

आयकर अपीलिय अधिकरण, 'ए' न्यायपीठ, चेन्नई
IN THE INCOME TAX APPELLATE TRIBUNAL
'A' BENCH, CHENNAI

श्री महावीर सिंह, उपाध्यक्ष एवं श्री मनोज कुमार अग्रवाल, लेखा सदस्य के समक्ष

**BEFORE SHRI MAHAVIR SINGH, VICE PRESIDENT AND
SHRI MANOJ KUMAR AGGARWAL, ACCOUNTANT MEMBER**

आयकर अपीलसं./ITA Nos.: **2632, 2633 & 2634/CHNY/2019**

निर्धारण वर्ष/Assessment Years: 2011-12, 2012-13 & 2013-14

MRF Limited,

MRF House, Thousand Lights,
Chennai – 600 006.

vs.

The DCIT,

Large Tax Payer Unit-2,
Chennai.

PAN: AAACM 4154G

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/Appellant by

: Shri R. Vijayaraghavan, Advocate

प्रत्यर्थी की ओर से/Respondent by

: Shri AR.V. Sreenivasan, Addl.CIT

सुनवाई की तारीख/Date of Hearing

: 04.08.2022

घोषणा की तारीख/Date of Pronouncement

: 24.08.2022

आदेश /O R D E R

PER MAHAVIR SINGH, VICE PRESIDENT:

These appeals by the assessee are arising out of the common order of Commissioner of Income Tax (Appeals)-12, Chennai in ITA Tr. Nos.192, 193 & 194/CIT(A)-9/2018-19 dated 31.07.2019. The assessments were framed by the DCIT, LTU-II, Chennai for the assessment years 2011-12, 2012-13 & 2013-14 u/s.143(3) r.w.s. 92CA(3) of the Income Tax Act, 1961 (hereinafter the 'Act') vide

orders of different dates 19.03.2014, 31.12.2014 & 29.12.2016 respectively.

2. The only issue in these three appeals of assessee is as regards to the order of CIT(A) confirming the action of AO in disallowing the provision for warranty amounting to Rs.5.66 Crores in AY 2011-12, Rs.4.65 Crores in AY 2012-13 and Rs.10.14 Crores in AY 2012-13. For this, assessee has raised identically worded grounds in all the three years except the quantum. Hence, we will take the facts and grounds from assessment year 2011-12 and decide the issue. The relevant grounds read as under:-

2. The Commissioner of Income tax (Appeals) erred in confirming the disallowance of provision for warranty amounting to Rs. 5.66 crore.

2.1 The Commissioner of Income tax (Appeals) erred in holding that the appellant had adopted a flat rate on the turnover of truck and non truck segment eventhough the assessee company is adopting the rate which changes from year to year based on previous year experience.

2.2 The Commissioner of Income tax (Appeals) ought to have appreciated that warranty is an estimate based on previous experience and that actual expenditure may not match the provision and any excess or shortage in the provision is made is adjusted in the subsequent year. Rotork Controls India P.Ltd Vs. CIT, 314 ITR 62(SC).

3. Briefly stated facts are that the assessee is engaged in the business of manufacturing of tyres. We noted that this matter travelled up to ITAT and ITAT in ITA Nos.641 to 645/Chny/2018 dated 09.05.2018 set aside the matter back to the file of the AO to follow the principle laid down by Hon'ble Supreme Court in the case of Rotork Controls India Pvt. Ltd., vs. CIT,314 ITR 62(SC). The AO while giving appeal effect to the order of ITAT passed order and confirmed the disallowance reiterating the original findings. Aggrieved assessee preferred appeal before CIT(A).

4. The CIT(A) after taking remand report from the AO and the AO in his remand report for all three years agitated the issues stating that the provisions made by the assessee is of unscientific basis and the same was again retained. It was also contended that for assessment year 2014-15 also, DRP upheld the issue for provision of warranty and even before AO nothing new was produced. The AO in his remand report dated 24.07.2019 observed as under:-

1. The issue of warranty provisions was dealt by the Hon'ble ITAT Order in ITA No.641 to 645/Chny/2018 dated 09.05.2018. As per Para 8.3 of the order, the Hon'ble ITAT has clearly given a finding that the provision was not made on scientific basis and no consistent method was followed by the assessee in creating warranty provisions. The Hon'ble ITAT set aside the matters to the file of the A.O. and asked for examining whether ratio of Rotork Controls India Pvt Ltd is applicable and if not then only the actual

amount incurred will be allowed. Pursuant to this, the A.O. examined and found that the provisions were made on an unscientific basis and the same was again retained. The relevant orders for the same are enclosed.

