

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "B": NEW DELHI**

**BEFORE SHRI KUL BHARAT, JUDICIAL MEMBER
AND
SHRI M. BALAGANESH, ACCOUNTANT MEMBER**

**ITA No. 7607/DEL/2019
Assessment Year: 2016-17**

Grey Orange India Pvt. Ltd., AWFIS, Plot no. 5 & 6, Shopping Complex, Nelson Mandela Marg, B-7, Vasant Kunj, New Delhi- 110070 PAN- AAFCG 6416 L	<u>Vs</u>	ACIT, Circle-10(2), New Delhi.
APPELLANT		RESPONDENT
Assessee represented by	Shri Vishal Kalra, Adv. ; Ms. Sumisha Murgai, CA; & Shri Kasshish Gupta, CA	
Department represented by	Shri Vivek Kumar Upadhyay, Sr. DR	
Date of hearing	03.04.2024	
Date of pronouncement	10.06.2024	

ORDER

PER KUL BHARAT, JM:

This appeal, by the assessee, is directed against the order of the learned Commissioner of Income-tax (Appeals)-4, New Delhi, dated 25.07.2019, pertaining to the assessment year 2016-17. The assessee has raised following grounds of appeal:

“1. That on facts and in circumstances of the case and in law, the Assessing Officer ('AO') erred in completing the assessment of the Appellant at a loss of INR 9,38,50,740, as against returned loss of INR 10,49,61,711.

*2. That on facts and in circumstances of the case and in law, the Ld. Commissioner of Income Tax (Appeals) [^ prime CIT * (A)'] erred in upholding the disallowance made by the AO in respect of provision for warranty expenses amounting to INR 23,51,396 without appreciating that the same was calculated on the basis of a reliable estimate.*

2.1 That on facts and in circumstances of the case and law, the Ld. CIT(A) erred in disregarding the details provided by the appellant substantiating that the provision recognized in the relevant AY, was actually utilized in the unexpired period which is evident of the fact that the same was calculated on a reasonable and reliable basis.

2.2 That on facts and in circumstances of the case and in law, the Ld. CIT(A) erred in not appreciating the fact that the warranty clause is an integral part of the sales agreement and or purchase order which imposed an obligation in the relevant AY (i.e. when the sale is concluded) and that the appellant is obliged to discharge the claims during the unexpired warranty period.

3. Without prejudice to the above, where the provision for unexpired period is not allowed in the relevant AY, the actual expenditure incurred on warranty claim, in the succeeding assessment year, should be allowed.

4. That on facts and in circumstances of the case and in law, the AO erred in initiating penalty proceedings under section 271(1)(c) Income-tax Act 1961.”

2. Ground no. 1 being general in nature, needs no adjudication . Ground no. 4, against initiation of penalty proceedings u/s 271(1)(c) of the Income-tax, 1961 (the “Act”), being premature, requires no adjudication at this stage.

3. The only effective ground that remains for adjudication is against sustaining the addition of Rs. 23,51,396/-, made in respect of disallowance of provision for warranty expenses,

4. Facts giving rise to the present appeal are that in this case the assessee company filed its return of income, through electronic mode, on 17.07,2017, declaring loss of Rs. 10,49,61,711/-. The case was selected for scrutiny assessment. In response to statutory notices issued by the Assessing Authority u/s 143(2) of the Act, the learned authorized representative of the assessee attended the proceedings. The AO after considering the submissions made addition amounting to Rs. 23,51,396/- by disallowing provision for warranty expenses and a sum of Rs. 87,59,575/- in respect of disallowance of lease equalization reserve amounting to Rs. 70,59,309; provision made for contractual labour amounting to Rs.14,85,384/-; and provision for security services expenses amounting to Rs. 2,14,882/-. Thus, the AO assessed total loss at Rs. 9,38,50,740/- as against the declared loss of Rs. 10,49,61,711/-. Aggrieved by this the assessee carried the matter in appeal before the learned CIT(Appels), who sustained the addition made on account of disallowance of expenses claimed for provision made for warranty expenses and rest of the additions were deleted. Now the assessee is in appeal before this Tribunal assailing the correctness of the order of learned CIT(A) whereby he sustained the disallowance of provision for warranty expenses amounting to Rs. 23,51,396/-.

