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IN THE HIGH COURT OF DELHI AT NEW DELHI

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INCOME TAX APPEAL No. 955/2018

Date of decision: 31st August, 2018.

THE PRINCIPAL COMMISSIONER OF INCOME TAX -6

..... Appellant

Through: Mr. Ruchir Bhatia, Sr. Standing
Counsel.

Versus

M/S NOKIA INDIA PVT. LTD.

..... Respondent

Through: Mr. Vikas Srivastava, Mr.
Sumit Mangal and Ms. Rashi Gupta,
Advocates.

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE CHANDER SHEKHAR

SANJIV KHANNA, J. (ORAL)

Present appeal by the Revenue under Section 260A of the Income Tax Act, 1961 ('Act', for short) in the case of Nokia India Pvt. Ltd ('respondent-assessee' for short) assails the order dated 30th January, 2018 passed by the Income Tax Appellate Tribunal ('Tribunal' for short). The appeal pertains to Assessment Year 2003-04.

2. First issue relates to provision for warranty of Rs. 5.48 crores. The Assessing Officer vide assessment order dated 27.02.2006 had disallowed claim for provision for warranty as unascertained liability,

and that only the actual warranty charges incurred could be allowed as expenditure. The Assessing Officer had also observed in the assessment order that the sales of the respondent-assessee had taken off on a large scale with substantial increase in sales of mobile phones etc. from Rs.58.9 crores to Rs.830.5 crores. To support the disallowance made, the Assessing Officer held that the technology in the mobile phone industry was rapidly improving and therefore, past experience regarding warranty claims was not relevant to scientifically compute and calculate provision for warranty as ascertained expenditure.

3. The Commissioner of Income Tax (Appeals) vide order dated 25.03.2010 affirmed these findings holding that the provision for warranty was a contingent liability and was not an allowable expense. The warranty expense was to be allowed on actual basis, in the year of occurrence and not in the year in which provision was made.

4. The Tribunal vide the impugned order has allowed the appeal of the respondent-assessee as the accounts were maintained on mercantile basis. Provision for warranty was made on the basis of scientific principles and on actuarial basis. Reference was made to ratio in ***Rotork Control India Pvt. Ltd. Vs. Commissioner of Income***

Tax (2009) 314 ITR 62 (SC). The Delhi High Court in the respondent-assessee's own case in ITA Nos.841/2009 and 842/2009 relating to Assessment Year 2001-02, has affirmed the order of the Tribunal deleting the same disallowance made by the Assessing Officer as unjustified and contrary to law.

5. Counsel for Revenue has drawn our attention to the table showing details of provisions for warranty claimed in different years referring to the table/chart in the order passed by the Commissioner of Income Tax (Appeals). The said table reads as under:-

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Asst year (a)	Opening balance of warranty (b)	Closing balance of warranty (c)	Amount of Provisio n disallow ed (d)	Actual warrant y expense (e)	(Rs. in Crore)		Percenta ge of closing provsn to sales (h)=(c)/ (g)
					Am of expense s debited to P/L a/c (f)	Total Sales for the year (from Mobile phone) (g)	
2001-02	1.65	1.44	0.94	1.78	1.57	66.57	2.16
2002-03	1.44	1.24	0.78	1.60	1.40	58.97	210
2003-04	1.24	6.73	5.48	5.87	11.36	830.51	0.81
2004-05	6.73	25.20	18.47	23.30	41.77	2,408.01	1.05
2005-06	25.20	64.10	32.02	68.70	107.60	4,729.14	1.36

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He submits that the claim for warranty was not based on scientific principles or actuarial basis. Therefore, notwithstanding the earlier order, the Tribunal was not justified in accepting the plea of the respondent/assessee.

6. We have considered the contention but do not find any merit in the same. As stated by the Assessing Officer in the assessment order, the table reveals that there was substantial increase and jump in sales year after year in the Assessment Years 2002-03, 2003-04, 2004-05 and 2005-06, from Rs.58.97 crores to Rs.830.51 crores to Rs.2408.01 crores, and then to Rs.4729.14 crores, respectively. The provision for warranty would accordingly increase in numerical terms. Pertinently, the percentage of closing provision of warranty with reference to quantum of sales had decreased and came down as is reflected in the figure in the column (h) of the table above. In the present case, we are only concerned with the Assessment Year 2003-04 in which the percentage of closing provision to sales was only 0.81%. Variation in figure would indicate that no thumb rule was applied. Moreover in case of doubt and debate, Income Tax Authorities should have asked for the basis and the formula/criteria applied by the respondent/assessee to compute provision for warranty. On the other

hand without disputing the computation, disallowance was made by holding that actual expenditure on warranty claims and not provision for warranty was allowable as expenditure. This proposition is wrong and incorrect. Improvement in technology would not justify disallowance of claim/expenditure on account of provision for warranty, though in a given case on basis of data it could be relevant factor in making the calculations.

