IN THE INCOME TAX APPELLATE TRIBUNAL
"D" BENCH, AHMEDABAD

BEFORE SHRI WASEEM AHMED, ACCOUNTANT MEMBER &
SHRI SIDDHARTHA NAUTIYAL, JUDICIAL MEMBER

I.T.A. No. 3235/Ahd/2015
With C.O. No. 219/Ahd/2015
(Assessment Year: 2012-13)

Deputy Commissioner of Income Tax, Circle-2(1)(1), Ahmedabad	Vs.	M/s. IRM Offshore & Marine Engineers Pvt. Ltd., SF-2, Agrawal Avenue, Opp. Naranpura Tel. Exchange, C.G. Road, Ahmedabad-380006
[PAN No.AAACI4327B]		
(**Appellant/Respondent**)	..	(**Respondent/Cross Objector**)

I.T.A. Nos. 356&357/Ahd/2018
(Assessment Years: 2013-14 & 2014-15)

Deputy Commissioner of Income Tax, Circle-2(1)(1), Ahmedabad	Vs.	M/s. IRM Offshore & Marine Engineers Pvt. Ltd., SF-2, Agrawal Avenue, Opp. Naranpura Tel. Exchange, C.G. Road, Ahmedabad-380006
[PAN No.AAACI4327B]		
(**Appellant**)	..	(**Respondent**)

I.T.A. No. 2119/Ahd/2018
(Assessment Year: 2015-16)

Assistant Commissioner of Income Tax, Circle-2(1)(1), Ahmedabad	Vs.	M/s. IRM Offshore & Marine Engineers Pvt. Ltd., SF-2, Agrawal Avenue, Opp. Naranpura Tel. Exchange, C.G. Road, Ahmedabad-380006
[PAN No.AAACI4327B]		
(**Appellant**)	..	(**Respondent**)

Appellant by :	Shri M. J. Shah, Shri Jimi Patel & Shri Rushin Patel, A.Rs.
Respondent by:	Shri Ashok Kumar Suthar, Sr. D.R.

Date of Hearing	30.08.2023
Date of Pronouncement	05.09.2023

O R D E R

PER SIDDHARTHA NAUTIYAL - JUDICIAL MEMBER:

All these four appeals have been filed by the Department and Cross Objection filed by the assessee (for A.Y. 2012-13) against the orders passed by the Ld. Commissioner of Income Tax (Appeals)-2 (in short "Ld. CIT(A)"), Ahmedabad vide different orders dated 24.08.2015, 06.11.2017 and 04.07.2018 passed for the different Assessment Years i.e. A.Ys. 2012-13 to 2015-16. Since common issues are involved for all the years under consideration, all the appeals are being disposed of by way of a common order.

We shall first discuss the Department's appeal for A.Y. 2012-13 (ITA No. 3235/Ahd/2015) and assessee's Cross Objection (C.O. No. 219/Ahd/2015).

2. The Department has taken the following grounds of appeal:-

"1. The Ld.CIT(A) has erred in law and on facts in capitalizing interest expense of Rs.20,18,037/- on CWIP, without properly appreciating the facts of the case and the material brought on record.

2. The Ld.CIT(A) has erred in law and on facts in deleting the disallowance of Rs.84,000/- made u/s.36(1)(iii) of the Act, without properly appreciating " the facts of the case and the material brought on record.

3. The Ld.CIT(A) has erred in law and on facts in deleting the disallowance of foreign commission expenses of Rs.60,64,640/- made u/s.40(a)(i) of the Act, without properly appreciating the facts of the case and the material brought on record.

4. The Ld.CIT(A) has erred in law and on facts in deleting the disallowance of Rs.2,96,84,828/- made on account of warrant liability treating the same as contingent liability, without properly appreciating the facts of the case and the material brought on record.

5. The Ld.CIT(A) has erred in law and on facts in deleting the disallowance of Rs.31,96,800/- out of interest expense claim on the business advance, without properly appreciating the facts of the case and the material brought on record.

6. The Ld.CIT(A) has erred in law and on facts in restricting the disallowance of Rs.3,95,014/- to Rs.1,95,599/- u/s.14A of the Act, without properly appreciating the facts of the case and the material brought on record.

7. On the facts and in the circumstances of the case, the Ld. CIT(A) ought to have upheld the order of the Assessing Officer.

8. It is, therefore, prayed that the order of the Ld. CIT(A) may be set aside and that of the Assessing Officer may be restored to the above extent.

9. The appellant craves leave to amend or alter any ground or add a new ground, which may be necessary."

3. The assessee has raised the following Cross Objections:-

"1. The CIT(A) has erred in confirming the addition of Rs.1,95,599/- out of total addition made of Rs.3,95,014/- u/s.14A of the Act.

2. The CIT(A) has erred in not allowing credit of TDS deducted of Rs. 2800/- though the party has deducted and credited the same in our Account in the current assessment year."

We shall first discuss Department's appeal for A.Y. 2012-13.

Ground No.1:- Ld. CIT(A) erred in capitalizing the interest expenditure of Rs. 20,18,037/- on Capital Work in Progress (CWIP).

4. The brief facts of the case are that the assessee is engaged in the business of Manufacturing and Trading of Rubber Fender and its accessories for offshore and marine engineering industry. During the course of assessment, the assessee was asked to furnish details of secured and unsecured loans taken during the year under consideration, alongwith the purpose of taking such loans and its utilization. Further, the assessee was also asked to explain whether any interest was capitalised towards the capital assets acquired from borrowed funds during the year up to the date of "put to use" of assets or towards CWIP. The Assessing Officer observed that the assessee did not furnish any details pertaining to funds flow movement to prove that only surplus funds available with the assessee were utilized for the purpose of purchase of various items grouped under the head CWIP. Further, the assessee was not able prove that there was no diversion

of interest bearing funds and that the interest free funds available with the assessee which were utilized for making investment in Capital Work in Progress. Accordingly, the Assessing Officer added back a sum of Rs. 20,18,037/- under Section 36(1)(iii) of the Act and added the same to the total income of the assessee.

