

## AO was justified in restricting provision for warranty as 'Apple' wasn't evaluating it at year end

**Summary – The Bengaluru ITAT in a recent case of Apple India (P.) Ltd., (the Assessee) held that where assessee-company created provision for warranty but there was no reversal after expiry of relevant period based on actual utilisation, Revenue Authorities were justified in restricting amount of allowable provision at 2.14 per cent of sale as adopted in earlier years**

### Facts

- The assessee-company was engaged in the business of marketing and related services for software products of its AE (Apple) Co.
- The Assessing Officer noticed that the assessee-company claimed deduction of provision for warranty expenses which was in addition to opening provision for warranty expenses. Based on the data furnished by the assessee-company, the Assessing Officer observed that the closing balance of provision for warranty was increasing tremendously on account of non-utilization and therefore, he inferred that the provision for warranty was not created in a robust way and further the provision of warranty in terms of percentage of sale was not constant and varied from year to year which increased from 2 per cent to 10 per cent. He concluded that provision created was on *ad hoc* basis and no scientific method was adopted nor based on the historical trends and that provision should not be allowed as a deduction. Further, the Assessing Officer noticed that the assessee-company had not reversed the excess provision created in earlier year after expiry of the warranty period. As a result, the provision for warranty got accumulated and the assessee-company was deriving advantage of not offering excess provision to tax and thus, that provision for warranty expenditure should be restricted to 2.14 per cent of the sales.
- The Commissioner (Appeals) confirmed the action of the Assessing Officer after due analysis of provision created during the year and utilization in the earlier year as well as in the subsequent periods.

### Held

- The Apex Court as well as the Accounting Standard 29 laid down the para-meters on which provision for warranty expenses can be allowed as a deduction:
  - (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 recognized.
- In the present case, there is no dispute as to the satisfaction of condition (a) and (b) above. The dispute is only with regard to whether provision made for warranty expenditure is reliable estimate of obligation to be settled.

- In the present case, on perusal of chart showing provision for preceding as well as succeeding assessment years of the year under consideration, year-end provision was getting accumulated disproportionate to increase in turnover which suggested that the system of accounting for provision for warranty was not robust/reliable. There is huge difference in the amount of provision made and actual utilization. Further, there is nothing to show that there is any system of re-assessment or evaluation of provision for warranty at the year end or any reversal of *pro rata* based on actual expenditure incurred in respect of period for which warranty had expired. Further, it is not demonstrated that the global policy of the company to provide for warranty expenditure meets the conditions laid down by the Apex Court. Nor is the working of the provision furnished demonstrating that the amount of provision worked out is in accordance with stated policy of the company for provision for warranty expenditure.
- The assessee derived advantage by deferring its income to the extent of excess warranty provision to subsequent years. Therefore, such excess provision cannot be allowed as a deduction. Therefore, the provision made for warranty cannot be said to be reliable. The Assessing Officer, as confirmed by the Commissioner (Appeals) had rightly restricted the amount of allowable provision for warranty at the rate of 2.14 per cent of sales. Therefore, there is no fallacy in the reasoning of the order of the Commissioner (Appeals).