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

% *Date of Decision: 30.09.2024*

\+ **ITA 551/2023 & CM Nos. 49717/2023 & 49718/2023**

PR. COMMISSIONER OF INCOME TAX -7, DELHI .....Appellant
Through: Mr. Puneet Rai, Mr. Ashvini Kumar & Mr. Rishabh Nangia, Advs.

Versus

SONY INDIA PVT. LTD. .....Respondent
Through: Mr. Nageswar Rao & Mr. Parth, Advs.

CORAM:
HON'BLE MR. JUSTICE VIBHU BAKHRU
HON'BLE MS. JUSTICE SWARANA KANTA SHARMA

VIBHU BAKHRU, J.

1. The Revenue has filed the present appeal under Section 260A of the Income Tax Act, 1961 (hereafter *the Act*) impugning an order dated 17.10.2022 passed by the Income Tax Appellate Tribunal (hereafter *the Tribunal)* in ITA No.493/Del/2021 captioned *M/s Sony India Pvt. Ltd. v. National E-Assessment Center*.

2. The Assessee had preferred the aforesaid appeal (ITA No.493/Del/2021) assailing a final assessment order dated 30.03.2021 passed under Section 143(3) of the Act read with Section 144C(13) and Sections 143(3A) and 143(3B) of the Act, for the assessment year (AY) 2016-17. The assessee's appeal was partly allowed.

3. The assessee company is engaged in the business of import and distribution of various products under the brand name 'Sony', which are

mainly audio and visual entertainment products. The assessee filed its income tax return on 30.11.2016 in respect of AY 2016-17 declaring a total income of ₹2,42,88,96,600/-. The assessee company also disclosed book profits of ₹98,16,78,477/- under Section 115JB of the Act. The return filed was picked up for scrutiny. The assessee had cross border transactions with associated enterprises (AEs) and the Assessing Officer (AO) referred the matter to the Transfer Pricing Officer (hereafter *TPO*) for examining whether the transaction with AEs were on arm's length basis.

4. The learned TPO passed an order dated 29.10.2019 proposing an adjustment of ₹5,66,31,02,637/-.

5. The AO framed a draft assessment order dated 31.12.2019, which also included the adjustments proposed by the learned TPO. Apart from the adjustments, the AO also proposed disallowance on account of stock valuation loss, royalty, and provision for warranties. The AO also proposed addition of corporate social responsibility (CSR) expenditure for computing Minimum Alternate Tax (MAT) under Section 115JB of the Act. The AO found fault with the assessee valuing the closing stock at a value less than the cost. The AO also reduced part of the provisions for warranty of product as the AO found that the warranty provisions were excessive. The AO held that the expenditure incurred for CSR was not required to be taken into account for the purposes of determining the book profits.

6. The assessee filed its objections before the Dispute Resolution Panel (hereafter *the DRP*), which was rejected by the order dated 27.01.2021. Thereafter, the AO framed the final assessment order dated 30.03.2021.

7. The Tribunal set aside an adjustment of ₹14,69,89,634/- on account of

royalty in respect of Sony products manufactured by Moser Bear India Ltd. (hereafter *MBIL*) and Competition Team Technology [India] Pvt. Ltd. (hereafter *CTTL*) as original equipment manufacturers (OEMs).

8. Insofar as the valuation of closing stock is concerned, the Tribunal found that the assessee had consistently followed Accounting Standard – AS 2 – for valuation of closing stock. The same was valued on the basis of cost or net realisable value, whichever is lower. Therefore, the Tribunal found that the addition or disallowance on account of valuation of closing stock was not sustainable. The Tribunal also rejected the addition of ₹52,12,77,597/- made by the AO on account of excessive provision for warranties. The Tribunal held that the assessee was entitled to deduction on account of provision made to meet the claims arising out of product warranties.

9. The Tribunal also accepted the assessee's contention that CSR expenditure amounting to ₹4,56,46,135/- was required to be taken into account under Section 115JB of the Act.

10. In the aforesaid context, the Revenue has projected the following questions for consideration of this Court:

> "A. Whether on the facts and circumstances of this case, Hon'ble ITAT was justified in not appreciating that Moser Baer India Ltd. (MBIL) and Competition Team Technology India Pvt. Ltd. (CTTL) are liable to pay royalty to the AE Sony Corporation, Japan since these companies are the ultimate users of the intangibles in the form of licensed patents and know-how provided by the AE Sony Corp, Japan for manufacturing of licensed products?
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> B. Whether on the facts and circumstances of this case, the

Hon'ble ITAT was justified in not appreciating that the assesse company had not used the licensed patents and know- how for manufacturing of licensed products and accordingly it is not liable to pay royalty charges to the owner of the intangibles i.e. the AE?

