

आयकर अपीलिय अधिकरण "बी" न्यायपीठ पुणे में ।
IN THE INCOME TAX APPELLATE TRIBUNAL "B" BENCH, PUNE

BEFORE SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER
AND
SHRI S.S. VISWANETHRA RAVI, JUDICIAL MEMBER

आयकर अपील सं. / ITA No.499/PUN/2017

निर्धारण वर्ष / Assessment Year : 2011-12

Racold Thermo Private Limited
(Formerly known as Racold Thermo Limited)
Gat No.265/374-376,
Kharabwadi, Chakan-Talegaon Road,
Tal. Khed, Chakan,
Pune – 410501

PAN : AAECM0766G

.....अपीलार्थी / Appellant

बनाम / V/s.

The Dy. Commissioner of Income-tax,
Circle – 10, Pune

.....प्रत्यर्थी / Respondent

आयकर अपील सं. / ITA No.2920/PUN/2016

निर्धारण वर्ष / Assessment Year : 2009-10

Racold Thermo Private Limited
(Formerly known as Racold Thermo Limited)
Gat No.265/374-376,
Kharabwadi, Chakan-Talegaon Road,
Tal. Khed, Chakan,
Pune – 410501

PAN : AAECM0766G

.....अपीलार्थी / Appellant

बनाम / V/s.

The Dy. Commissioner of Income-tax,
Circle – 10, Pune

.....प्रत्यर्थी / Respondent

Assessee by : Shri Ketan Ved
Revenue by : Shri Piyushkumar Singh Yadav

सुनवाई की तारीख / Date of Hearing : 11-03-2022

घोषणा की तारीख / Date of Pronouncement : 22-03-2022

आदेश / ORDER

PER INTURI RAMA RAO, AM:

These two appeals are filed by the assessee directed against separate orders of the Commissioner of Income Tax (Appeals)-6, Pune, dated 27.09.2016 and 15.12.2016 for the assessment years 2009-10 and 2011-12.

ITA No.499/PUN/2017 for A.Y. 2011-12

2. Briefly, the facts of the case are as under:

The appellant is a company incorporated under the provisions of the Companies Act and it is engaged in the business of manufacturing and trading of electrical application. The return of income for the assessment year 2011-12 was filed on 30.11.2011 declaring total income at Rs.27,95,14,094/-. Against the said return of income, assessment was completed by the Assessing Officer (in short 'AO') vide order dated 27.02.2015 passed u/s 143(3) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act') at a total income of Rs.29,26,10,090/-. While doing so, the AO disallowed the provision for warranty of Rs.33,96,000/- and provision for obsolete stock of Rs.97,00,000/-. The factual background of above disallowances is as under:

During the previous year relevant to the assessment under consideration, the appellant company made a provision for warranty of Rs.4,79,66,000/- . The opening balance of provision for warranty stood at Rs.5,31,29,000/- as against the actual expenditure for warranty during the year under consideration only 4,45,70,000/-. During the course of assessment proceedings, the appellant company was called upon to furnish the basis of working of provision for warranty. In response to the same, the appellant company made a detailed submission as to how the working of the provision for warranty was arrived at, as under:

“3.5....

“Provision for warranty is computed on monthly basis based on the past experience and scientific method. It is computed considering the various products and sub products of the Company. Following are details pertaining to computation of warranty provision:

For every product the provision for warranty is divided into two components:

- A. Repair [change of product (other than tank) + repairs]*
- B. Replacement of tank*

Hence, provision for warranty = Provision for repairs [change of product (other than tank) + repairs] + provision for replacement of tank.

A. Repairs [change of product (other than tank) + repairs]

Provision for repairs = Call rate x Sales for past 12 months x Unit cost of intervention

2 (warranty yrs)

Step 1:

Total Call rate = Total interventions

Avg total units sold in past 24 months

Call rate for product = $\frac{\text{Total product interventions}}{\text{Avg total units sold in past 24 months}}$

Avg total units sold in past 24 months

Call rate for repairs = Total Call rate (less) Call rate for product

Intervention means the number of complaints received from the customers. The total interventions data is collected from the service engineers of the Company which in turn get the data from the service franchisees of the Company.

