Nortel Networks India Pvt. Ltd., New ... vs Assessee

IN THE INCOME TAX APPELLATE TRIBUNAL
(DELHI BENCH "E" NEW DELHI)

BEFORE SHRI G.E. VEERABHADRAPPA, HON'BLE PRESIDENT
AND SHRI RAJPAL YADAV: HON'BLE JUDICIAL MEMBER

ITA No. 4924/Del/2010
Assessment Year: 2006-07

Nortel Networks India Pvt. Ltd. C-227, Ground Floor, near Garden of Five Senses, Westend Marg, Paryavaran Complex, New Delhi. (PAN: AABCN1424b)	Vs.	Additional CIT, Range-13, New Delhi.
(Appellant)		(Respondent)

Appellant by: S/Shri Salil Kapoor & Vikas Jain, Advs.
Respondent by: Shri Raj Tandon, CIT(DR)

ORDER

PER RAJPAL YADAV: JUDICIAL MEMBER The assessee is in appeal before us against the order of Learned Dispute Resolution Penal dated 30.08.2010 passed under section 144C(5) of the Income-tax Act, 1961 for assessment year 2006-07. The assessee has taken 14 grounds of appeal which are not in consonance with Rule 8 of the ITAT's Rules, they are descriptive and argumentative in nature. In ground Nos. 1 to 8, assessee has challenged the adjustment made in the price of international transaction entered by the assessee with its associate enterprises, on the recommendation of Learned Transfer Pricing Officer made under sec. 92CA(3) of the Income-tax Act, 1961. The assessee has pleaded that learned Assessing Officer/Dispute Resolution Panel has erred in confirming the order passed under sec. 92CA(3) of the Act making an addition of Rs.49,37,51,430 to the total income of the assessee on account of adjustment in the arm's length price of the international transaction entered by it with its associate enterprises. In ground Nos. 2 to 8, it has mentioned the different fold of submissions raised by it before the Learned DRP. We will be dealing with all its proposition in seriatim.

2. The brief facts of the case are that the assessee company has filed its return of income electronically on 8.3.2007 declaring an income of Rs.124,64,07,885. It has filed ITR-VI on 22.3.2007. According to the Assessing Officer, the return was filed beyond due date prescribed under section 139(1) of the Act. However, the return was processed under section 143(1) of the Act on 22.2.2008 at the returned income. The case of the assessee was selected for scrutiny assessment and a notice under sec. 143(2) of the Act was issued on 12.10.2007 which was duly served upon the assessee. Assessing Officer thereafter issued notices under sec. 142(1) and 143(2) of the Act on different dates, whereby he called upon various information from the assessee. According to the Assessing Officer, in compliance with the statutory notice, Shri Asim Mowar, CA and Ors. appeared before him on time to time and submitted the details. The assessee M/s. Nortel Network India Pvt.

Ltd (hereinafter referred to as NNIPL) is a wholly owned subsidiary of Nortel Network Mauritius Ltd. (NNML). The assessee is primarily engaged in the profession of marketing and after sales supports services to Nortel Group. It is also engaged in providing installation and commissioning services in respect of optical equipments supplied to Gas Authority of India by Nortel Group. On scrutiny of accounts, it revealed to the Assessing Officer that assessee had entered into international transactions with its associates enterprises on seven counts. He made a reference under section 92-CA(3) of the IT Act, 1961to the learned Transfer Pricing Officer for determining the arm's length price of the international transactions entered by the assessee with its associates enterprises.