C. Whether on the facts and circumstances of this case, the Hon'ble ITAT has erred in relying upon the decision of this Hon'ble Court in case of Cushman and Wakefield (ITA No. 475/2012) whereas the issues involved in this case are different from that of the assessee's case as arm's length price of International transactions related to payment of royalty has been determined by the TPO within the authority as prescribed u/s 92C of the Act?

D. Whether on the facts and circumstances of this case, the Hon'ble ITAT was correct in not appreciating the action of the TPO for calculating ALP at NIL for royalty payment made by the assessee to the AE Sony Corp for the licensed patents and know-how which are actually used by third parties and not by the AE?

E. Whether on the facts and circumstances of this case, the Hon'ble ITAT was correct in deleting the disallowance made by the assessing officer on account of stock valuation loss without appreciating that any provision for diminution in the value of assets is not allowable deduction either under the normal provisions of the Act or u/s 115JB of the Act?

F. Whether on the facts and circumstances of this case, the Hon'ble ITAT was correct in deleting the disallowance made by the assessing officer on account of CSR, the same being not covered by section 33AC of the Act and was actually in the nature of a reserve which needs to be added back to the book profits?

G. Whether on the facts and in the circumstances of this case, the Hon'ble ITAT was correct in deleting the disallowance made by the assessing officer on account of provision for warranty without appreciating that the

excess provision is proposed to be added under the normal provisions as well as book profits?"

11. As briefly noted above, the controversy in the present appeal relates to four issues – (i) deletion of the adjustment on account of royalty paid by the assessee on products, manufacturing of which was outsourced to OEM manufacturers – MBIL and CTTL; (ii) the additions of ₹10,42,09,037/- on account of closing stock being valued on cost or market value, whichever is less; (iii) addition of ₹52,12,77,597/- on account of excess provision for warranty; and (iv) addition of CSR expense of ₹4,56,46,135/- for determining the book profits under Section 115 JB of the Act.

PAYMENT OF ROYALTY

12. The assessee had entered into different types of international transactions with AEs. The same also included payment of royalty of a total value of ₹14,69,89,634/-. The said payment was subject to examination by the learned TPO for determining whether the same was on arm's length basis. The assessee had explained that there were certain categories of products where the manufacturing activities were outsourced to the OEMs (original equipment manufacturers) appointed by Sony Corporation, Japan. The assessee had obtained the license for manufacturing and selling of various products including blank optical disc of CD-R, CD-RW, DVD + R, DVR-R, DVD-RW and USB Memory under the Sony brand name.

13. The products were manufactured by the OEMs and supplied to the assessee. The learned TPO held that since the goods were manufactured by the OEMs, the same did not justify any payment of royalty by the assessee to the AE. Accordingly, the TPO held that royalty amount of ₹2,79,43,965/- paid

in respect of goods manufactured by MBIL and ₹10,04,88,528/- in respect of goods manufactured by CTTL were required to be benchmarked at Nil. Thus, according to the learned TPO, no royalty was payable on the goods of Sony brand dealt with by the assessee, which were manufactured by MBIL and CTTL.

14. The assessee had furnished the agreements with the concerned parties. It submitted that Sony Corporation, Japan had not licensed any technology to MBIL and CTTL but had only set out terms and conditions, which would govern the transactions between Sony Corporation or any of its subsidiaries with MBIL and/or CTTL. The assessee had also set out the commercial arrangement between the assessee and the AEs, which required payment of royalty.

15. The Tribunal referred to the decision of this Court in ***Commissioner of Income Tax-I v. M/s Cushman and Wakefield (India) Pvt. Ltd., Neutral Citation No. 2014:DHC:2764-DB*** and faulted the learned TPO for ignoring the commercial expediency and benchmarking the payment of royalty at Nil. The Tribunal held that the learned TPO was required to conduct a study to determine the arm's length price and not to determine the commercial expediency of the international transactions with the AEs. The Tribunal also accepted that Sony Corporation, Japan had invested significant amount for intangible properties, which the assessee has the license to use. The Tribunal examined the agreement between the assessee and Sony Corporation, Japan in respect of LCD TV products and other related components, whereby Sony Corporation, Japan had granted certain license for intangible properties to the assessee. The relevant extract of the said agreement, which indicates the scope of license, under the said agreement, as noted by the Tribunal is

reproduced below:

> (1) SONY hereby grants to SID a non-exclusive, indivisible, non-assignable and non-transferable and non-sublicensable license under the LICENSED PATENTS and/or the LICENSED KNOW-HOW (i) to manufacture or have the SUBCONTRACTOR manufacture the LICENSED PRODUCTS in the TERRITORY by using the COMPONENTS, and (ii) to sell, use lease or otherwise dispose of such LICENSED PRODUCTS in the TERRH ORY.
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> (2) SONY hereby grants to SID, a non-exclusive, indivisible, non-assignable, non-transferable and non-subliceasable license to use the LICENSED TRADEMARKS in the TERRITORY (i) to manufacture or have the SUBCONTRACTOR manufacture the LICENSED PRODUCT'S which shall meet the quality requirements to w'hich reference is made in Paragraph (1) of ARTICLE V of this Agreement, and (ii) to sell, use, lease, otherwise dispose of the"

16. In terms of the said agreement referred to by the Tribunal, the assessee had agreed to pay the royalty equal 2% on the net sales (as determined in terms of the agreement) as license fee.

