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IN THE HIGH COURT OF DELHI AT NEW DELHI

Date of decision: 15th September, 2014

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ITA 596/2014

COMMISSIONER OF INCOME TAX-X Appellant
Through Ms. Suruchi Aggarwal, Sr. Standing
Counsel.

versus

SMT PARAMJEET LUTHRA Respondent
Through

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE V. KAMESWAR RAO

SANJIV KHANNA, J. (ORAL)

Present appeal relates to assessment year 2007-08 and impugns order dated 7th February, 2014, passed by the Income Tax Appellate Tribunal ('Tribunal', for short).

2. The respondent-assessee an individual had shown returned income of Rs.2,85,924/-, for the assessment year in question. Assessing Officer, vide its order dated 24.12.1999, had made additions and enhanced the income to Rs.65,63,039/- on various counts. The, present appeal is concerned with addition of Rs.60,70,492/- made under Section 68 of the Income Tax Act, 1961 ('Act', for short).

The respondent-assessee, as proprietor of M/s

International Surgical Agency, had undertaken liaisoning work of sale of medical equipments etc. and had received commission of Rs.1,41,33,516/-. The assessment order records that the assessee had to provide comprehensive warranty for first 5 years, including spares on the medical equipments sold to the customers i.e. government hospitals. She was also required to provide trouble free annual maintenance of equipments without spares for the further/next 5 years. The aforementioned payment of Rs 1,41,33,516/- included service charges for providing maintenance for five years with the supply of spare parts and another five years for maintenance only without spare parts. The respondent–assessee had submitted that the medical equipments were installed in government hospitals, therefore, the machines required constant servicing and maintenance in view of large number of visiting patients. Expenditure on service and parts would increase as the equipments got older. So , Assessee had treated 39% (Rs 55,12,088) out of the aforementioned commission amount, as expenditure which would have been incurred during the tenure of first 5 years and therefore excluded Rs 55,12,088 from the returned income of assessment year in question. Rather, assessee had offered the entire amount of 55,12,088 for tax in proportionate basis, in 5 assessment years as

the corresponding or necessary expenditure would be incurred in the said span of 5 years . The Assessing Officer did not accept the said submission and observed that in Schedule 10 relating to Accounting Policies, the respondent-assessee had herself declared that there was “sale of goods” at the time of physical delivery with simultaneous preparation of invoice, therefore the price received was wrongly bifurcated towards sale price and maintenance charges. The warranty clause, it was observed, was compulsory in all trades and the assessee was not justified in treating 39% of the total price as an amount for fulfilment of the warranty conditions.

3. The Commissioner of Income Tax (Appeals) did not agree and reversed the aforesaid finding. He referred to the fact that the respondent-assessee had done liaisoning work for supply of medical equipments. Insofar as sale and purchase were concerned, the transactions were between the foreign suppliers and the concerned hospitals. The respondent-assessee’s work was confined to installation and maintenance of the medical equipments. The assessee had entered into an annual maintenance contracts and it was the obligation of the respondent-assessee to maintain the said equipments for the first 5 years etc. In initial year the cost of maintenance was low, but

would increase in the subsequent years with wear and tear and as the equipments got old. Accordingly, the total maintenance contract income to the extent 39% was allocated as 5% for the first year, 7% for the second year, 8% for the third year, 9% for the fourth year and 10% for the fifth year. For the assessment year 2007-08, no income or receipt from this 39% was allocated on the ground that the medical equipments were installed at the end of the said year, hence would not entail cost of maintenance in the said year. The details with regard to installation of equipments were set out and stand mentioned in tabulated form in paragraph 5.1 of the first appellate order. In paragraph 5.2, the assessee's stand that she had shown the deferred maintenance income in the subsequent assessment years 2008-09 to 2012-13, was recorded and the total quantum of Rs.55,12,088/- was bifurcated and shown as income, as per the following table:-