3. Learned TPO on receipt of such reference has examined all the international transactions entered by the assessee with its associate enterprises. In his order dated 26.8.2009, learned TPO has narrated all the transactions in paragraph No.3 along with the method adopted by the assessee for determining the arm's length prices and value of such transactions. They are seven transactions. On an analysis of these transactions, learned TPO arrived at a conclusion that no adjustment is required in these transactions except one i.e. transaction in respect of import of tele-communication equipments. The brief facts in respect of this transaction are that during August 2004, NNIPL had entered into a fixed price trunkey contract with BSNL for establishing wireless network in India for BSNL. In this contract, the assessee was responsible for supply, installation, testing and commissioning of GSM based cellular mobile network across various tele-communication circles in India. According to the assessee, the BSNL contract was awarded to NNIPL on the competitive bidding process. The assessee wanted to entered in Indian Telecommunication Market, therefore, it had given a bid at a lower price so as to secure the BSNL contract. For the purpose of supply telecommunication equipments under the BSNL contract, assessee imported telecommunication networking equipment from Nortel Group Companies and transfer the ownership during transit on high seas to BSNL. It was also emphasized by the assessee that BSNL contract is a loss making contract for Nortel Group globally. The losses are primarily driven by the existing contractual terms negotiated in response to the pricing pressure as a result of the competitive nature of the india's telecommunication market. The assessee further submitted that the total value of the international transaction related to BSNL contract having an impact on the taxable income of Nortel India for the relevant assessment year was only Rs.54,35,71,422. According to it, this is the balance amount after Nortel Group issued credit note to the assessee aggregating to Rs.454,41,21,331 for import from overseas group entities for the BSNL contract. In addition, Nortel Group also agreed for an additional transfer pricing adjustment of Rs.221,00,74,655 in order to reimburse Nortel India for the losses on the BSNL contract. In this way, assessee has ensured an arm's length price on the contract for the function performed in connection with execution of the BSNL contract. As a result of the credit note and additional transfer pricing adjustment, assessee had offered an additional income of Rs.221,00,74,655 to tax in the tax return on account of BSNL contract.

4. The learned TPO on an analysis of this contract found that assessee has adopted transactional net margin method (TNMM) to establish the arm's length price of its international transaction with overseas group of companies. It has adopted operating profit over operating revenue (OP/OPR) as the profit level indicator (PLI). In its transfer pricing analysis, the assessee has identified seven comparables. The average unadjusted margin of the seven companies worked by the assessee as comparable in its TP Study Report, is at 1.21%. This average was worked out on the basis of result

shown by these companies in the financial year ended on 31.3.2004 and 2005-06. Learned TPO further found that if the result for financial year ended on 31.3.2006, is taken into consideration then the average PLI of those seven comparables come to 1.83%. Learned TPO has accepted the method of TNMM adopted by the assessee as appropriate method to establish the arm's length price of its international transaction with the associate concern. However, with regard to the seven comparables identified by the assessee from the DATA available on prowess and capital line, he formed an opinion that three companies are not comparable. He observed that the HCL Comnet is not a comparable company, if an analysis is made in respect of function performed, assets employed and risk assumed (FAR). Similarly, he pointed out that Setcome Broadband Equipment Ltd. is also not a comparable because DATA in respect of this company are not available. He excluded Arraycom India Ltd. also because it has been showing losses from the last four years. Vide order sheet entry dated 17.6.2009, he directed the assessee to explain as to why Setcom Broadband Equipment Ltd. should not be rejected as a comparable since no data seems to be available in the public domain. He also sought explanation of the assessee for exclusion of Arraycom India Ltd. on the ground that this concern has shown unusual dip in its sales and it is showing persistent losses. Similarly, he sought explanation of the assessee with regard to exclusion HCL Comnet & Shyam Telecommunications. The assessee has made detailed submissions. Learned TPO has reproduced the submissions made by the assessee and thereafter on an analysis of all the comparables he accepted four comparables out of the seven. The arithmetic mean of the comparables which were accepted by the Assessing Officer comes to 6.96%. Learned TPO has recommended the adjustment by adopting PLI of 6.96%. The working made by him in paragraph 11 reads as under:

