

(2009) 10 MAD CK 0122
In the Madras High Court
Case No : T.C.A. No. 942 of 2008

Kone Elevator India Pvt. Ltd.

APPELLANT

Vs

Assistant Commissioner of Income Tax

RESPONDENT

Date of Decision : 28-10-2009

Acts Referred:

Citation : (2012) 340 ITR 46

Hon'ble Judges : M. M. Sundresh, J;K. Raviraja Pandian, J

Bench : Division Bench

Advocate : V. Ramachandran for Mrs. Anita Sumanth, for the Appellant; Arun Kurian, for the Respondent

Final Decision : Allowed

Judgement

K. Raviraja Pandian, J.—The tax case appeal is filed against the order of the income tax Appellate Tribunal, Chennai Bench ""B"" dated

March 27, 2008, in I. T. A. No. 2192/Mds/2007 and was admitted on the following questions of law :

1. Whether, on the facts and in the circumstances of the case, the income tax Appellate Tribunal is right in law in disallowing the claim of provision

of warranty made during the assessment year 2004-05 ?

2. Whether, on the facts and in the circumstances of the case, the income tax Appellate Tribunal, having found that the provision for warranty is

based on a scientific method and that it was based on past practice and experience, is right in law in holding that the provision is not allowable as

deduction ?

3. Whether, on the facts and in the circumstances of the case, the income tax Appellate Tribunal is right in law in coming to the conclusion that on

the ratio of the decision of the Madras High Court in Commissioner of Income Tax Vs. Rotork Controls India Ltd. (formerly Beacon Rotork

Controls Ltd.), Beema Manufacturers Pvt. Ltd. and Thompson Consumer Electronics, the claim made by the appellant towards provision for

warranty is not allowable as deduction in computing the income ?

2. The facts of the case are as follows :

The appellant is a company registered under the Companies Act and engaged in the business of manufacture, erection, installation and

commissioning of lifts and elevators and following a regular method of accounting ever since the commencement of the business. The contract of

supply, erection and installation of lifts and elevators entered into by the appellant with the customers contains a specific, warranty clause, which

obligates the appellant to rectify the defects in the system for a specific period. Since the rectification of defects based on the warranty is a

contractual obligation, which the applicant will have to comply with, the appellant had made a scientific ascertainment of the possible liability that

would arise on account of the warranty clause. A provision has been made based on such technical ascertainment on a scientific basis. The

appellant has been following a consistent method of accounting on this issue since many years. However, for the assessment year 2001-02, the

Assessing Officer disallowed the claim of warranty. On appeal, the Commissioner of income tax (Appeals) decided the issue in favour of the

assessee. Despite the same, the Assessing Officer continued to disallow the same in the subsequent section. For the assessment year 2004-05, the

appellant filed a return of income wherein it claimed a sum of Rs. 19,64,210 on account of provision for warranty of lifts based on the provision

made by it on the basis of regularly followed scientific method of ascertainment of the possible liability, taking into account of number of lifts sold

and the past data. The Assessing Officer completed the assessment by order dated December 28, 2006, by disallowing the provision for warranty

claim to the extent of Rs. 19,64,210 on the ground that it is in the nature of unascertained liability. The appeal filed by the assessee before the

Commissioner of income tax (Appeals) was allowed accepting the claim of the assessee. Against that order, the Department filed an appeal before

the Tribunal in I. T. A. No. 2192/Mds/2007. The Tribunal by referring to the

decision of this court in the case Commissioner of Income Tax Vs.

Rotork Controls India Ltd. (formerly Beacon Rotork Controls Ltd.), Beema Manufacturers Pvt. Ltd. and Thompson Consumer Electronics, , has

held that the provision for warranty cannot be allowed in the absence of incurrence of liability under warranty clause. The assessee is on further

appeal before this court by formulating the abovesaid questions of law.

3. When the matter is taken up for orders, learned counsel appearing for the appellant as well as the counsel for the Revenue submitted that the

issue is once for all settled by the Supreme Court in the case of Rotork Controls India (P) Ltd. Vs. Commissioner of Income Tax, Chennai,

wherein the order of this court followed by the Tribunal has been reversed by observing that (head note)

the valve actuators, manufactured by the assessee, were sophisticated goods and statistical data indicated that every year some of these were

found defective; that valve actuator being a sophisticated item no customer was prepared to buy a valve actuator without a warranty. Therefore,

the warranty became an integral part of the sale price; in other words, the warranty stood attached to the sale price of the product. In this case, the

warranty provisions had to be recognised because the assessee had a present obligation as a result of the past events resulting in an outflow of

resources and a reliable estimate could be made of the amount of the obligation. Therefore, the assessee had incurred a liability during the

assessment year which was entitled to deduction u/s 37 of the income tax Act, 1961.

The present value of a contingent liability, like the warranty expense, if properly ascertained and discounted on accrual basis can be an item of

deduction u/s 37. The principle of estimation of the contingent liability is not the normal rule. It would depend on the nature of the business, the

nature of sales, the nature of the product manufactured and sold and the scientific method of accounting adopted by the assessee. It would also

depend upon the historical trend and upon the number of articles produced.

A provision is a liability which can be measured only by using a substantial degree of estimation. A provision is recognised when :

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources will be required to settle the

obligation, and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognised.

The principle is that if the historical trend indicates that a large number of sophisticated goods were being manufactured in the past and the facts

show that defects existed in some of the items manufactured and sold, then provision made for warranty in respect of such sophisticated goods

would be entitled to deduction from the gross receipts u/s 37.

4. The Division Bench of this court by its order dated June 9, 2009, made in T. C. (Appeal) No. 341 of 2004 CIT v. F. L. Smedth Ltd., has also

followed the above referred judgment of the Supreme Court and allowed the appeal.

5. Therefore, in the light of the decision of the Supreme Court in the case of Rotork Controls India (P) Ltd. Vs. Commissioner of Income Tax,

Chennai, , the tax case appeal has to be allowed and the same is allowed by answering all the three questions of law in favour of the assessee and

against the Revenue.