
(2011) 12 KAR CK 0425
In the Karnataka High Court
Case No : Income Tax A. No. 574 of 2006.

Commissioner of Income Tax	Vs	APPELLANT
Infosys Technologies Ltd. (No. 5)		RESPONDENT

Date of Decision : 09-12-2011

Acts Referred:

Income Tax Act, 1961 — Section 37, 80 HHE

Citation : (2012) 349 ITR 610

Hon'ble Judges : V.G. Sabhahit, J;S.N. Satyanarayana, J

Bench : Division Bench

Advocate : Indrakumar, for G. Kamaladhar, for the Appellant; K.P. Kumar for M/s. King and Partridge, for the Respondent

Judgement

V.G. Sabhahit, J.—This appeal is filed by the Revenue being aggrieved by the order dated September 9, 2005/ passed by the income tax Appellate Tribunal, Bangalore Bench "B" (hereinafter called as "the Tribunal" for brevity) in I.T.A. No. 471/Bang/2003. This appeal has been filed raising the following substantial questions of law:

- (1) Whether the payment made to club subscription for obtaining corporate membership is a revenue expenditure and not capital expenditure as held by the Assessing Officer ?
- (2) Whether the Tribunal was correct in holding that provision for post-sale customer service which is a contingent liability should be allowed as an expenditure, despite the same having been not incurred by the assessee during the current assessment year?
- (3) Whether the Tribunal was correct in reversing the findings of the Assessing Officer that exchange rate variation gains had to be excluded from the total turnover and export turnover for computation of deduction u/s 80HHE of the Act in view of Explanation (c) to section 80HHE of the Act which contemplates only the actual amount of foreign exchange received in India ?

2. The appeal has been admitted on August 9, 2007, for considering the substantial questions of law already framed in connected I.T.A. No. 3232 of 2005. I.T.A. No. 3232 of 2005 has already been disposed of on November 4, 2011 (since reported in Commissioner of Income Tax and Another Vs. Infosys Technologies Ltd. (No. 3), Therefore, the abovesaid three substantial questions of law are to be considered in this case.

3. The material facts necessary for adjudicating the abovesaid substantial questions of law are as follows:

The assessee claimed deduction towards subscription for acquisition of corporate membership as a revenue expenditure. It also made provision for post-sale customer service which is a contingent liability as an expenditure. Despite the same having not been incurred towards after sale service in view of the warranty provided by the respondent-assessee. Further, the exchange rate variation gains had been excluded, from the total turnover and export turnover for computation of deduction u/s 80HHE of the Act. The Assessing Officer held that the expenditure incurred towards acquisition of corporate membership in the clubs is a capital expenditure and the said finding was set aside in appeal. Similarly, the amount claimed towards after sale service as contingent liability was also disallowed by the Assessing Officer and the same was deleted in appeal before the Commissioner of income tax. However, the Assessing Officer held that the exchange rate variation gains had to be excluded from the total turnover and export turnover for computation of deduction u/s 80HHE of the Act in view of Explanation (c) to section 80HHE of the Act which contemplates only actual amount of foreign exchange received in India and the said finding was also set aside in appeal. Being aggrieved by the order passed by the appellate authority allowing the appeal filed by the assessee, the Revenue preferred an appeal in I.T.A., No. 471/Bang/2003 on the file the Tribunal and the Tribunal by order dated September 9, 2005, dismissed the appeal filed by the Revenue.

4. Being aggrieved by the same, this appeal is filed by the Revenue in which the abovesaid substantial questions of law have to be considered. The first substantial question of law has already been answered by this court in I.T.A. No. 3232 of 2005 dated November 4, 2011, (since reported in CIT v. Infosys Technologies Ltd. (No. 3) Commissioner of Income Tax and Another Vs. Infosys Technologies Ltd. (No. 3), by holding that the finding of the appellate authorities that the expenditure incurred for acquisition of membership in clubs is revenue expenditure. Accordingly, following the reasons assigned in the said judgment, first substantial question of law is answered against the Revenue and in favour of the assessee. So far as the third substantial question of law is concerned, the said substantial question of law has already been answered by this court in I.T.A. No. 1189 of 2006 (since reported in CIT v. Infosys Technologies Ltd. (No. 4) Commissioner of Income Tax and Another Vs. Infosys Technologies Ltd. (No. 4), in favour of the assessee and against the Revenue, in respect of the same assessee but for different assessment year. Therefore, following the reasons

assigned in the said appeal, the third substantial question of law is also answered against the Revenue and in favour of the assessee. Therefore, the only substantial question of law that survives for consideration is, substantial question of law No. 2, i.e.,

Whether the Tribunal was correct in holding that provision for post-sale customer service which is a contingent liability should be allowed as an expenditure despite the same having been not incurred by the assessee during the current assessment year?

