

ITAT allowed provision for warranty services created in accordance with inputs received from technical team

Summary – The Delhi ITAT in a recent case of Huawei Telecommunication (India) Company (P.) Ltd., (the Assessee) held that where assessee, engaged in providing marketing, technical support installation and Commissioning services to telecommunication sector, made a provision for warranty services by way of repair and replacement for a pre-defined period, said provision was eligible for deduction under section 37(1)

Facts

- The assessee was a company engaged in providing marketing technical support installation and commissioning services to the telecommunication sector. During relevant year the assessee company provided certain amount for warranty expenses and debited the same to the profit and loss account.
- The assessee explained that the warranty expenses had been determined on the basis of the costs liable to be incurred in relation to warranty obligation contracted with respective customers.
- The Assessing Officer held that the provision of warranty expenses was not an allowable deduction in view of the note given by the auditors in the audit report. He further held that provision made by the assessee was a contingent. Therefore, he disallowance assessee's claim of warranty expenditure.
- The Commissioner (Appeals) confirmed said disallowance.
- On second appeal:

Held

- The assessee company is engaged in the business of trading of telecom equipment and provision for installation and commissioning services related to the same. In the trading and installation services of the telecom equipment, the assessee provides warranty to the buyers. As part of the contract with the customers, assessee was required to provide warranty services by way of repair and replacement for a predefined period. The obligation of the appellant to provide the services is inbuilt in the contract for the sale and services only. Therefore, apparently assessee is supposed to incur certain expenditure over the period of warranty claim contract. The assessee made a provision based on the inputs from technical team for each customer contract having regard to the nature of the products supplied and installation services provided.
- According to the assessee, it takes into account the labour cost, material cost and other technical services cost expected to be incurred to meet the warranty obligation with respect to these customers. Undoubtedly, the revenue earned during the year was credited to the profit and loss account of the year and the corresponding warranty provision expenditure required to be made over a period of the warranty claim was definitely to be charged to the profit and loss account to arrive at the correct figure of the profit, in such a case liability of warranty cost could not be

regarded as contingent at all. But it is necessary that such provision of warranty expenditure is made on some scientific basis so that the estimate of provision made by the assessee can be said to be a reliable estimate of such liability. Estimates of the warranty provision depends upon a different industry in which assessee operates. There may be different manner of making a provision because of warranty services in different industry. There cannot be straightjacket formulae for warranty provision in each industry alike. Therefore, the reliable estimate made by the assessee is required to be looked from the perspective of the industry in which the assessee operates.

- In the present case, the assessee has obtained the estimate of the warranty claim liability based on the percentage of actual work completed until 31-3-2008 as submitted by the technical team of the assessee. The assessee has also estimated the labour cost during the warranty period and other expenditure for execution of warranty claims of the customers. From the total liability as on 31-3-2008, the assessee has looked that the provision outstanding at the beginning of the year and the balance provision has been made during the current year by debiting to the profit and loss account. The lower authorities has considered the claim of the assessee and held that it is not based on any scientific methodology. However, the assessee has stated that it has received input from its technical team which is most competent to see what kind of expenditure is required to be made for the purposes of fulfilling the warranty obligation embedded in contract with the customers. Therefore, whether the provision of the assessee of warranty expenditure is reliable estimate or not the lower authorities should have looked into the basis of the estimate made by the assessee.
- It is further required to be seen that what kind of expenditure have been incurred by the assessee in subsequent years that will give the best picture with the original provision made by the assessee's reliable estimate or not. Further as the sale prices has been booked into the profit and loss account the corresponding expenditure on account of warranty expenses are also a liability in present and therefore it cannot be said that it is a contingent liability wherein the contract with the customers the clauses of warranty are existing. Therefore, it is an allowable expenditure. In fact, there cannot be any doubt that the assessee is eligible for deduction of warranty expenditure.
- The only dispute is whether the claim made by the assessee is a reliable estimate or not but in any case, it cannot be nil. Qualification in the audit report with respect to quantification is only because of non-availability of the reliable trend for the past years. The assessee has also disclosed in the notes on accounts the details of the warranty expenses. Furthermore, the assessee has also stated that expenditure incurred during the year is not separately identifiable. The lower authorities have not examined these details. The provisions of the warranty expenditure was required to be estimated based on the past experience of the assessee demonstrated on the basis of past warranty liability on similar type of contracts and further it could be proved by incurring the warranty expenditure in subsequent period to the sales. This exercise has not been done either by the assessee or by the revenue.
- In view of this, the whole issue is remanded back to the file of the Assessing Officer with a direction to the assessee to prove before the Assessing Officer how the warranty provisions have been made

by the assessee along with the technical inputs received from the technical team of the assessee. The Assessing Officer may examine the above claim and then decide the issue afresh on merits after giving assessee a reasonable opportunity of hearing.