

**IN THE INCOME TAX APPELLATE TRIBUNAL  
[ DELHI BENCH "G" : NEW DELHI ]  
(THROUGH VIDEO CONFERENCING)**

**MS. SUCHITRA KAMBLE, JUDICIAL MEMBER  
A N D  
SHRI B.R.R. KUMAR, ACCOUNTANT MEMBER**

ITA. No. 2228/Del/2017  
Assessment Year : 2012-13

M/s. Senior India Private Limited,  
4<sup>th</sup> Floor, Rectangle No. 1,  
Behind Sheraton Hotel,  
Commercial Complex D4, Saket,  
New Delhi – 110 017.

**PAN : AAACI2419N**  
(Appellant)

DCIT,  
Vs. Circle : 23 (2),  
New Delhi.  
(Respondent)

Assessee by : Shri Vishal Kalra, Adv.;  
Ms. Rajnandni Shukla; &  
Ms. Sumisha, A.R.;

Department by : Shri Prakash Dubey, Sr. D.R.;

Date of hearing : 16/02/2021.

Date of order : 16/04/2021.

**ORDER**

**PER SUCHITRA KAMBLE, JM :**

This appeal is filed by the assessee against the order dated 10.01.2017 passed by the Commissioner of Income Tax (Appeals)-8, New Delhi, for Assessment Year 2012-13.

2. The assessee has raised the following grounds of appeal :-

“ 1. That the impugned order of Ld. CIT(A) sustaining the addition/ disallowance made by the Ld. AO is erroneous on facts and in law and thus, the

adverse findings recorded by the Ld. CIT(A) and Ld. AO deserve to be set aside, as also the addition sustained to the total income declared by the Appellant;

2. That Ld. CIT(A) has erred both on facts and in law in confirming a disallowance of INR 7,37,150 in respect of provision for warranty made for AY 2012-13. That Ld. CIT(A) has failed to appreciate that the Appellant had created the provision on the basis of past history and was based on a scientific and reliable method and as such, the disallowance sustained by the Ld. CIT(A) deserves to be deleted. The said provision made was towards accrued liability ought to have been held allowable as such.

- 2.1. That Ld. CIT(A) has erred on facts and in law in mis-interpreting the 'matching concept', and holding that provision for warranty of INR 7,37,150 made by the Appellant was excessive and unnecessary' by reason that opening balance of provision for warranty account was substantial.
- 2.2. That Ld. CIT(A) has erred on facts and in law in stating that the Appellant has been indulging on over-provisioning of warranty' expense, without appreciating that the Appellant has been consciously revising and reducing its estimates based on historical trends and technological improvements.
- 2.3. The Ld. CIT(A) has erred on facts in stating that the Appellant resorts to revisioning of basis of provisioning quite frequently, in disregard of the actual fact that the Appellant has followed the same basis for estimating warranty provision regularly.

3. Without prejudice to the above grounds, the Ld. CIT(A) has erred on facts and in law in not allowing the Appellant's alternate claim of actual warranty' expenses incurred during the subject assessment year in lieu of allowing warranty' provision.

4. That on facts and circumstances of the case and in law, the Ld. AO erred in initiating penalty proceedings under section 27i(i)(c) of the Act, as not adjudicated by the Ld. CIT(A).

The appellant craves leave to alter, amend or withdraw all or any of the grounds herein or add any further grounds as may be considered necessary' at any' time either before or during the hearing.”

3. The assessee filed return of income on 29.11.2011 for Assessment Year 2012-13 declaring total income of Rs.8,10,30,030/-. The case was taken up for scrutiny and assessment under Section 143(3) of the Act was passed on 6.02.2015 determining total income at Rs.8,17,67,180/- by making disallowance of Rs.7,37,150/- being provision made for warranty expenses.

4. Being aggrieved by the assessment order the assessee filed appeal before the CIT (Appeals). The CIT (Appeals) dismissed the appeal of the assessee.