17. On the basis of the material on record, the Tribunal concluded that MBIL and CTTL were manufacturing sub-contractors and the assessee had been granted the license for use of the license patents, license know-how, and license trademarks. The assessee was also entitled to get the products manufactured through sub-contractors. The Tribunal also observed that it was not the Revenue's case that MBIL and CTTL had paid royalty to Sony Corporation, Japan for manufacturing their products and using the licensed patents, know-how and trademarks. The said finding of fact is not controverted.

18. In view of the above, we are unable to accept that any question of law arises regarding disallowance on account of royalty paid by the assessee to the AEs. It is not disputed that the learned TPO is not required to examine the efficacy of commercial transactions and its role is confined to determining the price or value of the transactions on an arm's length basis. We find no infirmity with the conclusion of the Tribunal.

(II) RE: VALUATION OF CLOSING STOCK

19. The assessee had valued its opening stock and closing stock on the basis of cost or net realisable value, whichever is low. The AO had faulted the assessee from valuing the stock at a value lower than the cost. There is no dispute that the assessee had been consistently valuing its stock – both opening stock and closing stock – on the basis of cost or realisable value, whichever is lower. The aforesaid basis is well accepted for valuation of stock. The said basis was also noted by the Supreme Court in ***CIT v. Woodword Governor India (P.) Ltd.: (2009) 312 ITR 254***. The learned counsel for the Revenue also does not dispute that if the aforesaid basis is followed consistently, the assessee's income for the year would be fully captured as the element of profit would also not be included in the opening stock.

20. The finding of the Tribunal cannot be faulted. Clearly, no substantial question of law arises from the decision of the Tribunal to delete the addition made on account of the valuation of closing stock.

RE: EXCESS PROVISIONS FOR WARRANTY

21. The AO had made a deletion in the sum of ₹52,12,77,597/- on account

of excess provision for claims against warranties. The AO held that 1.75% of the total sales would be sufficient, which was determined at ₹1,41,98,33,755/-. The assessee had made a provision of ₹1,93,41,11,353/-. Thus, the AO held that the balance amount ₹52,12,77,597/- was excessive. It was the assessee's case that it had made the provision for meeting the claims against warranties on the basis of its past experience. This contention was accepted by this Court in an earlier decision of the assessee's own case relating to another assessment year. The AO was of the view that the assessee had taken advantage of the decision of this Court and had started creating large provisions in an irrational manner.

22. The assessee had provided a tabular statement, which set out its sales; opening provisions for warranties; the provision created and utilised during the year; and the closing amount of the provision. The said tabular statement as set out in the assessment order is reproduced below:

Particulars/ Years	Sales - 1	Opening Provision - 2	Created during the year - 3	Utilised during the year - 4	Reversed during the year - 5	Closing Provision - 6
FY 2009-10	38,56,32,59,962	20,08,23,000	25,68,01,929	27,13,71,000	-	18,62,53,791
FY 2010-11	56,95,58,20,877	18,62,53,791	38,11,09,522	35,63,44,000	-	21,10,19,753
FY 2011-12	67,55,54,46,980	21,10,19,753	71,86,87,000	61,15,41,000	-	31,81,65,585
FY 2012-13	82,58,65,19,196	31,81,65,585	94,07,69,817	82,47,13,833	-	43,42,21,569
FY 2013-14	1,00,16,42,25,151	43,42,21,569	3,05,99,84,007	2,05,20,38,088	-	1,44,21,67,488
FY 2014-15	1,10,10,30,08,336	1,44,21,67,488	2,47,41,55,169	2,56,83,83,121	-	1,34,79,39,537
FY 2015-16	80,73,33,57,459	1,34,79,39,537	1,93,41,11,353	2,31,42,46,202	-	96,78,04,688