2. It is also brought to your kind notice that the Hon'ble DRP for the A.Y. 2014-15 has also upheld the issue of provisions for warranty in form of expenses. The relevant order is enclosed.

3. In view of the above the AO/DRP has already examined the applicability of M/s Rotork Controls India Pvt Ltd in this case and found that the assessee has not made provision in a scientific manner. Since the issue is already examined, no opportunity is provided to the assessee and this office is not in receipt of any new evidences in this case.

The CIT(A) adjudicated the issue and confirmed the disallowance by observing in para 6.7 (iv) (c) & (d) & (v) as under:-

6.7

(iv).....

(c) In the case under consideration, the appellant is manufacturing only tyre which is a single item and not an army of items running into thousands of units of sophisticated goods. Therefore, the provision for warranty in the case under consideration can constitute a contingent liability not entitled to deduction u/s 37 as per the decision of the Hon'ble Supreme Court.

(d) The appellant could not establish satisfactorily that all the conditions prescribed by the Hon'ble Supreme Court are satisfied.

(v) In view of the above and also for the reasons stated by the AO in the appeal effect order as well as findings of the Hon'ble DRP for the AY 2014-15, it is concluded that the facts and circumstances of the case under

consideration are different and distinguishable from the facts and circumstances of the case of Rotork Controls India Pvt. Ltd., vs. CIT, 180 Taxman 422(SC)

Aggrieved assessee came in appeal before us.

5. Now before us, the Id.counsel for the assessee filed completed details of provision for warranty working for three assessment years as under:-

Provision for warranty workings for the Assessment Year 2011-12

Amount in INR Crores

Particulars	Reference	Truck		Non truck		Total
		April 2010 to September 2010	October 2010 to March 2011	April 2010 to September 2010	October 2010 to March 2011	
Sales for the relevant preceding 12 month period	A		2724.83		2891.6	
Actual warranty claims for the above period	B		29.4		13.06	
% of actual warranty expenditure	C=B/A		0.0108		0.0045	
<u>Current year (AY 2011-12)</u>						
Sales for the year ended 31.3.2011	D	1435.67	1669.99	1550.87	1742.48	
Average % of outstanding warranty	E	14.36%	71.00%	29.61%	78.07%	
Provision for outstanding warranty as on March 2011	F=D*E*C	0.00	12.79	0.00	6.14	18.94
Add: Additional claims	G					8.68
Less: Disputed claims	H					-0.42
Total provision for the year ended 31.3.2011	I=F+G-H					27.2
Opening provision as on 1.4.2010	J					27.07
Net amount debited to P&L as warranty expenses	K=I-J					0.13
Actual warranty expenses debited to P&L						45.04

Provision for warranty workings for the Assessment Year 2012-13

Particulars	Reference	Amount in INR Crores				Total
		Truck		Non truck		
		April 2011 to September 2011	October 2011 to March 2012	April 2011 to September 2011	October 2011 to March 2012	
Sales for the relevant preceding 12 month period	A	2724.83	3530.9	2891.6	3798.4	
Actual warranty claims for the above period	B	29.4	31.41	13.06	17.62	
% of actual warranty expenditure	C=B/A	0.0108	0.0089	0.0045	0.0046	
Current year (AY 2012-13)						
Sales for the year ended 31.3.2012	D	1865.26	2163.14	2052.16	2185.15	
Average % of outstanding warranty	E	14.60%	72.21%	22.44%	79.12%	
Provision for outstanding warranty as on March 2012	F=D*E*C	2.84	14.05	2.08	8.05	27.02
Add: Additional claims	G					10.94
Less: Disputed claims	H					-0.60
Total provision for the year ended 31.3.2012	I=F+G-H					37.36
Opening provision as on 1.4.2011	J					32.72
Net amount debited to P&L as warranty expenses	K=I-J					4.64
Actual warranty expenses debited to P&L						90.67

