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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: September 23, 2015
Date of decision: October 06, 2015

ITA 898/2009

SEAGRAM DISTILLERIES PVT. LTD
(NOW PERNOD RICARD INDIA PVT.LTD.) ..... Appellant
Through: Mr. Deepak Chopra, Mr Aditya Gupta, and Ms Neha Singh, Advocates.

versus

COMMISSIONER OF INCOME TAX- III, NEW DELHI ..... Respondent
Through: Mr. Kamal Sawhney, Senior Standing counsel with Mr. Raghavendra Singh, Junior Standing counsel and Mr Shikhar Garg, Advocate.

WITH

ITA 899/2009

SEAGRAM DISTILLERIES PVT. LTD
(NOW PERNOD RICARD INDIA PVT.LTD.) ..... Appellant
Through: Mr. Deepak Chopra, Mr Aditya Gupta, and Ms Neha Singh, Advocates.

versus

COMMISSIONER OF INCOME TAX- III, NEW DELHI ..... Respondent
Through: Mr. Kamal Sawhney, Senior Standing counsel with Mr. Raghavendra Singh, Junior Standing counsel and Mr Shikhar Garg, Advocate.

WITH

ITA 900/2009

SEAGRAM DISTILLERIES PVT. LTD.
(NOW PERNOD RICARD INDIA PVT.LTD.) ..... Appellant
Through: Mr. Deepak Chopra, Mr Aditya Gupta, and Ms Neha Singh, Advocates.

versus

COMMISSIONER OF INCOME TAX- III, NEW DELHI ..... Respondent
Through: Mr. Kamal Sawhney, Senior Standing counsel with Mr. Raghavendra Singh, Junior Standing counsel and Mr Shikhar Garg, Advocate.

WITH

\+ **ITA 901/2009**

SEAGRAM DISTILLERIES PVT. LTD.
(NOW PERNOD RICARD INDIA PVT.LTD.) ..... Appellant
Through: Mr. Deepak Chopra, Mr Aditya Gupta, and Ms Neha Singh, Advocates.

versus

COMMISSIONER OF INCOME TAX III NEW DELHI ..... Respondent
Through: Mr. Kamal Sawhney, Senior Standing counsel with Mr. Raghavendra Singh, Junior Standing counsel and Mr Shikhar Garg, Advocate.

AND

\+ **ITA 237/2015**

SEAGRAM MANUFACTURING PVT.LTD.
(NOW PERNOD RICARD INDIA PVT.LTD.) ..... Appellant

Through: Mr. Deepak Chopra, Mr Aditya Gupta, and Ms Neha Singh, Advocates.

versus

PRINCIPAL COMMISSIONER OF INCOME TAX,
CENTRAL CIRCLE- III, NEW DELHI. ..... Respondent
Through: Mr N. P. Sahni, Senior Standing Counsel with Mr Nitin Gulati, Junior Standing Counsel.

CORAM:
DR. JUSTICE S. MURALIDHAR
MR. JUSTICE VIBHU BAKHRU

J U D G M E N T

% **06.10.2015**

Dr. S. Muralidhar, J

1. These five appeals under Section 260A of the Income Tax Act, 1961 ('Act') by the two assesses, Pernod Ricard India Private Limited (earlier, Seagram Distilleries Private Limited) and Seagram Manufacturing Private Limited, raise a common question of law as to whether provision for transit breakages has a scientific basis or is contingent in nature and as such is not an allowable deduction while computing the total income of the Assessees. The Assessment Years (AYs') involved in the present appeals are AYs 2001-02 to 2004-05.

2. The first Assessee, Seagram Distilleries Private Limited was a 100% subsidiary of Seagram India Private Limited engaged in the business of manufacture and sale of Grain Neutral Spirit (GNS) and India Made Foreign Liquor (IMFL) from its Nasik plant. The parent company, originally incorporated under the Companies Act, 1956 on 3rd September, 1993 under

