

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'C', NEW DELHI**

Before Sh. A. D. Jain, Vice-President

Dr. B. R. R. Kumar, Accountant Member

ITA No. 7147/Del/2018 : Asstt. Year : 2009-10

ACIT, Circle-11(2), New Delhi	Vs	Humboldt Wedag India Pvt. Ltd., A-36, Mehtab House, Mohan Co- operative Industrial Area, Mathura Road, New Delhi-110044
(APPELLANT)		(RESPONDENT)
PAN No. AAACH7474G		

Assessee by : Sh. S. K. Aggarwal, CA

Revenue by : Ms. Meenakshi J. Goswani, CIT DR

Date of Hearing: 25.10.2021

Date of Pronouncement: 28.01.2022

ORDER

Per Dr. B. R. R. Kumar, Accountant Member:

The present appeal has been filed by the revenue against the order of Id. CIT(A)-4, New Delhi dated 13.08.2018.

2. Following grounds have been raised by the revenue:

"1. Whether on the facts and in circumstances of the case and in law, the Id. CIT(A) has erred in deleting the disallowance of Rs. 15,22,91,304/- claimed as deduction by the assessee on account of provision for liquidated damages, disregarding the findings of the AO that the provision was made without any scientific or rational basis.

1. a) Whether the Ld. CIT(A) has erred in deleting the disallowance of provision for liquidated damages, not appreciating the fact that the basis of recognition as well as the estimation/quantification of the provision for liquidated damages made by the assessee in respect of various contracts was completely ad hoc in nature, not supported by relevant of details and documents regarding contract-wise delays.

2. Whether on the facts and in circumstances of the case and in law, the Ld. CIT(A) has erred in deleting the addition of Rs. 10,22,90,817/- made by the Assessing Officer on account of disallowance of provisions for warranties, ignoring the settled principles of law that Warranty Provisions can be allowed only if they are proved to be computed on a scientific or rational basis and their quantification is demonstrably robust, based on historical trends & experience.

2. a) Whether, the Ld.CIT(A) has erred in deleting the addition on account of disallowance of Provision for Post-Sales Support and Warranties, ignoring the findings recorded by the AO that given the wide fluctuations in the amount of provisions made by the assessee from year to year, the quantification of provision was neither rational nor reliable.

3. Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) had erred in deleting the disallowance of Rs. 33,02,179/- claimed by the assessee as deduction on account of 'advances and deposits written off', no appreciating the fact that the assessee had neither furnished relevant details nor substantiated the nature of the advances and deposits.

4. Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) has erred in deleting the disallowance of Rs. 8,81,12,017/- claimed by the assessee as deduction on account of provision for loss on suspended contracts, not appreciating the findings of the AO that the provision made by the assessee had no rational basis, was not in conformity with the principle and was excessive.

3. The brief facts of the case are that the return of income was filed on 30.09.2009 declaring total income of Rs.22,89,31,000/-. Thereafter, the assessee filed a revised return of income on 28.03.2011 showing total income of Rs.26,79,74,360/- under normal provisions of the Income-tax Act, 1961 and book profit of Rs.18,09,48,092/-.

4. The assessee is engaged in the business of industrial plant engineering and supply of equipments for cement and coal and mineral plants. During the current F.Y. 2008-09 relevant to this A.Y. 2009-10, the assessee company had international transactions with its Associated Enterprises (AEs) totaling to Rs.140,38,45,328/- on account of purchase of raw materials, transaction in respect of intangible property and transaction in respect of services. The said international transactions were referred to the Transfer Pricing Officer (TPO) for determination of Arm's Length Price and adjustment, if any, thereof.

1. Liquidated Damages:

5. The similar issue has been adjudicated in the case of the assessee for the A.Y. 2014-15 by the order passed by this bench in ITA No.8119/Del/2018 order dated 18.08.2021. During the year, the provision has been made on liquidated damages for delay in delivery to customer and under performance in accordance with the terms prescribed under the contract.

