IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 8.7.2015

CORAM

THE HON'BLE MR.JUSTICE R.SUDHAKAR
AND
THE HON'BLE MRS.JUSTICE S.VIMALA

T.C.(A).No.379 of 2008

Erbis Engineering Company Ltd.
No.39, II Main Road
R.A.Puram
Chennai - 600 028. .. Appellant/ Respondent

Vs.

The Deputy Commissioner of Income Tax
Company Circle II(1)
No.121, Mahatma Gandhi Road
Chennai - 600 034. .. Respondent/ Appellant

PRAYER: Appeal under Section 260A of the Income Tax Act against the order of the Income Tax Appellate Tribunal, 'A' Bench, Chennai, dated 30.11.2007 made in I.T.A.No.983/ Mds/2006 for the assessment year 2002-2003 against the order dated 16.1.2006 made in ITA.No.250/2005-06/A III passed by the Commissioner of Income tax (Appeals) III Chennai-34 against the order dated 14.3.2005 made in PAN/GIR-AAACE6859-D passed by the Assistant Commissioner of Income Tax, Company Circle II (1) Chennai for the assessment year 2002-2003.

For Appellant : Mr.Rahul Balaji

For Respondent : Mr.R.Hemalatha
Standing Counsel

J U D G M E N T

(Delivered by R.SUDHAKAR, J.)

The assessee has filed this appeal under Section 260A of the Income Tax Act, 1961 challenging the order of the Income Tax Appellate Tribunal, 'A' Bench, Chennai, dated 30.11.2007 made in I.T.A.No.983/ Mds/2006 for the assessment year 2002-2003, and the same was admitted on the following questions of law:

(i) Whether the Tribunal is right in applying the ratio as laid down by the judgment of this Court reported in Commissioner of Income Tax v. Rotork

Controls India Ltd. and others, (2007) 293 ITR 311?

(ii) Whether the judgment of this Court reported in Commissioner of Income Tax v. Rotork Controls India Ltd. and others, (2007) 293 ITR 311 is in direct conflict to the judgment of the Supreme Court in the case of Bharat Earth Movers v. Commissioner of Income Tax, (2000) 245 ITR 428?

(iii) Whether the warranty amount which is inclusive of the sale amount is an accrued liability or a contingent liability?

2.1. The facts in a nutshell are as under: The appellant/ assessee is engaged in the business of distributing sophisticated diagnostic imaging equipments to various government and private hospitals. The appellant provides warranty of its product, which includes preventive maintenance service, breakdown calls and provision for spares, as per the warranty clause. The said warranty clause is based on contractual obligation and is provided in the respective sales contract.

2.2. The assessee debited a sum of Rs.1,53,01,497/- being the amount of unexpired warranties and claimed deduction. However, the Assessing Officer disallowed the claim of the unexpired warranties on the ground that the liability is unascertained and, therefore, the same cannot be considered as proper deduction. He further held that under the mercantile system of accounting, which the appellant follows, a deduction in respect of a contract liability for warranty can be allowed only if the liability has accrued in the relevant accounting period.

2.3. Assailing the said order, the assessee appealed to the Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals) allowed the appeal filed by the assessee and held that the liability towards warranty is an ascertained liability and the same is in accordance with the principles of the income tax law.

2.4. Aggrieved by the said order, the Revenue pursued the matter before the Tribunal. The Tribunal following the decision of this Court in Commissioner of Income Tax v. Rotork Controls India Ltd. and others, (2007) 293 ITR 311 came to hold that since the warranty provision made as against the liability had not crystallized against the assessee, the plea of the assessee seeking deduction is unsustainable. Accordingly, the Tribunal set aside the order passed by the Commissioner of Income Tax (Appeals) and allowed the appeal.

2.5. Challenging the said order, the assessee has filed this appeal on the questions of law referred supra.

3. At the time of hearing of the appeal, the learned counsel on either side submitted a decision of the Supreme Court in the case of

Rotork Controls India (P) Ltd. v. Commissioner of Income Tax, Chennai, (2009) 314 ITR 62 (SC) and stated that the decision of this Court in Commissioner of Income Tax v. Rotork Controls India Ltd. [2007] 293 ITR 311 (Mad), on which heavy reliance was placed by the Tribunal, was reversed by the Supreme Court in the aforesaid decision. The principles enunciated in the said decision reads as under:

> “The principle which emerges from these decisions is that if the historical trend indicates that a 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.”

In the said decision, the Supreme Court also laid down certain conditions, which read as under:

> “11. What is a provision? This is the question which needs to be answered. 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. If these conditions are not met, no provision can be recognized.
>
> 12. Liability is defined as a present obligation arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.”

4. In the light of the decision of the Supreme Court in Rotork Controls India (P) Ltd., referred supra, the order of the Tribunal stands set aside and the matter is remanded to the Assessing Officer to pass appropriate orders in the light of the decision of the Supreme Court cited supra.

5. In the result, this appeal is allowed by way of remand to the Assessing Officer. In view of the remand order passed by this Court, the questions of law formulated need not answered in this appeal. No costs.

Sd/-
Asst.Registrar (CS II)

/true copy/
Sub Asst. Registrar

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To:

1. The Assistant Registrar,
   Income Tax Appellate Tribunal
   Chennai Bench "A", Chennai.

2. The Commissioner of Income Tax (Appeals) - III
   Chennai.

3. The Deputy Assistant Commissioner of Income Tax
   Company Circle II(1), Chennai.

1 cc to Mr.T.R. Senthilkumar, Advocate, Sr. 34266

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