

In the High Court of Judicature at Madras

Dated: 03.06.2013

Coram

The Honourable Mrs.JUSTICE CHITRA VENKATARAMAN
and
The Honourable Ms.JUSTICE K.B.K.VASUKI

TCA.No. 38 of 2010

M/s. FL Smidth Minerals Pvt. Ltd
Chennai .. Appellant

Vs.

The Deputy Commissioner of Income Tax
Company Circle II (1)
121, Nungambakkam High Road
Chennai 600 034. .. Respondent

Tax Case Appeal against the order of the Income Tax Appellate Tribunal, Chennai 'C' Bench,
dated 15.5.2009 passed in I.T.A.No. 1578/MDS/2008.

For Appellant : Dr.Anita Sumanth
For Respondent : Mr.T.Ravikumar
Standing Counsel for Income Tax

JUDGMENT

(Judgment of the Court was delivered by CHITRA VENKATARAMAN,J.)

The above Tax Case Appeal is filed at the instance of the assessee as against the order of Income Tax Appellate Tribunal in respect of assessment year 2003-04. The Tax Case Appeal was admitted on the following substantial questions of law:-

(i) Whether on the facts and in the circumstances of the case the Income Tax Appellate Tribunal is right in law in confirming the disallowance of Rs.40 lakhs on account of the provision for warranty?

(ii) Whether on the facts and in the circumstances of the case the Income Tax Appellate Tribunal is right in law in confirming the addition of Rs.87,74,691/- on account of the write back of the provision?

2. The facts leading to filing of tax case appeal are as follows:-

The assessee company is engaged in the business of designing, engineering, supply and installation of plant and equipments used in mining and mineral processing industry. The assessee company is subsidiary of FL Smidth Minerals Holding APS, Denmark. In computing the income for the assessment year 2003-04, the assessee claimed deduction regarding provision for warranty claims. The contention of the assessee is that this provision was made based on scientific data related to the past experience, nature of the contract and the plausible client claims.

3. It is seen from the facts projected before us that the assessee had made provision for warranty expenses amounting to Rs.1,53,21,630/-. According to the Revenue, the provision being unascertained liabilities, same was not allowable. It is seen from the data given in the order of the Tribunal that the claim to an extent of Rs.1,13,21,638/- were related to retention money for the liquidated damages. Following the order passed by the Tribunal in M.P.No. 283/ Mds/ 2003 in I.T.A. No. 2002 & 197/ Mds/2000 dated 21.7.2004, after analysing the different clauses in various agreements, the Commissioner of Income Tax Appeals allowed the claims. This was challenged by the Revenue before the Tribunal. In respect of disallowance to the claim of Rs.40 lakhs as referable to liquidated damages, the assessee went on appeal before the Tribunal. The Tribunal after hearing both the parties, confirmed the order of the Commissioner of Income Tax (Appeals). Hence, the above appeal by the assessee.

4. Learned standing counsel for the assessee placed before us the order of this Court rendered in the assessee's own case in T.C.(A). No. 341 of 2004 dated 9.6.2009 relating to assessment year 1999-2000 and T.C.No. 35 of 2008 dated 7.12.2009 for the assessment year 2002-03, wherein the Division Bench of this Court had followed the earlier order passed by this Court in Tax Case (Appeal). No. 341 of 2004 dated 9.6.2009. In both these decisions, this Court following the decision of the Apex Court in the case of ROTORK CONTROLS INDIA P. LIMITED v. CIT (2009) 314 ITR 62, held that a provision is a liability which can be measured only by using a substantial degree of estimation. Taking note of nature of the business, nature of sales, the nature of the product manufactured and sold and the scientific method of accounting adopted by the assessee, this Court held that the assessee would be entitled to deduction under Section 37 of the Act for the provision made for the warranty. Thus, learned counsel for the assessee submitted that the facts of the present case are not different from that of the earlier decided issues. It is further submitted that T.C.(A).No.341 of 2004 was taken on appeal by the Revenue before the Apex Court and the same was also dismissed on 29.3.2010 in Special Leave Appeal (Civil) CC 4446/2010.