6. For the sake of ready reference, the operative part of the earlier order is reproduced below:

23.- "13 ... The Id. CIT(A) has categorically noted that assessee has provided for liquidated damages based on the period of delay which occurred during the end of the year and on the basis of percentage of the contract the value payable as damages in terms of the agreement. Apart from that, assessee has also reversed the provision for liquidated damages in the year in which clients waived the said liquidated damages and the write back amount has been offered to tax by the assessee. Whence a provision is arising out of a contractual obligation and the basis of providing the provision is based on past

experience and such a reasonable basis of estimation has been regularly followed by the assessee in the past, then ostensibly it cannot be held that the basis of estimation or working of the provision is not correct. Further, once it is brought on record that assessee on the year of reversal has paid taxes on excess provision and similar feature appeared in the earlier years and assessee had payments for liquidated damages on delay in delay of deliverables, then no adverse view can be taken, because it is not the charge of the Assessing Officer that assessee has made some kind of excessive provision in this year in relation to past. The finding and observations of the Id. CIT(A), are based on correct appreciation of facts and law, hence we confirm the order of CIT(A) on this score and accordingly, ground No. 1 by the Revenue is dismissed.”

7. Since, the provision for liquidated damages has been made regularly and allowed in P&L account and since the unutilized portion has been reversed at a regular intervals from year to year, since, the ITAT for AY 2008-09, AY 2010-11, AY 2011-12, AY 2012-13 & AY 2013-14 has allowed provision for liquidated damages, the provision made during AY 2009-10 is on same basis as in all the years is hereby allowed.

2. Provision for Warranty:

8. The assessee contended that the issue of warranty is a recurring provision made in the past several years and that in all the year from 2009-10 onwards by the various judicial authorities.

9. Further, we also find that the Co-ordinate Bench of ITAT vide order dated October 31, 2017 for AY 2008-09, has dismissed the Revenue's appeal filed against the order of Id.

CIT(A) allowing the deduction for provision for warranty. The relevant extract from the order is as follows:

“14. So far as the issue relating to disallowance of ‘provision for warranty’, it is an admitted fact that under the terms of agreement, assessee has provided warranty for the period ranging from 12 to 36 months to which assessee is contractually obliged to pay warranty on its own case in case of any breach in supply and services, in case if there is any demand from the purchaser. The terms of agreement clearly provides that assessee has to take effective steps; for rejection or modify or replace or remove the defect or deficiency or in case of damage of equipment; assessee shall do the needful and for this purpose it has been making provision for making such guarantee. The Id. CIT(A) has also taken note of the actual expenses incurred on warranty by the assessee in earlier years and also calculated the percentage of such expenditure (as noted by us herein above). If based on such actual expenditure incurred on warranty, assessee has made the provision for warranty, then ostensibly it can be held that, not only assessee has made the provision as per past experience but there was a certain degree of certainty while making such estimate.

The ratio laid down by the Hon ‘ble Apex Court in the case of Rotork Controls India (P) Ltd Vs. CIT (supra) is squarely applicable...

15. The observations and finding of the Id. CIT(A) is not only in accordance with the facts and material on record, but also in conformity with the principle laid down by the Hon’ble Supreme Court, hence there is no reason to deviate from such a finding and accordingly same is confirmed.”

10. The Co-ordinate Bench of ITAT vide combined order dated June 11, 2018 for AY 2010-11 & AY 2011-12, has dismissed the Revenue's appeal filed against the directions of Id. DRP allowing the deduction of provision for warranty, following their order for AY 2008-09. The relevant extract from the order is as follows:

For AY 2010-11

"12.2 Ground No. 3 challenges the direction of the Ld. DRP in allowing the provision for warranty amounting to Rs. 288,112,854/-. We find that the Ld. DRP had held the issue in a similar issue had arisen in AY 2008-09 wherein the Ld. CIT (A) had deleted the disallowance. The Ld. DRP has noted that the facts were identical in AY 2008-09 and the year under consideration and, therefore, the disallowance was to be deleted. ... The Department has not been able to bring out any distinguishing factor with respect to the facts in the proceedings before us. In the circumstances, we find no reason to interfere and dismiss ground no. 3."

