Exp. allowable if assessee was responsible for warranty towards engines supplied to IAF manufactured by Russian Co.

Summary – The Pune ITAT in a recent case of Indo Russian Aviation Ltd., (the Assessee) held that where in terms of tripartite agreement entered into between assessee, a Russian company and Indian Air Force, assessee had to supply engines of aircrafts to Indian Air Force manufactured by Rusian company, in view of fact that warranty in respect of engines so supplied was responsibility of assessee for a specified period, assessee's claim for deduction of warranty expenses was to be allowed

Facts

- The assessee was engaged in the business of trading in Aircraft parts and engines. It entered into a tripartite agreement with a Russian Company namely UFA and Indian Air Force (IAF) in terms of which assessee had to supply engines IAF manufactured by UFA.
- The assessee filed its return claiming deduction of warranty expenses in respect of engines supplied to IAF.
- The Assessing Officer rejected said claim holding that assessee was working as dealer of supplier company (UFA) and thus warranty expenses were not attributable to it.
- The Commissioner (Appeals) confirmed said disallowance.
- On second appeal:

Held

- As per understanding between the parties, the claim during warranty period has to be made to the assessee and where the customer repairs the terms during warranty period, then the assessee had to refund expenses borne. Alternatively, it was also provided that customer had the light to deduct amount from any outstanding dues to the assessee. In other words, though the assessee was not manufacturing or refurbishing the engines but it had to bear the cost of warranty expenses, wherein if within stipulated period any defect was found in the engines, then the same would be reimbursed by third party to the Contract *i.e.*, UFA.
- The orders of authorities below suffer from infirmity to the extent that it cannot be held that merely because liability had not been discharged by assessee and was being pursued for reimbursement from the Russian authority would make the claim of assessee as not allowable. As understood from the terms of agreement after the engines were supplied, then warranty in respect of engines supplied to IAF for the specified period was the responsibility of assessee though to be discharged jointly by UFA *i.e.* for taking care of any defects in refurbishment of engines which have been supplied to IAF. However, in the present case, there was complete failure of engine which resulted in MIG accident in 2002 and after enquiry was completed in 2006, it was established that accident

was due to the engine failure and hence, the claim was raised by IAF upon the assessee to reimburse cost of engines. The assessee forwarded the said claim to the Russian company, which refused to acknowledge it on the ground that it was not made within time frame stipulated in the agreement. The assessee was no doubt raising the issue with the Russian company till date and there are series of correspondence but in none of the said correspondence, the Russian company had acknowledged its liability of paying damages on account of failure of engine. The assessee on the other hand, was also corresponding with IAF to which it was making regular supplies and IAF had not released the payments due to the assessee because the issue of warranty claim had not been settled by the assessee. In other words, the payments which were due to assessee, were being withheld by IAF against warranty claims. Undoubtedly, it is the liability of assessee as per contract to provide warranty within stipulated period to the customer *i.e.* IAF. In this case under the circumstances, where there was engine failure within warranty period, then as per terms of agreement and since the enquiry had been completed in 2006, the assessee which was following mercantile system of accounting, had accounted for the said claim of warranty under the head 'Provision for Warranty'. Such claim made by the assessee under the provisions of the Act was duly allowable as deduction in the hands of assessee, applying the ratio laid down by the Apex Court in *Bharat Earth Movers* v *CIT* [2000] 245 ITR 428/112 Taxman 61. It may also be reiterated that other claim of warranty provision of about Rs. 48 lakhs had been allowed by Assessing Officer. Accordingly, there is no merit in the orders of authorities below and the same is reversed.

- In the result, appeal of assessee is allowed.