the name and style of Seagram India Private Limited, changed its name to Pernod Ricard India Private Limited (PRIPL) and obtained a fresh certificate of incorporation on 23rd April, 2007. Thereafter, Seagram Distilleries Private Limited was merged into the parent company, PRIPL by a scheme of amalgamation which received sanction from this Court vide an order dated 8th October 2010. The second Assessee, Seagram Manufacturing Limited (SML) is a 100% subsidiary of Seagram India Private Limited, now PRIPL, and is engaged in the business of blending, bottling, and trading of IMFL. The memo of parties in the appeal by the second Assessee, being ITA No. 237, shows the second Assessee as also 'now Pernod Ricard India Private Limited.' Both the Assessees' products are transported in glass bottles by roads to various states in the country. According to the Assessees, since the bottles are prone to breakages, the Assessees while dispatching the goods make a provision for breakages on the basis of the past history of the region to which the goods are transported. Once the goods reach their intended destination the Assessees reverse the provision and debits the actual breakages to the profit and loss account ('P&L Account'). At the close of the accounting year i.e. March 31st the Assessees make a similar provision for all goods under dispatch and debit the same to the P&L Account. However such provision is reversed on the first day of the following financial year and only actual breakages are debited to the P&L Account in the succeeding year as and when the goods under dispatch reach the destination.

3. The Assessing Officer ('AO'), in the case of the first Assessee, by the order dated 26th March 2004 for AY 2001-02, held that in cases of breakage

and pilferage, the liability is not certain. Consequently, the provision made was treated as a contingent liability and, therefore, not allowable. It was added back to the total income of the first Assessee. The Commissioner of Income Tax (Appeals) ['CIT (A)'] by an order dated 31st March 2006 allowed the Assessee's appeal. The CIT (A) held that the provision had been made on a scientific basis and that the method of accounting for transit breakages had been followed by the first Assessee year after year. The CIT (A) held that the decision of the Supreme Court in ***Bharat Earth Movers v.CIT 245 ITR 428 (SC)*** supports the case of the first Assessee.

4. The Revenue then appealed to the ITAT by filing ITA No. 2532/Del/2006 for AY 2001-02. By the time the said appeal was taken up for hearing, the appeals for the other AYs i.e. 2002-03, 2003-04 and 2004-05, being ITA Nos. 113, 114 and 3170/Del/2007, were also filed by the Revenue. By the common order dated 16th March 2009, the ITAT allowed the appeals of the Revenue on the above aspect of provision for breakages for AYs 2001-02, 2002-03, 2003-04 and 2004-05. It was held that the provision made was without "any basis much less scientific one". It was noted that this was evident by the fact that the first Assessee itself had reversed the provision on the first day of the following year. Analysing the chart submitted by the first Assessee on the provision made on the actual breakages for each of the AYs, the ITAT noted that in each year the provision made was excessive. The first Assessee did not have enough experience of its own to enable it to make provision of expenditure on scientific basis. It appeared to have been made on ad hoc basis depending on the places of destination. By a subsequent order dated 28th November 2014, the ITAT followed its earlier

aforementioned decision and dismissed the second Assessee's cross appeal on the same issue for AY 2001-02. Against the said dismissal the second Assessee has filed ITA No. 237 of 2015. Thus, the five appeals before this Court are as under:

Appeal before the High Court	**Appeal before the ITAT**	**Assessment Year**	**ITAT Order**
ITA 237/2015 (Second Assessee's appeal)	ITA No. 4535/Del/2004 (Assessee's Appeal)	2001-02	28th November, 2014
ITA No. 898/2009 (First Assessee's appeal)	ITA No. 2802/Del/2007 (Assessee's appeal)	2004-05	16th March, 2009
ITA No. 899/2009 (First Assessee's appeal)	ITA No 146/Del/2007 (Assessee's appeal)	2002-03	16th March, 2009
ITA No. 900/2009 (First Assessee's appeal)	ITA No. 147/Del/2007 (Assessee's appeal)	2003-04	16th March, 2009
ITA No. 901/2009 (First Assessee's appeal)	ITA No. 2532/Del/2006 (Revenue's appeal)	2001-02	16th March, 2009

5. It must be noticed that the first Assessee's appeal, being ITA No. 1369 of 2009, against the order of the ITAT dated 14th September, 2009 in ITA No. 3195 of 2009 for the AY 2005-06 raising the same question of law is pending.

6. This Court has heard the submissions of Mr. Deepak Chopra, learned counsel appearing for the Assessees, Mr. N.P. Sahni, Senior Standing counsel and Mr. Raghvendra Singh, Junior Standing counsel for the Revenue.

