

No deduction of provision for warranty if its estimated cost wasn't on basis of past experience

Summary – The High Court of Madras in a recent case of Laser Soft Infosystems Ltd., (the Assessee) held that where assessee claimed deduction of provision towards liability for warranty for goods supplied, since there was no material on record to show that estimate of cost was based on past experience, it could be concluded that liability did not crystallise at end of relevant year and, thus, assessee's claim was to be rejected

Facts

- The assessee was engaged in the business of software development. During relevant year, assessee made provision towards liability for warranty for goods supplied.
- In course of assessment, the Assessing Officer rejected assessee's claim for deduction of said provision on ground that it was not crystallised or ascertained at the end of the previous year.
- The Tribunal upheld the order of the Assessing Officer.
- On appeal:

Held

- Admittedly, the assessee has not placed any material before the Assessing Officer with regard to the previous experience as to how the provision has been created. The Assessing Officer found that the assessee has deducted a sum of Rs. 17,15,000 towards provision for warranty and he found that it was made as a provision towards an unascertained liability and therefore, proposed that it is not an admissible expenditure being contingent in nature. In the light of the said provisional conclusion, the assessee submitted a letter stating that the provision created in the accounts for the possible costs that may be incurred have to be borne by the assessee-company for rectification of the bugs in the software supplied to the customer and also will have to be done free of charge to customers and it is claimed that the provision for warranty is calculated based on estimate of costs from previous experience. However, the assessee failed to produce any material before the Assessing Officer to show that the estimate of costs was based on the previous experience. Therefore, the Assessing Officer rightly held that the provision made is not crystallised or ascertained at the end of the previous year and therefore, the assessee's claim is merely provisional in nature.
- The Commissioner (Appeals), while reversing the finding of the Assessing Officer, did not touch upon this aspect, but was largely influenced by the fact that the Assessing Officer did not fault the method of accounting followed by the assessee. The Commissioner (Appeals) misdirected itself in not addressing the correct question, which required to be determined. The Commissioner (Appeals) ought to have examined the correctness of the findings of the Assessing Officer, taking note of the conduct of the assessee that the provision made was not crystallised or ascertained at the end of the

previous year and unless and until this finding was held to be non-substantiated or factually incorrect, the Commissioner (Appeals) could not have interfered with the order passed by the Assessing Officer.

- On a perusal of working submitted by assessee, it is found that there is absolutely no historical trend based on which, the assessee has made such a deduction. In fact, everything appears only to be a provision and nothing has been substantiated and as rightly pointed out by the Assessing Officer, the assessee has failed to crystallise the said provision at the end of the previous year.
- In the light of the above reasons, assessee's appeal is dismissed.