



IN THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 19th January, 2010

+ **ITA 82/2010**

COMMISSIONER OF INCOME TAX Appellant
Through: Ms P.L. Bansal

versus

WOODWARD GOVERNOR INDIA LTD. Respondent
Through: Mr Prakash Kumar

CORAM:

HON'BLE MR JUSTICE BADAR DURREZ AHMED

HON'BLE MR JUSTICE SIDDHARTH MRIDUL

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

BADAR DURREZ AHMED, J (ORAL)

CM 628/2010 (Exemption)

Allowed subject to all just exceptions.

The application stands disposed of.

ITA 82/2010

1. The Revenue has filed this appeal in respect of the assessment year 2004-05 against the order dated 26th March, 2009 passed by the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') in ITA No. 1973/Del/2008



2. The issue raised before the Tribunal was with regard to the disallowance of the provision made for warranty expenses amounting to Rs 31,35,150/-

3. In the course of the assessment proceedings, the Assessing Officer noticed that the assessee had claimed warranty expenses as under:-

(i)	Warranty on actual expense basis	Rs 35,69,999/-
(ii)	Provision for warranty expenses	<u>Rs 31,35,150/-</u>
		<u>Rs 67,05,149/-</u>

4. The Assessing Officer asked the assessee to explain as to why the provision for warranty expenses amounting to Rs 31,35,150/- should not be disallowed, inasmuch as the claim of provision for warranty expenses was contingent in nature. The Assessing Officer pointed out that in earlier years, the claim of warranty expenses were on payment basis i.e., on actual basis, but in the current year the assessee was claiming warranty expenses on both actual payment basis as well as on accrual basis by making provision for warranty expenses and the assessee was, therefore, following a mixed accounting system, which was not permissible under Section 145 of the Income Tax Act, 1961 (hereinafter referred to as 'the said Act').

5. Regarding the provision for warranty expenses, the assessee explained that the same was made by quantifying the amount on the basis of sales of 18 months beginning from October, 2002 to 31st March, 2004, by taking the average rate at which the warranty expenses had been incurred on payment



basis in the past. The assessee indicated that it had taken into account the sales of six months of the immediate previous year i.e. of October, 2002 to March, 2003, since the claim of warranty in respect of the same were to be settled in the current year itself.

6. The Assessing Officer considered the submissions made by the assessee and took the view that the assessee was not entitled to claim warranty expenses on provision basis in respect of the prior period sales i.e., period from October, 2002 to March, 2003 and as such an amount of Rs 10,41,476/-, being the provision for warranty relating to that period, was disallowed under Section 37(1) of the said Act. It was further observed that warranty claims are contingent i.e., dependent upon the happening of an event in future, such as, a fault occurring in the goods and resultant claims made by the customers. As a result, the Assessing Officer disallowed the assessee's total claim for provision made for warranty amounting to Rs 31,35,150/- by treating the same to be of a contingent nature.

7. The Commissioner of Income Tax (Appeals) confirmed the finding of the Assessing Officer.

8. Being aggrieved, the assessee preferred an appeal before the Tribunal. Since the assessee had been allowed the claim of actual warranty expenses amounting to Rs 35,69,999/-, the dispute before the Tribunal was only with regard to the provision for warranty expenses amounting to Rs 31,35,150/- made during the year by changing the accounting system



from actual payment basis to accrual basis. The assessee had calculated the provision amounting to Rs 31,35,150/- by applying an average rate of 1.1% to the total sales made from October, 2002 to March, 2004. The Tribunal held that the working of the average rate of warranty expenses was rational and scientific and thus acceptable, however, the rate had to be applied to the sales made during the current year only. The sales made during the period from October 2002 to March, 2003 had been recognized in the previous year ended on 31st March, 2003 and the assessee had incurred actual warranty expenses in the current year with regard to the same. Moreover, the actual warranty expenses amounting to Rs 35,69,999/- had already been allowed by the Assessing Officer and thus there was no reason to make a provision for warranty expenses for the sales of the previous year. Consequently, the Tribunal reduced the provision of Rs 31,35,150/- by the sum of Rs 10,41,476/- pertaining to sales for the period from October, 2002 to 31st March, 2003. As such, the provision for warranty expenses during the year were to be reduced to Rs 20,93,674/- (Rs 31,35,150 – Rs 10,41,476/-). The figure of Rs 25,28,523/- mentioned in the impugned order is incorrect. However, the principle adopted by the Tribunal is correct, inasmuch as the sum of Rs 10,41,476/- is to be reduced from the provision for warranty expenses as claimed by the assessee.

9. The Tribunal also held that in view of the decision of this Court in the case of **Commissioner of Income Tax v. Vinitec Corporation Pvt. Ltd.**: 278

ITR 337 (Del), the provision made by the assessee for the current year, on



the basis of past year figures, towards warranty liability to be discharged in the future, was an accrued liability and not contingent in nature and, therefore, was allowable as deduction in computing profit and gains of the business. We may also point out that the said decision of this Court has been confirmed by the Supreme Court as reported in **309 ITR (Statute) 54**.

10. In view of the foregoing, we see no error in the impugned order, apart from the calculation error mentioned above. No substantial question of law arises for our consideration. The appeal stands disposed of.

BADAR DURREZ AHMED, J

SIDDHARTH MRIDUL, J

JANUARY 19, 2010

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