5. The Ld. AR submitted that during the relevant assessment year the assessee made provision for warranty expenses amounting to Rs.7,37,150/- while the actual warranty expenses incurred during the year amounting to Rs.10,74,034/-. During the year under consideration the assessee sold products to various original manufacturers of equipment in India with the three year warranty period and was, therefore, under a legal obligation to carry out the parts manufactured by it and supplied to the manufacturers of the original equipment in case of any manufacturing defect within a period of three years from the sale of such parts. The ld. AR further submitted that the basis / rate of provision for warranty is duly re-assessed by the assessee at the end of each assessment year based on the past history of expenses incurred and consistent improvement in technology by the assessee company. Thus where the provisions existing in the books of assessee considered as being excessive the same is adequately reversed and offered to tax in the year of reversal. The Ld. AR further submitted that for assessment year 2012-13 onwards it was decided by the assessee to maintain the closing balance for provision of warranty equipment of last three years sales including sale of the respective assessment year. The particulars of provision made by the assessee and the actual expenses incurred during the assessment year are that of provision of warranty expenses debited to profit and loss account amounting to Rs.7,37,150/- and actual warranty expenses incurred during the year and set off against opening balance for provision of warranty amount of Rs.10,74,034/-. The Ld. AR submitted that provision for warranty was made by the assessee since the period of warranty provided in respect of sales made which was not expired and such a provision for warranty was created to meet those claims of warranty in respect of sales made during the year which has been duly offered to tax. The Ld. AR submitted that the assessee has accounted for the income of sale and the warranty cost are an integral part of the sale

price then the assessee has to provide such warranty cost in its accounts for the relevant year otherwise matching concept will be violated. The Ld. AR relied upon the decision of the apex court in the case of Calcutta Co. Ltd. Vs. CIT (1959) 37 ITR 1 (SC). The ld. AR further submitted that the assessee company has provided for warranty expenses on the basis of actual claims received from the customers in the past few years and under the matching concept. If revenue is recognized, the cost incurred to earn the revenue including the warranty cost has to be fully provided. The Ld. AR has given computation of the subject years in which provision was made as under:-

<b>Particulars</b>	<b>AY 2011-12</b>	<b>AY 2010-11</b>	<b>AY 2009-10</b>	<b>AY 2008-09</b>
Sales	53,48,73,462	38,56,67,864	37,86,12,373	48,27,77,110
Warranty provision utilised	18,15,848	2,19,991	38,36,940	10,33,722
% Warranty expense /sales	<b>0.3%</b>	0.05%	1%	0.21
Average of last 4 years percentage	<b>0.39%</b>			

6. In view of the above table, the Ld. AR pointed out that the provision for warranty for the subject year was computed considering the percentage of warranty expenses / sales of immediately preceding assessment year and further the average of warranty expenses / sales of last four years. Thus, the provision for warranty for the subject assessment year was computed on scientific basis and accordingly should be allowed as deduction. The Ld. AR relied upon the decision of the apex court in the case of Rotork Controls India Pvt. Ltd. Vs. CIT (2009) 314 ITR 62 (SC). Thus, the Ld. AR submitted that since all the conditions such as existence of present obligation as a result of the past event as well as its resources probable will be to settle and reliable estimate can be made of the accounts of obligation as laid down by the Apex court pertaining to the allowance of provision for warranty as tax deductible are satisfied in the present assessee's case. The disallowance made by the Assessing Officer / CIT (Appeals) deserves to be deleted. The Ld. AR further submitted that in the preceding years the Revenue authority even in the remand proceedings allowed the provisions for warranty to the

assessee company on ad-hoc basis. Thus, the basis or rate for provision for warranty is duly re-assessed by the assessee at the end of each assessment year. Thus, where the provisions existing in the books of the assessee is considered as being excessive, the same is adequately reversed.

7. As regards Ground No. 3 relating to disallowance of actual warranty expenses amounting to Rs.10,74,034/- incurred during the subject assessment year, the Ld. AR made the submissions as to without prejudice stating therein that the provision of warranty amounting to Rs.7,37,150/- should be allowed as in the case of the assessee actual warranty expenses have not been separately debited to the profit and loss account and have only been set off with the provision account only. The Ld. AR further submitted that the actual expenses incurred in the normal course of the conduct of business and are wholly and exclusively for the business of the assessee. Such expenses constitute an allowable expense under Section 37 of the Income Tax Act, 1961 (the Act). The provisions of Section 37(1) of the Act prescribes that any expenditure is allowable as a revenue expenditure if it is not a capital expenditure, not a personal expenditure and has been incurred wholly and exclusively for the purposes of its business. The Ld. AR relied upon the decision of *Sassoon J. David Vs. CIT (1979) 118 ITR 261* as well as the decision of the Hon'ble Delhi High Court in the case of *CIT Vs. EKL Appliances Ltd. 341 ITR 241 (Del)*. Thus, the Ld. AR submitted that the expenditure in respect of warranty was wholly and exclusively incurred by the assessee for the purpose of its business and was not in the nature of capital or personal nature and thus entitled to deduction under Section 37(1) of the Act.

