* **HIGH COURT OF DELHI : NEW DELHI**

\+ **ITA No. 943 of 2007**

Judgment reserved on: February 19, 2008

% Judgment delivered on: March 31, 2008

Commissioner of Income Tax
Bangalore-I, Bangalore ...Appellant

Through Mrs. Prem Lata Bansal, Adv.

Versus

M/s Hewlett Packard India (P) Ltd.
(now merged with Hewlett Packard India Sales (P) Ltd.)
24, Salarpuria Arena
Hosur Main road, Adugodi
Bangalore – 560 030 ...Respondent

Through Mr. Kaanan Kapur with Mr. Y.K. Kapur, Advs.

Coram:

HON'BLE MR. JUSTICE MADAN B. LOKUR
HON'BLE MR. JUSTICE V.B. GUPTA

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

MADAN B. LOKUR, J.

For orders, please see ITA No. 486/2006.

MADAN B. LOKUR, J

V.B. GUPTA, J

March 31, 2008
ncg

Certified that the corrected copy of the judgment has been transmitted in the main Server.

31.3.08

* **HIGH COURT OF DELHI : NEW DELHI**

\+ **ITA No. 486 of 2006**

Judgment reserved on: February 19, 2008

% Judgment delivered on: March 31, 2008

Commissioner of Income Tax
Delhi-IV, New Delhi
...Appellant

Through Mrs. Prem Lata Bansal, Adv.

Versus

M/s Hewlett Packard India (P) Ltd.
(now merged with Hewlett Packard India Sales (P) Ltd.)
Maa Anandmai Marg
Chandi Wala Estate
New Delhi
...Respondent

Through Mr. Soli Dastur, Sr. Advocate with
Mr. Kaanan Kapur and Mr. Madhur
Aggarwal, Advs.

Coram:

HON'BLE MR. JUSTICE MADAN B. LOKUR
HON'BLE MR. JUSTICE V.B. GUPTA

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

MADAN B. LOKUR, J.

The Revenue is aggrieved by an order dated 20th May, 2005 passed by the Income Tax Appellate Tribunal, Delhi Bench 'D' in ITA No.5417/Del/04 relevant for the assessment year 2001-2002.

2. The Revenue had raised five issues for our consideration. In respect of two of those issues, it was stated by learned counsel for the Revenue on 23rd May, 2007 that the matter is covered either by a judgment of this Court or by a judgment of the Supreme Court. As such, those two issues were not pressed. With regard to the remaining three issues, we heard learned counsel for the parties and in our opinion no substantial question of law arises in respect of these three issues also.

3. The first issue is whether the Income Tax Appellate Tribunal (the Tribunal) was correct in law in permitting the Assessee to lead additional evidence in accordance with Rule 46A of the Income Tax Rules, 1962 (the Rules).

4. It appears that the Assessee had wanted to lead additional evidence before the Commissioner of Income Tax (Appeals) [CIT (A)] but the request was declined. Against this view expressed by the CIT (A), the Assessee approached the Tribunal which held that the CIT (A) ought to have taken the additional evidence on record. In our opinion,

no substantial question of law arises for consideration out of this finding.

5. But that apart, we have been told by learned counsel for the Assessee that as a result of the Tribunal permitting the Assessee to lead additional evidence, the matter was remanded to the file of the Assessing Officer and now, the Assessing Officer has, after taking the additional evidence on record, passed a fresh assessment order in February, 2007 accepting the contention of the Assessee on merits. The assessment order appears to have been accepted by the Revenue and, therefore, the entire exercise in this regard has become academic.

6. Even otherwise, out attention has been drawn to a decision of this Court in ***R. Dalmia v. Commissioner of Income Tax (Central), [1978] 113 ITR 522*** wherein this Court held that it is entirely for the Tribunal to decide whether to admit additional evidence or not. The Tribunal has a discretion in doing so and no question of law would arise if additional evidence was led provided the Tribunal had not acted on any wrong principle.

7. Nothing has been shown to us to suggest that in the present case, the Tribunal had acted on a wrong principle. Clearly, therefore, no substantial question of law arises for consideration.

