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W.P.Nos.2204 of 2020 and 15299 of 2022

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated: 04.09.2023

CORAM:

THE HONOURABLE MR.JUSTICE C.SARAVANAN

W.P.Nos.2204 of 2020 and 15299 of 2022

and

W.M.P.Nos.2578 and 2579 of 2020, 14467, 14468, 13895 and 25110
of 2022

M/s. Lucas Indian Service Limited,
No.11, Pattulos Road,
Chennai – 600 002.
Represented by its Director,
Ms.Priyamvada Balaji

... Petitioner in both W.Ps.

vs.

1.The Assistant Commissioner of Income Tax,
Corporate Circle – 4(1),
Chennai – 600 034.

... Respondent in both W.Ps.

2.The Income Tax Officer,
National Faceless Assessment Centre,
Ministry of Finance,
Delhi.

... Respondent in W.P.No.15299 of 2022

Prayer in W.P.No.2204 of 2020: Writ Petition is filed under Article 226 of the Constitution of India, Writ of Certiorari, to call for the records of the respondent and quash the notice dated 12.10.2018 passed under Section 148 SC of the Act in PAN/GIR:AAACL1018J



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and the consequential order in Document No.20121183578 dated 30.12.2019.

Prayer in W.P.No.15299 of 2022: Writ Petition is filed under Article 226 of the Constitution of India, Writ of Certiorari, to call for the records of the respondent to quash the impugned notice issued under Section 274 r.w.s 271(1)(c) by the 1st respondent in DIN and Notice No : ITBA/PNL/S/271(c)/2019-20/1023472442(1) 2012-13, dated 30.12.2019 and the penalty order passed by the 2nd respondent in DIN and Letter No.ITBA/PNL/F/271(1)(c)/2021-22/1042087274(1), dated 30.03.2022 for the Assessment year 2012-13 in PAN : AAACL1018J.

For Petitioner : Mr.Vijayaraghavan and
(in both W.Ps) Mr.R.Venkataraman for
M/s.Subburaya Aiyar Padmanabhan

For Respondents : Mr.V.Mahalingam
(in both W.Ps) Senior Standing Counsel

COMMON ORDER

By this common order, both these writ petitions are being disposed of.



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2. In W.P.No.2204 of 2020, the petitioner has challenged the impugned Assessment order dated 30.12.2019 passed under Section 143(3) read with 148 of the Income Tax Act, 1961. The impugned order precedes a notice under Section 148 of the Income Tax Act, 1961 dated 12.10.2018 seeking to re-open the Assessment that was completed on 10.03.2015.

3. In W.P.No.15299 of 2022, the petitioner has challenged the notice issued under Section 274 read with 274(1)(c) of the Income Tax Act, 1961. Pursuant to impugned Assessment order dated 30.12.2019 passed under Section 143(3) of the Income Tax Act, 1961.

4. The reasons given for re-opening of the Assessment completed on 10.03.2015 as communicated to the petitioner by the Assessing officer/Respondent vide communication dated 04.12.2019 reads as under:

“1.Justify the provision for warranty created to the extent of Rs.111.47 lakhs during the F.Y.2011-12. Give reasons why the same should not be added to total



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income as the opening balance of provision was more than the amount utilized during the year.

2.The reasons for reopening is reproduced as under:-

It is seen from the Balance Sheet schedule 10 that an amount of Rs.165.21 lakhs has been shown as provision for warranty under short term provisions Note (i) to the above shows that there is an opening balance of Rs.166.94 lakhs as on 01.04.2011, Rs.111.47 lakhs additions during the year after utilization of Rs.113.20 lakhs. The amount of Rs.111.47 lakhs created as provision for warranty during the year should be added back and brought to tax.”

5. In the impugned order, the respondent has justified the re-opening of the Assessment and has thus passed the impugned order dated 30.12.2019.

6. The specific case of the petitioner is that there is no suppression of fact by the petitioner regarding information that was required at the time of assessment pursuant to return filed under Section 139 of the Income Tax Act, 1961. It is further submitted that issue relating to deduction on account of warrant was discussed at length. In this connection, a reference was made to communication



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dated 06.03.2015 of the petitioner, wherein, the petitioner has give the basis on which the deduction was arrived.

7. It is submitted that another explanation was also submitted by the petitioner on 10.03.2015, wherein, the petitioner has clearly explained that deduction was sought to be denied contrary to the law laid by the Hon'ble Supreme Court in ***Rotork Controls India (P) Ltd Vs. Commissioner of Income-Tax, Chennai*** reported in [2009] 180 Taxman 422 (SC).