5. In appeal, Ld. CIT(A) decided the issue in favour of the assessee by observing that during the year under consideration, the assessee had sufficient interest free funds in the form of share capital, reserve and surplus of Rs. 18.12 crores as on 31.03.2012. Further, even the net profits before depreciation after tax were at Rs. 4.82 crores. At the same time Ld. CIT(A) observed that the Work-in-Progress reduced substantially from Rs. 4.05 crores as on 31.03.2011 to 0.5 crores as on 31.03.2012. Further, the addition in CWIP were on account of electric installation (Rs. 17.36 lakhs) factory building (Rs. 48.74 lakhs), furniture (Rs. 2.78 lakhs) and plant and machinery (Rs. 67.29 lakhs), totalling to Rs. 1.36 crores. In view of the above facts, Ld. CIT(A) held that since the interest free funds available with the assessee were much higher than the investment as Capital Work in Progress (CWIP), it cannot be said that interest bearing funds have been utilized for the purpose of investment in CWIP. Accordingly, the Ld. CIT(A) deleted the additions of Rs. 20,18,037/- under Section 36(1)(iii) of the Act on account of funds utilized for Capital Work in Progress.

6. The Department is in appeal before us against the deletions made by Ld. CIT(A). Before us, the Ld. D.R. primarily reiterated the contents of the assessment order. In response, the Counsel for the assessee placed reliance on the observation made by Ld. CIT(A) in the appellate order. The Counsel

for the assessee submitted that firstly, looking into the instant facts Ld. CIT(A) has very correctly and categorically observed that the interest free funds available with the assessee in far excess of the investment made in CWIP. Secondly, the Counsel for the assessee relied on various judicial precedents, including one rendered by Jurisdictional Gujarat High Court which is to the effect that once substantial interest free funds are available with the assessee, no additions are called for under Section 36(1)(iii) of the Act.

7. We have heard the rival contentions and perused the relevant material available on record. It would be useful to reproduce the relevant extracts of the Ld. CIT(A) ruling of ready reference:-

> *"3.7. On the other side, it has been found that the appellant had the sufficient interest free funds in the form of share capital, reserve and surplus of Rs.18.12 crore as on 31/03/2012, as against Rs.16.61 crores as on 31/03/2011. While, there were the work in progress of Rs.0.50 crore on 31/03/2012 and Rs.4.05 crore as on 31/03/2011. Hence, the availability of interest free funds were much higher than the investment as capital work in progress. Thus,, it cannot,be said that the borrowed funds have been utilized for the purpose of capital work in progress. The AO has not established any nexus of such utilization with ,the borrowed funds.*
>
> *3.8. Further, it is noticed that during the year, the CWIP was reduced to the large extent. The balance in CWIP account as on 31/03/2011 at Rs.4.05 crore was reduced to Rs.0.50 crore as on 31/03/2012 which means that the substantial CWIP amount has been capitalized in the*

asset account for the purpose of the assets ready for use. There is no finding of the AO that those capitalized assets have not been used for the purpose of business in the year under consideration.

3.9. Further, the additions in the CWIP were on account of electric installation at Rs. 17.36 lacs, factory building at Rs.48.74 lacs, furniture at Rs.2.78 lacs and plant and machinery at Rs.67.29 lacs totaling to Rs. 1.36 crores. While, during the year, even the net profits before depreciation after tax were at Rs.4.82 crores. Thus, the interest free funds generated in the year under consideration on account of. the profits were even much higher than the expenditures made towards various heads under the CWIP as notified above. Thus, on this account also, it cannot be said that the interest bearing loans have been utilized for the purpose of investment in CWIP.

3.10. It was also noticed that the AO has worked out the disallowance of expenses based on average investment in W.I.P. as compared to average interest borrowings which was not correct as the AO has ignored the availability of own funds and assumed that the CWIP investment was entirely made out of the borrowed funds.

3.11. It has also been noticed that on this issue, which was identically involved in preceding years, the AO has not taken any adverse view in the scrutiny assessment completed from A. Ys. 2008-09 to 2011-12. But, at the first time, this disallowance of interest has been carried out by the AO. Since, in the preceding years, the AO has treated the investment in CWIP out of the interest free own funds, then in absence of any specific information / details, he cannot change his stand and assume that the

investment in CWIP was from the borrowed funds and not from owned funds, more particularly when the total amount of CWIP was reduced from Rs.4.05 crore to Rs.0.50 crore at the end of the year. The AO could not make the change in its own stand, unless in the earlier assessment years, the interest would have been disallowed on this account by holding that the borrowed funds have been utilized for the purpose of CWIP. In other words, there could not be different parameters of judgment of an identical issue."

8. A perusal of the observations made by Ld. CIT(A) clearly shows that substantial interest free funds were available with the assessee far in excess of the investment made in Capital Work in Progress. In the case of **Hero Cycles (P.) Ltd. 63 taxmann.com 308 (SC)**, the Hon'ble Supreme Court held that once it is established that there is nexus between expenditure and purpose of business revenue cannot justifiably claim to put itself in arm-chair of businessman or in position of Board of Directors and assume role to decide how much is reasonable expenditure having regard to circumstances of case. In the case of **PCIT v. Shapoorji Pallonji and Co. Ltd 141 taxmann.com 509 (SC)**, the Hon'ble Supreme Court dismissed SLP filed by the Department against the order of High Court which held that that where assessee had not utilized interest bearing borrowed funds for making interest-free advances as assessee had its own interest-free fund far in excess of interest-free advance, interest on borrowed capital could not be disallowed. In the case of **CIT v. Reliance Industries Ltd. 102 taxmann.com 52 (SC)**, the Hon'ble Supreme Court held that where Assessing Officer rejected assessee's claim under section 36(1)(iii) taking a view that interest would not have been payable to banks if funds were not