8. The second issue relates to a provision of Rs.83,38,507/- for warranties which was allowed by the Tribunal. According to learned counsel for the Revenue, the amount did not represent an accrued liability and, therefore, the Tribunal was not justified in allowing the provision made.

9. In this regard, it is worth noting that the Assessee follows the mercantile system of accounting and it carries on the business of dealing in computers and computer peripherals. The sales of the Assessee run into a huge volume and are spread over a large geographical area. The Assessee provides a warrantee to its customers for replacing defective parts within a period ranging from one to three years depending upon the goods supplied. This obligation to accept the warrantee claim is in-built in the contract of sale that the Assessee enters into with its customers. This is not disputed by the Revenue.

10. According to the Revenue, the liability is contingent upon a defect appearing in the goods and the customer informing the Assessee about the defect. It was submitted that till then there is no liability which accrues and, therefore, the claim for deduction is based on an estimate and the liability may or may not fructify.

11. The Tribunal has noted that because of the large volume of the

goods and a large geographical area in which they are sold as well as the fact that the claim for warrantee is in-built in the contract that the Assessee has with its customers, the warrantee liability cannot be construed to be a contingent liability. The incurring of a liability is reasonably certain.

12. In this regard, the Tribunal placed reliance upon ***Bharat Earth Movers v. Commissioner of Income Tax, [2000] 245 ITR 428*** wherein the Supreme Court observed as follows:

> "If a business liability has definitely risen 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 as contingent one. The liability is in presenti 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."

13. Reference was also made to ***Commissioner of Inland Revenue v. Mitsubishi Motors, New Zealand, [1996] 222 ITR 697 (PC).*** Relying upon these two decisions and the facts noted above as well as the fact that the Assessee follows the mercantile system of accounting, the Tribunal held that the provision for warrantee claims was justified and is entitled to a deduction.

14. On the issue of the basis of estimating the liability, the Tribunal took note of the fact that the Assessee followed a scientific method of making the estimate. This was based on the past historical cost, failure rate experienced in the past, the length of warrantee, increase in volumes, etc. On this basis, it was held that the estimation made by the Assessee was not at all arbitrary and, therefore, the Assessee was entitled to succeed in the appeal.

15. We cannot find fault with the view taken by the Tribunal inasmuch as it has been held by this Court in ***Commissioner of Income Tax v. Vinitec Corporation Pvt. Ltd., [2005] 278 ITR 337*** that where the warrantee clause is a part of the sale document and it imposes a liability on the assessee to discharge its obligation for the period of warrantee, the liability could be capable of being construed in definite terms and, therefore, could be deducted while working out the profits and gains of business.

16. This Court referred to the decision of the Supreme Court in ***Bharat Earth Movers*** as well as the decision of the Privy Council in ***Mitsubishi Motors***. It was observed, following ***Bharat Earth Movers***, that in a case where the assessee follows the mercantile system of accounting, the liability would accrue in presenti but it may be

quantified and discharged at a future date and the assessee would be entitled to claim a deduction thereon.

17. The decision in ***Vinitec Corporation*** was followed by another Division Bench of this Court in ***Commissioner of Income Tax v. Sony India (P) Ltd., [2007] 160 Taxman 397.*** The matter now having been conclusively settled by this Court in at least two decisions, no substantial question of law arises for consideration.

18. The third issue relates to deduction in respect of provision made by the Assessee for doubtful debts, customs duty, warrantee, gratuity and loss due to foreign exchange rate fluctuations while computing the book profit for the purposes of Section 115-JB of the Income Tax Act, 1961 (the Act).

19. In so far as the provision for customs duty is concerned, learned counsel for the Revenue rightly did not press that because it appears that the provision was made as a result of a demand notice raised by the customs authorities. In respect of the matter of warrantee, we have already dealt with this and on the question of loss due to foreign exchange rate fluctuations, the matter was not pressed by learned counsel for the Revenue as noted in our order dated 23rd May, 2007. The two provisions that we are concerned with, therefore, are

with regard to doubtful debts and gratuity.