7. Mr. Chopra relied on the decisions in ***Bharat Earth Movers (supra), Commissioner of Income Tax v. Vinitec Corporation P. Ltd. 278 ITR 337 (Del), Commissioner of Income Tax v. Insilco Ltd. 179 Taxman 55 (Del), Commissioner of Income Tax v. Sony India Pvt. Ltd. [2007] 160 Taxman 397 (Del), Commissioner of Income Tax v. Beema Manufactures Pvt. Ltd. [2003] 130 Taxman 162 (Del) and Commissioner of Income Tax v. Hewlett Packard (P) Ltd. [2008] 173 Taxman 162 (Del)*** to urge that the provision for transit breakages, having been calculated on a scientific basis, was an allowable deduction under Section 37(1) of the Act. Relying on the decision in ***Commissioner of Income Tax v. Balaji Distilleries Ltd. 126 Taxman 264 (Madras)*** and ***Commissioner of Income Tax v. Brindavan Beverages (P) Ltd. 335 ITR 163 (Karn)***, Mr. Chopra submitted that transit breakages were normal to the bottling business and, therefore, allowable as a revenue expenditure. By the same analogy, the provision for said breakages should also be allowed particularly since the provision was reversed on the opening day of the following year. Thereby, there was no loss to the Revenue. He placed reliance on the decision of the ***Commissioner of Income Tax v. Excel Industries Ltd. 358 ITR 295 (SC)***.

8. Mr. Chopra referred to the ledger accounts of transit breakages and transit stocks pertaining to the AYs in question. He pointed out that it was not as if

the estimate of breakages made by the Assessees was totally off the mark as was sought to be projected by the Revenue. Referring to the Accounting Standards 29 (AS 29) issued by the Institute of Chartered Accountants of India (ICAI), he submitted that it was incumbent on the Assessees to make a provision for known liabilities failing which the balance sheet would not reflect the true and fair picture of the accounts. He also referred to the Notification No. SO 69(E) dated 25th January 1996, issued by the Central Board of Direct Taxes ('CBDT') which required that "provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information." The CBDT had highlighted the need for the Assessees to adopt such accounting policies "so as to represent a true and fair view of the state of affairs of the business, profession or vocation in the financial statements prepared and presented on the basis of such accounting policies." It is accordingly submitted that the ITAT erred in holding the provision for the known liabilities for transit breakages made by the Assessees to be a contingent liability and, therefore, not allowable as a revenue expenditure. Reliance was also placed on the decision of the Supreme Court in ***Rotork Controls India P. Ltd. v. Commissioner of Income Tax [2009] 314 ITR 62 (SC)***.

9. Countering the above submissions, Mr. N.P. Sahni, learned Senior Standing counsel and Mr. Raghvendra Singh, learned Junior Standing counsel appearing for the Revenue pointed out that the very nature of the line of business of the Assessees was such that the breakages would be known within 15 to 30 days of the dispatch or at the latest on the delivery of

the goods. The matching of the breakages by debiting it to the P&L Account would occur soon thereafter within that financial/accounting year itself. Therefore, there was no occasion for making any provision for the contingent liability of transit breakages likely to take place during the ensuing financial year. Counsel for the Revenue pointed out that the estimates of transit breakages made by the Assessees for the AYs in question were off the mark and in fact in excess of the actual breakages, which in any event were allowed as revenue expenditure in the year in which such breakages occurred. They submitted that the ITAT's impugned orders do not call for any interference.

10. The Court proposes to begin examining the above contentions by first referring to the applicable AS. The cue for this is to be found in the CBDT Notification No. SO 69(E) dated 25th January 1996 issued under Section 145(2) of the Act, which states that provisions should be made for "all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information." AS-29 deals with "Provisions, Contingent Liabilities and Contingent Assets'. The purpose of the AS is to ensure that the balance sheet and P&L Account of an enterprise should present a true and fair view of its business affairs. Under AS 29 a 'provision' is defined to mean "a liability which could be measured only by using a substantial degree of estimation." The word 'liability' is defined as "a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits." 'Contingent Liability' is defined as under:

"(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation;

or

(ii) a reliable estimate of the amount of the obligation cannot be made."