provided to subsidiaries, in view of fact that interest free funds were available to assessee which were sufficient to meet its investment in subsidiaries, appellate authorities were justified in allowing assessee's claim for deduction. In the case of **E City Investments And Holdings Company (P.) Ltd. 117 taxmann.com 124 (SC)**, the Hon'ble Supreme Court held that where High Court upheld Tribunal's order allowing assessee's claim for deduction under section 36(1)(iii) by taking a view that assessee's decision to give loan to its subsidiaries was derived by business exigency, SLP filed against said order was to be dismissed. In the case of **Amod Stamping (P.) Ltd. 45 taxmann.com 427 (Gujarat)**, the Hon'ble High Court held that where assessee had sufficient interest free fund available with it to be invested in mutual funds, deduction of interest expenditure on borrowed fund could not be disallowed under section 36(1)(iii) of the Act. In the case of **Gujarat State Fertilizers & Chemicals Ltd. 36 taxmann.com 230 (Gujarat)**, the Hon'ble High Court held that where assessee's own funds exceeded investment made to earn exempted income, and borrowed funds had not been used for investments, disallowance of 10 per cent of dividend income was impermissible. In the case of **Beekons Industries Ltd. 149 taxmann.com 383 (Punjab & Haryana)**, the High Court held that where assessee-company had given loan to a directors' relative without charging interest and it also claimed deduction under section 36(1)(iii) of interest paid on loan taken from bank, since loan to director's relative was financed by assessee from self sources without any cost, disallowance of interest paid on loan taken on pro rata basis was not justified.

9. Further, we observe that on identical set of facts, the Assessing Officer did not make any disallowance in the hands of the assessee under Section 36(1)(iii) of the Act in the previous assessment. Therefore, in view of the facts of the instant case and the judicial precedents on the subject, we find no infirmity in the order of Ld. CIT(A) in deleting the additions made under Section 36(1)(iii) of the Act.

10. In the result, Ground No. 1 of the Department's appeal is dismissed.

Ground No.2:- Disallowance of Rs. 84,000/- under Section 36(1)(iii) of the Act.

11. The facts in relation to this ground of appeal are similar to those of Ground No. 1 of the Department's appeal. During the course of assessment, the Assessing Officer observed that while the assessee had debited interest expenditure amounting to Rs. 96 lakhs in the Profit & Loss Account, the assessee had granted interest free loans and advance to IRM Infra – Projects Pvt. Ltd. amounting to Rs. 7 lakhs. Accordingly, the Assessing Officer made a disallowance of Rs. 84,000/- under Section 36(1)(iii) of the Act on the ground that the assessee could not prove by way of submitting "funds flow statement" that there was no diversion of interest bearing funds and that the interest free funds were available were at the time when loans and advances were given.

12. In appeal, the Ld. CIT(A) observed that during the year under consideration, the assessee had net profits before depreciation and after tax at Rs. 4.82 crores which were much more than the advances given to the

sister concern. Further, the Assessing Officer has not established any nexus to prove that interest bearing loans have been utilized for the purpose of aforesaid advances to the sister concerns. On the contrary, the assessee has provided a copy of the bank statement establishing that the advances were given out of sale proceeds of the business and not from any borrowings. Accordingly, the Ld. CIT(A) directed that the addition of Rs. 84,000/- under Section 36(1)(iii) of the Act may be deleted.

13. On going through the facts of the instant case and the detailed discussion while discussing Ground No. 1 of the Department's appeal, where similar disallowance was made under Section 36(1)(iii) of the Act, we are of the considered view that Ld. CIT(A) has not erred in facts and law in deleting additions made under Section 36(1)(iii) of the Act.

14. In the result, Ground No. 2 of the Department's appeal is dismissed.

Ground No.3:- Ld. CIT(A) erred in deleting disallowance of Foreign Commission Expenses of Rs. 60,64,640/- made under Section 40(a)(i) of the Act.

15. The brief facts of the case are that during the course of assessment, the Assessing Officer observed that the assessee had debited Foreign Commission Expenses of Rs. 60,64,640/- during the year under consideration. Further, the assessee was asked to furnish details of TDS deducted on all the aforesaid expenses. In response, the assessee submitted that the commission expenses has been paid to non-resident parties through banking channels for arranging orders of foreign parties. The details of

services rendered are evident from their copy of bills / invoices attached. It was submitted that none of the parties to whom commission have been paid have any permanent establishment in India and all services have been rendered outside India and such parties have no income chargeable to tax in India. The Assessing Officer observed that assessee has not provided the nature and evidences of services rendered by the foreign commission agent for which commission was paid by the assessee. No copy of Agreement or documentary evidences in support of commission payment etc. was given by the assessee which could justify the reasonableness of the commission payment to the non-resident as well as the genuineness of the expenditure incurred for the purpose of business. Further, in absence of copy of agreement with foreign commission agent, identity of commission agent and evidences pertaining to services rendered by the foreign commission agent having nexus with the business of the assessee, the Assessing Officer made a disallowance of Rs. 60,64,640/- under Section 40(a)(i) of the Act.

16. In appeal, Ld. CIT(A) allowed the appeal of the assessee with the following observations:-

> *"6.5 He also provided the relevant details to the AO during assessment proceedings like name and address of the broker, copies of bank debit advice for outward remittance, copies of debit notes, bill quantity, export value in US $ and realization in INR with brokerage in US $ and brokerage in INR. Along with the aforesaid details, the appellant also provided to the AO, the broker wise payment evidences along with bank payment details, company payment advice, debit note from overseas brokers. Thus, it was submitted that the payment of*

commission to overseas brokers was part of export of products and an important mediatory channel to book the export orders and obtaining the consultancy for supply of the goods. Thus, the commission payment was genuine and paid through banking channels on export orders procured. The same were made for the purpose of business in prudent way to increase export and increase customer base in foreign countries.

6.6. With regard to the provisions of section 9(1)(i), it was submitted that the overseas brokers were not doing any business in India. This fact was even noticed on the face of the debit notes / bills received from foreign brokers. They were merely providing export orders to facilitate appellant. Further, the overseas brokers did not have any business connection in India. It was further claimed that there is no income deemed to accrue or arise in India in view of the explanations to the provisions of section 9(1)(i) of the I. T. Act as the overseas brokers had rendered services outside India and the commission was also paid to them outside India. Hence, there was no obligation to deduct the tax from such commission payments as per the provisions of section 195 of the I. T. Act. It was also claimed that the appellant had been making the commission payments to the overseas brokers since F.Y. 2009-10 which shows that this was not a single year in which such commission payments have been made and also emphasized that these payments have been allowed by the AO in the preceding years in scrutiny assessment completed u/s. 143(3) of the I. T. Act, 1961.

.....

