IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "A", PUNE

BEFORE SHRI R.S. SYAL, VICE PRESIDENT
AND SHRI VIKAS AWASTHY, JUDICIAL MEMBER

आयकर अपील सं. / ITA Nos.1130 to 1132/PUN/16
निर्धारण वर्ष / Assessment Years : 2007-08, 2008-09 & 2010-11

Thuse Electronics Pvt. Ltd., Plot No.33A, Sector-7, PCNTDA, Bhosari, Pune – 411 003 PAN : AAACT6285F	**Vs.**	Addl.CIT, Range-7, Pune/ DCIT, Circle-7, Pune
(Appellant)		(Respondent)

Appellant by	Shri C.H. Naniwadekar
Respondent by	Ms. Shabana Parveen
Date of hearing	05-02-2019
Date of pronouncement	06-02-2019

आदेश / ORDER

PER R.S.SYAL, VP :

These three appeals by the assessee relate to the assessment years 2007-08, 2008-09 & 2010-11. Since some of the issues raised in these appeals are common, we are, therefore, proceeding to dispose them off by this consolidated order for the sake of convenience.

A.Y. 2007-08 :

2. The first ground is against disallowing Research & Development capital expenditure of Rs.1,26,100/- on the

ground that no documentary evidence of any real R&D activity by the assessee, was furnished.

3. Briefly stated, the facts of the case are that the assessee company is manufacturing electronic products since 1989. It claimed deduction of R&D capital expenditure of Rs.1,26,100/- and revenue expenditure of Rs.1,01,455/-. The Assessing Officer allowed deduction in respect of the revenue expenditure. As regards the capital expenses of Rs.1,26,100/-, the AO held that the claim made u/s 35(2) of the Income-tax Act, 1961 (hereinafter also called `the Act') was not sustainable as the assessee was not approved by any Central Government Agency. Treating such amount of Rs.1,26,100/- as capital expenditure, the AO allowed depreciation @15% and made disallowance of Rs.1,16,550/-. The ld. CIT(A) held that there was no requirement of registration as held by the AO. He however, did not allow any relief on the ground that the assessee could not prove the fact of having carried out any R&D activity, against which the assessee has approached the Tribunal.

4. We have heard the rival submissions and gone through the relevant material on record. Section 35(1) of the Act

provides for deduction in respect of Research & Development expenditure. Clause (i) of section 35(1) states that any expenditure, not being in the nature of capital expenditure, laid out or expended on scientific research related to the business shall be allowed as deduction. Clause (iv) of section 35(1) provides that deduction in respect of expenditure of capital nature on scientific research related to the business carried on by the assessee shall be allowed as deduction in terms of sub-section (2). Sub-section (2) of section 35, in so far as it concerns the issue in the instant appeal, provides for allowing the deduction for the full amount of capital expenditure. Thus, if some capital expenditure is incurred on Research & Development, the same has to be allowed as deduction in full in the year of incurring. If on the other hand, the assessee fails to prove that the expenditure of capital nature was in connection with the Research and such expenditure involves creation of any asset, the said expenditure entitles the assessee to claim depreciation at the eligible rate.

5. Adverting to the facts of the instant case, we find that the assessee claimed to have incurred capital expenditure of Rs.1,26,100/-. Despite the AOs' requirement, the assessee could not produce any evidence to show that it was really

engaged in doing some research activity. Similar position prevailed before the ld. CIT(A). It has been recorded in para 3.3 of the impugned order that no documentary evidence on real Research & Development activities was furnished. The position is no better before us as well. On a specific requisition, the ld. AR could not draw our attention towards any cogent material or evidence to demonstrate that it was engaged in carrying out any real research activity. Under such circumstances, action of the authorities below in allowing depreciation @15%, as against 100% claimed by the assessee on the capital expenditure, is unimpeachable. This ground is not allowed.

6. Ground No.2 is against disallowance of Warranty expenses. The facts of this issue are that the assessee created warranty provision for the year at Rs.22 lakhs against sales to IFB at Rs.3.78 crore. This was in contrast to the warranty provision of Rs.9 lakhs against the sale to IFB at Rs.3.81 crore for the A.Y. 2006-07 and warranty provision of Rs.3.90 lakhs against sales to IFB at Rs.2.55 crore for the A.Y. 2005-06. The Assessing Officer observed that no expenditure was actually incurred for the A.Ys. 2005-06 and 2006-07 and only a sum of Rs.11,39,474/- was debited by IFB for the extant

year. He further observed that the warranty provisions of Rs.20 lakhs and Rs.15 lakhs were created for the A.Y. 2008-09 and 2009-10 as against the actual expenditure incurred of Rs.4.65 lakhs and Rs.3.19 lakhs for such years. Considering the incremental increase in warranty provision, the AO disallowed Rs.13 lakhs (Rs.22 lakhs provision for the year and Rs.9 lakhs provision for immediately preceding year). The ld. CIT(A) did not allow any relief on this issue, against which the assessee has come up in appeal before the Tribunal.