For AY 2011-12

"13.3 Ground No. 4 challenges the direction of the Ld. DRP in deleting the disallowance pertaining to provision of warranty amounting to Rs. 187,687,197/-. We find that a similar issue had come up in Assessment Years 2008-09 and 2010-11 and the department's ground challenging the deletion had been dismissed by the ITAT in ITA Nos. 2295/Del/2013 and 567/Kol/2015 respectively. The Department has not been able to bring out any distinguishing factor with respect to the facts

in the proceedings before us. In the circumstances, we find no reason to interfere and dismiss ground no. 4."

11. The Co-ordinate Bench of ITAT vide combined order dated April 7, 2021 for AY2012-13 and AY 2013-14, has dismissed the Revenue's appeal filed against the order of Id. CIT(A) allowing the deduction of provision for warranty, following their order for AY 2008-09. The relevant extract from the order is as follows:

"13. Since, the matter stands adjudicated and allowed for several years prior, in the absence of any material change, we hereby hold that the addition made by the AO cannot be sustained."

12. Since, the provision for warranties has been made @ 3% and the unutilized portion has been reversed at a regular intervals from year to year, the appellant has been consistently following the policy of making provision for warranty as per the terms of the contract, the ITAT for AY 2008-09, AY 2010-11, AY 2011-12, AY 2012-13 & AY 2013-14 has allowed provision for warranty, the provision made during the instant year is on same basis as in all the years is hereby allowed.

3. Advances and Deposits Written Off:

13. The assessee has claimed DEPB license and DEPB receivable written off of Rs.33,02,179/- by debiting the P&L A/c during AY 2009-10. The assessee recognized amount of DEPB license and DEPB receivable at the time of export of certain items and the same was also credited as income in the P&L A/c of earlier years. However, during the subject assessment year, the assessee has written off such amount by debiting the P&L

a/c since the assessee became un-entitled to DEPB license and DEPB receivable amount.

14. This issue has been decided in assessee's own case in other assessment years by ITAT and the Id. DRP which has been followed by Id. CIT(A) in deleting the disallowance.

15. The ITAT vide order dated June 11, 2018 for AY 2010-11, has dismissed the Revenue's appeal against favourable directions of the Id. DRP allowing the deduction of advances and deposits written-off. The relevant extract from the order is as follows:

"12.1 As far as ground no. 2 pertaining to advances and deposits written off are concerned, it is seen that the assessee had written off of Rs. 10,50,092/- pertaining to deposits and allowances and the disallowance was made on the ground that party wise details were not provided by the assessee. The Ld. DRP directed deletion of disallowance by observing that from the material available on record, the same appeared to be revenue in nature. Thus, it is not the case of the department that issue was not examined. The Ld. DRP has returned a categorical finding in this regard and accordingly, we find no reason to interfere on this issue also. Ground No. 2 also stands dismissed."

16. The ITAT vide combined order dated April 7, 2021 for AY 2012-13 and AY 2013-14, has allowed the deduction for advances and deposits written off. The relevant extract from the order is as follows:

"24. On going through the facts and circumstances of the instant case, keeping in view the judgments of Hon'ble

Supreme Court since the amount has been incurred during the regular course of business, the same is allowed to be claimed under expenses for the year.

25. As a result, both the appeals of the revenue are dismissed and the Cross Objections of the assessee are allowed."

17. The Id. DRP vide order dated November 3, 2015 for AY 2011-12 has directed the Ld. AO to delete the disallowance of advances and deposits written off. The relevant extracts are as follows:

"DRP Directions:

The AO shall delete the proposed adjustment subject verification of the nature of the written off amounts in line with DEPB receivables and reasons thereto for such write off. The objection is disposed of as above."