6.16 The issue whether the payer has to apply for a certificate under section 195 if some payment has been made, has been considered by

various courts. The special bench of Chennai ITAT in the case of Prasad Productions reported in 125 ITD 263 has held in para-35 of the order that if the assessee has not applied to the Assessing Officer under section 195(2) for deduction of tax at a lower or nil rate of tax under a bona fide belief that no part of the payment made to the non-resident is chargeable to tax, then he is not under any statutory obligation to deduct tax at source on any part thereof. While deciding the case the honourable bench has considered several cases which were relevant to the issue. It has submitted that the commission paid to non-resident agent was not liable to tax under the provisions of the act when the services were rendered outside India, not in India, payments were made outside India and there was no permanent establishment or business connection in India. The submission given by the appellant clearly demonstrates its bona fide belief.

6.17. The last issue which is to be adjudicated is that whether the commission payment was genuine and the services were rendered. The AO has dealt with the issue in para - 6.1 to 6.9 of his order. It is further observed that the payments have been made through banking channel and are duly documented. Various correspondences were made between the appellant and the commission agents at the time of booking the order. The correspondence indicate that the agents were fully involved and the commission has been rightly paid to them for the work done. The appellant has made commission payment to agents during the year and it has provided copies of debit notes, bank debit advices and some copies of e-mail correspondences with the agents. The appellant has given satisfactory evidences in respect of all commission payments and

therefore, considering the overall facts and circumstances the payment made to the agents is taken as genuine. Accordingly, in my considered opinion the appellant has given satisfactory evidences regarding the services rendered by the agents and the genuineness of payment of commission. The similar payments have been allowed in the past year by the AO.

6.18. The AO has also placed reliance on the decision of Hon'ble Authority of Advance Rulings in the case of SKF Boilers and Driers (P.) Ltd. (2012) 18 Taxmann 325 and Rajiv Malhotra (2006) 284 ITR 564 (Delhi). The judgements are not applicable to the present facts as there are several other decisions which hold that such kind of commission is not taxable in India and accordingly no liability to deduct tax was there. Further the decision of honourable Supreme Court of India in the case of CIT vs. Toshoku Limited 125 ITR 525, still prevails as on date and is the law of the land as regards applicability of TDS provisions to commission paid to overseas/non-resident agents by Indian Exporters.

6.19. Further, reliance is placed on the following decisions / judgments:-

* *ACIT Vs.Modern Insulators Ltd. [56 DTR 362 (Jaipur Trib.)]*
* *Ishikawajama - Harima Heavy Industries Ltd. Vs. Director of Income Tax [207 CTR 361]*
* *Dy. Commissioner of Income Tax Vs. Divi's Laboratories Ltd. [(2011) 60 DTR (Hyd) (Trib) 210]*
* *ITO, International Taxation, Chennai Vs. Prasad Prodictoin Ltd.[(2010) 125 ITD 263 Chennai) (SB)*

* *ACIT, Circle - 16(3) (Hyderabad-Trib) vs. Priyadarshini Spinning Mills (P.) Ltd. (2012) ITA No. 1776 (2011)*

6.20. In view of the preceding discussions and the submissions of the appellant, besides the judgments / decisions of various courts, it is clear that the appellant was not liable to deduct tax on the commission payment to foreign agents. Therefore, the disallowance of Rs. 60,64,640/-under section 40(a)(ia) made by the AO is directed to be ***deleted****.*

6.21. The ground of appeal is accordingly ***allowed.****"*

17. Before us, the Ld. D.R. submitted that in absence of any Agreements which have been submitted by the assessee either before the Assessing Officer or Ld. CIT(A) it is unclear as to the precise nature of services which were rendered by the so-called commission agents. The Ld. CIT(A) has given relief only on the ground that the payments were made through banking channels. However, in absence of agreements, which were not provided by the assessee despite several opportunities, the nature of services are not clear and accordingly, Ld. CIT(A) erred in facts and in law deleting the addition on account of foreign commission expenses. In response, Ld. Counsel for the assessee placed reliance on the observations made by Ld. CIT(A) in the appellate order. We observe that the Ld. CIT(A) has primarily given relief to the assessee on the ground that names and address of the brokers / agents, copies of bank debit advice issued for outward remittance, debit notes and export invoices etc. were furnished by the assessee and accordingly, the Ld. CIT(A) directed to delete the addition. However, in the instant facts, we observe that the commission expenses has

risen substantially from Rs. 46,903/- to 60,64,640/- during the impugned year under consideration. The Counsel for the assessee has placed on reliance on certain documents which have been placed before us for our consideration in order to substantiate the nature of expenses which have been incurred in support of the fact that services were rendered outside of India. However, what we notice that there has been a substantial increase in foreign commission expenses during the year under consideration and the Department i.e. both the Assessing Officer and Ld. CIT(A) did not have opportunity to examine the foreign commission expenses in absence of copies of Agreements which have not been furnished at any stage of the proceedings. In our considered view, in order to decide on the nature / genuineness of services which have been rendered by the broker / agents and whether TDS is required to be deducted on such payments, it is important that the Department should analyze the details including copies of Agreements, which have been furnished before us on sample basis for the first time. Accordingly, in the interest of justice this issue is being restored to the file of Assessing Officer for denovo consideration, after giving the opportunity of hearing to the assessee.

18. In the result, Ground No. 3 of the Department's appeal is allowed for statistical purposes.

Ground No.4:- Ld. CIT(A) erred in deleting disallowance of Rs. 2,96,84,828/- made on account of warranty liability.