8. The learned Senior Standing Counsel for the respondent submits that the impugned order dated 30.12.2019 is well reasoned and does not require any interference. That apart, it is submitted that the petitioner has an alternate remedy and therefore on this count also, the impugned order cannot be assailed before this Court.

9. The learned Senior Standing Counsel for the respondent submits that no grounds exist in the facts of the case to warrant an



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exercise of discretion in favour of the petitioner under Article 226 of the Constitution of India.

10. I have considered the arguments advanced by the learned counsel for the petitioner and the learned Senior Standing Counsel for the respondents and also perused the communication exchanged between the petitioner and the Assessing Officer that preceded the Assessment under Section 143(3) of the Income Tax Act on 10.03.2015 and the reasons given by the petitioner for re-opening of the Assessment by communication dated 04.12.2019. The content of which has been extracted above.

11. The petitioner has explained the manner in which the deduction was arrived. The explanation of the petitioner reads as under:-

“3.1.a. Nature of warranty:

a) The company is engaged in the business of trading in automobile ancillaries. As per the company's policy, on every sale made by the company, the company gives a warranty/ guarantee of its product for 12 to 18 months (until year 2011-12,



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warranty was extended up to 26 months) from the date of dispatch, depending on the capacity of the product. When the company makes the sale, it also undertakes the liability to replace/repair the product or part of the product, if there is any manufacturing defect during the warranty period.

b) To meet this expenditure, the company makes a provision in the books of account as 'Provision for Warranty'. The obligation for meeting expenses on repair/replacement of the product during the warranty period accrues on the date when the sale agreement is executed with warranty clause and the provision for warranty claim is made on a *scientific basis*.

c) The provision made towards warranty on the sale of automobile ancillaries is on a scientific method based on past experience and is not an adhoc provision. The basis of provision for warranty depends on the ratio of actual warranty cost to the sales for the past three years.

d) On every sale made by the company, there exists an 'inbuilt liability' to replace or repair any defective product. It is evident that the sale as well the warranty expenses are inextricable linked with each other and therefore, if the sales are considered in a year, then the liability in respect of the warranty expenditure is also to be considered in the same year. From the above, it is clear that the provision for warranty is a definite and certain liability.

3.1.b. Judicial precedent:

a) In this connection, we wish to place reliance in the case of ***Rotork Controls India (P.) Ltd. Vs. CIT*** (180 Taxman 422), where the Apex court has held that:

"A provision to qualify for recognition, there must be a present obligation arising from past events, settlement of which is expected to result in an



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outflow of resources and in respect of which a reliable estimate of amount of obligation is possible. If historic trend indicates that large number of sophisticated goods were being manufactured and defects existed in some of items manufactured and sold, then provision made for warranty would be entitled to deduction under section 37(1)"

b) In similar terms, the appellant also relies on the decision of the Delhi High Court in the case of **CIT vs. Vinitee Corporation (P) Ltd.**, (278 ITR 337):

"The sale as well the warranty are inextricable bound with each other and therefore, if the sale proceeds are taken note of in a year, the liability in respect of the warranty is also to be taken note of in the same year. The liability is not contingent. It is a definite and certain liability. Only the quantification of the liability is based on estimate, which in turn is based on the past experience"

3.1.c. Applicability:

a) In the present case, the amount of 'provision for warranty' to be created during the current year, is determined on a scientific basis, after analysing the past trends of the company.

b) Further, the company undertakes the warranty/guarantee/liability to replace or repair the product at the time of sale. Hence, on every sale made by the company, there exists an inbuilt liability' to replace or repair any defective product.

c) It is evident that the sale as well the warranty expenses are inextricable linked with each other and therefore, if the sales are considered in a year, then the liability in respect of the warranty expenditure is also to be considered in the same year.

d) In light of the above submissions and judicial pronouncements, we wish to highlight that the provision made for warranty is based on scientific



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expenditure and therefore it is an ascertained liability allowable under section 37 of the Act.”