The service franchisees maintain the said data with all details, as they get paid by the Company for the services rendered by them to the customers.

From 2013 onwards the Company follows the Call Register Management (CRM) module for the total interventions. The customer complaints are received directly at the Company call centre and are then allocated to the regional service franchisees.

Step 2:

The Call rate is then multiplied by the total units sold in past 12 months to get the number of products which may require interventions/warranty expenses.

Number of products for interventions = Call rate for product x Total sales in past 12 months

2 (warranty yrs)

The costing of these products requiring interventions is arrived at by computing the 'Unit cost of intervention'.

Step 3:

Unit cost of intervention = Labour cot + Spare part cost

Labour cot = Total cost paid to franchisees in last 12 months

Total interventions

Spare part cost = Total cost of spare parts given to the franchisees

Total no. of spare parts given to franchisees

Provision for repairs (for change of product) = Number products requiring intervention x unit cost of intervention.

Similarly, provision for repairs (only repairs) is computed.

B. Replacement of tanks

Step 1:

Call rate = Total interventions for replacement of tank x 6/7 years.

Avg total tanks sold in last 6/7 years

Step 2:

Number of tanks for interventions = Call rate x Total sales in past 6/7 years

2 (warranty yrs of product)

Step 3:

Unit cost of intervention = Labour cost + Spare part cost

Provision for replacement of tanks = Number tanks requiring intervention x unit cost of intervention

*Sample copy of the provision for warranty computation is enclosed as **Annexure-1***

*Accordingly, it is respectfully submitted that the provision for warranty is made on scientific basis, past historical trend and in accordance with the law laid down by the Supreme Court in the cast of **Rotork Controls India (P.) Ltd. v. CIT 314 ITR 62 (SC).....***

3. It is claimed that the above method of working for the provision of warranty is based on scientific method, past historical data, which is in consonance with the ratio laid down by the Hon'ble Supreme Court in

Rotork Controls India (P.) Ltd. vs. CIT 314 ITR 62 (SC). However, the above submission of assessee had been rejected by the AO by holding that mere provision made towards warranty cannot be allowed as deduction while computing business income. It is further held that the methodology of working adopted by the assessee had not revealed any such scientific method / historical data. The AO noticing that the opening balance of provision for warranty stood at Rs.5,31,29,000/- as against actual liability incurred at Rs.4,79,66,000/- held that the difference between provision and actual liability is nothing but unforeseen liability and accordingly, disallowed sum of Rs.33,96,000/- as contingent liability.

4. As regards to disallowance of provision for obsolete stock, during the previous year relevant to the year under consideration, the appellant company made a provision for obsolete inventory of finished goods of Rs.97,00,000/- in accordance with Inventory Value Policy. It is submitted that the company is engaged in the manufacturing and trading of water heaters like electric water heaters, gas water heaters, solar water heaters, etc. Due to technological advancements and the development of the markets with respect to water heaters and the technology used in it, any unsold goods (finished goods as well as spares) over a period of 1 year starts becoming obsolete. This obsolescence is on account of newer and better models being launched in the market (with additional features) and/or new technology being used in the entire product line. This company also reversed the provision when it was not required in the subsequent year. The methodology adopted for identification of obsolete finished products is extracted by the AO at pages 13 and 14 of the assessment

order. The appellant also relied on plethora of decisions including the Hon'ble Bombay High Court in the case of Alfa Laval India Vs. DCIT (2004) 186 CTR 390 (Bom), which was confirmed by the Hon'ble Supreme Court in the case of CIT Vs. Alfa Laval India Ltd. 295 ITR 451 (SC). However, the AO disallowed the provision by holding that the provision cannot be allowed based on the internal accounting policy of the company and inventory has to be valued at cost or market price, whichever is lower. Aggrieved by the above decision an appeal was filed before the Id. CIT(A), who vide impugned order has upheld the action of AO by holding that the formulae adopted by the assessee is not based on the scientific or historical trends. Similarly, the Id. CIT(A) also confirmed the addition made on account of provision made for obsolete stock by holding that the mathematical formulae adopted by the assessee does not take into consideration the real market value of the stock or consumables. During the course of proceedings before the Id. CIT(A), the appellant raised an additional ground of appeal urging that difference arising on account of payment of net present value of sales tax liability and the deferred sales tax liability should be allowed as deduction in computation of taxable income.