18. The Id. DRP vide order dated September 17, 2018 for AY 2014-15 has directed the AO to delete the disallowance of advances and deposits written off. The relevant extracts are as follows:

"6. The duty entitlement is a balance sheet item, which can be claimed after necessary condition are fulfilled in specified period and would lapse. From the draft assessment order it is noticed that DEPB entitlement on export was credited, as income in the P&L account which has now been written off due to the assessee unable to claim the set off. Further, advances of Rs.7,00,425/- made to suppliers/ vendors in the course of business became irrecoverable and has been written-off.

6.2 Having considered the submission of the assessee the AO is directed to allow the deduction.”

Basis of writing off advances & deposits written off of Rs.33,02,179/-:

19. The following details of DEPB license and DEPB receivable written off during AY 2009-10 by debiting the P&L A/c show GL code, GL description and amount written off:

GL Code	GL description	Amount written off in Rs.
8050004	DEPB license	4,30,304
8050005	DEPB receivable	28,71,875
Total		33,02,179

20. The assessee has written off DEPB license of Rs.4,30,304/- during AY 2009-10 owing to non-entitlement of such licenses. Details showing license no., license date, opening & closing balance of license and amount of license written.

21. Similarly, DEPB receivable written off represents amount written off by assessee during the subject year of Rs.28,71,875/- owing to non-entitlement, of such receivable amounts. Details showing invoice reference no., date of invoice, opening & closing balance of DEPB receivable and amount of DEPB receivable written off.

22. The AO held that the assessee has claimed DEPB license and DEPB receivable written off of Rs.33,02,179/- by debiting the P&L A/c during AY 2009-10 u/s 36(1)(vii)/ 36(2) of the Act. The assessee has claimed such deduction of Rs.33,02,179/- as business loss u/s 28 of the Act. Therefore, conditions prescribed under section 36(1)(vii)/ 36(2) of the Act are not

applicable to the case of assessee. However, Since, the assessee has offered such amounts as income in earlier years and have been written off in the subject year since the assessee has become un-entitled.

23. Therefore, the DEPB license and DEPB receivable written off of Rs.33,02,179/- debited to the P&L A/c as business loss u/s 28 of the Act for AY 2009-10 is an allowable deduction.

24. It is generally accepted principle that losses, other than capital losses, which arise out of and are incidental to the business of assessee must be necessarily deducted in the ascertainment of profits of the business u/s 28 of the Act. On the basis of various judgments of the Hon'ble Courts, in order that an item of loss can be taken into account in computing the profits of the business, it should fulfill the following conditions:

- It should be a real loss, not notional or fictitious;
- It should be a loss on revenue account and not on capital account;
- It must have actually arisen and been incurred, not merely anticipated as certain to occur in future;
- It should be one that is incidental to the carrying on of the business and must arise or spring directly from or be incidental to the carrying out of an operation of the business; and
- There should be no prohibition in the Act, express or implied, against the deductibility thereof.

25. Keeping in view, the facts and circumstances, provisions of the Act, the judgments of the various Courts, precedence narrated above, we hereby hold that the addition is liable to be deleted.

4. Loss on Suspended Contracts:

26. The assessee has debited to its P&L A/c an amount of Rs.41,64,92,017/- being provision for loss on suspended/ cancelled contracts. On the basis of its contracts with customers, the assessee places orders with its vendors for acquiring various materials and equipment. In the cases where the contracts with customers are partly/ wholly cancelled, the contract with the vendors for purchases are also required to be cancelled since material purchased are tailor- made for the contracts with customers. Where the contract with vendors gets cancelled, the assessee is required to pay compensation to vendors as agreed in the contracts. In the cases where contract with vendors for purchase could not be cancelled, the assessee had to take delivery of the material and to the extent such material could not be used, the same after reducing the scrap value is to be written off as loss on cancellation/ suspension of contracts.