12. This was also explained by the petitioner earlier in response to a notice prior to completion of Assessment under Section 143(3) of the Act, wherein, the petitioner had stated as follows:

“The provision made towards warranty on the sale of automobile ancillaries made is on a scientific method based on past experience and is not an adhoc provision. The basis of provision for warranty depends on the ratio of actual warranty cost to the sales for the past three years. Based on past experience, the movement on provision for warranty for the year ended 31st March 2012 is as below:

Movement in provision for warranty	(INR)
Provision at the beginning of the year	16,694,000
Expenditure incurred	11,319,966

Excess of Expenditure over opening provision	5,374,034
Current Year provision	11,146,637
Provision at the end of the year	16,520,671

On every sale made by the company, there exists an 'inbuilt liability' to replace or repair any defective product. It is evident that the sale as well the



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warranty expenses are inextricable linked with each other and therefore, if the sales are considered in a year, then the liability in respect of the warranty expenditure is also to be considered in the same year. From the above, it is clear that the provision for warranty is a definite and certain liability.”

13. The stand taken by the petitioner is in consequences of the views of the Hon'ble Supreme Court in ***Rotork Controls India (P) Ltd Vs. Commissioner of Income-Tax, Chennai*** reported in [2009] 180 Taxman 422 (SC), wherein, was held as under:

“13. In this case we are concerned with Product Warranties. To give an example of Product Warranties, a company dealing in computers gives warranty for a period of 36 months from the date of supply. The said company considers following options: (a) account for warranty expense in the year in which it is incurred; (b) it makes a provision for warranty only when the customer makes a claim, and (c) it provides for warranty at 2 per cent of turnover of the company based on past experience (historical trend). The first option is unsustainable since it would tantamount to accounting for warranty expenses on cash basis, which is prohibited both under the Companies Act as well as by the Accounting Standards which require accrual concept to be followed. In the present case, the Department is insisting on the first option which, as stated above, is erroneous as it rules out the accrual concept. The second option is also inappropriate since it does not reflect the expected warranty costs in respect of



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revenue already recognized (accrued). In other words, it is not based on matching concept. Under the matching concept, if revenue is recognized the cost incurred to earn that revenue including warranty costs has to be fully provided for. When Valve Actuators are sold and the warranty costs are an integral part of that sale price then the appellant has to provide for such warranty costs in its account for the relevant year, otherwise the matching concept fails. In such a case the second option is also inappropriate. Under the circumstances, the third option is most appropriate because it fulfils accrual concept as well as the matching concept. For determining an appropriate historical trend, it is important that the company has a proper accounting system for capturing relationship between the nature of the sales, the warranty provisions made and the actual expenses incurred against it subsequently. Thus, the decision on the warranty provision should be based on past experience of the company. A detailed assessment of the warranty provisioning policy is required particularly if the experience suggests that warranty provisions are generally reversed if they remained unutilized at the end of the period prescribed in the warranty. Therefore, the company should scrutinize the historical trend of warranty provisions made and the actual expenses incurred against it. On this basis a sensible estimate should be made. The warranty provision for the products should be based on the estimate at year end of future warranty expenses. Such estimates need reassessment every year. As one reaches close to the end of the warranty period, the probability that the warranty expenses will be incurred is considerably reduced and that should be reflected in the estimation amount. Whether this should be done through a pro rata reversal or otherwise would require assessment of historical



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trend. If 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 above example, may not arise in a significant way. In our view, on the facts and circumstances of this case, provision for warranty is rightly made By the appellant-enterprise because it has incurred a present obligation as a result of past events. There is also an outflow of resources. A reliable estimate of the obligation was also possible. Therefore, the appellant has incurred a liability, on the facts and circumstances of this case, during the relevant assessment year which was entitled to deduction under section 37 of the 1961 Act. Therefore, all the three conditions for recognizing a liability for the purposes of provisioning stands satisfied in this case. It is important to note that there are four important aspects of provisioning. They are provisioning which relates to present obligation, it arises out of obligating events, it involves outflow of resources and lastly it involves reliable estimation of obligation. Keeping in mind all the four aspects, we are of the view that the High Court should not to have interfered with the decision of the Tribunal in this case.”

14. Thus, the impugned order is unsustainable. It is liable to be quashed. Consequently, the impugned notice dated 30.12.2019 issued under Section 274 read with Section 271(1)(c) of the Income Tax Act, 1961 issued by the first respondent is quashed. Consequently, the



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penalty order passed by the second respondent dated 30.03.2022 is also liable to be quashed.

15. These writ petitions stand allowed. No costs. Consequently, connected writ miscellaneous petitions are closed.

04.09.2023

Index:Yes/No
Internet:Yes/No
Speaking/Non-speaking Order
Neutral Citation : Yes/No
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To

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Chennai – 600 034.

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National Faceless Assessment Centre,
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