

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

**Before Sh. A.D. Jain, Vice President
Dr. B. R. R. Kumar, Accountant Member**

**ITA No.4509/Del/2018
Asstt. Year: 2013-14**

M/s Eberspeacher Suetrak Bus climate Control Systems Private Limited, Unit No.112, 1 st Floor, North Delhi Mall-1, Plat No.B-2, 3,4, Netaji Subhash Palace, Pitmapura, New Delhi-110034	Vs	Assistant Commissioner of Income Tax, Circle-8(1), New Delhi
(ASSEESSEE)		(REVENUE)
PAN No. AACCE3922E		

**Assessee by : Sh. Ved Jain, Adv. &
Sh.Ashish Goel, CA
Revenue by : ****

Date of Hearing: 10.05.2022	Date of Pronouncement: 27.06.2022
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ORDER

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

** The Revenue filed letter of adjournment signed by the ITO of the Bench which has been rejected owing to the grounds taken up by the assessee.

The present appeal has been filed by the assessee against the order of the Id. CIT(A)-34, New Delhi, dated 28.03.2018, relating to AY 2013-14.

Provisions for warrantee charges.

2. At the outset it was argued that no addition has been made on this account in the orders passed u/s 143(3) for the Assessment Years 2016-17, 2017-18 and 2018-19. The assessee company had been assessed to Income Tax Act u/s 143(3) for the Asstt Year 2013-14, wherein addition of Rs.43,88,118/- had been made to the Returned Income on account of "provisions for Warrantee Charges". The details of the warrantee charges, the additions, utilization/reversal over the period of eight years are as under:-

Assessment Years	2001-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Opening Balance of provision of (A)	6,311,000.00	5,482,508.00	12,418,817.00	16,806,935.00	13,342,559.00	16,172,962.00	23,630,497.00	42,454,550.00
Additions (B)	11,970,790.00	18,078,086.00	13,921,294.00	4,148,813.00	8,944,861.00	14,504,795.00	31,002,349.00	28,534,137.00
Utilization /Reversal (C)	12,799,282.00	11,141,777.00	9,533,176.00	7,613,189.00	6,114,458.00	7,047,260.00	12,178,296.00	28,258,751.00
Closing balance (A+B+C)	5,482,508.00	12,418,817.00	16,806,935.00	13,342,559.00	16,172,962.00	23,630,497.00	42,454,550.00	42,729,936.00

3. Brief facts involved in the case of appellant are that the appellant had debited expenses in the P&L A/c, under the head "Provision for Warranty" amounting to Rs. 1,39,21,294/-. During the course of assessment proceedings, AO observed that assessee, during the year under consideration, has actually incurred expenses amounting to Rs. 95,33,176/- only on account of meeting out the warranty obligations. The balance amount of Rs. 43,88,118/- which was debited in P&L A/c purely on provisional basis has been treated as unascertained liability.

Since, it is unascertained liability claimed purely on provisional basis without actually incurring during the year, the amount is disallowed by the AO.

4. We have examined the record and the judicial pronouncements on this issue.

5. On the issue of allowability of provision made by appellant, Hon'ble Supreme Court in case of Rotork Controls India P. Ltd. 314 HR 62 observed as under:-

"For determining an appropriate historical trend, it is important that the company has a proper accounting system for capturing relationship between the nature of the sales, the warranty provisions made and the actual expenses incurred against it subsequently. Thus, the decision on the warranty provision should be based on past experience of the company. A detailed assessment of the warranty provisioning policy is required particularly if the experience suggests that warranty provisions are generally reversed if they remained unutilized at the end or the period prescribed in the warranty. Therefore, the company should scrutinize the historical trend of warranty provisions made and the actual expenses incurred against it. On this basis of sensible estimate should be made. The warranty provision for the products should be based on the estimate at year end of future warranty expenses. Such estimates need reassessment every year. As one reaches close to the end of the warranty period, the probability that the warranty expenses will be incurred is considerably reduced and that should be reflected in the estimation amount. Whether this should be done through a pro rata reversal or otherwise would require assessment of historical trend. If warranty provisions are based on experience and historical trend(s) and if the working is robust then the question of reversal in the subsequent two years, in the above example, may not arise in a significant way."

6. Perusal of the said judgement of Hon'ble Supreme Court shows that Hon'ble Supreme Court has laid down conditions which are required to be satisfied for making claim with respect to warranty cost. These are,

"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."