> "11. In this context, it also becomes important for the assessee to show where each of the comparables lies in its business cycle if the assessee insists on the use of multiple year data. In this case, nothing has been brought on record to show where any of the comparable lie in their market cycle and therefore, a comparison becomes necessary with only those companies whose data is available for the current year. The final list of comparables, based on the above discussion is as under:

S.No.	Comparables	Operating profits on operating revenue (%)	Remarks
1	Arraycom India Ltd.	(18.73%)	Rejected on account of persistent losses
2	Gemini Communication	11.97%	Accepted
3	HCL Comnet Ltd.	NC	Rejected, since it is not comparable
4	ORG Informatics Ltd.	7.65%	Accepted
5	Satco Broadband Equipment	NA	Rejected - No data available

6	Shyam Telecom Ltd	(2.06%)	Accepted
7	Spanco Telesystems and Solutions Ltd.	10.30%	Accepted

The arithmetic mean of the comparables finally selected is 6.06% whereas NNIPL has been compensated by the parent company (Nortel Group) to ensure a 2% margin on this transaction.

12. The ALP based on the Arm's length arithmetic mean earned by the assessee is as under:

(i)	Operating profit of the assessee @ (As Reflected in Ann.14)	-	Rs.19,88,92,822/-
(ii)	Operating profit determined as per ALP	@6.96%	Rs.69,26,44,252/-
(iii)	Difference	-	Rs.49,37,51,430

The difference between the Arm's Length Price, based on the Operating Profit margin of 6.96% is beyond the +/-5% range. The Assessing Officer shall therefore, enhance the total income of the assessee by Rs.49,37,51,430/-."

5. Assessing Officer has accepted the recommendations made by the learned TPO in his draft order. The assessee has filed objection before the Learned DRP, however, Learned DRP has rejected all the objections submitted by the assessee and accepted the recommendations made by the learned TPO. Learned DRP has directed the Assessing Officer to finalize the assessment order by making an adjustment in the ALP as recommended by the learned TPO. -

6. With the assistance of learned representative, we have gone through the record carefully. As observed earlier, we are required to examine whether assessee has shown the transaction in respect of import of telecommunication equipments at arm's length price or not. As far as the other six international transactions with the A.E. are concerned, they have been accepted by the Assessing Officer. The first area of dispute between the revenue and assessee could be in respect of most appropriate method required to be adopted for determination of arm's length price as provided in section 92C of the Act read with Rule 10B of the Income-tax Rules. The section 92C provides five methods. The assessee has discussed all these five methods in its TP study report in respect of all the international transactions. Ultimately, it selected transactional net margin method as the most appropriate method in respect of international transaction relating to import of telecommunication

equipments. It has pointed out that this method is less effected by transactional difference than CUP method or any other method. This method is generally appropriate for the transactions where other methods cannot be adequately applied. The method adopted by the assessee has been accepted by the TPO also, therefore, it is not in the area of dispute and we are not required to make much discussion on the issue.

7. The learned counsel for the assessee in his first fold of submissions has pointed out that TPO and DRP have failed to specify the basis under section 92C for rejecting the transfer pricing documentation maintained by the assessee, therefore, the order of the TPO is without jurisdiction. On due consideration of this argument and perusal of the order of the learned TPO, we do not find any substance in it, the assessee was unable to give any specific argument in support of this submission. TPO has considered the transfer pricing study report submitted by the assessee and thereafter proceed to eliminate some of the comparables which in his understanding were not comparable. Thus, there is no force in the contentions of the learned counsel for the assessee that the order of the TPO is without jurisdiction. In our opinion, before proceeding to evaluate the arm's length price of the international transaction, the report submitted by the assessee was considered by the learned TPO and it was not acceptable to him. The whole object of the reference to the TPO was to determine the arm's length price of the international transaction. The reasoning assigned in the order of the TPO for not accepting the PLI shown by the assessee is the basis for rejecting the T.P. study report of the assessee. Thus, it is just theoretical argument without any substance.