5. Learned counsel for the assessee apropos to the grounds of appeal vehemently argued that the learned CIT(A) was not justified in sustaining the addition. He submitted that the learned CIT(A) erred in upholding the disallowance without appreciating that same was calculated on the basis of reliable estimate. He further submitted that the learned CIT(A) failed to appreciate the fact that provision recognized in the relevant assessment year was actually utilized in the unexpired period, which goes to demonstrate that the same was calculated on reasonable and reliable basis. He further submitted that the warranty clause is an

integral part of the sales agreement and/or purchase order which imposes an obligation in the relevant assessment year which the sale is effected and the assessee was under obligation to discharge the claim during the unexpired warranty period. He contended, without prejudice, that where the provision for unexpired period is not allowed in the relevant assessment year, the actual expenditure incurred on warranty claim in the succeeding assessment year should be allowed.

5.1 Learned counsel submitted that the authorities below have sustained the addition on the basis that provision is created for the unexpired period of warranty which does not fall within the subject financial year and pertains to immediate next financial year. Expenses of next financial year cannot be considered as expenses of current financial year. The formula applied by the assessee cannot be considered to be on scientific basis for computing the provision for warranty charges. The assessee is in second year operation and as per sample period for which analysis could be done is not available. The judgment of the Hon'ble Supreme Court rendered in the case of Rotork Controls India (P) Ltd. v. CIT (2009) 314 ITR 62 is not applicable.

5.2 Learned counsel further submitted that the warranty expenses, made on the same basis, have been allowed in the subsequent years.

5.3 Learned counsel submitted that the assessee is engaged in the business of sales, trading, marketing, production and assembly of products and parts for warehousing automation where the products are highly sophisticated and it is incumbent upon the assessee to provide warranty cover on such products for a certain period of time, ordinarily one year. He contended that the assessee would be under obligation to repair or replace the products if it is found defective during the warranty period. This obligation generates a liability at the time when the

product is sold. The liability would start when the risk and rewards in the products are transferred to the buyer as per the terms and conditions agreed upon. He submitted that assessee has to provide for such warranty costs in its accounts for the relevant year, otherwise the matching concept would be violated. He contended that as per the mercantile system of accounting, the profit is to be arrived at after taking into account all the accrued receipts and expenses.

6. On the other hand learned DR opposed the submissions and supported the orders of the authorities below.

7. We have heard rival contentions and perused the material available on record. The learned CIT(A) sustained the addition related to expenses on warranty provision by observing as under:

“5.2 By way of facts during the year under consideration, which is the second year of the operation of the company, the company has debited an amount of Rs.68,64,400/- in the profit and loss account towards the warranty expenses. This amount included an amount of Rs. 45,13,004/- actually incurred on account of warranty and the balance amount of Rs. 23,51,396/- is provision created for the unexpired period of warranty.

5.3 The AO disallowed the provision amounting to Rs. 23,51,396/- created for unexpired period of warranty. Before AO as well as before me, the appellant contended that the provision created for unexpired period of warranty is an allowable expense in terms of the decision of the Hon'ble Supreme Court in the case of Rotork Controls India (P) Ltd. v. CIT (2009) 314 ITR 62.

5.4 I have considered the submission of the assessee and the finding of the AO. The appellant has laid down a formula and on the basis of that formula, the assessee has computed the amount of provision. According to the appellant, the formula which is used for computation of provision for warranty expenses is on scientific basis and falls within the guidelines laid down by the Hon'ble Supreme Court in the case of Rotork Controls India (P) Ltd. v. CIT (2009) 314 ITR 62.

5.5 I have considered the methodology adopted by the appellant and find the same to be devoid of merits. A provision of warranty would be an allowable expense if the same is a present obligation at the first place though the outflow may happen at a later date. Furthermore, there should be reliable method of computation of the provision of warranty expenses.