5. Learned standing counsel for the Revenue submitted that even though this Court had considered the same assessee's case in its favour earlier, yet, as far as the present case is concerned, in the absence of any scientific working made on the provision towards warranty, the details given being on a percentage of the contract value, not supported by any other materials, the claim can not be granted. Thus, this Court had not considered this aspect in the earlier Tax

Cases. Hence, it requires reconsideration. In this context, he placed reliance on the decision of this Court rendered in T.C.(A).Nos. 148 to 155 of 2005 dated 9.7.2012 in the case of CIT v. M/S.FORBES CAMPBELL FINANCE LIMITED and submitted that in the absence of any scientific working, the claim cannot be granted.

6. As far as the claim of the assessee herein towards the sum of Rs.40 lakhs is concerned, as a provision of warranty, we find that the assessee had made provision for liquidated damages under two heads viz., one towards delay in delivery and other towards non performance. The clauses governing the liquidated damages in one of the contract is extracted in the order of the Commissioner of Income Tax (Appeals), which are safely extracted here too for the purpose of the case, which are as follows:-

" Delivery

The plant should be given complete in all respects ready for commissioning positively within 13 months and commercial production within 3 weeks of commissioning considering from 12.11.2001.

All other payments shall be made in time (within 15 days of receipt of invoice) in order to complete the project on schedule.

Liquidated damages

Liquidated damages @ Rs.3.8 lakh for delay of every completed week subject to maximum of Rs.36.00 lakh (plus Rs.2 lakh on FFE's nominated erection contractors) shall be applicable for any delay in execution, commissioning and commercial production beyond 14 months from 12.11.2001.

Commissioning

Commissioning means the successful commencement of commercial production of desired purity duly corrected as per input conditions.

Liquidated damages (L.D) for non performance

In case the performance tests do not give satisfactory results, and the performance guarantees are not fulfilled, you shall be liable to pay the following liquidated damages.

Production capacity 135 MTPD (100% rated)

L.D. @ Rs.7.6 lakhs for every full 1% (one percent) shortfall in the capacity subject to maximum Rs.38.00 lakhs shall be applicable.

Quality of Product (Purity of Lime) 82% as available CaO (at 80% rated capacity)

L.D. @ 7.6 lakhs for every 1% shortfall in purity of lime subject to maximum Rs.38.00 lakh shall be applicable.

Fuel consumption 1512 Kcal/ kg (155 kg/T at 80% rated capacity)

L.D. @ Rs.3.04 lakh for every 1 kg/T increase in fuel consumption subject to maximum Rs.38.00 lakh shall be applicable.

Electric power consumption 37 KWH/T (80% rated capacity)

L.D. @ Rs.1.52 lakh for every 1 KWH / MT increase in power consumption subject to a max. Rs.38.00 lakh shall be applicable.

Emission level 80 Mg/Nm³ (wet basis) (at 100% rated capacity)

L.D. @ Rs.7.6 lakhs for every 5 mg/ Nm³ increase in emission level subject to a max Rs.38.00 lakh shall be applicable.

Rectification Expenses:-

During the completion stage of the project, some of the equipments supplied by us require some repairs or replacement. Our technical team estimate such kind of expenses and intimate the accounts for such provisions. We make provision for such expenses which is ultimately incurred subsequently".

7. A reading of the above clauses reveals that given the assurance on the capacity of functioning of the machinery and the quality of the product manufactured, the assessee had to make provision for liquidated damages for any shortfall on the assured capacity and quality commensurate to the percentage of the shortfall. Even though such payment is termed as liquidated damages, yet, on going through the various clauses, it is evident that it is more in the nature of warranty as to the performance of the machinery, rather than, granting damages for the short fall in production. Thus the warranty provision which falls under the head of liquidated damages for non performance of order, came to the tune of Rs.20 lakhs. In paragraph 4.10.2, the Commissioner of Income Tax (Appeals) pointed out to the aspect of deficiency in the performance as per letter of intent dated 12.6.2001 and held that though provision had been stated to have been created towards deficiency for the performance and the assessee had stated to have actually incurred expenses for the accounting period, still in the absence of any material to show that the liability had crystallised to the extent of the claim in the accounting period ended 31.3.2003, the claim could not be granted.