8. In the next fold of submissions, learned counsel for the assessee pointed out that BSNL contract was a loss making contract for Nortel Group. It has been showing net operating margin of 2% which is above the arm's length price in this line of business. This issue has been pleaded by the assessee in Ground Nos.1 to 4 of the grounds of appeal. Learned DR on the other hand relied upon the orders of the Learned DRP as well as the TPO. He questioned the authenticity of the claim made by the assessee. He pointed out that the assessee at his own has submitted that it is a loss making contract for Nortel Group globally. If that be so, then assessee ought to have substantiated the claim by complete documentation. He further submitted that no prudent business would continue with a loss making contract year after year and no AE would give a credit note of more than a Rs.221 crores to the assessee. On due consideration of the submissions, we do not find any merit in the contention of the learned counsel for the assessee. The object of transfer price regulation is to determine whether an assessee has shifted the profit base from one part to the other part. The contention of the assessee that BSNL contract is a loss making contract and Nortel Group has been compensating it from the losses incurred on such contract by giving credit note which are on an arm's length basis. To our mind, there could be two situations which ought to have been established by the assessee on the record. The first situation is that the assessee should have established on the record with demonstrative proof, the exact loss it has been suffering on this contract. This could be established by bringing the relevant details on the record i.e. value of imported articles by producing their invoices and how those rates are comparable in the open international market. The second situation would be by bringing the details on the record exhibiting the contract value with other concerns indulging in the similar field. By merely saying that it is a loss making contract and Nortel Group is compensating the loss by giving credit note at a operative margin of 2% is not sufficient. It is a self-styled declaration of results. It has to be verifiable. The declaration of the assessee ought to be

cross verifiable with the relevant details, otherwise it is meaningless and the revenue authorities have rightly observed that this claim of earning 2% operating margin is of no consequence for determining the ALP of the international transaction in respect of import of telecommunication equipments. Therefore, this argument is of de void of any merit, it is rejected.

9. In his next fold of submissions, learned counsel for the assessee pointed out that learned TPO has erred in rejecting use of multiple year data and has erred in using single year data for Financial Year 2005-06. He pointed out that Rule 10D required the assessee to keep and maintain the information and documentation for the purpose of transfer pricing regulation. Rule 10D(4) contemplates that information and documentation should be contemporaneous for that year, in the case of the assessee, it should be 31st October 2006. The assessee had used multiple year data because according to it, single year data would not adequately capture the characteristic of the transaction under the BSNL contract, such contract was entered in earlier year which has a life for a number of years. Therefore, assessee in its TP study report used the data of multiple years. He further submitted that no doubt Rule 10B(4) specifies the most appropriate data to be used but that does not mean that multiple years data would not be used. If it is difficult to determine the transaction on the basis of single year data then multiple years data ought to be used. According to the learned counsel for the assessee, some times multiple year data would be useful in providing information about the relevant business and product like cycles of comparables. The earlier year's data may show whether independent enterprises engaged in comparable transaction was effected by comparable economic condition in a comparable manner. Learned DR on the other hand, pointed out that learned TPO has considered this aspect elaborately and has made reference to the Special Bench's decision of the ITAT in the case of Aztc. Ltd. reported in 294 ITR (AT) 32. He also submitted that in the case of Mentographic Noida Vs. DCIT reported in 109 ITD 101, the ITAT again held that comparability analysis is to be conducted on the basis of current year data.

10. On due consideration of the facts and circumstances, we are of the view that Rule 10B(4) used an expression "shall" which make it clear that current year data of uncontrolled transaction is to be used for the purpose of comparability, while examining the international transaction with A.E. In the proviso appended to this section though an exception is provided which contemplates that data relating to the period of being more than two years prior to such Financial Year may also be considered, if such data reveals facts which could have an information on the determination of transfer price in relation to the transaction of comparison. The main section used the expression "shall" which make it mandatory to first use the current year data. If certain other circumstances put an influence on the determination of transfer pricing in relation to the transaction then other data for period not more than two years prior to such Financial Year may be used. The ITAT in a large number of cases has observed that current year data has to be used. The learned counsel for the assessee has not pointed out any exceptional circumstances which could persuade us to look forward about the applicability of proviso appended to Rule 10B(4) of the Income-tax Rules, 1962. Learned TPO as well as the Learned DRP has considered this aspect and we do not find any error in their findings.