8. As regards ground No. 4, the Ld. AR submitted that the same is consequential.

9. The Ld. DR submitted that the Assessing Officer has rightly made addition / disallowance relating to provision for warranty as the assessee while adopting the continuous dues provision for warranty account in past years during 2004-05 to 2007-08 had to make reversal of warranty expenses

during assessment years 2006-07, 2007-08 and 2008-09, which was pointed out by the CIT (Appeals) in para 4.1.2 of the order of the CIT (Appeals). In assessment years 2008-09 and 2009-10, the assessee made provision for warranty at 0.75% of the sale / turnover made which was subsequently made at 0.5% of sales / turnover during assessment year 2010-11 and assessment year 2011-12. In assessment year 2009-10 utilization of provision of warranty was more than brought forward balance of provision for warranty, but in rest of the years for assessment years 2007-08 to 2011-12 the overall utilization of provisions of warranty was less than the provision carried forward from earlier years. Because of the abnormal situation in assessment year 2009-10 during assessment years 2010-11 and 2011-12, the assessee reduced the provision of warranty at 0.5% of sales / turnover and subsequently to 0.3% in assessment year 2012-13, instead of provision of warranty at 0.75% of turnover as was made in its books of earlier two assessment years is that assessment years 2008-09 and 2009-10. The Ld. DR submitted that from the facts of the case of the assessee it emerges that provisions of Rs.7,37,150/- during assessment year was excessive as the opening balance for provision of accounts was substantial sum of Rs.51,51,526/- against which provision utilization during the year was merely Rs.10,34,034/- thus suggesting that the assessee was indulging in over provision of warranty provision in preceding assessment years which has resulted into substantial opening balance in provision for warranty account which was not getting utilized as claims are not to the extent to which assessee is making provisions from year to year. The ld. DR submitted that the Assessing Officer as well as CIT (Appeals) rightly held that these expenditures / provisions are not tenable and rightly disallowed the same in respect of alternative / without prejudice argument of the Ld. AR, the DR submitted that the same is also not tenable as the consistently principle itself is not followed by the assessee, hence the Ld. DR relied upon the assessment order and the order of the CIT (Appeals).

10. We have heard both the parties and perused all the relevant material available on record. It is pertinent to mention herein that as per

the submissions of the Ld. AR, the assessee was maintaining the provisions for warranty and the same is reflected from the documents filed before us. The peculiar situation in the current assessment year is that, from assessment year 2012-13 onwards the assessee decided to maintain the closing balance for provision for warranty for the last three years sales including sale of the respective assessment year. The concept of provision of warranty expenses especially in consumer products or the manufacturing products is always a business necessity as to the effect that if the machinery of the product does not function within the warranty period, the same has to be substituted or has to be repaired without any remuneration / price taken from the customers / clients i.e. at the expenses of the manufacturer or merchant. But the treatment given by the assessee as to the price of provision of the warranty expenses debited to profit and loss account and actual warranty expenses incurred during the year was set off against opening balance for provision of warranty amount. This concept how has been taken into account was not properly demonstrated before the Assessing Officer as well as before the CIT (Appeals). The decisions relied upon by the assessee especially that of Hon'ble Apex court decision in the case of Rotork Controls India Pvt. Ltd. Vs. CIT (supra) the conditions whether fulfilled by the assessee should be first looked into. The Hon'ble Apex Court held as under:

*10. 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.*

*11. 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.*

*12. A past event that leads to a present obligation is called as an obligating event. The obligating event is an event that creates an obligation which results in an outflow of resources. It is only those obligations arising from past events existing independently of the future conduct of the business of the enterprise that is recognized as provision. For a liability to*

qualify for recognition there must be not only present obligation but also the probability of an outflow of resources to settle that obligation. Where there are a number of obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement, is determined by considering the said obligations as a whole. In this connection, it may be noted that in the case of a manufacture and sale of one single item the provision for warranty could constitute a contingent liability not entitled to deduction under Section 37 of the said Act. However, when there is manufacture and sale of an army of items running into thousands of units of sophisticated goods, the past event of defects being detected in some of such items leads to a present obligation which results in an enterprise having no alternative to settling that obligation. In the present case, the appellant has been manufacturing and selling Valve Actuators. They are in the business from assessment years 1983- 84 onwards. Valve Actuators are sophisticated goods. Over the years appellant has been manufacturing Valve Actuators in large numbers. The statistical data indicates that every year some of these manufactured Actuators are found to be defective. The statistical data over the years also indicates that being sophisticated item no customer is prepared to buy Valve Actuator without a warranty. Therefore, warranty became integral part of the sale price of the Valve Actuator(s). In other words, warranty stood attached to the sale price of the product. These aspects are important. As stated above, obligations arising from past events have to be recognized as provisions. These past events are known as obligating events. In the present case, therefore, warranty provision needs to be recognized because the appellant is an enterprise having a present obligation as a result of past events resulting in an outflow of resources. Lastly, a reliable estimate can be made of the amount of the obligation. In short, all three conditions for recognition of a provision are satisfied in this case.

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% 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 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 fulfills 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 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.

.....

17. .... The principle which emerges from these decisions is that if the historical trend indicates that 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. It would all depend on the data systematically maintained by the assessee. It may be noted that in all the impugned judgments before us the assessee(s) has succeeded except in the case of Civil Appeal Nos. of 2009 - Arising out of S.L.P.(C) Nos.14178-14182 of 2007 - M/s. Rotork Controls India (P) Ltd. v. Commissioner of Income Tax, Chennai, in which the Madras High Court has overruled the decision of the Tribunal allowing deduction under Section 37 of the 1961 Act. However, the High Court has failed to notice the "reversal" which constituted part of the data systematically maintained by the assessee over last decade.*

*18. For the above reasons, we set aside the impugned judgment of the Madras High Court dated 5.2.07 and accordingly the civil appeals stand allowed in favour of the assessee with no order as to costs.*

After going through the decisions of the Apex Court we find that there are three conditions which should be looked into, firstly, whether an enterprise has a present obligation as a result of a past even; secondly, whether it is probable that an outflow of resources will be required to settle the obligation; and thirdly, whether a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognized.

11. Now coming to the present case, the assessee from assessment year 2004-05 till 2009-10 has not shown any percentage for maintaining provision of warranty / liability account closing balance on sales / turnover of last three assessment years including current assessment year while giving us the chart. In assessment years 2008-09 and 2009-10 the assessee has made provision of warranty creation on sales / turnover which is at 0.75% and in assessment years 2010-11 and 2011-12 till 2015-16 which include the present assessment year, no provision of warranty creation of sale / turnover is reflected in that chart. The actual warranty expenses incurred during the present year over and above provision utilization is also not reflected in the present assessment year. Besides this, the provision reversed during the year is also not reflected and actual warranty expenses utilized during the year from the provision created for the year is also not reflected. The assessee at its sweet will is changing its provision for warranty and there is no scientific calculations given by the assessee though

the same is claimed by the Ld. AR during the hearing that it is the scientific method which has been followed by the assessee for creating provision for warranty. Following are the charts showing warranty expenses for the period A.Ys. 2004-05 to 2015-16):

Chart showing tally of warranty expenses (A.Y. 2004-05 to 2009-10)

Particulars		Assessment Year					
		2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Sales turnover without excise duty		38,56,67,864	53,48,73,462	63,21,82,048	57,00,89,083	49,06,46,844	43,09,78,209
%for provision of warranty creation on sales /turnover		0.5	0.5	-	-		-
% for maintaining provision of warranty (Liability Account) closing balance on sales/turnover of last three assessment years (Including current A.Y				0.3	0.3	0.2	0.2
Opening balance of provision of warrant	A	25,86,962	42,91,924	51,51,526	45,65,334	52,06,680	33,91,627
Amount credited in provision for warranty account	B	19,24,953	26,75,450	7,37,150	21,89,402	58,943	8,67,242
Provision utilized during the year from opening provision	C	2,19,991	18,15,848	10,74,034	(4,92,715)	18,73,996	12,60,864
Provision reversed during the year	D	0		-	20,40,771	-	
Provision transferred to other provision	E			2,49,308	-	-	
Actual warranty expenses incurred during the year over and above provision utilization	F	1,18,777			-	-	
Actual; expense	G	-	-		-		

utilized during the year from the provision created for the year.							
Net amount claimed in profit & loss A/c corporate tax return	I=( B+ F+- D)	20,43,730	26,75,450	7,37,150	1,48,631	58,943	8,67,242
Closing provision	1=( A+ B+ C- D- E)	42,91,924	51,51,526	45,65,334	52,06,680	33,91,627	29,98,005