19. The brief facts in relation to this ground of appeal are that during the course of assessment, the Assessing Officer observed that the assessee has

debited a sum of Rs. 2,96,84,828/- on account of warranty claim expenses. During the course of assessment, the assessee was required to furnish complete details and reasonableness for the claim of warranty expenses. The Assessing Officer, on analysis of details furnished by the assessee was of the view that there was no consistency in recognizing warranty claim expenses based on any scientific formula. Further, the Assessing Officer observed that prior to Assessment Year 2009-10, there was no such claim of warranty expenses or warranty provision made by the assessee. Further, the assessee has not expressed as to why it made the provision for warranty is for a period of 5 years. Further, no justification or evidences were furnished by the assessee such as expenditure incurred by the assessee post sales so that assessee could justify its claim for warranty provision based on 5 years actual expenditure. Thus, the assessee has failed to establish any scientific basis in respect of determination of amount of warranty expenses @ 5% of sales. Accordingly, the Assessing Officer was of the view that assessee was not able to provide any scientific percentage of warranty claim expenses based on the turnover of the last 5 years. The Assessing Officer observed that from the facts of the case, it is evident that even though there was no actual expenditure incurred by the assessee year after year up to Assessment Year 2012-13, the assessee has been making provision for warranty expenses @ 5%. The Assessing Officer observed that in A.Y. 2009-10 warranty claim expenses were Rs. 31,36,470/- whereas the actual expenditure was Rs. NIL. Further in A.Y. 2010-11, 2011-12 and 2012-13 the warranty claim expenses debited by the assessee were Rs. 2,92,66,687/-, Rs. 2,27,00,497/- and Rs. 2,96,84,828/- respectively, whereas the actual expenditure during the years were Rs. NIL. Thus, it is clearly evident that

the warranty claim expenses was clearly a contingent liability which is not allowable as per the provisions of law. Further the assessee failed to establish any scientific basis adopt by it year after year for determining the warranty claim expenses @ 5% based on duly supported documentary evidence. Accordingly, the Assessing Officer made a disallowance of Rs. 2,96,84,828/- debited by the assessee in the Profit & Loss Account on account of warranty claim expenses.

20. In appeal, assessee submitted that items sold by the assessee have long life cycle and are generally capital goods for the purchasers. Therefore, these products carry manufacturer's warranty for 5 years i.e. the fault in the products within the warranty period have to be rectified by the assessee free of cost. Further, the assessee provided bank guarantee to its customer covering 2% to 10% of the contract price towards performance guarantee. In case the assessee does not fulfill the warranty obligations, the customers can invoke the bank guarantee. The Ld. CIT(A) observed that in some of the cases the warranty period was 8 years and therefore, the period of warranty for which the provision has been made i.e. 5 years by the assessee was fair and does not warrant any interference. Further, Ld. CIT(A) observed that even the bank guarantee @ 10% of sale amount of the contract value has been provided to the customers as is evident from the details provided by the assessee during the course of appellate proceedings. Further, Ld. CIT(A) observe that the assessee has written back the provision after the expiry of warranty period i.e. 5 years and offered the amount at the maximum marginal rate of tax and it was therefore a tax neutral exercise. Accordingly, Ld. CIT(A) was of the view that the provision were made was

not a contingent liability and the Assessing Officer had allowed the claim of the assessee in previous year as well and in absence of any new details / information the assessee had no basis to change its stand during the impugned year under consideration.

21. The Department is in appeal before us against the aforesaid relief granted by the CIT(A).

22. Before us, the Ld. D.R. submitted that during the past 5 years the assessee has not claimed any actual expenses towards warranty expenses have not been incurred warranty expenses towards the sale made by the assessee. Secondly, in absence of any actual warranty expenses having being incurred, there is no rational or scientific basis in making the provision of 5% of the sales.

23. In response, the Counsel for the assessee placed reliance on the observation made by Ld. CIT(A) in the appellate order. Further, the Counsel for the assessee submitted that even on the principle of consistency, the claim of the assessee should be allowed, since as noted by Ld. CIT(A) the claim of the assessee has also been allowed in the earlier assessment years, which have withstood the test of scrutiny assessment. Thirdly, it was submitted that the assessee has also provided bank guarantee to its clients which can be forfeited in the event of default in providing in after sales / obligations. Further, it was submitted that the assessee is following reversal method of accounting wherein the unutilized provision of warranty at the end of 5 years was returned back to the Profit & Loss Account and offered to tax at the end of the fifth year. Therefore, the entire exercise is taxed

neutral since the tax rates applicable to the company remained static during the period under consideration. The Counsel for the assessee placed reliance on several judicial precedents in support of the contention that warranty provision, once computed on a scientific basis, is an allowable expenditure.

24. We have heard the rival contentions and perused the material on record. In the case of **Rotork Controls India (P.) Ltd. v. Commissioner of Income-tax, Chennai 180 taxmann 422 (SC)** the Hon'ble Supreme Court held that for a provision to qualify for deduction, there must be a present obligation arising from past events, settlement of which is expected to result in an outflow of resources and in respect of which a reliable estimate of amount of obligation is possible. Further, the Hon'ble Supreme Court held that if historical trend indicates that in past large number of sophisticated goods were being manufactured and defects existed in some of items manufactured and sold, then provision made for warranty in respect of army of such sophisticated goods would be entitled to deduction from gross receipts under section 37(1) of the Act. In the instant facts, the Assessing Officer has pointed that in the past assessment years the assessee has incurred "NIL" expenses towards actual warranty claims for the past five assessment years. In the instant case, certain facts are noteworthy. Firstly, on identical set of facts, the Department has allowed the appeal of the assessee for the past years as well. The Department has not pointed out to any specific circumstances which would necessitate a change in the position taken by the Department. Second, it is observed that in some cases, the goods supplied by the assessee carry a warranty period of upto eight years.

It is for this specific reason, as observed that Ld. CIT(A) that the assessee has made a provision for warranty for a period of five years from the date of sale. Thirdly, after the period the warranty period is over i.e. after five years, the assessee has suo moto offered the unutilized portion of the provision for warranty expenses and offered the same to tax in the return of income. Therefore, the provision for warranty is a Revenue neutral exercise and after the period when the warranty is over, the assessee suo moto offers the same to tax in its return of income. This fact has also been specifically taken note of by Ld. CIT(A) while allowing the appeal of the assessee on this issue. Fourthly, the assessee has given a reasonable basis as to why a provision of warranty @ 5% of net sales has been booked, which is for the reason that the assessee has provided a bank guarantee of Rs. 10.42 cores to its clients which can be forfeited in the event of default in providing any after sales application. The Ld. CIT(A) has observed that the assessee is clearly incurred substantial risk on account of bank guarantees which have been given to its customers and therefore, looking into the instant facts, a provision of warranty @ 5% of the net sales is quite reasonable, looking into the instant facts. Further, Ld. CIT(A) also observed that on perusal of various instances of warranty provided to customers, it was seen that in several cases the period of warranty ranged to eight years as well. Accordingly, a provision of warranty for a period of five years was justified in the instant set of facts. It is a well settled principle that provision of warranty, if done on a scientific and rational basis is allowable to the assessee. However, what qualifies as scientific / rational would depend on assessee's line of business, the nature of warranty that it provides and a period of warranty provided by the assessee. In this case it would be useful

to reproduce the relevant observations made by the Mumbai ITAT in the case of **Stove Industries Ltd. vs. ACIT (ITA No. 6949/Mum/2013 & 6643/Mum/2013** vide order dated 11.04.2018):-