7. Ld.CIT(A) held that identical issue was involved in the case of appellant in A.Y. 2011-12 and the same has been decided by the Id. CIT(A) in which he has given a finding that the warranty expenses are to be allowed on the basis of their actual incurring during the year and not on provisional basis, Accordingly, the Id. CIT(A) held in the instant case that, out of total warranty expenses debited to the P&L A/c, the warranty expenses actually incurred during the year under consideration are allowable and the expenses which have not been actually incurred but have been debited purely on provisional basis were disallowed. While deciding the appeal the Ld. CIT(A) also referred to the order passed by Ld.DRP-1, Delhi in the case of appellant in AY 2012-13, where Ld.DRP-1 has discussed identical issue involving the allowability of warranty expenses on provisional basis, as claimed

by the appellant. While passing the order, Ld.DRP-1, Delhi has also referred the decision of the Hon'ble Supreme Court in the case of M/s Rotork Controls India (P) Ltd. vs CIT [2009] 314 ITR 62 (SC). Perusal of the order passed by DRP-1, Delhi shows that the panel has discussed the applicability of three conditions laid down by Hon'ble Supreme Court in the case referred (M/s Rotork Controls India (p) Ltd V/s CIT [2009] 314 ITR 62 (SC), as to whether the three conditions are satisfied in the case of appellant or not. The panel has concluded that none of the three conditions in the case of appellant are satisfied, so as to allow to the appellant, the warranty expenses on provisional basis.

8. Relevant portion of the order of the Ld.CIT(A) in the case of appellant for AY 2011-12, in appeal no. 285/14-15 is as under.

"(viii) I am in agreement with the findings of DRP and the AO on the issue at hand. The above mentioned background of the case of the j appellant and the facts involved therein clearly indicate that the appellant ' is just creating provisions for warranty expense year after year based upon certain percentage of quantum of sales made during the year. Even in following this methodology, appellant has not been consistent. In F. Y. 2010-11, it was created at 34.97% of sales turnover of finished goods, while in F.Y. 2011-12 it was created at 43.2% of sales turnover of finished goods and in F.Y. 2012-13 it was created at 39.34% of sales turnover of finished goods. It is on record that appellant had failed to provide any scientific working of the provisions created. Not only any such working could be provided before AO but even during the course of appellate proceedings, no such working could be provided. AO has correctly observed that working of warranty expenses based on units sold, price I per unit, percentage of expenses allocated to warranty expenses which are provisional in nature etc, could provide some scientific basis for creating such

provisional expenses hut no such working could be made available. DRP has observed that it appellant's explanation that "it may be verified that the amount of warranty provision made during the year, represents the present/current ascertained liability of warranty obligation to be met in subsequent year, as period of warranty has not expires on such sales, hence by no means of imagination, the liability may be termed as "Continent Liability" is by no means an answer to a description of a scientific and reliable estimate of the amount of the provision and its obligation in future.

The three conditions laid down in case of M/s Rotork Controls India (p) Ltd. are certainly not satisfied in the case of appellant and thus the AOs finding that the provision of warranty expenses debited/claimed in the P&L account cannot be allowed as the same is not an ascertained liability, is correct However, the AO has disallowed the entire claim debited to P & L Account; amounting to Rs. 1,19,70,790/-. This view of AO is not correct since the entire amount of Rs.1,19,70,790/- does not represent provision, while a part of it has actually been spent during the year under consideration. The actual expenses incurred during the year, amounts to Rs.1,27,99,232/- which includes the expenses incurred towards opening balance of provision for warranty expenses amounting to Rs. 63,11,000/-, Therefore, a sum of Rs. 64,88,282/- (Rs.1,27,99,282/- minus Rs. 63,11,000/) can be said to have been actually incurred towards the overall provision for warranty expenses created during the year amounting to Rs. 1,19,70,790/-. Accordingly, out of total disallowances amounting to Rs. 1,19,70,790/- made by the AO, the sum of Rs. 64,88,282/- deserves to be allowed to the appellant and the balance sum of RS.54,82,508/- (Rs.1,19,70,790/- minus Rs.64,88,282/-) deserves to be confirmed as if represents the expenses claimed purely on provisional basis and thus unascertained liability. The disallowances are accordingly restricted to Rs. 54,82,508/-. The appellant gets a relief of Rs. 64,88,282/-."

9. We have Perused the details on record.

The following facts gush from the record.

