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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% Date of Decision : 29th May, 2012.

\+ ITA 255/2012

EICHER MOTORS LTD ..... Appellant
Through: Mr. Ajay Vohra with Ms. Kavita Jha & Mr. Somnath Shukla, Advocates.

versus

CIT ..... Respondent
Through: Mr. N. P. Sahni, Sr. Standing Counsel.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V. EASWAR

SANJIV KHANNA,J: (ORAL)

The impugned findings recorded by the Income Tax Appellate Tribunal ('Tribunal', for short) in their order dated 16.09.2011 in the case of Eicher Motors Ltd. are as under: -

> "*Thus, the CIT (A) has granted the part relief. The CIT (A) has accepted the settled legal position. Provisions for warranty based on scientific study and calculated on the basis of actuarial and past history of case is allowable. In all cases relied upon by learned AR, it has been held that*

provision for warranty is allowable only when it is based on scientific study basis and past history of case. Provision of warranty is a present obligation as a result of past events resulting in an outflow of resources and a reliable estimate could be made of the amount of obligation. As stated above, assessee has been granted part relief by CIT (A) on the estimate for provision based on past history. The method of accounting for such liability must be scientific. The trend for increase in claims must be based on reality. The trend must be based on actual incidences. Since assessee has failed to show or establish that claim had been increased, therefore, additional warranty of ₹91.70 lacs supposedly for eng. & transmission for LCV could not be allowed. The additional claim for provision of warranty which is not based on the past history of case is unjustified and contingent. The assessee's claim that there is increasing trend in the warranty has been taken care of by the provision for warranty which is based on past history. In absence of any further ascertainable liability based on scientific study and reliable estimate, cannot be an allowable provision for warranty in view of the decision of Hon'ble Supreme court and also in view of the decision of Hon'ble Delhi High Court in the case of Whirlpool of India Limited (cited supra) wherein the Hon'ble Court has clearly held that such provision should be based on scientific study and actuarial basis. In view of these facts, we see no reason to deviate from the decision taken by the CIT (A) on this issue. This ground of assessee's appeal is dismissed."

2. The appellant-assessee is in the business of manufacture and sales of automobiles in India and by way of export. During the period relevant to the assessment year 2005-06 the appellant-assessee had estimated and made provision towards warranty claim of ₹1424.12 lakhs, which was

bifurcated into the following heads: -

1)	Normal warranty (@ 0.39% on domestic sales + 0.89% on export sales)	₹951.00
2)	Extended warranty on Engine and Transmission component in light commercial vehicle (LCV) for one year (@ 0.39% on percentage sales of LCV to total sales of commercial vehicles during the year (81%) and percentage of warranty claim settled in past on engine and transmission components (70%))	₹285.69
3)	Extended warranty for one year on HCV (@ 0.39%) of percentage of sales of HCV to total sales of commercial vehicle (19%))	₹95.73
4)	Additional provision for warranty on domestic sales, considering the increase in trend of settlement of actual warranty claims in the past	₹91.70 lacs
	Total	₹1424.12 lacs

3. Learned counsel for the appellant has produced before us a chart which for the sake of convenience we are reproducing as table A. The said chart shows the domestic sales during the financial years 2001-02 to 2004-05. It also discloses the average warranty claim made during the last three preceding years on the basis of which provision for warranty was computed. The chart also states the actual warranty claim made on domestic sales: -

TABLE 'A'

Particulars	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05
Sales Domestic	43847.98	59724.68	79397.12	129194.67
Average of actual warranty to total sales in last three years –Domestic	0.56%	0.42%	0.33%	0.39%
Normal provision for warranty (on domestic sales)	245.54	421.61	224.64	885.28
Actual warranty claims on Domestic sales	117.73	229.75	375.80	683.32
% of actual warranty to domestic sales	0.27%	0.38%	0.46%	0.53%
Addl. Provision for warranty (upward revision of last three years' average from 0.39% to 0.43%)				91.70