27. In the AY 2009-10, on cancellation/ suspension of contracts with the customers, amount of Rs.32,83,80,000/- received from customers has been included in income. On the other hand, the liability to pay to the vendors for cancellation of purchase contracts and cost of material aggregating to Rs.41,64,92,017/- has been debited as provision for loss on suspended contracts and claimed as deduction.

28. The AO in the assessment order has disallowed Rs.8,81,12,017/- out of the total provision of Rs.41,64,92,017/- by stating that the assessee had accounted for revenue from contracts to the tune of Rs.32,83,80,000/- and on that basis AO concluded that provision, of Rs.41,64,92,017/- is excessive. The reasoning given for

disallowing Rs.8,81,12,017/- is apparently not correct as the loss in respect of contracts with vendors cannot be restricted to the compensation received from customers on cancellation of contracts. The liability incurred towards vendors on cancellation of contracts and purchases made which after providing for scrap value has to be written off is allowable as business expenditure.

Basis of creating the provision:

29. The assessee has claimed provision of Rs.41,64,92,017/- during the subject year since there was cancellation/suspension of some contracts by customers who are unable to obtain financing for those contracts. As the customers had not accepted claims for realization of cost incurred on such contracts, there were significant uncertainties in recovery of such costs. In such an event, assessee had either to cancel order and face penalties or to take delivery of goods and scrap the same as they were customized to each customer.

30. Thus, the assessee suffered business loss in the process of placing and cancelling contracts. Hence assessee created provision in respect of costs incurred in relation to contracts entered into by assessee with its customers i.e. Dalmia Cements, JSW and Star and which were cancelled/ suspended during the FY 2008-09.

31. The assessee submitted details on the basis of which it had created provision of Rs.41,64,92,017/- during the instant year.

32. Upon cancellation of contracts with customers, as per note 3(k) of the audited financial statements for instant year,

revenue of Rs.32,83,80,000/- has been recognized by assessee to the extent of advances received from customers in respect of cancelled/ suspended contracts. The assessee has enclosed the communication from its customers wherein it has been conveyed that the contracts entered by customers i.e., Dalmia Cement, JSW Cement Ltd and Star Cement Meghalaya Ltd. with the assessee have either been terminated or suspended. Relevant extracts of such communication are reproduced below:

Contract with JSW Cement Ltd

E-mail dated November 4, 2008

'This is further to our meeting on 24th October 2008 in your office in Mumbai, wherein we were advised for cancellation of Plant 3 (Selam) and possible Price reduction in Plant 1 & 2 Prices, kindly note that we are still in the process of discussion with our suppliers, as well as working on the figures internally, and we hope to complete the entire exercise in a couple of days.

Letter dated December 9, 2008

"We thank you for your understanding and appreciation of the compelling circumstances as explained in our mail of 1st December 2008. As asked by you in your letter referred above and well conceived by stipulation in the contract, as of now we convey you by this letter to consider the following:

Contract with Dalmia Cement Ventures Ltd.

Letter dated November 17, 2008

"This refers to the meeting we had in our office at Noida on 27th Oct'08. Please find below the points discussed and confirmed in and email dated 27th Oct '08.

i) Due to the unforeseen financial crisis across the world, leading to difficulties in financial closures of Projects, we are cancelling our order for Raw Mill, Cement Mill for Plant 3 and Pyro for Plant 4.

Letter dated November 27, 2008

"With reference to the meeting we had in our office at Noida on 27th November, 2008 and as discussed, we confirm for cancellation of plant No. 1 & 2 also, which were under hold.

Contract with Star Cement Meghalaya Ltd.

Letter dated February 3, 2009

"There are certain further developments which need to be discussed, therefore, you are requested to continue the suspension of the contract as communicated vide your letter dated 17.12.2008 beyond 06.02.2009 till further improvement in the circumstances, which are absolutely beyond our control".

A perusal of the communication would show that even the customers have acknowledged that the assessee has incurred contractual liability for material cost/ compensation for cancellation of contracts with vendors (e.g. Letter from Dalmia Cement dated November 17 and 27, 2008) on the customer contracts which have been cancelled/ suspended.