- ❖ Calculation of amount of provision of Rs. 1,39,21,294/- made by the assessee, in comparison to the invoice wise details of sales made by the assessee company during the Financial Year 2012-13.
- ❖ Transaction wise details of amount of warranty charges of Rs. 50,15,953/- incurred during the Financial Year 2012-13.
- ❖ Transaction wise details of amount of excise duty on replacement materials issued of Rs. 2,03,019/- incurred during the Financial Year 2012-13.
- ❖ Transaction wise details of amount of service charges of Rs. 43,14,203/- incurred during the Financial Year 2012-13.
- ❖ That against the provision of Rs. 1,39,21,294/- and provision brought forward from last year Rs. 1,24,18,817/-, the assessee company had already incurred expenditure of Rs. 95,33,176/-, thereby leaving the balance of Rs. 1,68,06,935/- outstanding as on 31.03.2013 which is further being bifurcated into Long Term & ShortTerm Provision.
- ❖ Both AO and CIT(A) has not made any comment over the details filed by the assessee regarding the provision made during the year.
- ❖ Neither of them has brought on record any instance which shows that the provisions made by the assessee is an unascertained liability.

- ❖ It is not disputed by the AO as well as CIT(A) that the assessee is not dealing with these Electrical Items. The Electrical items are generally sold under the warranty clauses. The policy of warranty was also not disputed by both AO and CIT(A).
- ❖ The disallowance has been made arbitrarily grossly ignoring the contentions and submissions made by the assessee that the provision was made on scientific basis and therefore the judgement of Hon'ble Supreme Court in the case of Rotork Controls India Private Limited is squarely applicable to the assessee.
- ❖ AS 29 denotes , " Provisions, Contingent Liabilities and Contingent Assets", in which the provision is defined. A provision is defined as a liability which can be measured only by using a substantial degree of estimation.

A provision should be recognized when
(repeated)

- (a) an enterprise has a present obligation as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits 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 should be recognized.

- ❖ In the present case, the assessee had claimed warranty charges of Rs.1,39,21,294 on account of provision for warranty. The provision for warranty represents the ascertained liability which was computed on a scientific basis, based on quantum of sales made during the year. It can be verified that the amount of warranty provision made during the year represents the present/current ascertained liability of warranty obligation to be met in subsequent year, as period of

warranty has not expired on such sales. Also the assessee company has an obligation to render the requisite warranty services on account of sales made at the relevant point of time. Thus it can be said that the assessee company has a present obligation of rendering warranty services as a result of past event i.e. sale of products in the present case. It can also be noted an outflow of resources is necessarily required to meet the warranty obligations and the amount of obligation for warranty is being scientifically computed by the assessee company every year consistently. Thus all the three conditions pertaining to recognition of provision as specified in AS 29, are being met in the case of assessee company.

- ❖ The Warranty provision amounting to Rs. 1,39,21,294/- has been charged to Profit and Loss A/c by the assessee company which was computed on a scientific basis, based on quantum of sales made during the year. However, the amount actually incurred may vary nominally in comparison to the amount of provision made. Based on materiality concept, the amount of provision made, can't be termed as unascertained liability, as the % for which provision is being made had been derived based on technical study, past experience of the company and the industrial standards. Also matching of warranty costs as against their goods being sold is the most appropriate way of accounting because it fulfills accrual concept as well as the matching concept. Detailed product wise computation of provision of warranty and warranty expenses utilized/reversed during the year is placed (PB Pg 26 to 67) before us.
- ❖ It is also pertinent to invite the attention to the fact that assessee has claimed the similar expenditure with the same accounting policy in following assessment years and the same have been accepted in the regular scrutiny assessments.

Assessment year	Amount of provision for warranty claimed	Section under which the assessment order was passed	Date of assessment order
AY 2015-16	89,44,861/-	143(3)	28.11.2017
AY 2016-17	1,45,04,795/-	143(3)	19.12.2019
AY 2017-18	3,10,02,349/-	143(3)	24.04.2021
AY 2018-19	2,85,34,1377-	143(3)	26.12.2021

10. M/S. ROTORK CONTROLS INDIA (P) LTD. VERSUS COMMISSIONER OF INCOME TAX, CHENNAI [20093 314 ITR 62 (SC)- Dated.- May 12, 2009 was reiterated in the following judgments.