11. In the next fold of submission, it was contended by the assessee that learned TPO has erred in excluding M/s. Arraycom Net Ltd. from the list comparables. It was pointed out by the learned

counsel for the assessee that according to the learned TPO, M/s. Arraycom showing persistently loss, therefore, it deserves to be excluded. The loss is an incidence of business and that cannot be a criteria for excluding a comparables, if such an entity is otherwise comes within the ambit of comparables. He also pointed out that as far as the function performed and the assets employed by the assessee as well as M/s. Arraycom is concerned, both are into the distribution of the equipments and the assets employed by the entity were similar. They are exposed to the similar risk. M/s. Nortel India Pvt. Ltd. was assured of a 2% return on the BSNL contract from M/s. Nortel Group, therefore, it was bearing lesser risk when compared with M/s. Arraycom and in subsequent year Arraycom has shown profit.

12. Learned DR on the other hand, pointed out that in the director's report, available at page 236 of the paper book, M/s. Arraycom itself has shown losses in this year. Its business has been reduced to a great extent. In Financial Year 2004-05, this concern has domestic revenue of Rs.4568.07 lacs for a period of 15 months but in Financial Year 2005-06, its revenue has been reduced to Rs.534.82 lacs which is all time low since Financial Year 2000-01. It was not working with its full potentiality and all these aspects have been considered by the learned TPO while excluding this concern from the comparables.

13. We have duly considered the rival contentions of the learned representatives. The observations of the learned TPO in this connection read as under:

> "In facts, Arraycom and Shyam Telecom Ltd. were commented upon in last year's TP order also since Arraycom was a loss making concern and Shyam Telecom Ltd. was not comparable in one of the years. Thus, the primary onus is on the taxpayer to prove that the margins of the comparable companies are affected by the business cycle and therefore earlier years' data should also be taken into consideration. The taxpayer has not pointed out even in a single case the circumstances which may warrant use of earlier year's data. Therefore, only the current year financial data of the assessee and that of the comparables are taken for comparability analysis.
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> With respect to Arraycom India Ltd. which has been making persistent losses the assessee has stated that loss making companies are part and parcel of any industry. The assessee's contentions regarding loss making companies cannot be accepted because if a company continues to make losses over a period of time, as in the case of this comparable, there is no question of using it since any comparison with this company's result would result in an aberration and an anomalous situation. It has been held in the recent judgment of the Hon'ble ITAT in the case of M/s. Sony India (P) Ltd. Vs. DCIT (2008) 114 ITD 448 (Delhi) that while a loss making comparable need not be rejected by itself but if there is cumulative effect then it needs to be considered whether the comparables can be accepted or not.

Arraycom India Ltd. has been making losses since 2002 and as can be seen from the data submitted by the assessee itself. Therefore, it is being rejected as a comparable".

14. There is no dispute with regard to the proposition that a concern will not lose its status of comparability, merely because it has shown losses. The profit and losses are the two incidence of the business. Every venture makes effort for earning the profit but it is not necessary that it will get the profit every time. However, on an analysis of the comparative details made by the learned TPO as well as by the learned DRP, we find that learned TPO has not excluded M/s. Arraycom simply for the reasons that it has shown losses. He has excluded such concern because it has been showing persistent losses. Its operation has also a reducing tendency. The function in terms of volume also on the lower side then the assessee. It is setting of all these factors cumulatively which make this concern as uncomparable, therefore, we do not find any error in the order of learned DRP for excluding this concerned from the comparables.