5.6 After considering the formula and methodology used by the appellant, it is apparent that the appellant itself is suggesting that the provision which is created is for unexpired period of warranty which does not fall within the financial year and falls outside the purview of the financial year in consideration. The appellant itself conceded to the fact that the provision which is computed pertains to that unexpired period of warranty which falls beyond the period of the captioned financial year and thus relates to immediate next financial year.

5.7 Thus, the expense which pertains to the next financial year, cannot be considered to be an expense of this financial year, even if a provision is created. Provision could have been an allowable expense only if such provision pertains to the captioned financial year, though the outflow may happen in next year. As per the explanation and methodology adopted by the appellant, the provision created for warranty expense pertains to that period of warranty which falls outside the ambit of the year under consideration.

5.8 Thus, the formulae used by the assessee itself is devoid of merits and cannot be considered to be a scientific basis of computing the provision for warranty charges.

5.9 Furthermore, it is also important to note that the company is in its second year of operation and in such a scenario, having a scientific basis to study and compute the warranty charges would not be reliable as the sample period for which analysis could be done is not available. The approach adopted by the appellant is not based on principles of consistency and certainty. Ideally, the claim of provision should be based on comparability with the other similar businesses in the industry. Claiming entire possible warranty expenses simply on pro rata basis without taking into account probability analysis cannot be termed as scientific. Thus, the submission of the assessee, that the methodology adopted is scientific and reliable does not have any legs to stand in view of the circumstances and facts of the case. Thus, decision of the Hon'ble Supreme Court in the case of Rotork Controls India (P) Ltd. v. CIT (2009) 314 ITR 62, is not strictly applicable in this case and therefore the addition made by the AO is to be sustained.

5.10 Thus, in view of the above, the addition made by the AO is upheld. The ground of appeal of the assessee is dismissed.”

7.1 There is no dispute in regard to the fact that under identical facts the Revenue has allowed provision for warranty expenses for subsequent years. In the present assessment year the objection of the Revenue is with regard to adoption of formula and since this is the second year of operation there was no data available with the assessee to arrive at the provision based upon scientific study of past data. The law is well settled that the provision for warranty expenses would be allowable in the event of assessee proves that same has been computed on the basis of past experience and on scientific basis. In the present case, no past history is available, but the claim is based purely on estimation basis. The assessee has applied a formula and claimed this formula has been applied in subsequent years as well. The claim of the assessee based upon such formula has been allowed in subsequent years. Further, alternate prayer of the assessee is that the expenses may be allowed in the year of payment without prejudice to the other contentions. It is not the case of Assessing Authority that the expenses, even if actually incurred, would not be allowable. It is also admitted fact that the assessee is maintaining its books of account on accrual basis. The assessee has claimed that the payments of expenses were actually made in subsequent year. As per the assessee, this fact goes to prove that provision so made is justified and ought to have been allowed, at first instance, in the year under appeal. Otherwise same may be allowed in the year when such expenses are incurred. So far question of allowablility of the expenses in the year of payment, same cannot be allowed in view of the fact that the accounts are maintained on the basis of mercantile system of accounting. The nature of expenses being business cannot be lost sight. The factum of actual incurrence of expenses goes to prove that the provision so computed on the basis of formula devised and applied by the assessee is correct. The Hon’ble Supreme Court in the

case of Rotork Controls India (P) Ltd. (supra), has held that if the facts establish/show that the 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 under section 37 of the Act. In the present case, the assessee has demonstrated that defects were occurred and rectified during the warranty period. Thus, in our considered view, the learned CIT(A) erred in holding that the ratio of decision of Hon'ble Supreme Court in the case of Rotork Controls India (P) Ltd. (supra), is not applicable. We, therefore, direct the AO to allow claim of the assessee after verifying the claim of the assessee that it actually incurred the impugned expenses during the unexpired warranty period. Ground is allowed for statistical purposes.

8. Assessee's appeal is allowed for statistical purposes.

Order pronounced in open court on 10th June. 2024.

Sd/-
(M. BALAGANESH)
ACCOUNTANT MEMBER

Sd/-
(KUL BHARAT)
JUDICIAL MEMBER

MP

Copy forwarded to:

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

ASSISTANT REGISTRAR
ITAT, NEW DELHI