

**SC in Rotork Controls India (P) Ltd. reversing Madras High Court ruling reported at 293 ITR 311 : Held Warranty claim provided in books on estimated basis as %age of turnover is allowable tax expense u/s 37 of the Income Tax Act.**

**(ALSO REFER DHC in VINITEC 278 ITR 337):**

*“Under the circumstances, the third option (it provides for warranty at 2% of turnover of the company based on past experience (historical trend)) is most appropriate because it fulfills accrual concept as well as the matching concept. For determining an appropriate historical trend, it is important that the company has a proper accounting system for capturing relationship between the nature of the sales, the warranty provisions made and the actual expenses incurred against it subsequently. Thus, the decision on the warranty provision should be based on past experience of the company. A detailed assessment of the warranty provisioning policy is required particularly if the experience suggests that warranty provisions are generally reversed if they remained unutilized at the end of the period prescribed in the warranty. Therefore, the company 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. The warranty provision for the products should be based on the estimate at year end of future warranty expenses.*

Such estimates need reassessment every year. As one reaches close to the end of the warranty period, the probability that the warranty expenses will be incurred is considerably reduced and that should be reflected in the estimation amount. Whether this should be done through a pro rata reversal or otherwise would require assessment of historical trend. If warranty provisions are based on experience and historical trend(s) and if the working is robust then the question of reversal in the subsequent two years, in the above example, may not arise in a significant way. In our view, on the facts and circumstances of this case, provision for warranty is rightly made by the appellant-enterprise because it has incurred a present obligation as a result of past events. There is also an outflow of resources. A reliable estimate of the obligation was also possible.

Therefore, the appellant has incurred a liability, on the facts and circumstances of this case, during the relevant assessment year which was entitled to deduction under Section 37 of the 1961 Act.”