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| S1.No. | AY | Income | Remarks |
|--------|---------|-------------|---------|
| 1. | 2008-09 | 7,06,678/- | @ 5% |
| 2. | 2009-10 | 9,89,349/- | @ 7% |
| 3. | 2010-11 | 11,30,685/- | @ 8% |
| 4. | 2011-12 | 12,72,020/- | @ 9% . |
| 5. | 2012-13 | 14,13,356/- | @ 10% |

| | | |
|--|--------------------|--------------|
| Total maintenance contract receipts = | 55,12,088/- | @ 39% |
|--|--------------------|--------------|

”

4. The stand of the respondent-assessee was that the entire contractual receipt of Rs.55,12,088/- was on account of annual maintenance contract with spares, for 5 years and, therefore, the said amount could not have been taxed or treated as income of one year. This amount was shown in the balance sheet under the head “current liability” of Rs.61,57,890/-, which included amount of Rs.55,12,088/- and another amount of Rs.5,58,404/- on account of local maintenance i.e. with regard to local sale and purchase of medical equipments. Other deficiencies and incorrect assumptions made by the Assessing Officer were highlighted. It was pointed out that addition of Rs.60,70,492/- was based upon wrong assumption by adding up figures of Rs.55,12,088/- and Rs.5,58,404/-. Further out of this amount of Rs.5,58,404/-, expenditure of Rs.3,39,526/- was made in the subsequent assessment year 2008-09 and the balance amount was carried forwarded. The Commissioner of Income Tax (Appeals) has referred to the assessee’s detailed written submission dated 7th May, 2010, in which assessee had mentioned about the manner and mode of her business operations and stated that she had entered into an annual contract for maintenance of medical equipments supplied by them.

Assessee highlighted the mistake made by the Assessing Officer in clubbing the local business of sale and purchase of medical equipments and the liaisoning of supply of foreign medical equipments and their annual maintenance contracts, which were two separate lines of business.

5. In view of the submissions made and to adjudicate the matter, Commissioner of Income Tax (Appeals) called for a remand report from the Assessing Officer, the relevant portions of which stand quoted in the first appellate order, read as under:-

“--While going through the case file I have observed that the assessee had filed the details asked by the AO. The last details were **filed on 17/12/2009** and the case was discussed. The then AO had not issued any show cause notice during the course of assessment hearings. I have not found any adverse remark made by the AO regarding the disagreement over the amount and nature of provision for equipment maintenance. No note in the file was found to explain the nature of NMICDEC Account at any stage during the course of assessment proceedings.....As per the case file or the order sheet I have observed that the above facts were not reconciled before making the addition and the assessee was not asked to correlate the facts that how 39% provision of sale proceeds amounts to Rs 60,70,492/-, if made on sale. If not then how the provision was created.....In view of the above submission made by the assessee and the comments made thereupon, the matter may kindly be considered by your good self accordingly.”

6. After having considered the remand report, the Commissioner of Income Tax (Appeals) found merit in the submission made by the

respondent-assessee and deleted addition of Rs.5,58,404/-. Even with regard to addition of Rs.55,12,088/-, he upheld the contention of the assessee recording as under:-

“5.8 So far as the balance amount of Rs.55,12,088/- is concerned, there is no dispute regarding the facts of the case and the business of the assessee regarding the liaisoning: facilitation, installation and the annual maintenance etc of the medical equipments for the next five years. It is apparent from the facts of the case that the assessee has the obligation of maintaining the medical equipments for the next five year with the spare parts and another five years without spare parts. There is also no dispute regarding the receipt of the income which has been deferred by the assessee and declared in the subsequent years spread over in five AYs as discussed earlier. It is apparent from the order of the AO and the remand report of the AO that the addition has been made without proper appreciation of the facts and circumstances of the case. There is no denying that the assessee has the future obligation of maintenance of medical equipments for the next five years with spare parts and another five years without spare parts, so there is considerable merit in the submission of the assessee that the entire income cannot be offered for taxation in one AY as the assessee has the future obligation of maintenance service and the necessary expenditure required for the same.”