The appellant had availed the package scheme of incentives introduced by the Govt. of Maharashtra and as per this scheme the appellant was entitled to the defer the payment of sales tax collected during the period 1/7/2009 to 31/12/2014. This scheme was applicable in respect of the manufacturing unit setup at Nashik. The sales tax department of Maharashtra had allowed the premature payment of deferred sales tax liability at net present value and it was deemed to be the

full discharge of deferred sales tax liability. The appellant company had a deferred sales tax amount of Rs.2,12,67,332/- and the net present value of the same was Rs.57,36,372/-. The appellant paid this net present value and as a result the difference of Rs.1,55,30,960/- was taken as a revenue receipt. The appellant claimed during the assessment proceedings that the amount should be treated as a capital receipt in view of the Special Bench decision in the case of Sulzer India Ltd vs. JCIT [2010-TIOL-670-ITAT-Mum-SB] wherein it held that the prepayment of deferred sales tax liability at its net present value cannot be classified as remission or cessation of trading liability, so as to attract the provisions of sec.41(1) of the Act. This decision was also confirmed by the Bombay High Court reported in 369 ITR 717 (Mum). The appellant submitted that it had made the claim before the AO to consider the decision of the Special Bench and to provide the necessary relief. However, the AO did not make any mention of this claim in the assessment order passed.

5. The said claim was rejected by the Id. CIT(A) by holding that though the issue was decided in favour of the assessee by the Hon'ble jurisdictional High Court and since the issue is still debatable, not admitted the additional ground of appeal. Being aggrieved by this order of Id. CIT(A), the appellant is in appeal before the Tribunal in the present appeal.

6. The first ground of appeal relates to the disallowance of provision for warranty. It is submitted that the provision for warranty was made by the assessee in terms of scientific formulae adopted by this corporate entity

and the provision is not made on adhoc basis. The formulae adopted by the assessee fulfills the conditions laid down by the Hon'ble Supreme Court in Rotork Controls India (P.) Ltd. vs. CIT (supra) and the ld. CIT(A) without appreciating this in proper perspective has confirmed the action of AO.

7. On the other hand, the ld. Sr.CIT-DR placing reliance on the order of ld. CIT(A) has submitted that the appellant is not in the practice of reversing the excess provision to the Profit and Loss Account especially deferring the current taxable income to the future years.

8. We have heard the rival contentions and perused the record. The issue in the present ground of appeal relates to the issue as to whether or not the methodology of the appellant company for the computation of provision of warranty is in consonance with the parameters laid down by the Hon'ble Supreme Court in the case of Rotork Controls India (P.) Ltd. vs. CIT (supra). The case of the appellant company is that the provision for warranty is made based on the global policy of the company i.e. CRM Module and that provision was not made on adhoc basis. The AO noticing the fact that there is wide difference between the provision made and actual liability of warranty inferred that the provision made is neither based on historical trends nor a robust and therefore, made disallowance of Rs.33,96,000/-. On an appeal before the ld. CIT(A), the ld. CIT(A) also confirmed the action of AO. We have gone through the orders of lower authorities and find that though the lower authorities had considered the decision of Hon'ble Supreme Court in the case of Rotork Controls India (P.)