> *"7. We find that the provision for warranty claimed by assessee during the relevant AY is Rs. 21,10,038/- which is net of the provision utilized during the year. Further it is also a fact that the provision for warranty has never been disallowed in any of the earlier assessment year even though the assessment proceedings were conducted under section 143(3) of the Act. The learned counsel for the assessee informed the Bench that during AY 2010-11, warranty provision was disallowed by the AO but subsequently allowed by the CIT(A) and Tribunal dismissed the appeal of Revenue on account of low tax effect. We also find that the assessee also follows reversal method of accounting wherein, the provision utilized is reduced from the provision for warranty lying in the books of accounts assessee. In such circumstances, we have to go through the decision of Hon'ble Supreme Court in the case of Rotork Controls India Private Limited vs. CIT (314 ITR 62) (SC), wherein Hon'ble Supreme Court has observed as under: -*
>
> > *"Where there are a number of obligations (e.g., product warranties or similar contracts) the probability that an outflow will be required in settlement, is determined by considering the said obligations as a whole. In this connection, it may be noted that in the case of a manufacture and sale of one single item the provision for warranty could constitute a contingent liability not entitled to deduction under section 37 of the said Act. However, when there is manufacture and sale of an army of items running*

into thousands of units of sophisticated goods, the past event of defects being detected in some of such items leads to a present obligation which results in an enterprise having no alternative to settling that obligation. "

8. Further, the learned Counsel for the assessee also relied on Bharat Earth Movers (supra), which has been relied on by the learned Sr. Departmental Representative and he referred to the particular observations of Hon'ble Supreme Court which reads as under:-

"4. The law is settled: if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied, the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain."

9. In view of the above factual and legal position, we are of the view that this provision for warranty is estimated by the assessee on scientific basis and assessee has claimed net of provision utilized during the year as per reversal method of accounting and hence we find no infirmity in the claim of the assessee. Accordingly, we reverse the orders of the lower authorities and allow the claim of the assessee. This issue of assessee's appeal is allowed."

Further, the Gujarat High Court in the case of **PCIT vs. Stovec Industries Ltd. 416 ITR 63** held that provision for warranty made on a scientific basis is on allowable expenses. The Gujarat High Court made the following observations in this regard:-

> *"4. The second question pertains to disallowance of a sum of Rs. 20.10 lakhs which was by way of provision of warranty expenses. CIT(Appeals) and the Tribunal noted that the assessee had been making such claim consistent with the past which was never disallowed by the assessing officer in scrutiny the assessment order except the one which was reversed by the CIT(Appeals). The Tribunal relied on the decision of the Supreme Court in the case of Rotork Controls India (P.) Ltd. v. CIT [2009] 180 Taxman 422/314 ITR 62 (SC) and Bharat Earth Movers v. CIT [2000] 112 Taxman 61/245 ITR 428 and observed that the provision for the warranty was estimated by the assessing officer by scientific basis and was therefore allowable.*
>
> *5. In the result, Tax Appeal is dismissed."*

25. Accordingly, in view of the facts of the assessee's case the observations made by Ld. CIT(A) in the appellate order and the judicial precedents as applicable to the assessee's set of facts, we find no infirmity in the order of Ld. CIT(A) so as to call for any interference.

26. In the result, Ground No. 4 of the Department's appeal is dismissed.

Ground No. 5:- Ld. CIT(A) erred in deleting disallowance of Rs. 31,96,800/- out of interest expenses claimed on business advances under Section 36(1)(iii) of the Act.

27. The brief facts in relation to the ground of appeal are that the assessee had given advances of Rs. 2,66,40,000/- for the purchase of office to M/s. Shivalik Reality Pvt. Ltd. in F.Y. 2010-11 i.e. A.Y. 2011-12. The said purchase was completed in F.Y. 2014-15 i.e. A.Y. 2015-16.

28. During the course of assessment, the Assessing Officer observed that the assessee has not given any documentary evidences in support of the contention that the advances for the purchase of office were made out of surplus funds and internal approvals. Thus, in absence of evidences, the Assessing Officer held that borrowed fund was utilized for giving capital advances for the purchase of office. Had the assessee not utilized borrowed funds for the purpose of advances towards purchases of capital assets, there would not have been any need for taking loans to the extent of amount utilized for advances towards purchase of capital assets. Accordingly, the Assessing Officer held that interest on borrowed funds to the extent of advance for purchase of capital assets has to be capitalized under Section 36(1)(iii) of the Act.

29. In appeal, Ld. CIT(A) observed that the assessee had made the claim on interest expenditure on various bank loans which had been availed for certain specified purposes. The Ld. CIT(A) observed that the interest payments incurred by the assessee on loans which were taken for specific purposes and the Assessing Officer has not given any findings that any of

the amounts from the these loans have direct nexus with the utilization for Capital Work in Progress. At the same time, the Ld. CIT(A) observed that the assessee had sufficient interest free funds in the form of share capital reserve and surplus of Rs. 18.01 crores as on 31.03.2012 as against Rs. 16.61 crores as on 31.03.2011. Further, there was work-in-progress of Rs. 0.50 crores on 31.03.2012 and Rs. 4.05 crores as on 31.03.2011. Hence, the availability of interest free funds was much higher than the investment as Capital Work in Progress. Thus, it can be said that borrowed funds have been utilized for the purpose of Capital Work in Progress. Accordingly, looking into the instant facts the Ld. CIT(A) deleted the aforesaid addition of Rs. 31,96,800/- under Section 36(1)(iii) of the Act.