11. AS 29 further states that 'provisions' are distinguishable from other liabilities such as trade payables and accruals "because in the measurement of provisions substantial degree of estimation is involved with regard to the future expenditure required in settlement." However a 'provision' is recognised only where:

"(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 recognised."

12. Appendix A to AS-29 sets out in a tabular the summary of the AS. The provisions which are recognised and those that are not are set out in separate columns. What is not recognised is a provision for a liability which arises from 'a possible obligation' that may, but probably will not, require an outflow of resources.

13. It is not in dispute that as and when transit breakages do occur the resultant losses are allowable as revenue expenditure, given the nature of the business of the Assessees. The decision in ***Commissioner of Income Tax v. Balaji Distilleries Ltd.*** (*supra*) and ***Commissioner of Income Tax v. Brindavan Beverages (P) Ltd.*** (*supra*) recognised this. In fact, for AYs 2002-03 to 2004-05 the AO has allowed transit breakages as revenue expenditure in the year in which the breakages occurred.

14. The issue, however, is the justification for creating a provision for such breakages anticipating them in advance of the occurrence of the actual breakages. If such transit breakages cannot be estimated with a reasonable degree of certainty then the liability on that score would be considered 'contingent' in terms of the definition of that expression in AS 29 i.e. "a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise". AS 29 itself makes it explicit that no provision for a contingent liability would be recognised.

15. As regards the judicial decisions on the point, the Court proposes to first

discuss the decision in ***Bharat Earth Movers*** (*supra*). There the Assessee had floated a beneficial scheme for its employees for encashment of leaves. The Assessee made a provision for meeting the liability to the extent of the entitlement of the officers and staff to accumulated earned leaves in terms of the scheme and claimed that provision as a deduction. The ITAT held in favour of the Assessee but the High Court reversed it on the ground that the provision for the accrued leaves was a contingent liability. The Supreme Court, however, disagreed with the High Court and held as under:

> "The law is settled: if a business liability has definitely arisen in the accounting 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 the actual quantification may not be possible. If these requirements are satisfied, the liability is not a contingent one. The liability is *in prasenti* 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."

16. The Court further summarised the decision in ***Metal Box Co. of India Ltd. v. Their Workmen [1969] 73 ITR 53 (SC)*** as under:

> "(i) For an assessee maintaining his accounts on mercantile system, a liability already accrued, thought to be discharged at a future date, would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy. It is not as if such deduction is permissible only in case of amounts actually expended or paid;
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> (ii) Just as receipts, though not actual receipts but accrued due are brought in for the income-tax assessment, so also liabilities accrued due would be taken into account while

working out the profits and gains of the business;

(iii) A condition subsequent, the fulfilment of which may result in the reduction or even extinction of the liability, would not have the effect of converting that liability into a contingent liability; and

(iv) A trader computing his taxable profits for a particular year may properly deduct not only the payments actually made to his employees but also the present value of any payments in respect of their services in that year to be made in a subsequent year if it can be satisfactorily estimated."

17. On facts, in ***Bharat Earth Movers*** (*supra*), the Supreme Court was satisfied that the provision made by the Assessee for meeting the liability "incurred by it under leave encashment scheme proportionate with the entitlement earned by the employees of the company... is entitled to deduction out of the gross receipts for the accounting year during which the provision is made for the liability" and that "the liability is not a contingent liability." The decision acknowledged that where a scheme for leave encashment is floated by a company, the number of employees and their entitlements to leave encashment can be estimated with a reasonable degree of certainty. It would be a case of a 'known' liability.

18. In ***Commissioner of Income Tax v. Vinitec Corporation P. Ltd.*** (*supra*) the question for consideration was whether a provision for future warranty expenditure is a contingent liability. On facts, it was not in dispute that the warranty clause was part of the sale document and imposed a liability on the Assessee to discharge an obligation under the clause for the period of warranty. "It was a liability which was capable of being construed in definite

terms which had arisen in the accounting year even though the actual quantification and discharge was deferred to a future date." In terms of the accepted principles of commercial practice and accountancy, it was held that a liability accrued, though discharged at a future date would be a proper deduction.