33. The assessee has enclosed details of cost of cancellation of Rs.12,41,59,090/- in respect of PO already placed by assessee with vendors. Such details include project code, vendor name PO no., item description, PO value and cost of cancellation.

34. The assessee has enclosed minutes of meeting with vendors which shows cost of cancellation which assessee incurred in respect of cancelled/ suspended contracts with customers.

35. Since, this amount represents compensation for not taking delivery of equipment, this cost is a normal business expense and should be allowed as deduction.

36. Cost of Rs. 29,23,32,927/- in respect of material fully/ partly/ processed/ delivered by vendors after adjusting

material cost already recognized in books and reducing realizable value of material.

37. The assessee has enclosed details of cost Rs. 29,23,32,927/- in respect of material fully/ partly processed/ delivered by vendor after adjusting material cost already recognized in books of accounts and reducing realizable value of material. Such details include project code, vendor name PO no., item description, PO value and WIP value of items. This represents the net cost incurred by the assessee for materials in respect of which delivery has been taken by assessee from vendors.

38. The above facts would substantiate that the provision has been made for material cost and/ or compensation for cancellation/ suspension of contracts which is incurred under contracts with its vendors entered pursuant to pre-existing commitments against supply contracts with customers, the latter having been subsequently cancelled/ suspended.

39. Further, we have perused the judgments of various Courts relevant this issue. Quote a few,

- The Hon'ble Delhi High Court in the case of R C Jain Vs. CIT [1973] 91ITR 557 (Delhi IIC) wherein compensation paid by assessee to vendor owing to not taking delivery of goods was held as an allowable deduction. Relevant extracts are reproduced below:

"If the assessee had taken delivery of the pipes and resold the same himself he would have suffered the same loss in the market. The fact that the assessee did not take delivery but preferred the transaction to end in a resale by his vendor does not make it any the less a business loss. It is,

therefore, difficult to find that the loss is not allowable on account of the fact that the goods were not taken delivery of."

- The Hon'ble Rajasthan High Court in the case of Madira Kraya Vikraya Sangh Vs CIT [1993] 69 Taxman 556 (Rajasthan HC) has held as follows:

"... it cannot be denied that the loss which has been suffered by the assessee on account of the stipulation contained in the contract/licence to lift a particular quantity and that it was his obligation to make the payment of the loss to the Government which would certainly be a liability which arose from carrying on the business and was laid out wholly and exclusively for the purposes of business. The said amount was allowable as a trading loss."

- Similar decision was rendered by Rajasthan HC in the case of CIT Vs Motilal Chunnilal Bhanwarilal [1987] 33 Taxman 267 (Rajasthan HC), CIT Vs Chunilal Tak [1986] 24 Taxman 730 (Rajasthan HC) and CIT Vs Ramesh Chand Gopi Chand [1994] 76 Taxman 201 (Rajasthan HC).

- The Hon'ble Bombay High Court in the case of CIT Vs Lubrizol India Ltd [2013] 37 taxmann.com 294 (Bombay HC) wherein compensation paid by assessee due to termination/ cancellation of contracts was held to be allowable as a business deduction.

40. Hence, we hold that the provision of Rs.8,81,12,017/- is an allowable deduction in the subject assessment year based on judicial precedents

41. In the result,

- a. Provision for liquidated damages is allowed.
- b. Provision is warranty is allowed.
- c. Advances and deposits written off is allowed.
- d. Provision for loss on suspended contracts is allowed.

42. In the result, the appeal of the revenue is dismissed.

Order Pronounced in the Open Court on 28/01/2022.

Sd/-

(A. D. Jain)
Vice President

Dated: 28/01/2022

Subodh Kumar, Sr. PS

Copy forwarded to:

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

Sd/-

(Dr. B. R. R. Kumar)
Accountant Member

ASSISTANT REGISTRAR