30. On going through the facts of the instant case, we observe that the assessee has substantial share holder funds including reserves and surplus at its disposal. Further, the assessee has profit after tax of Rs. 2,80,11,727/-, which is in excess as compared to the advance of Rs. 2,66,40,000/- given to M/s. Shivalik Reality Pvt. Ltd. The Ld. CIT(A) on consideration of the above facts had arrived at the factual finding that the advances have been made by the assessee from own interest free funds and further in the immediately preceding Assessment Year 2011-12, no disallowances was made by the Assessing Officer in respect of such advances. Accordingly, looking into the facts of the instant case we find no infirmity in the order of Ld. CIT(A), while allowing the appeal of the assessee.

31. In the result, Ground No. 5 of the Department's appeal is dismissed.

Ground No.6 of Department's appeal and Ground No. 1 of the assessee's Cross Objection:- Ld. CIT(A) erred in confirming addition of Rs. 1,95,599/- out of total addition made of Rs. 3,95,014/- under Section 14A of the Act.

32. Before us, at the outset, the Counsel for the assessee submitted that he shall not to be pressing for the Cross Objection and accordingly, the matter may be decided in accordance with law. Further, with respect to Cross Objection Ground No. 2 filed by the assessee (Non-grant of TDS of Rs. 2,800/-), the matter is being set-aside to the file of the Assessing Officer to carry out necessary verification and grant credit of the same as per law.

33. Now coming to the Department's appeal, we observe that during the course of assessment, the Assessing Officer had made disallowances under Section 14A of the Act amounting to Rs. 3,95,014/-. In appeal, the CIT(A) observed that during the year under consideration, the dividend income which was claimed to be exempt amounted to Rs. 1,95,599/-. During the appellate proceedings, the assessee placed on record several judicial precedents in which it was held that disallowance of interest expenditure under Section 14A of the Act cannot exceed the dividend income. Accordingly, Ld. CIT(A) restricted the disallowance to Rs. 1,95,599/- which was the dividend income claimed to be exempt by the assessee. While passing the order CIT(A) made the following observation:-

"9.7. Reliance is also placed on the decisions of jurisdictional ITAT, Ahmedabad in the following cases:-

(i) M/s. Shree Laxmi Bidi Trading Co. Vs. DCIT [CO No.315&316/Ahd/2014 dt. 30/03/2015]

(ii) Jivraj Tea Limited Vs. DCIT Circle -. 1, Surat [ITA No. 866/Ahd/2012 dated 28/08/2014 (Ahmedabad Tribunal)

(iii) Madhusudan Industries Ltd. Vs. 1TO [ITA No. 1715/Ahd/2011 dated 13/02/2015 (Ahmedabad Tribunal)

9.8. Further, reliance has been made on the judgment of following authorities:-

(i)Hon'ble ITAT, Chandigarh in the case of ACIT Vs. Punjab State Co-operative Marketing Federation Ltd. 14 ITR (T) 69

(ii) Decision of Hon'ble ITAT, Delhi in the case of Sahara India Financial Corporation Ltd. Vs. DCIT [148 ITD 336].

9.9. The submission of the appellant has been examined and noticed that as per the decisions of the aforesaid authorities, the disallowance of interest expenditure u/s. 14A of the Act cannot exceed the dividend income.

9.10. In view of the aforesaid discussion, the disallowance made by the AO u/s. 14A of the I. T. Act is restricted to Rs.l,95,599/- i.e. the dividend income exempt in place of Rs. 3,95,014/- made by the AO. Relief is granted for the balance disallowance.

9.11. The ground is accordingly ***partly allowed.****"*

34. The Department is in appeal before us against the aforesaid order passed by Ld. CIT(A). It is a well settled principle of law that the amount

of disallowance under Section 14A of the Act cannot exceed the amount of income claimed to be exempt by the assessee. Accordingly, in the light of the facts of the assessee's case, judicial precedents on the subject and the observations made by Ld. CIT(A) in the appellate order, we find no infirmity in the order passed by Ld. CIT(A) so as to call for any interference.

35. In the result, Ground No. 6 of the Department's appeal is dismissed.

36. In the combined result, the appeal of the Department in ITA No. 3235/Ahd/2015 for A.Y. 2012-13 is partly allowed for statistical purposes.

ITA No. 356/Ahd/2018 (A.Y. 2013-14):-

37. The Department has raised the following grounds of appeal:-

"1. The Ld. CIT(A) has erred in law and on facts in deleting the part of disallowance of interest u/s. 36(1)(iii) of the IT Act

1.1 The Ld CIT(A) has failed to appreciate that the assessee could not establish that such interest free advances made to the related concerns were out of business expendiency.

1.2 The Ld CIT(A) failed to appreciate that it was for the assessee to lead evidence to prove the business expediency test.

2. The Ld. CIT(A) has erred in law and on facts in deleting the disallowance amounting to Rs. 11071224/- paid on the alleged export handling charges .

2.1 The Ld. CIT(A) has erred in law and on facts in deleting the disallowance of commission to foreign agents amounting to Rs. 11071224/- without properly appreciating the facts that the assessee was unable to lead evidences to prove the genuineness of such expenditure and also the factum of actual rendering of services by such recipients. Reference in. this regard is made lo the decision of Hon'ble Supreme Court in the case of ***Premier Breweries Ltd vs CIT Cochin 2015 56 Taxmann.com 361 (SC).***

2.2 Without prejudice to the above, the Ld. CIT(A) has erred in law on facts in deleting the disallowance u/s. 40(a)(ia) of the I.T. Act on export commission payments made to the Non-resident Agents solely relying on the decision of the Hon'ble Supreme Court in the case of CIT vs. Toshuku Ltd. (1980) 125 ITR 525 (SC) which stands superseded by the subsequent amendment;, brought in I.T. Act.

2.3 The Ld. CIT(A) has failed to appreciate that such payments are chargeable to tax in India under the provisions of Section 9(1)(vii) of the I.T. Act and therefore the assessee was required to deduct TDS on such remittances.

3. The Ld CIT(A) failed to appreciate that the provision made for warranty are contingent expenses as these have not been computed on a scientific basis and therefore the order of the CIT(A) is liable to the set-aside.

4. The appellant craves leave to amend or alter any ground or add a new ground, which may be necessary."

Ground No.1:- CIT(A) erred in deleting part of disallowance of interest under Section 36(1)(iii) of the Act.