8. As far as the balance sum of Rs.20 lakhs is concerned, it related to rectification expenses. The rectification expenses is mainly for repairs and replacements. The assessee stated that during completion stage of the project, some of the equipments supplied required some repairs or replacement. The technical team estimated such kind of expenses and intimated the accounts for such provisions. Accordingly, provision was made for such expenses which were ultimately incurred subsequently. Having noted the distinction between the liquidated damages for delayed performance and liquidated damages for short performance, and the warranty relating to the defective parts, which required repairs or replacement, the Commissioner of Income Tax (Appeals) however came to the conclusion that no deduction could be allowed in respect of the claim.

9. Referring to the decision of this Court reported in (2007) 293 ITR 311 - CIT v. ROTORK CONTROLS INDIA LIMITED, the Commissioner of Income Tax (Appeals) rejected the assessee's plea holding that a sum of Rs.40 lakhs being a provision did not fall under the provision towards warranty. Consequently, no deduction could be allowed in respect of the same. It is neither a

provision created towards liquidated damages nor a provision created on a scientific basis or a provision created on the basis of the actual expenditure incurred by the company during the past years, nor it is an ascertained liability. Thus, the Commissioner of Income Tax (Appeals) allowed a sum of Rs.1,13,21,638/- alone following Income Tax Appellate Tribunal's order in the appellant's own case and rejected the claim of the balance provision of Rs.40 lakhs.

10. On appeal before the Income Tax Appellate Tribunal, the Tribunal referred to the reasoning of the Commissioner of Income Tax and by following the decision of this Court referred to above, rejected the assessee's case. The assessee's contention is that the provision made towards the non performance guarantee is more in the nature of warranty. Thus, the company assured quality and performance and on any shortfall agreed for damages making provision based on the performance capacity of the machineries supplied. Based on the materials available, on the assured capacity of the machinery and the quality of the product, the assessee had worked out the provision. Consequently, we do not find any ground to support the reasoning of the Commissioner of Income Tax (Appeals) which persuaded the Tribunal to reject the assessee's case. In this regard, we may point out that the decision of this Court reported in 293 ITR 311 CIT v. ROTORK CONTROLS INDIA LIMITED AND OTHERS was reversed by the Apex Court in the decision reported in [2009] 314 ITR 62 ROTORK CONTROLS INDIA P. LTD v. CIT, wherein the Apex Court held that a provision is recognised when an enterprise has a present obligation as a result of a past event; that it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made on the amount of the obligation. If these conditions are not met, no provision could be recognised. Although the Commissioner of Income Tax (Appeals) pointed out the obligation that had arisen to the company has to be seen by reason of its assurance given on the aspect of quality production and the extent of production, yet he failed to take it to the logical end in granting the relief. Thus, when the company made reliable estimate based on the performance capacity and the quality therein and the materials relating thereto, we do not find any justifiable ground to reject the plea of the assessee on the provision made to the extent of Rs.20 lakhs. The Commissioner of Income Tax (Appeals) pointed out to the distinction between the liquidated damages for the delay execution and the liquidated damages for non performance. However, the Commissioner of Income Tax (Appeals) committed an error in his finding on the ground that the amount claimed in the nature of warranty was not stated so, but described as provision towards the liquidity damages. We do not find that the description of the claim would govern the claim on the provision for warranty when the terms of the agreement specifically provided that the liquidated damages was for non performance. Given the above fact, one can not reject the claim for provision made towards the warranty on the performance of the machineries supplied.

11. As far as the balance provision of Rs.20 lakhs towards rectification expenses is concerned, it was stated that the said provision was based on the information that some of the equipments supplied by the company required repair and replacement and that technical team estimated such expenses for making provision in the account. The claim thus based on materials and the information of the technical team, the claim would certainly fall for consideration within the dictum of decision of the Apex Court reported in (2009) 314 ITR 62 - ROTORK CONTROLS INDIA P. LTD v. CIT. In the circumstances, we have no hesitation in setting aside the Tribunal's

order in rejecting the claim of the assessee in respect of assessee's claim to the tune of Rs.40 lakhs being provision towards warranty. Consequently, the order of the Tribunal is set aside and the above Tax Case (Appeal) is allowed. No costs.

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To

The Deputy Commissioner of Income Tax
Company Circle II (1)
121, Nungambakkam High Road
Chennai 600 034