6. In support of the legal position, the Commissioner of Income Tax (Appeals) referred to the decision of the Tribunal *In Re Mahindra Holidays & Resorts (India) Ltd.* (2010) 39 SOT 438 (Chennai) and decision of the Supreme Court in *M/s. Madras Industrial Investment*

Corporation Ltd. vs CIT, (1997) 225 ITR 802 (SC), on the question of matching of income with expenditure.

7. Tribunal in the impugned order has affirmed the said finding.

8. We had asked the learned counsel for the appellant-Revenue to state whether the aforesaid income were declared in the subsequent years and had been taxed and whether on the question of bifurcation or the quantum i.e. 39%, any objection was taken by the Assessing Officer/Departmental Representative before the Tribunal on the ground that it did not represent a fair, correct and reasonable estimate, based upon past or scientific data. Before the Commissioner of Income Tax (Appeals), the respondent-assessee was directed to submit a note in this regard, which was accepted. The tribunal has referred to remand report of assessing officer in which he had reported that expenditure made for the maintenance of equipments in the subsequent years was adjusted against the provisions made for equipment maintenance by the assessee and the provision for equipment maintenance for Assessment Years 2006-07, 2007-08 and 2008-09 were verified by the Assessing Officer. The Tribunal has observed that aforesaid calculations had been made on scientific basis and the balance amount was offered for taxation in the subsequent years. We had specifically asked from the counsel for the appellant revenue to show as to what was the actual expenditure incurred in the subsequent years. She was unable to answer. In fact,

the said details are not available. Thus on the said factual aspect and in absence of material, we are not inclined to interfere.

9. On the principle of matching of income, the issue stands decided by the decision of Delhi High Court in *Commissioner of Income Tax vs. Dinesh Kumar Goel* [2011] 331 ITR 10 (Delhi). In the said case, the assessee had received full consideration in one year, but was liable to provide service over two or more assessment years. It was held that the entire amount received cannot be taxed in one year as expenses had to be incurred and the assessee was to provide service in future years. In case the entire amount received was taxed in one year, whereas services and expenditure was to be incurred in future year, it would lead to an anomaly. Income/receipt would be taxed in one year, and expenditure in the other years. Reference was made to the decisions of the Supreme Court in *E.D. Sassoon and Co. Ltd. Vs. CIT* [1954] 26 ITR (SC), *Calcutta Co. Ltd. Vs. CIT* [1959] 37 ITR 1 (SC) and *CIT Vs. Woodward Governor India (P) Ltd.* [2010]321ITR147(Delhi).

10. *In Rotork Controls India (P) Ltd. Vs. Commissioner of Income Tax, Chennai* [2009] 314 ITR 62(SC), while interpreting section 37 of the Income Tax Act, 1961, the Supreme Court observed that a “provision” is a liability which can be measured only by using a substantial degree of estimation. A provision is recognized 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. A past event that leads to a present obligation is called as an obligating event. Under the matching concept, if revenue is recognized, the cost incurred to earn that revenue including warranty costs has to be fully provided for. Assessee 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. For a liability to qualify for recognition there must be not only present obligation but also the probability of an outflow of resources to settle that obligation. Where there are a number of obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement, is determined by considering the said obligations as a whole. if the historical trend indicates that large number of sophisticated goods were being manufactured in the past and in the past if the facts established show that defects existed in some of the items manufactured and sold then the provision made for warranty in respect of the any of such sophisticated goods would be entitled to deduction from the gross receipts under Section 37 of the Act. It would all depend on the data systematically maintained by the assessee.

11. Finally, we observe that invoking Section 68 of the Act was not warranted. The source of money and genuineness of credit entry of Rs 1,41,33,516/- was never doubted. Thus addition of Rs 60,70,492/- was not relatable to section 68 of the Act.

In view of the aforesaid, we do not find any merit in the present appeal and the same is dismissed.

SANJIV KHANNA, J.

V. KAMESWAR RAO, J.

SEPTEMBER 15, 2014
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