20. At the outset, we may state that book profits for the purposes of Section 115-JB of the Act is the profit shown in the profit and loss account prepared in accordance with Part II and III of Schedule VI of the Companies Act, 1956. As held by the Supreme Court in ***Apollo Tyres Ltd. v. Commissioner of Income Tax, [2002] 255 ITR 273***, the profit and loss account so prepared cannot be changed unless it is not drawn up in accordance with the provisions of the Companies Act, 1956. This should be a complete answer to the contention raised by learned counsel for the Revenue.

21. Nevertheless, in so far as the provision for doubtful debts is concerned, it was contended that this is not an ascertained liability. We cannot agree with this proposition in view of Explanation (c) to Section 115-JB(2) of the Act. It has been held by this Court in ***Commissioner of Income Tax v. Eicher Ltd., [2006] 287 ITR 170*** that Explanation (c) to Section 115-JA(2) of the Act makes it clear that the book profit means a net profit as shown in the profit and loss account as increased by an amount set aside for meeting liabilities other than ascertained liabilities. It cannot be said that a bad and doubtful debt is not an ascertained liability. That being so, Explanation (c) to Section 115-

JB(2) of the Act (which is similar to Explanation (c) to Section 115-JA(2) of the Act) would not come into play.

22. In ***Commissioner of Income Tax v. HCL Comnet Systems and Services Ltd., [2007] 292 ITR 299***, it was noted that the expression 'provision' defined in Part III of Schedule VI to the Companies Act, 1956 means any amount written off or retained by way of providing for depreciation renewals or diminution in value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy. In respect of a bad or doubtful debt, there would be a diminution in the value of assets and consequently such an amount cannot be included in the book profits.

23. In view of the two decisions of this Court, we do not think that any substantial question of law arises for consideration in this regard.

24. As regards the provision for gratuity, the Tribunal has found that that provision was made on the basis of actuarial valuation.

25. In this regard, learned counsel for the Assessee drew our attention to ***Metal Box Co. of India Ltd. v. Their Workmen, [1969] 73 ITR 53*** wherein it has been observed at Page 67 of the Report that an estimated liability under gratuity schemes (such as the one that was before the Supreme Court), if properly ascertainable, is deductible from

the gross receipts while preparing the profit and loss account.

26. In ***Delhi Flour Mills Co. Ltd. v. Commissioner of Income Tax, [1974] 95 ITR 151***, the Supreme Court applied the principle enunciated in ***Metal Box*** and held as follows:-

> "In other words, the gratuity payable to an employee represents a part of the emoluments payable to him for rendering service during each year. The right to receive gratuity accrues to the employee as soon as he completes one year of service and, as a corollary, the liability to pay the gratuity to the employee arises to the assessee at the end of each year. The amount of the liability is also ascertainable and there is no question in the present case of the discounted present value of the liability being not ascertainable. It is no doubt true that the actual payment of the gratuity is deferred to a later date on the happening of a certain event, namely, death or voluntary retirement of the employee. But, as observed by the Allahabad High Court, these are not uncertain events. Therefore, the provision made by the assessee for the payment of gratuity under the agreement dated February 14, 1956, is in the nature of a revenue expenditure in respect of the assessment years under reference."

27. As already mentioned above, the Tribunal has found as a matter of fact that the provision was made on the basis of actuarial valuation. That being so, and in view of the two decisions referred to hereinabove, no substantial question of law arises for consideration.

28. Learned counsel for the Revenue submitted that it has been recorded by the Assessing Officer that the Assessee was asked to state as to why the provision for doubtful debts etc. has been added back for

the purposes of computing profit under Section 115-JB of the Act but the Assessee did not submit any reply and, therefore, the adjusted book profit had to be increased by the amounts set aside for provisions made for meeting liabilities, other than ascertained liabilities. We are of the view that this observation cannot be of much assistance to learned counsel for the Revenue, particularly in view of the facts and the law that we have discussed above. Merely because the Assessee did not submit a reply at the appropriate stage cannot, on the facts of this case, lead to any adverse conclusion against the Assessee.

29. Since no substantial question of law arises for consideration, the appeal is dismissed.

MADAN B. LOKUR, J

March 31, 2008
ncg

V.B. GUPTA, J

Certified that the corrected copy of the judgment has been transmitted in the main Server.