

IN THE HIGH COURT OF PUNJAB & HARYANA AT CHANDIGARH

Date of Decision: 19.05.2015

1. **Income Tax Appeal No. 434 of 2014**

The Commissioner of Income Tax, Faridabad

..Appellant

versus

M/s Carrier Air-Conditioning and Refrigeration (Formerly known as Aircon Limited).

..Respondent

2. **Income Tax Appeal No. 439 of 2014**

The Commissioner of Income Tax, Faridabad

..Appellant

versus

M/s Carrier Air-Conditioning and Refrigeration (Formerly known as Aircon Limited).

..Respondent

CORAM: HON'BLE MR. JUSTICE S.J.VAZIFDAR, ACTING CHIEF JUSTICE.
HON'BLE MR. JUSTICE G.S.SANDHAWALIA.

1. Whether Reporters of local papers may be allowed to see the judgment?
2. Whether to be referred to the Reporters or not ?
3. Whether the judgment should be reported in the Digest?

Present : Mr. Tajender K.Joshi, Advocate, for the appellant.
Mr. Deepak Chopra, Advocate with
Mr. Piyush Singh, Advocate, for the respondent.

S.J.VAZIFDAR A.C.J. (Oral)

This order will dispose of Income Tax Appeal Nos. 434 and 439 of 2014 as similar questions of law are involved in both the cases. The facts have been taken from I.T.A. No. 434 of 2014.

2. Both these appeals are against the order of the Income Tax Appellate Tribunal dismissing the appellant's appeal against the order of the Commissioner of Income Tax (Appeals). The C.I.T. (Appeals) deleted the

disallowance of warranty provision. The matter pertains to the assessment years 1998-99 and 2001-02.

3. The appellant contends that the following substantial question of law arises:-

- “i) *Whether on the facts and in the circumstances of the case, the Hon’ble ITAT was right in law in treating provision for warranty in the present case as an ascertained liability, despite failure on part of the assessee to establish historical or scientific basis of arriving at the said provision.*
- ii) *Whether on the facts and in the circumstances of the case, the Hon’ble ITAT was right in law in disregarding the fact that conditions laid down in Rotork Controls India P. Ltd. vs. CIT (2009) 314 ITR 62 (SC) and Majestic Auto Ltd. 156 460 are not fulfilled in the present case.”*

We have answered the questions in favour of the respondent-assessee and against the appellant-revenue.

4. In our view a substantial question of law does not arise. In any event, the questions are answered in favour of the respondent-assessee in view of the judgment of a Division Bench of this Court and by a judgment of the Supreme Court.

5. The respondent filed a return of income of ₹ 11,72,00,980/-. The revised return declared the same income. The assessment was completed under section 143(3) of the Income Tax Act, 1961 (for short ‘the Act’) at a total income of ₹11,64,04,200/-. The assessee had debited an amount of ₹ 2,66,33,000/- on account of warranty expenses in the Profit and Loss account. The respondent stated that the warranty costs were determined on the basis of the past experience and are provided for in the

year of sale. This provision was increased from the previous year by an amount of ₹ 60,25,000/-.

6. Proceedings under section 147 and 148 of the Act were initiated. The Assessing Officer enquired why the warranty expenses to the extent of ₹ 60,25,000/- should not be added back to the respondent's income. In its written submissions filed before the Assessing Officer, the respondent stated that it had calculated the provision for warranty expenses based on actual expenses incurred in the past; that it consistently followed the practice of making a provision for warranty in its books of accounts; that the entire sale consideration in respect of which the provision was made had been recorded in the books as revenue; that the corresponding warranty expenses had to be necessarily deducted in order to arrive at the respondent's taxable income and the basis of making the warranty provision was also disclosed in the financial statements.

7. The Assessing Officer held that the warranty expenses are not an allowable deduction and that the liability was contingent and not *in praesenti*. The Assessing Officer held that the test was whether a provision provides for a known liability of which the amount can be determined with substantial accuracy. He held that the decisive factor is not the methodology of accountancy or the practice followed by the respondent but the principle is whether such a liability is contingent or *in praesenti*. Observing that it was a liability that may or may not have to be discharged, the Assessing Officer added the amount of ₹ 60,25,000/- back to the respondent's net income and initiated penalty proceedings under section 271(1)(c) of the Act. The C.I.T. (A) allowed the respondent's appeal. The Income Tax Appellate Tribunal

dismissed the appellant's appeal leading to the appellant's filing the present appeals.

8. The respondent follows the mercantile system of accounting. The warranty expenses are therefore included in the Profit & Loss account. It is not disputed that the entry in this regard is reversed and the amount is added to the Profit & Loss account if the expenses towards meeting the warranty are not actually incurred for any reason upon the expiry of the warranty period. The Assessing Officer's view that the warranty expenses are liable to be added to the respondent's income on account of the warranty being a contingent liability is not well founded. The respondent is engaged in the business of manufacture and sale of air conditioners. As noted by the C.I.T. (A), under the agreements entered into by it with its customers, the respondent gives free of cost repair and replacement warranty for a minimum period of one year from the date of sale.

9. The respondent contended that the amount debited to its Profit & Loss account was based on the past experience. The respondent has been in this same line of business for several years. It is not suggested that the records, including the books of account are not reliable or that the expenses towards meeting the obligations for fulfilling the warranties were not incurred. There is in any event no loss to the revenue. If the respondent does not incur any expenses towards meeting its obligation under the warranty clause on account of the claims thereunder not matching the provision for any reason including on account of the expiry of the warranty period without the warranty being invoked, the unspent/unutilized provision is debited to the warranty provision account.

The contention that the provision was not made on any scientific basis is equally unfounded. The provision is based essentially on the respondent's past experience.

10. The question is answered in favour of the respondent by the judgment of a Division Bench of this Court in the case of *Commissioner of Income Tax v. Majestic Auto Ltd.* [2006] 156 Taxman 460 (P&H) which was also relied upon by the Tribunal.

The Division Bench held as under:-

"6. In Bharat Earth Movers case (supra), Hon'ble the Supreme Court dealing with the proposition that the assessee would be entitled to deduction in the accounting year, although the liability may have to be quantified and discharged at a future rate, held that such a liability is to be treated in the present time and would not be contingent liability. It was held as under:

So is the view taken in *Calcutta Co. Ltd. v. CIT* [1959] 37 ITR 1 (SC) wherein this Court has held that the liability on the assessee having been imported, the liability would be an accrued liability and would not convert into a conditional one merely because the liability was to be discharged at a future date. There may be some difficulty in the estimation thereof but that would not convert the accrued liability into a conditional one; it was always open to the tax authorities concerned to arrive at a proper estimate of the liability having regard to all the circumstances of the case....."

11. The matter is also covered in the respondent's favour by the judgment of the Supreme Court in *Rotork Controls India P. Ltd. v.*

Commissioner of Income Tax [2009] 314 ITR 62 (SC). It was contended on behalf of the Department that the provision for warranty is towards unforeseen liability which is not certain nor could it be foreseen with precision and was, therefore, only contingent. It was contended that being contingent, deduction as expense(s) was not available. The Supreme Court rejected the contentions. Further, in paragraph No. 14, the Supreme Court expressly held that if the 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 example furnished therein may not arise in a significant way.

12. In the circumstances, both the appeals are dismissed.

(S.J.VAZIFDAR)
ACTING CHIEF JUSTICE

(G.S.SANDHAWALIA)
JUDGE

19.05.2015

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