Ltd. vs. CIT (supra), had not applied the ratio of the said decision in right perspective. The appellant company also has failed to demonstrate before us as to how the methodology adopted by it for computation of provision for warranty satisfies the parameters laid down by the Hon'ble Supreme Court in the case of Rotork Controls India (P.) Ltd. vs. CIT (supra). In the circumstances, we are of the considered opinion that the matter requires remand to the file of AO for *de novo* consideration of the issue in terms of the law laid down by the Hon'ble Supreme Court in Rotork Controls India (P.) Ltd. vs. CIT (supra). Accordingly, this ground of appeal is remitted back to the file of AO for *de novo* consideration and decide this issue in accordance with ratio of decision in the case of Rotork Controls India (P.) Ltd. vs. CIT (supra) after providing a reasonable opportunity of hearing to the assessee. Thus, ground of appeal No.1 filed by the assessee stands partly allowed for statistical purposes.

9. The ground of appeal No.2 challenges the disallowance of provision made for obsolete of inventory of Rs.97,00,000/-.

10. The appellant company made a provision for obsolescence inventory of finished goods as well as spares of Rs.97,00,000/- in terms of Accounting Policy of the company. The computation for provision of obsolescence of inventory was made following a methodology applied for identification of obsolete finished goods. The AO opined that the provision for obsolete items cannot be allowed in terms of accounting policy of the company and the valuation of inventory of the same should be done at the cost or market price, whichever is lower and disallowed the same. Even

before the Id. CIT(A), the Id. CIT(A) confirmed the same. Being aggrieved by the same, the appellant is in appeal in the present appeal.

11. It is contended that the provision for obsolete stock should be allowed following the decision of Hon'ble Bombay High Court in the case of Alfa Laval India Vs. DCIT (supra) as confirmed by the Hon'ble Supreme Court in the case of CIT Vs. Alfa Laval India Ltd. (supra) and also the Co-ordinate Bench of Tribunal and also the Hon'ble Rajasthan High Court in the case of CIT vs. Wolkem India Limited 221 ITR 767 (Raj) and the Hon'ble Delhi High Court in the case of CIT Vs. Hotline Teletube & Components Ltd. (2008) 175 Taxman 286 (Del).

12. On the other hand, the Id. Sr.CIT-DR opposed the submissions of assessee and submitted that the provision was not based on the Accounting Standard No.2, but based on the accounting policy which may not be really the identified percentage of obsolete stock.

13. We have heard the rival contentions and perused the record. The issue in the present ground of appeal relates to the allowance of provision for obsolescence of finished goods and spares. There can be no dispute that inventory should be valued either at cost or market price, whichever is lower. In the present case, the appellant company followed inventory valuation policy, based on which item-wise analysis was carried out to determine whether a particular item or a part of finished goods has become obsolete or not and it also adopted a methodology for identification of obsolete finished goods, etc. Thus, the provision for obsolete items is

clearly allowable, in view of the settled position of law that inventory should be valued at cost or market price whichever is lower in view of decision of Hon'ble Bombay High Court in the case of Alfa Laval India Vs. DCIT 266 ITR 418 is clearly applicable, wherein the Hon'ble Bombay High Court has held as under:

“8. In the present case, there is no dispute that the duly certified auditor's report placed before the AO clearly justified valuation of obsolete items at 10 per cent of cost. There is no dispute that the assessee is entitled to value the closing stock at market value or at cost whichever is lower. It is also not in dispute that the value of the closing stock has been taken as the value of the opening stock in the subsequent year. Moreover, it is also not disputed that the obsolete items were in fact sold in the subsequent year at a price less than 10 per cent of the cost. Under the circumstances, it could not be said that the valuation of the obsolete items done by the assessee and certified by the auditors was not proper or arbitrary. The AO in fact has arbitrarily valued the items in question at 50 per cent of the cost without disclosing the basis of such valuation. The AO had not doubted the correctness of the certificate of the auditors regarding the valuation of obsolete items. The summary of the obsolete items were before the AO. There is nothing on record to show that the assessee was called upon to furnish the list of obsolete items or that the assessee was called upon to establish that the items were not moving for 3 years. Under these circumstances, it could not be said that the assessee has failed to furnish list of obsolete items and failed to establish that the said items were not moving. In the absence of any basis for valuing the obsolete items at 50 per cent of the cost, the Tribunal could not have upheld the findings of the AO on the ground that the list of obsolete items were not produced by the assessee. Accordingly, we answer the question No. 1 in the negative, that is, in favour of the assessee and against the Revenue.”

