on 30th September, 2021.

Sd/-
(PRASHANT MAHARISHI)
ACCOUNTANT MEMBER

Sd/-
(SUDHANSHU SRIVASTAVA)
JUDICIAL MEMBER

Dated: 30/09/2021

PK/Ps

Copy forwarded to:

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

ASSISTANT REGISTRAR
ITAT NEW DELHI