19. In ***Rotork Controls India P. Ltd. v. Commissioner of Income Tax*** (*supra*), the Assessee sold valve actuators and at the time of sale provided a standard warranty whereby in the event of the product or a part thereof becoming defective within the periods specified thereunder, the Assessee had an obligation to rectify or replace the defective part free of charge. It was noticed that although the AYs in question were 1991-92 to 1994-95 the claim of such allowance had been allowed since AY 1983-84 itself. It was held that the warranty became an integral part of sale price and, therefore, warranty provision has to be recognised because "the Assessee had a present obligation as a result of past event resulting in an outflow of resources and a reliable estimate could be made of the amount of obligation." The Assessee was held entitled to a deduction in respect of the warranty provision under Section 37 of the Act.

20. The Court in ***Rotork Controls India P. Ltd.*** (*supra*) explained:

> "The principle of estimation of the contingent liability is not the normal rule. It would depend on the nature of the business, the nature of sales, the nature of the product manufactured and sold and the scientific method of accounting adopted by the assessee. It would also depend upon the historical trend and upon the number of articles produced."

21. Having examined the decisions that explain the legal position, the Court proceeds to examine the facts on hand. The chart produced by the first Assessee shows that for AY 2001-02 the total amount debited to the P&L Account by way of provision for transit breakages was Rs.6,40,338 and the actual breakages were Rs.2874. In effect, therefore, the provision was in excess by Rs.6,37,464. However, the AO while disallowing the provision added back the entire amount of Rs.6,40,338.

22. For the next four years i.e. AYs 2002-03 to 2005-06, the actual breakages were less than the provision created. The AO allowed the expenditure of the actual breakages as revenue expenditure and added back the excess provision made since it was in the nature of a contingent liability. In other words what was disallowed was the difference between the provision created and reversed.

23. The Court is unable to discern any uniform scientific method followed by the Appellant in making provision for the breakages. As noticed by the ITAT in its order dated 16th March 2009, the explanation offered by the Appellant was that on an ad hoc basis it fixed a rate per case of bottles. In the case of Andhra Pradesh, the rate was Rs.10 per case, for Goa and Karnataka it was Rs.15 per case. Also the breakages are known within a period of 15 to 30 days after despatch of the goods. The Court also concurs with the view of the ITAT that with the first Assessee having entered the line of business only from AY 2001-02, it cannot be said to have gathered sufficient experience to have reasonably estimated such breakages for the AYs in question. In the circumstances, the 'liability' on that score could at

best be described as a 'contingent liability' as defined in AS-29.

24. Extensive reference has been made to AS-29 since one of the submissions of the Assessees is that its failure to make a provision for transit breakages would violate the applicable accounting standards. However, as has been discussed hereinbefore, the AS is clear that "an enterprise should not recognise a contingent liability". Therefore, a provision made by the Assessees for transit breakages in future which cannot be reasonably estimated would not adhere to the AS and the balance sheet so prepared would not present a true and fair view of the state of its business affairs.

25. The question is not whether on account of the reversal of the provision made by the Assessees on the first day of the following year, there would be no loss as such to the Revenue. The question is whether making a provision for transit breakages would be allowable as a business expenditure. In light of the law explained in the above decisions, the Court is satisfied that the view taken by the ITAT in the present case is not erroneous in law.

26. To summarise the legal position as far as the Assessees are concerned:

(a) There is no reasonable scientific method adopted by the Assessees to estimate the transit breakages so as to justify creating of provision for such breakages.

(b) The provision would, in the circumstances, be a provision for a contingent liability and, therefore, in terms of the AS 29 ought not be

recognised.

(c)The actual transit breakages as and when they occur are allowable as revenue expenditure in the accounting year in which such breakages occur.

27. Consequently, the question framed is answered in favour of the Revenue and against the Assessees.

28. It is clarified that while giving an appeal effect to this order, the AO shall allow the actual transit breakages for AY 2001-02 as revenue expenditure consistent with the settled legal position. The Assessees would also be permitted to get the benefit of the reversal of the provision for transit breakages made in the AYs in question accordance with law.

29. The appeals are dismissed but in the circumstances with no order as to costs.

S. MURALIDHAR, J

VIBHU BAKHRU, J

OCTOBER 06, 2015
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