7. We have heard both the sides and gone through the relevant material on record. The Hon'ble Supreme Court in *Rotork Controls India (P) Pvt. Ltd. Vs. CIT (2009) 314 ITR 62 (SC)* has held that a provision made by an assessee for warranty claim on the basis of its expenditure is allowable as deduction u/s.37 of the Act. While allowing deduction on account of warranty provision, the Hon'ble Apex Court added a caveat by observing in Para No.44 of its judgment that : "*it would depend on the nature of business, the nature of sales, the nature of the product manufactured and sold and the scientific method of accounting being adopted by the assessee. It will also depend on the historical trend*". It is clear from the *ratio decidendi* in *Rotork Controls India (P) Ltd. (supra)*

that though warranty provision is a permissible deduction but the provision must be made on a scientific basis. Any warranty provision made *de hors* any scientific calculation or considering the past trend of sales and actual expenditure etc., cannot qualify for deduction.

8. Reverting to the facts of the instant case, we find from para No.4 of the assessment order that the assessee created provision of Rs.3.90 lakh for the A.Y. 2005-06 but the expenditure incurred on repair was Nil. For the A.Y. 2006-07, provision was made for Rs.9 lakh but the expenditure incurred was again Nil. Such provision of Rs.9 lakh was made as against sales to IFB at Rs.3.81 crore. For the year under consideration, when the amount of sales dipped to Rs.3.78 crore, amount of provision increased multifold from Rs.9 lakh to Rs.22 lakh as against the actual expenditure incurred on repairs standing only at Rs.11,39,474/-. This narration of facts amply proves that the creation of warranty provision was not based on any scientific calculation but was rather an *ad hoc* exercise. Under such circumstances, we cannot grant deduction in respect of warranty provision.

9. Once it is held that the creation of provision cannot be allowed as deduction, it is further clarified that the reversal of provision should also not be brought to tax, if the creation of such provision was earlier not allowed as deduction. To put it simply, neither the creation of provision nor its reversal, if earlier not allowed as deduction at the time of making it, would lead to deduction or taxability of any sum but the actual expenditure incurred by the assessee on repairs on year to year basis would qualify for deduction. With these observations, we set aside the impugned order to this extent and remit the matter to the file of AO for deciding the issue in accordance with our above directions.

10. In the result, the appeal is partly allowed for statistical purposes.

A.Y. 2008-09 :

11. Both the grounds raised by the assessee for this year are *mutatis mutandis* similar to those for the A.Y. 2007-08. Following the view taken hereinabove, we decide the first ground against the assessee by holding that Research & Development capital expenditure cannot be granted 100% deduction, but the same should be allowed depreciation at the

eligible rates. Second ground of warranty expense is also decided accordingly in as much as neither the provision for warranty will be allowed as deduction nor its reversal, if not allowed as deduction at the time of creation of provision, should be charged to tax and the actual amount of expenditure on repair should be allowed as deduction.

12. In the result, the appeal is partly allowed for statistical purposes.

A.Y. 2010-11 :

13. First two grounds are similar to those of preceding two assessment years. We hold accordingly that the Research & Development capital expenditure cannot be allowed as deduction @100% but depreciation should be allowed at the eligible rate. Similarly, in so far as warranty provision is concerned, it is held that provision for warranty should not be allowed as deduction; reversal of the provision in the year, if not allowed as deduction at the time of its creation, should not be charged to tax but the actual expenditure incurred should be allowed as deduction.

14. Last ground regarding the disallowance u/s.14A of the Act was not pressed by the ld. AR, which is hereby dismissed.

15. In the result, the appeal is partly allowed for statistical purposes.

Order pronounced in the Open Court on 06th February, 2019.

Sd/-	Sd/-
(VIKAS AWASTHY)	**(R.S.SYAL)**
JUDICIAL MEMBER	**VICE PRESIDENT**

पुणे Pune; दिनांक Dated : 06th February, 2019
सतीश

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order is forwarded to:

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. आयकर आयुक्त(अपील) / The CIT (Appeals)-5 Pune
4. The Pr.CIT-4, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे "ए" / DR 'A', ITAT, Pune;
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

// True Copy //

Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

		Date	
1.	Draft dictated on	05-02-2019	Sr.PS
2.	Draft placed before author	05-02-2019	Sr.PS
3.	Draft proposed & placed before the second member		JM
4.	Draft discussed/approved by Second Member.		JM
5.	Approved Draft comes to the Sr.PS/PS		Sr.PS
6.	Kept for pronouncement on		Sr.PS
7.	Date of uploading order		Sr.PS
8.	File sent to the Bench Clerk		Sr.PS
9.	Date on which file goes to the Head Clerk		
10.	Date on which file goes to the A.R.		
11.	Date of dispatch of Order.		

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