23. The assessee had explained the manner of making the provisions. It

stated that for computing the provision, the assessee had taken into account the number of items reported for repair. On the said basis it determined the failure ratio and also the actual cost of repairing the product. The assessee stated that it divided the actual repair cost by the number of failure items for determining the provisions to be made. The above tabular statement clearly indicates that the provision for warranties has a direct co-relation with the volume of sales. During the relevant assessment year, the assessee has incurred an expenditure of ₹2,31,42,46,202/- but the provision made was much significantly lower by ₹1,93,41,11,353/-. Thus, the provision standing at the end of the financial year 2015-16 relevant to AY 2016-17, stood at ₹96,78,04,688/-, which was lower than the provision of ₹1,34,79,39,537/- for warranties at the end of the financial year 2014-15. It is apparent that this was because the sales in the financial years 2012-13, 2013-14 and 2014-15 were higher than the sales during the financial year 2015-16

24. The final assessment order dated 30.03.2021 does not indicate that the AO had conducted any detailed examination of the method of calculating the provison as adopted by the assessee. As noted above, the assessee had set out the method deployed and the calculation, however, the calculation of the same was not examined by the AO. Without examination in detail the methodology deployed by the assessee for determining the amount of provision, the AO's conclusion regarding the reasonableness and efficacy of the provision would at best be arbitrary and, thus, unjustified.

25. The Tribunal had taken note of the decision of this Court in ***Commissioner of Income Tax v. M/s Sony India (P) Ltd., Neutral Citation No.2006:DHC:24184-DB*** for the earlier assessment years, wherein this Court had observed as under:

"We have heard learned counsel for the parties and perused the order under challenge. The issue whether amounts set apart by the assessee to meet claims arising out of warranties issued by it to its customers can be taken as a permissible deduction under section 37 is no longer res integra in the light of a Division Bench of this Court in *Commissioner of Income Tax Vs. Vinitec Corpn (P.) Ltd*, ***278 ITR 337***. This Court has relied upon the decision of the Supreme Court in *Bharat Earth Movers Vs. CIT,* **245 ITR 428** and *Commissioner of Inland Revenue v. Mitsubishi Motors New Zealand Ltd.*, **222 ITR 697** held that the liability arising out of a warranty is an allowable deduction even when the amount payable by the assessee is quantified and discharged in future. The following passage from the above decision is in this regard apposite:

> "The ratio decidendi of the above cases is squarely applicable to the facts of the present case. It is not disputed that the warranty clause is part of the sale document and imposes a liability upon the assessee to di scharge its obligations under that clause for the period of warranty. It is a liability which is capable of being construed in definite terms which has arisen in the accounting year. May be its actual quantification and discharge is deferred to a future date. Once an assesee is maintaining his accounts on the mercantile system, a liability accrued, though to be discharged at a future date would be a proper deduction while working out the profits and gains of his business, regard being had to the accepted principles of commercial practice and accountancy."

In the instant case also, the assessee has on the basis of the past experience and the extent of claims made against it, set apart different amounts for different assessment years. It is not the case of the revenue that the amounts set apart were unreasonably disproportionate to the amounts which were claimed by the customers on the basis of the warranties in the past. In that view, the Tribunal was justified in holding that the amounts set apart by the assessee was an allowable deduction. No substantial question of law arises for our consideration in

this appeal, which fails and is hereby dismissed."

26. Although, the AO had attempted to distinguish the facts obtaining in earlier years, it is apparent that the AO had failed to do so.

27. As noted above, the method adopted by the assessee to make a provision for warranties was examined in any detail and therefore, the AO's premise that it was unscientific one is clearly not sustainable. In our view, no substantial question of law arises with regard to the decision of the learned Tribunal in directing deletion of the addition made by the AO on account of the provision for warranties.

RE: EXPENDITURE ON CSR

28. The AO had deleted the expenses on CSR amounting to ₹4,56,46,135/- for the purposes of calculating book profits and determining the tax payable under Section 115JB of the Act. It is also material to note that since the tax determined under the normal provisions of the tax was higher, the AO had assessed the tax chargeable on the said basis and not on the basis of book profits of the assessee.

29. The Tribunal had found that there was no provision under Section 115 JB of the Act, which required the expenditure on CSR to be adjusted for arriving at book profits. It is also settled law that except for adjustments as expressly set out under Section 115JB of the Act, book profits are required to be determined on the basis of accounts maintained in accordance with general accepted accounting principles and in accordance with the applicable law.

30. We find no reason why expenditure incurred on CSR be excluded from the final accounts. The learned counsel for the Revenue has also not provided

any basis for excluding the expenditure on CSR for determining book profits. We find no infirmity with the decision of the Tribunal in rejecting the AO's adjustment of expenditure on CSR for determining the book profits under Section 115JB of the Act. Clearly, no substantial question of law arises in this regard as well.

31. In view of the above, the present appeal is dismissed. All pending applications are also disposed of.

VIBHU BAKHRU, J

SWARANA KANTA SHARMA, J

SEPTEMBER 30, 2024
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Click here to check corrigendum, if any