Provision for warranty workings for the Assessment Year 2013-14

Particulars	Reference	Amount in INR Crores				Total
		Truck		Non truck		
		April 2011 to September 2011	October 2011 to March 2012	April 2011 to September 2011	October 2011 to March 2012	
Sales for the relevant preceding 12 month period	A	3530.9	4397.65	3798.4	4544.23	
Actual warranty claims for the above period	B	31.41	48.25	17.62	22.98	
% of actual warranty expenditure	C=B/A	0.0089	0.0110	0.0046	0.0051	
Current year (AY 2013-14)						
Sales for the year ended 31.3.2012	D	2231.96	2370.18	2361.78	2416.47	
Average % of outstanding warranty	E	15.08%	72.61%	24.09%	80.95%	
Provision for outstanding warranty as on March 2013	F=D*E*C	2.98	18.89	2.62	9.85	34.35
Add: Additional claims	G					13.80
Less: Disputed claims	H					-0.65
Total provision for the year ended 31.3.2013	I=F+G-H					47.50
Opening provision as on 1.4.2012	J					37.36
Net amount debited to P&L as warranty expenses	K=I-J					10.14
Actual warranty expenses debited to P&L						115.97

5.1 The Id.counsel for the assessee stated that assessee has given scientific basis of this warranty in respect of tyres sold to truck segment and non-truck segment as is clearly reflecting from the above charts. When a query was put to Id.counsel for the assessee that what happened in assessment year 2010-11, the Id.counsel for the assessee filed copy of Tribunal's order in ITA No.740/Mds/2014, dated 15.05.2015 wherein Tribunal has remitted back the matter to the file of the AO to re-decide the issue on the basis of directions. The Id.counsel stated that this issue is pending with the AO because he has to verify the details in term of the decision of the Hon'ble Supreme Court in the case of Rotork Controls India Pvt. Ltd., *supra*, wherein the Hon'ble Supreme Court has observed as under:-

“17. At this stage, we once again reiterate that a liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow of resources and in respect of which a reliable estimate is possible of the amount of obligation. As stated above, the case of Indian Molasses Co. (*supra*) is different from the present case. As stated above, in the present case we are concerned with an army of items of sophisticated (specialised) goods manufactured and sold by the assessee whereas the case of Indian Molasses Co. (*supra*) was restricted to an individual retiree. On the other hand, the case of Metal Box Company of India (*supra*) pertained to an army of employees who were due to retire in future. In that case the company had estimated its liability under two gratuity schemes and the amount of liability was deducted from the gross receipts in the profit and loss account. The company had worked out its estimated liability on actuarial valuation. It had made provision for such liability spread over to a number of years. In such a case it was held by this Court that the provision made by the assessee-company for meeting the liability incurred by it under the gratuity scheme would be entitled to deduction out of the gross receipts for the accounting year during which the provision is made for the liability. The same principle

is laid down in the judgment of this Court in the case of Bharat Earth Movers (supra). In that case the assessee company had formulated leave encashment scheme. It was held, following the judgment in Metal Box Company of India (supra), that the provision made by the assessee for meeting the liability incurred under leave encashment scheme proportionate with the entitlement earned by the employees, was entitled to deduction out of gross receipts for the accounting year during which the provision is made for that liability. The principle which emerges from these decisions is that if the historical trend indicates that large number of sophisticated goods were being manufactured in the past and in the past if the facts established show that defects existed in some of the items manufactured and sold then the provision made for warranty in respect of the army of such sophisticated goods would be entitled to deduction from the gross receipts under Section 37 of the 1961 Act. It would all depend on the data systematically maintained by the assessee. It may be noted that in all the impugned judgments before us the assessee(s) has succeeded except in the case of Civil Appeal Nos. of 2009 - Arising out of S.L.P.(C) Nos.14178-14182 of 2007 - M/s. Rotork Controls India (P) Ltd. v. Commissioner of Income Tax, Chennai, in which the Madras High Court has overruled the decision of the Tribunal allowing deduction under Section 37 of the 1961 Act. However, the High Court has failed to notice the "reversal" which constituted part of the data systematically maintained by the assessee over last decade."

The Id.counsel stated that once the provision for warranty is calculated on scientific basis, warranty should have been allowed as expenses u/s.37(1) of the Act as revenue expenditure.