4. Today during the course of hearing, learned counsel for the appellant has filed before us another chart which gives bifurcation of the provision of warranty claim in respect of the assessment year 2005-06 on commercial vehicles division, two-wheeler and Tractor division domestic sales. The said table (table B) is as under: -

"TABLE – B"

Movement of Provision for warranty for the FY 2004-05

Rs. in lacs

Particulars	Commercial Vehicles Division	Two Wheelers & Tractors Division	Total
Opening balance as on 01.04.2004	462.98	350.95	813.93
Additions during the year	1,034.76	389.36	1,424.12
Claims paid during the year	(714.10)	(341.35)	(1,055.45)
Closing balance as on 31.03.2005	783.64	398.96	1,182.60

5. At the outset we may note that the dispute/ subject matter of the present appeal is in respect to the disallowance of the 4th claim/head i.e. claim of additional warranty on domestic sales of Rs.91.70 lakhs. There is no dispute and the Revenue has accepted the claim of appellant-assessee with regard to the normal warranty at the rate of 0.39% on domestic sales and 0.89% on export sales. There is also no dispute with regard to item Nos.2 & 3 which pertain to the extended warranty on engineering and transmission for LCV and extended warranty of one year on HCV of ₹285.69 and ₹95.73 lakhs, respectively.

6. As per the findings recorded by the Assessing Officer and the Tribunal, the assessee has computed the provision for warranty by taking average of warranty claims in the last three years excluding the previous year in question. On this basis, the warranty claim provision made in the

assessment year 2001-02 was 0.56% of the domestic turnover but decreased to 0.42% in the assessment year 2003-04 and to 0.28% or 0.33% for the assessment year 2004-05. Learned counsel for the appellant however says that there was miscalculation and extended warranty was not provided in the assessment year 2004-05. This aspect was not raised before the authorities/Tribunal. We are only referring to the figures/chart before the authorities/Tribunal. Keeping in view the average warranty claims in the assessment year 2002-03 to 2004-05 deduction towards warranty claim of 0.39% was made and has been allowed for the assessment year 2005-06. The figure is ₹951 lakhs. Additional warranty has been allowed both in respect of LCV and HCV of ₹285.69 and ₹95.73 lakhs, respectively.

7. The claim of the appellant-assessee is that as the warranty claims had shown an increase and therefore the appellant-assessee wanted to make an additional warranty of ₹91.70 lakhs in the assessment year 2005-06. It is this claim, which has been rejected by the Tribunal holding that the assessee has been regularly following and computing the provision of warranty claim on average of last three years. In this year, because of extended warranty claim further benefit as additional warranty has been given to the assessee.

8. The appellant submits the additional warranty claim is justified as the claims have shown an upward trend. The appellant's right has been abbrograted and denied

9. We notice from the Table No.B above that the opening balance as on 01.04.2004 in respect of commercial vehicle division was ₹462.98 lakhs and addition towards provision towards warranty of ₹1034.76 was made during the year in question. The total warranty claims were ₹714.10 lakhs and the closing balance under the head provision for warranty, therefore, increased to ₹783.64 lakhs. Thus, there was substantial increase in the surplus at the end of the year. The figure/amount available to meet the warranty claims increased from ₹462.98 to ₹783.64 lakhs as on 31.3.2005.

10. Learned counsel for the appellant submitted that the increase in the closing balance was due to increase in the sales/ turnover of the assessee and it also represents subsisting liability towards warranty liability. This is partly correct as the turnover is also reflected and forms part of the corpus which is calculated @ 0.39% of the turnover. The vehicles sold were also subject matter of warranty during the assessment year. The increase in surplus available is substantial. Lastly, it is apparent that there have been increase and decrease in warranty claims in past but the estimate was calculated on the formula of average of last three years. In the assessment year 2002-03 the provision for warranty claim was calculated at 0.56%. Thus this was not a new trend or abnormal situation. The increase in percentage allowed, is only due to increase in warranty claims. Keeping the said aspect in mind we do not think that the order of

the Tribunal calls for any interference.