14. In the present case, though the appellant made a provision for obsolescence of stock of finished goods following a methodology but it was not demonstrated before us that there was no under-valuation of the finished goods or spares and the excess provision, if any, was written back in the succeeding year or in the year of sale of obsolete stock, etc. nor was it demonstrated that obsolete stock was valued at lower of cost or net realizable value. In the circumstances, in principle, we hold that the provision for obsolete stock is allowable but it requires to be satisfied that the value of obsolete items of finished goods is valued on the cost or

market price whichever is less. In the circumstances, we remand the matter back to the file of Assessing Officer with a direction that the provision for obsolete stock be allowed as deduction subject to satisfying himself that the valuation is done based on the principle that at cost or market price or net realizable value, whichever is less. Thus, this ground of appeal is allowed for statistical purposes.

15. The ground of appeal No.3 challenges the decision of Id. CIT(A) in not admitting the ground of appeal challenging the denial of claim for allowance of difference between net present value of deferred sales tax and the deferred sales tax liability. The Commissioner had not admitted this ground of appeal by holding that this issue is debatable, though decided by the jurisdictional High Court. The decision rendered by the Hon'ble High Court is binding on all the authorities situated within the territorial jurisdiction of the Hon'ble High Court. Once the issue is decided by the Hon'ble High Court, it cannot be said that there exists a debate on the issue. The judicial discipline demands that the decision of Hon'ble High Court should be followed by all the lower authorities employed in execution of Act. Thus, the Id. CIT(A) had clearly fell in error in not admitting and adjudicating this ground of appeal, since this ground of appeal is purely legal in nature and requires no verification of facts, we admit this ground of appeal for adjudication. The issue in this ground of appeal is decided by the Hon'ble Bombay High Court in CIT Vs. Sulzer India Ltd. (2014) 369 ITR 717 (Bom), wherein the Hon'ble High Court upheld the decision of Special Bench of Tribunal. Respectfully following this decision of the Hon'ble High Court, we direct the AO to reduce the sum of Rs.1,55,30,960/- from the

taxable income on account of difference between the net present value of deferred sales tax and deferred sales tax liability. Thus, this ground of appeal filed by the assessee shall stand allowed.

16. In the result, the appeal filed by assessee stands partly allowed for statistical purposes.

ITA No.2920/PUN/2016 for A.Y. 2009-10

17. The ground of appeal No.1 raised in this appeal relates to the disallowance of provision for warranty. The identical issue was decided by us in ITA No.499/PUN/2017 for A.Y. 2011-12 and for the reasons stated therein, this ground of appeal is remanded back to the file of AO on the same lines. Thus, this ground of appeal is partly allowed for statistical purposes.

18. In the result, both the appeals are partly allowed for statistical purposes.

Order pronounced in the open court on 22nd March, 2022.

Sd/-
S.S.VISWANETHRA RAVI
JUDICIAL MEMBER

Sd/-
INTURI RAMA RAO
ACCOUNTANT MEMBER

पुणे / Pune; दिनांक / Dated : 22nd March, 2022
GCVSR

आदेश की प्रतिलिपि अद्येषित/Copy of the Order is forwarded to :

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. आयकर आयुक्त(अपील) / The CIT(A)-6, Pune;
4. The Pr.CIT-5, Pune;
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे "B" / DR 'B',
ITAT, Pune;
6. गार्ड फाईल / Guard file.

आदेशानुसार / BY ORDER,

//सत्यापित प्रति// True Copy//

वरिष्ठ निजी सचिव / Sr. Private Secretary
आयकर अपीलीय अधिकरण, पुणे / ITAT, Pune