Chart showing tally of warranty expenses (A.Y. 2004-05 to 2009-10)

Particulars		Assessment Year					
		2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Sales turnover without excise duty		27,41,35,481	35,78,28,16	36,26,25,471	49,21,85,590	48,27,77,110	37,86,12,373
%for provision of warranty creation on sales /turnover				-		0.75	0.75
% for maintaining provision of warranty (Liability Account) closing balance on sales/turnover of last three assessment years (Including current A.Y							
Opening balance of provision of warranty	A		3,84,941	24,26,639	10,94,022	12,13,718	35,98,902
Amount credited in provision for warranty account	B	3,84,941	20,41,698	10,94,022	12,13,718	35,98,902	28,25,000
Provision utilized during the year from the opening position	C			11,55,000	4,93,426	10,33,722	38,36,940
Provision utilized during the year from opening provision	D			12,71,639	6,00,594	1,79,996	
Provision	E						

transferred to other provision							
Actual warranty expenses incurred during the year over and above provision utilization	F			45,25,721	32,99,603	68,41,062	5,48,415
Actual; expense utilized during the year from the provision created for the year.	G						2,38,038
Net amount claimed in profit & loss A/c corporate tax return	H=( B+F +-D)	3,84,941	20,41,104	43,48,104	39,12,727	1,02,59,968	33,73,415
Closing provision	1=( A+B +C- D-E)	3,84,941	24,26,639	10,94,022	12,13,718	35,98,902	25,86,962

From the above charts which is referred by the Ld. AR it is clear that the variation in the methods adopted for the provision for warranty has not been clearly set out after 2010-11 by the assessee. The CIT (Appeals) has rightly held that the assessee has not made a reliable estimate of amount of provision on the basis of past historical trend of warranty claimed. The assessee itself has admitted that due to up-gradation of technology, the defects in components were minimized and, therefore, warranty claim were substantially reduced. But in subsequent assessment year 2013-14, the assessee reversed the provision keeping in mind the quantum of brought forward of provision of warranty amount and which reduced the actual claim during the year. In assessment year 2013-14 the utilization of provision during the year from opening provision, balance figure also became a negative figure. Therefore, it clearly establishes that assessee had not been stick in making the provision for warranty at the end of financial year under consideration when it had all the available facts relating to warranty claim made and historical trend of available claim as laid down by the Hon'ble Apex court in the case of Rotork Controls India Pvt. Ltd. Vs. CIT (supra). The assessee's warranty provision equally lack in the proper

accounting / calculating factors and, therefore, the claim of the assessee is not sustainable. The CIT (Appeals) has rightly rejected the set off of actual warranty expenses on payment basis as well as warranty expenses on payment basis. Hence, ground Nos. 2 and 3 are dismissed.

12. In the result appeal of the assessee is dismissed.

Order pronounced in the open court on : 16/04/2021.

**Sd/-**  
**( B. R. R. KUMAR )**  
**ACCOUNTANT MEMBER**

**Sd/-**  
**( SUCHITRA KAMBLE )**  
**JUDICIAL MEMBER**

DATED : 16/04/2021.

\*MEHTA\*

Copy forwarded to:

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

ASSISTANT REGISTRAR  
ITAT NEW DELHI

Date of dictation	6/04/2021
Date on which the typed draft is placed before the dictating Member	6/04/2021
Date on which the typed draft is placed before the Other Member	16/04/2021
Date on which the approved draft comes to the	16/04/2021
Date on which the fair order is placed before the Dictating Member for pronouncement	16/04/2021
Date on which the fair order comes back to the	16/04/2021
Date on which the final order is uploaded on the website of ITAT	16/04/2021
Date on which the file goes to the Bench Clerk	16/04/2021
Date on which the file goes to the Head Clerk	
The date on which the file goes to the Assistant Registrar for signature on the order	
Date of dispatch of the Order	