7. In the aforesaid factual matrix and in view of the decision of the Supreme Court in **Rotork Control India Pvt. Ltd.** (supra) and decision of this Court in respondent-assessee's case in ITA Nos.841/2009 and 842/2009, we do not find any good ground or reason to accept the aforesaid contention of the Revenue.

8. Second issue raised by the Revenue relates to capitalization of marketing expenses to the extent of Rs.39.98 lakhs. Assessing Officer had observed that the respondent-assessee had provided mobile handsets to their dealers, employees and after-sale-service centres. He held that these mobile handsets should be considered as capital assets used by the respondent-assessee for its business and accordingly the respondent-assessee was entitled to claim depreciation on these mobile handsets. This addition was upheld by the Commissioner of Income

Tax (Appeals) holding his predecessors in the Assessment Years 2000-01, 2001-02 and 2002-03 had upheld the said decision, though appeals were pending before the Tribunal.

9. The Tribunal in the impugned order has held that the respondent-assessee was engaged in the manufacture, import and sale of mobile handsets. They had a large number employees, a wide team of dealers and sales personnel. The respondent-assessee had transferred title or ownership of the mobile handsets to the employees, dealers, sales personnel etc., who were given mobile handsets free of cost and were no longer owned by the respondent-assessee. These mobile phones were not to be returned to the respondent-assessee. Accordingly, the cost of the mobile phones was business expenditure and was rightly reduced from the inventory. Thus, the respondent-assessee was justified in treating these mobile phones as expenditure incurred. The amount cannot be capitalized.

10. The aforesaid finding regarding capitalization or business expenditure is a finding of fact. Obviously, respondent-assessee could not have claimed title and depreciation, once the mobile phones etc. had been given and ownership had been transferred to the employees, dealers, sales personnel and after-sales-service centres. In the absence

of any material and evidence to show that the findings of fact are perverse, we do not see any reason to interfere with the impugned order on the said aspect.

11. The third issue raised by Counsel for Revenue relates to addition of more than Rs.2.68 crores on account of stocks damaged during transportation etc., which had not been included in the closing stock. The Assessing Officer held that value of the mobile phones damaged in transit should be included the closing stock. The Commissioner of Income Tax (Appeals) had affirmed the addition observing that he would follow the orders of the earlier assessment years, though appeals on this issue was pending before the Tribunal.

12. The Tribunal has deleted the said addition on the ground that it would amount to double addition. No other reason is stated.

13. Counsel for respondent-assessee, at this stage, states that this issue may be remanded to the Tribunal for fresh decision as the reasoning given by the Tribunal is not correct and not germane to the issue in question. He states that the question of law need not be framed. Recording the said concession, this issue with regard to the

damaged handsets and their inclusion in the closing stock is remitted to the Tribunal for fresh decision.

14. Fourth issue raised in the present appeal relates to addition of Rs.8.50 lakhs made on account of disallowance of the claim on account of obsolescence. Respondent-assessee had written off and debited the profit and loss by Rs.34,00,339/- as provision for obsolescence of inventory. The Assessing Officer had made an adhoc disallowance of 25% from the Rs.34,00,339/- , i.e. Rs. 8.50 lakhs observing that respondent-assessee had not been able to justify and show the total extent of disallowance. Reference was made to the assessment orders for the Assessment Years 2000-01 and 2001-02 wherein similar additions were made. This addition was upheld by the Commissioner of Income Tax (Appeals).

15. Tribunal while deciding the said issue had noticed and had referred to the order of High Court in ITA No.841/2009 and 842/2009, decided on 14.07.2009, wherein the addition was upheld. The decision in ITA Nos.841 and 842/2009 was distinguished by the Tribunal on facts as in the said case the Assessing Officer had issued a questionnaire requiring the respondent-assessee to furnish details and justify claim for provision for obsolescence of inventory. As no

details/papers were furnished, the addition of 25% of the total claim for obsolescence was made.

16. In the present case, after noticing the factual matrix the Tribunal observed that the closing stock has to be valued on the basis of net realisable value. The said issue has been remanded to the Assessing Officer to determine and decide afresh the cost of obsolete items with reference to net realizable value. In view of the said direction for remand, we do not think that any substantial question of law arises for consideration.

17. Recording the aforesaid including the concession made by the respondent-assessee on the issue of damaged stock, the present appeal is disposed of without any order as to costs.

18. To cut short the delay, the parties on the issue of damaged stocks are directed to appear before the Tribunal on 26th September, 2018.

SANJIV KHANNA, J.

CHANDER SHEKHAR, J.

AUGUST 31, 2018/NA