6. On the other hand, the Id. Senior DR relied on the orders of the lower authorities.

7. We have heard rival contentions and gone through facts and circumstances of the case. We noted from the order of CIT(A) that neither the AO nor CIT(A) has examined the details filed before

them during the set aside assessment proceedings or even remand proceedings by the AO and simply noted that the assessee could not establish that all the conditions prescribed in the decision of Hon'ble Supreme Court in the case of Rotork Controls India Pvt. Ltd., *supra* are satisfied. We noted that the authorities below have neither examined the issue nor gone into the details and just simpliciter confirmed the disallowance. Moreover, we noted from the Tribunal order for assessment year 2010-11 in ITA No. 740/Mds/2014 dated 15.05.2015, wherein the Tribunal has given categorical finding while setting aside the matter to the file of the AO by observing in para 7 as under:-

7. We have heard both the sides and perused the materials on record. According to the Id.AR, the assessee has adopted the financial year 2008-09 as base year. The retail sale and actual warranty paid for 9 months was taken to arrive at the percentage of warranty to sales. This warranty percentage was further split into truck and non-truck segment. Such percentage of warranty to sales was adopted for the year under consideration and the warranty requirement was debited in the profit and loss accounts of the assessee. Further, when the provision created is more than the claim, it is reversed in the next year and this provision was consistently followed by the assessee. In the light of the circumstances, a legal obligation to make payment in future said to have been accrued. According to the AR, it is not required to wait for the contingency to offer and it can be inferred that a better liability has definitely arisen in the assessment year under consideration though the quantification is discharged on this warranty liability at a future date. The assumption of the assessee's liability is in praesenti. Though the liability discharged at a future date, it is not a contingent one. The contention of the Id. DR is that the assessee has not provided details of actual working of warranty before the Assessing Officer. According to him, expenditure which is deductible under income-tax is one which is towards a liability actually existing at the time, but putting aside of money which may become expenditure on happening of an event which

IS not expenditure. The former is deductible but not the later. However, the Supreme Court in the case of *Bharat Earth Movers V. CIT (245 ITR 428)* held that if a business liability has definitely arisen in a financial year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though actual quantification with accuracy may not be possible, if these requirements are satisfied, the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain. In the present case, the assessee has not produced any basis on which the provision of warranty was determined before the Assessing Officer. However, it has produced actual working of warranty before the Commissioner of Income-tax(Appeals). Therefore, it is not clear that what extent the liability actually required in the assessment year under consideration while framing the assessment by the Assessing Officer. The provision made whether on actual quantification or not, was not verified by the Assessing Officer. The Commissioner of Income-tax(Appeals) after getting the assessee's actual working of warranty not get verified from the AO and he has decided himself that it is correct. Therefore, in our opinion it is appropriate to remit the issue to the file off the Assessing Officer to examine the actual quantification of the provisions made towards warranty and decide in the light of the judgment of Supreme Court in the case of *Rotork Controls India Pvt. Ltd. (supra)*.

7.1 We noted that the issue of warranty can be allowed on satisfying the following conditions as held by Hon'ble Supreme Court in the case of *Rotork Controls India Pvt. Ltd. (supra)*:-

- a. That there an enterprise has a present obligation as result of past event.
- b. It is probable that an out flow of resources will be required to settle the obligation and
- c. A reliable estimate can be made on the amount of obligations

From the above, we noted that even now, the assessee could not produce before the AO or the CIT(A) as to how the provision is made based on historical trend and a realiable estimate as held by Hon'ble Supreme Court. Now the assessee has filed the details before us

but we have no mechanism to verify the same and accordingly, the matter needs to go back to the file of the AO. The details are recorded in para 5 above.

7.2 One more fact that assessment for assessment year 2010-11 is pending before AO and the AO can examine the issue in assessment year 2010-11 according to above observation of ours and the directions of the Tribunal in AY 2010-11. Hence, we set aside these three appeals to the file of the AO for fresh adjudication in term of the above directions.

8. In the result, the appeals filed by the assessee in ITA Nos.2632, 2633 & 2634/Chny/2019 are allowed for statistical purposes.

Order pronounced in the open court on 24th August, 2022 at Chennai.

Sd/-

(मनोज कुमार अग्रवाल)

(MANOJ KUMAR AGGARWAL)

लेखा सदस्य/ACCOUNTANT MEMBER

Sd/-

(महावीर सिंह)

(MAHAVIR SINGH)

उपाध्यक्ष /VICE PRESIDENT

चेन्नई/Chennai,

दिनांक/Dated, the 24th August, 2022

RSR

आदेशकीप्रतिलिपिअग्रेषित/Copy to:

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|------------------------|--------------------------|------------------------------|
| 1. अपीलार्थी/Appellant | 2. प्रत्यर्थी/Respondent | 3. आयकर आयुक्त (अपील)/CIT(A) |
| 4. आयकर आयुक्त /CIT | 5. विभागीय प्रतिनिधि/DR | 6. गार्ड फाईल/GF. |