5. Learned counsel appearing for the appellant submitted that the Assessing Officer had rightly disallowed the amount claimed towards contingent expenditure on the ground that the said sum was included without any basis and the same could not be sustained as the actual expenses has not been incurred during the assessment year. The appellate authority set aside the said finding by holding that the estimate made towards expenditure is based upon past expenditure as also scientifically maintained accounts by the assessee and cannot be said to be contingent as the said amounts claimed towards after sale service in a sum of Rs. 2,19,18,587 towards post-sales customers support, was well founded. The appellate authorities have set aside" the order passed by the Assessing Officer.

6. The learned counsel appearing for the appellants submitted that in view of the recent decision of the hon'ble Supreme Court which is rendered after the decision of the Tribunal dated September 9, 2005, in the case of Rotork Controls India (P) Ltd. Vs. Commissioner of Income Tax, Chennai, the matter is required to be reconsidered by the Tribunal as in the said case the Supreme Court has laid down the basis on which the said amount towards post-sale customer service can be claimed and the final authority on the question of fact has to consider the conditions which are required to be satisfied for making such a claim. In support of his claim he has relied upon paragraph 13, wherein it has been observed as follows (page 72):

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 per cent, 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 cost 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 cost have 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 fulfils 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 u/s 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.

7. Learned counsel appearing for the respondent submitted that the Tribunal has followed the decision in the case of Wipro GE Medical Systems Ltd. v. ITO (TDS) which has been confirmed by the Division Bench of this court in I.T.A. No. 3047 of 2005 and connected matters disposed of on September 21, 2007, and the said judgment has been confirmed by the hon"ble Supreme Court in Rotork Controls

India (P) Ltd. Vs. Commissioner of Income Tax, Chennai, and since the Tribunal has considered all the contentions which are prerequisite for making claim as per the decision in Rotork Controls India (P) Ltd. Vs. Commissioner of Income Tax, Chennai, there is no necessity to set aside the order passed by the appellate authority and the appeal is devoid of merit.

8. We have given careful consideration to the contentions of the learned counsel appearing for the parties and scrutinised the material on record.

9. The material on record would clearly show that the order was passed by the Tribunal on September 9, 2005. Therefore, the benefit of the decision of the hon'ble Supreme Court in Rotork Controls India (P) Ltd. Vs. Commissioner of Income Tax, Chennai, was not available to the Tribunal. In the said decision, the hon'ble Supreme Court has laid down the conditions which are required to be satisfied for making claim in respect of post-sale customer service and has laid down the principles pertaining to the same. In Rotork Controls India (P) Ltd. Vs. Commissioner of Income Tax, Chennai, the hon'ble Supreme Court has considered the principles laid down having regard to the facts of the said case and has stated that in each case all the conditions to be satisfied are to be considered.

10. On a perusal of the order passed by the Tribunal we find that the above said factors which are required to be satisfied, have not been considered by the Tribunal and the Tribunal has only considered the past experience and the expenses incurred in the previous year, on the basis of which the claim was made. Under the circumstances, the Tribunal being the final authority on the question of fact, is required to consider the claim made by the assessee with reference to the decision in Rotork Controls India (P) Ltd. Vs. Commissioner of Income Tax, Chennai,

11. Accordingly, we refrain from expressing any opinion on the merits of the case in view of the order of remand proposed to be passed by us. Accordingly, it is unnecessary to answer the substantial question of law and the matter is remitted to the Tribunal by setting aside the finding allowing the claim, confirming the order passed by the appellate authority allowing the claim of Rs. 2,19,18,587 towards post-sales customers support. Appeal is disposed of accordingly in the light of the principles laid down in Rotork Controls India (P) Ltd. Vs. Commissioner of Income Tax, Chennai, and the matter is remanded to the Tribunal to pass fresh orders in accordance with law on the said question. All the contentions on the said question are kept open to be urged before the Tribunal.

Note:

The above is true transcription of the judgment dictated to me by late hon'ble Shri Justice V.G. Sabhahit presiding over the Division Bench with hon'ble Shri Justice S.N. Satyanarayana in open court on December 9, 2011.

(Sd.)... B.N. Susheela, Judgment Writer.