38. In light of our observations made with respect to A.Y. 2012-13 Ground No. 1 of the Department's appeal is dismissed.

Ground No.2:- Ld. CIT(A) erred in deleting disallowance of Rs. 1,10,71,224/- on account of commission to foreign agents.

39. In light of our observations made on A.Y. 2012-13 the matter is being restored to the file of the Assessing Officer for carrying out necessary verification, since the Department did not have the opportunity of analyzing the necessary Agreements etc. which have been placed on record before us for the first time.

40. In the result, Ground No. 2 of the Department's appeal is allowed for statistical purposes.

Ground No. 3:- Ld. CIT(A) erred in allowing the provision for warranty expenses.

41. In light of our observation made for A.Y. 2012-13, Ground No. 3 of the Department's appeal is dismissed.

42. In the result, appeal of the Department is partly allowed statistical purposes.

ITA No. 357/Ahd/2018 (A.Y. 2015-16):-

43. The Department has raised the following grounds of appeal:-

"1. The Ld. CIT(A) has erred in law and on facts in deleting the part of disallowance of interest u/s. 36(1)(iii) of the IT Act

1.1 The Ld CIT(A) has failed to appreciate that the assessee could not establish that such interest free advances made to the related concerns were out of business expendiency.

1.2 The Ld CIT(A) failed to appreciate that it was for the assessee to lead evidence to prove the business expediency test.

2. The Ld. CIT(A) has erred in law and on facts in deleting the disallowance amounting to Rs. 6512709/- paid on the alleged export handling charges .

2.1 The Ld. CIT(A) has erred in law and on facts in deleting the disallowance of commission to foreign agents amounting to Rs. 6512709/- paid without properly appreciating the facts that the assessee was unable to lead evidences to prove the genuineness of such expenditure and also the factum of actual rendering of services by such recipients. Reference in. this regard is made lo the decision of Hon'ble Supreme Court in the case of ***Premier Breweries Ltd vs CIT Cochin 2015 56 Taxmann.com 361 (SC).***

2.2 Without prejudice to the above, the Ld. CIT(A) has erred in law on facts in deleting the disallowance u/s. 40(a)(ia) of the

I.T. Act on export commission payments made to the Non-resident Agents solely relying on the decision of the Hon'ble Supreme Court in the case of CIT vs. Toshuku Ltd. (1980) 125 ITR 525 (SC) which stands superseded by the subsequent amendment;, brought in I.T. Act.

2.3 The Ld. CIT(A) has failed to appreciate that such payments are chargeable to tax in India under the provisions of Section 9(1)(vii) of the I.T. Act and therefore the assessee was required to deduct TDS on such remittances.

3. The Ld CIT(A) failed to appreciate that the provision made for warranty are contingent expenses as these have not been computed on a scientific basis and therefore the order of the CIT(A) is liable to the set-aside.

4. The appellant craves leave to amend or alter any ground or add a new ground, which may be necessary."

Ground No.1:- CIT(A) erred in deleting part of disallowance of interest under Section 36(1)(iii) of the Act.

44. In light of our observations made with respect to A.Y. 2012-13 Ground No. 1 of the Department's appeal is dismissed.

Ground No.2:- Ld. CIT(A) erred in deleting disallowance of Rs. 65,12,709/- on account of commission to foreign agents.

45. In light of our observations made on A.Y. 2012-13 the matter is being restored to the file of the Assessing Officer for carrying out necessary verification, since the Department did not have the opportunity of analyzing the necessary agreements etc. which have been placed on record before us for the first time.

46. In the result, Ground No. 2 of the Department's appeal is allowed for statistical purposes.

Ground No. 3:- Ld. CIT(A) erred in allowing the provision for warranty expenses.

47. In light of our observation made for A.Y. 2012-13, Ground No. 3 of the Department's appeal is dismissed.

48. In the result, appeal of the Department is partly allowed statistical purposes.

ITA No. 2119/Ahd/2018 (A.Y. 2015-16):-

49. The Department has raised the following grounds of appeal:-

"1. The Ld. CIT(A) has erred in law and on facts in deleting the disallowance without properly appreciating the facts that the assessee was unable to lead evidences to prove the factum of actual rendering of services by such recipients.

2. Without prejudice to the above, the Ld. CIT(A) has erred in law on facts in deleting the disallowance u/s. 40(a)(ia) of the I.T. Act on export commission payments made to the Non-resident Agents.

3. The Ld CIT(A) has failed to appreciate that the provision for warranty are contingent expenses as these have not been computed on a scientific basis and therefore the order of the CIT(A) is liable to be set aside.

4. The appellant craves leave to amend alter any ground or add a new ground, which may be necessary"

Ground Nos. 1&2:- Ld. CIT(A) erred in deleting disallowance on export commission made to non-resident agents.

50. In light of our observations made for A.Y. 2012-13, wherein we observe that the assessee has placed on record copies of Agreements, invoices and other supporting documents, which have not been analyzed by the Department at any prior stage of the proceedings, the matter is being restored to the file of the Assessing Officer for carrying out the necessary verification as per law.

51. In the result, Ground Nos. 1 & 2 of the Department's appeal are allowed for statistical purposes.

Ground No.3: Ld. CIT(A) erred in allowing the appeal of the assessee with respect to provision for warranty.

52. In light of our observation made for A.Y. 2012-13 wherein this issue has been dealt in detailed, Ground No. 3 of the Department's appeal is dismissed.

53. In the result, the appeal of the Department is partly allowed for statistical purposes.

54. In the combined result, all the appeals of the Department are partly allowed for statistical purposes and Cross Objection of the assessee is dismissed as not pressed.

This Order pronounced in Open Court on 05/09/2023

Sd/-	**Sd/-**
(WASEEM AHMED)	**(SIDDHARTHA NAUTIYAL)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Ahmedabad; Dated 05/09/2023
TANMAY, Sr. PS ***TRUE COPY***

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

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त(अपील) / The CIT(A)-
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, अहमदाबाद / DR, ITAT, Ahmedabad
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt.Registrar)
आयकर अपीलीय अधिकरण, अहमदाबाद / ITAT, Ahmedabad