- ❖ THE PRINCIPAL COMMISSIONER OF INCOME TAX -6 VERSUS M/S. NOKIA INDIA PVT. LTD. 2018 (9) TMI 877 - DELHI HIGH COURT- Dated.- August 31, 2018

6. *We have considered the contention but do not find any merit in the same. As stated by the Assessing Officer in the assessment order, the table reveals that there was substantial increase and jump in sales year after year in the Assessment Years 2002-03, 2003-04, 2004-05 and 2005-06, from Rs.58.97 crores to Rs.830.51 crores to Rs.2408.01 crores, and then to Rs.4729.14 crores, respectively. The provision for warranty would accordingly increase in numerical terms. Pertinently, the percentage of closing provision of warranty with reference to quantum of sales had decreased and came down as is reflected in the figure in the column (h) of the table above. In the present case, we are only concerned with the Assessment Year 2003-04 in which the percentage of closing provision to sales was only 0.81%. Variation in figure would indicate that no thumb rule was applied. Moreover in case of doubt and debate, Income Tax Authorities should have asked for the basis and the formula/criteria applied by the respondent/assessee to compute provision for warranty. On the other hand without disputing the computation, disallowance was made by holding that actual expenditure on warranty claims and not provision for warranty was allowable as expenditure. This*

proposition is wrong and incorrect. Improvement in technology would not justify disallowance of claim/expenditure on account of provision for warranty, though in a given case on basis of data it could be relevant factor in making the calculations.

7. *In the aforesaid factual matrix and in view of the decision of the Supreme Court in Rotork Control India Pvt. Ltd. (supra) and decision of this Court in respondent-assessee's case in IT A Nos. 841/2009 and 842/2009, we do not find any good ground or reason to accept the aforesaid contention of the Revenue.*

❖ ACIT, CIRCLE-11 (2) NEW DELHI VERSUS HUMBOLDT WEDAG INDIA PVT. LTD. 2022 (2) TMI 277 - ITAT DELHI - Dated January 28, 2022

"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."*

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.

❖ CPS CASH PROCESSING SOLUTIONS PRIVATE LTD. [FORMERLY KNOWN AS-DE LA RUE CASH PROCESSING SOLUTIONS INDIA PVT. LTD. VERSUS DCIT CIRCLE-1 (1) , GURGAON- 2018 (7) TMI 224 - ITAT DELHI- Dated.- July 3, 2018

"10. We have heard both the parties and perused all the records. Ground No. 1 and 1.1 is relating to disallowance of Rs.1,76,90,14/- on account of warranty provisions which was estimated at 10% of sales. It is settled position that provisions for warranty is a business necessity and such provision is an allowable expenses. The CIT(A) in 2006-07 held that the warranty provision provided at 10% of sales was actually utilized only to the extent of 1.16% by the Company and the rest was reversed. Thus, the CIT(A) held that it is considered fair and reasonable that warranty provision to the extent of 1.50% of the sales would justifiable and remaining provision needs to be added back. The contention of the Ld. AR that warranty obligation is inbuilt in the purchase order/agreement as mentioned in Clause 6 & Clause 3. Thus, the liability on account of warranty is integral part of the sales revenue. Since, the entire sales revenue is accounted as revenue by the assessee. Therefore, corresponding deduction for warrant provision who also be allowed. The Tribunal for A.Y. 2006-07 being IT A No. 7056/Del/2010 order dated 02.02.2016 held as under:

"6. We have considered the submissions of both the parties and perused the records of the case. We are in agreement with the reasoning given by Ld. CIT(A) for which he has given reasons in his order, enumerated above. Merely because the assessee had written back the provision in subsequent year cannot be a basis for disallowing the assessee's claim in the current year, particularly when assessee had given specific basis for making this warranty

provision. Assessee's claim is fortified by the decision relied upon by Ld. CIT(A). Accordingly, we see no reason to interfere with the order of Ld. CIT(A) on the issue in question. Accordingly, order of Ld. CIT(A) is upheld. "

After looking to the order of the ITAT for Assessment Year 2007-08, the ITAT have dismissed appeal of the Revenues by holding that merely because the assessee had returned back the provisions in subsequent year cannot be a basis for disallowing the assessee's claim in the current year, particularly when the assessee had given specific basis for making warranty provisions. The Hon'ble Apex Court in case of Rotork Controls India (P) Ltd. (supra) has given the criteria which are fulfilled by the assessee herein. Thus, issue is squarely covered in favour of the assessee and, therefore, Ground No. 1 and 1.1 of the assessee's appeal is allowed."

11. Thus, in view of the above facts and the judicial pronouncements, the claim of the assessee on account of provision of warranty is hereby allowed.

12. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on 27/06/2022.

Sd/-

(A.D. Jain)
Vice President

Dated: 27/06/2022

Shekhar

Copy forwarded to:

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

Sd/-

(B. R. R. Kumar)
Accountant Member

ASSISTANT REGISTRAR