11. At this stage learned counsel for the appellant-assessee has relied on the decision of the Supreme Court in ***Rotork Controls India P. Ltd. v. CIT***, (2009) 314 ITR 62 (SC). Our attention has been drawn to the following paragraphs: -

> "…….*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……"*
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> *XXX XXX XXX*
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> *"……This aspect, therefore, indicates that the present value of the contingent liability like the warranty expense, if properly ascertained and discounted on accrued basis, could be an item of deduction under section 37 of the said Act. This aspect is not noticed in the impugned judgment. We may add a caveat. As stated above, the principle of estimation of the contingent liability is not the normal rule. As stated above, it would depend on the nature of business, the nature of sales, the nature of the product manufactured and sold and the scientific method of accounting being adopted by the assessee……."*

12. In the said case the Supreme Court had examined, what is a

warranty provision and whether the provision is a liability which can be claimed as an expense. The observations record that an assessee is entitled to compute the warranty provision on the basis of estimate every year for future warranty expenses. Such estimates may be re-assessed every year but the re-assessment has to be on some scientific method of accounting which is to be adopted by the assessee. In the present case the Tribunal has noticed that the scientific method constantly adapted and followed by the assessee was on the basis of average of last three years. In the present case the warranty provision was increased from 0.28% to 0.39% of the turnover. We have also noticed that earlier in point of time in the assessment year 2002-03, the warranty provision was as high as 0.56%. In the year, the assessee had enhanced the warranty provision on the basis of the formula regularly followed and adopted. The assessee wants to make an additional provision of ₹91.70 lakhs over and above ₹885.28 lakhs already made. This is an increase of more than 12% in the provision for warranty as per the formula regularly adopted. On year and year basis, surplus has been increasing. We also record that initially before the Assessing Officer claim of Rs.9170 lacs was made for a different reason i.e. Additional warranty (Engineering & Transmission on LCV) for earlier years (See Broad Submissions of the assesse and para 3.2 of the assessment order).

13. Reference may be made to the Delhi High Court judgment in ***CIT v. Whirlpool of India Ltd.***, ITA No.1154/2009 decided on 24.01.2011. In

the said case it was held as under: -

> "*20. The legal principle delineated in the aforesaid judgment would clearly demonstrate that whenever there is a warranty clause in the bulk product sold by the company/assessee to its customers, warranty provision can be made and it would not be treated as contingent liability. There is no quarrel to this proposition and in fact in this very case the assessee has been making the provisions for warranty every year which was accepted by the AO. The question that really calls for an answer is as to whether such a provision which has already been made in the previous years can be revised later on in a particular year as sought to be done by the assessee in the present case. Going by the reasons which justifies making of such a provision and treating them as expenditure under Section 37 of the Act, more particularly when it fulfills the accrual concept as well the matching concept, we see no reason as to why the assessee could be precluded from revising this provision after taking into consideration that warranty period of the goods sold under warranty was existing provision already provided in a particular is falling short of the expected claims that may be received. It is, however, to be kept in mind that such a provision is based on scientific study and actuarial basis that is precisely done by the assessee in the instant case and, therefore, we see no reason to differ with the view taken by the Tribunal in the impugned order. We, therefore, answer this question no.'(a)' in the affirmative.*"

14. A careful reading of the said paragraph reflects that while estimating the provision for warranty the closing balance at the end of the year in respect of a warranty provision can be taken into consideration. As noticed above in Table B, the provision for warranty standing in the

books of accounts has increased from ₹462.98 lakhs to ₹783.64 lakhs. The said jump is quite substantial. In these circumstances we do not think that the order of the Tribunal calls for any interference. No substantial question of law arises. The appeal is dismissed.

SANJIV KHANNA, J

R.V.EASWAR, J

MAY 29, 2012
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