15. In the next fold of submissions, assessee has pleaded that learned TPO failed to make necessary adjustment on account of risk profile of the assessee vis-à-vis comparables. According to the assessee, M/s. Nortel India was assured a minimum profit of 2%. Thus, it bears less risk vis-à-vis comparables. The assessee further contended that comparables selected for the analysis include companies which have fairly diversified area of specialization and functioning in marketing etc. There was a large risk to those companies in comparison to the assessee, therefore, risk adjustment ought to be made by the learned TPO. He pointed out that a risk adjustment for credit difference ought to have been made by the learned TPO. Learned DR on the other hand submitted that no such plea was raised by the assessee before the learned TPO. Learned TPO has duly taken cognizance of all the objections raised by the assessee. He relied upon the order of the learned DRP.

16. We have duly considered the rival contentions and gone through the record carefully. The assessee has placed on record the TP study report on page Nos. 144 to 235. In its TP study report, it has annexed the list of comparables selected by it. The two data base used by the assessee i.e. Prowess and Capital Line have given 587 comparables, which on application of filters short listed to seven. Learned TPO on an analysis of all these seven further eliminated three. The assessee has objection for exclusion of one only. It has been observed time and again that there cannot be any straight jacket formula for determining the ALP for international transaction. It is to be determined by considering the results shown by the comparables who are functioning in independent and uncontrolled situations. The element of adjustment and some guess work would always be there. Whenever we make analysis of the data with different angles, results would vary to some extent. In the rules, an effort has been made that comparable which are nearly similar to the assessee should be identified. The important factor having influence on the transaction and functioning of the assessee as well as comparable working in uncontrolled conditions are to be taken. Thus, the various filters are provided for eliminating the subjectivity in determining the ALP. In the present case, learned TPO had made an analysis from different angles and thereafter selected the comparables which has been upheld by the learned DRP, we do not see any reason to disturb.

17. The next issue agitated by the assessee with regard to determination of arm's length price of the international transaction with A.E. is that learned TPO/AO has erred in not providing the benefit of 5% in respect of the arm's length range as provided under the proviso to section 92C(2) of the Act, Prior to its substitution by the new proviso by the Finance Act, 2009 w.e.f. October 1, 2009. The learned counsel for the assessee has submitted that the assessee is entitled for a standard deduction

of 5% in the PLI determined by the learned TPO. He relied upon the order of ITAT, Bangalore in the case of Sap Lab India (P) Ltd. rendered in ITA No.398/Bang/08. He also relied upon the decision of the ITAT in the case of UE Trade Corporation India Pvt. Ltd. Vs. ACIT. On the other hand, learned DR submitted that the ITAT in a large number of cases has declined such type of claim by the assessee. He relied upon the order of the ITAT in the case of S.T. Micro Electronics ITA No. 1806/Del/08. He also relied upon the order of the Hyderabad Bench in ITA No.1082/Hyd./2010 in the case of DCIT Vs. M/s. Deloitte Consulting India Pvt. Ltd.

18. We have duly considered the rival contentions and gone through the record carefully. In the case of S.T. Micro Electonics, ITAT has considered an identical issue and made the following observations:

> "44. With the assistance of learned representatives, we have gone through the record carefully. Learned CIT(Appeals) in assessment year 2003-04 has examined this issue in detail. He observed that in order to avoid hardships to the assessees in the initial years of implementation of the TP provisions, the Government of India, through a press note issued by the Ministry of Finance on 22nd August 2001 expressed its intention that no adjustment could be made if the transfer price adopted by the assessee was within the band of ± 5% of the ALP determined by the Assessing Officer. CBDT had issued Circular No.12 on 23.8.2001 specifying that Assessing Officer shall not make any adjustment to the price shown by the assessee if it is within the ± 5% band, the effect of the Circular was that transfer price shown by the assessee was not to be disturbed if it was up to 5% less in case of receipt and up to 5% more in case of outgoing. The relaxation extended by this Circular was in substance brought on to the statute by the Finance Act 2002 by amending the proviso to sec. 92C(2) with retrospective effect from 1.4.2002. It provides a tolerance band. It also suggests that there will be no TP adjustment in cases of marginal variation up to ± 5% but substantial variation would result in appropriate TP adjustment. Learned CIT(Appeals) has explained the meaning of tolerance band which read as under:
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> • "Whether there is an international transaction involving sale of a product or export of services, there would be a credit entry in the profit & loss account. By allowing a margin of (-) 5% for such a transaction, a taxpayer is permitted to have a credit entry which is not below 95% of the ALP so that profit from the transaction is not understated beyond the tolerance level of (-) 5%.
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> • Whenever there is an international transaction involving purchase of a product or import of services, there would be a debit entry in the profit and loss account. By allowing a margin of (+) 5% under such a transaction, a taxpayer is permitted to have a debit entry which is not above 105% of the ALP so that profit from the transaction is not understated beyond the tolerance level of (+) 5%.
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> 11.18.3 The decision rule contained in the proviso to the sec.

92C(2) of the Act containing a tolerance band is akin to a similar decision rule of confidence interval used in the theory of statistical inference. Under that theory, a 5% level of significance would provide for a tolerance band consisting of 95% & 105% of the arithmetical mean and these points are known as "Critical Values". The rule is one of "All" or "Nothing" kind of a situation. If a computed value falls within the tolerance band, a favorable inference is drawn. The decision rule contained in the proviso to section 92C(2) of the Act thus is a "All" or "Nothing" kind of rule. After all in the transfer pricing analysis, a sample set of comparables along with the distribution of profitability of this set is examined and an inference is sought to be drawn about the appropriateness of profitability shown by a taxpayer. Therefore, statistical inference theory based on sampling is directly applicable to the benchmarking analysis carried out in the transfer pricing analysis with the help of a sample set of comparables. There is no scope for any "standard deduction" under this rule. In other words, if the ALP falls outside the tolerance band, TP adjustment would have to be made for the difference between the ALP determined by the A.O. based on the arithmetical mean of the prices and the price shown by the assessee"

> 45. The contention of the learned counsel for the assessee was that arithmetic mean of the comparable price should be reduced by 5% for determining the ALP. He pointed out that in 2009, the proviso appended to section 92C has been amended but this amendment would be applicable prospectively, because the basis of determination of ALP in respect of international transaction get changed. This amendment effects imposing a new liability by taking the option away from the taxpayers. Thus, according to the learned counsel for the assessee, the amended proviso is not applicable. On the other hand, Learned DR has submitted that under the proviso no standard deduction has been provided to the assessee.
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> 46. On due consideration of the facts and circumstances and perusal of the proviso introduced in 2002 as well as in 2009, we are of the view that this tolerance band provided in the proviso is not to be construed as a standard deduction. In the present appeals, learned TPO has adopted the arithmetic mean of several comparables for taking out a PLI which would be tested with the PLI of the assessee. If that arithmetic mean falls within the range of alleged tolerance band then there may not be any adjustment but if it exceeds then ultimate adjustment is not required to be computed after reducing the arithmetic mean by 5%. The actual working is to be taken. Learned First Appellate Authority has considered this aspect elaborately in assessment year 2003-04 and after going through his order, we do not see any merit in the ground of appeal raised by the assessee in all these three assessment years.

19. Similar view has been taken by the ITAT, Delhi Benches in the case of CRM Services India. No doubts, a different opinion has also been taken by the ITAT in some of the cases referred by the learned counsel for the assessee. We have been informed that appeals are pending against such conclusion before the Hon'ble High Court. In the case of S.T. Micro Electronics, one of us is the author i.e. Judicial Member whereas in the case of M/s. Marubeni India (P) Ltd. in ITA No.809/Del/09, both of us has taken a similar view. In view of the above discussion, we do not find any merit in the contentions raised by the learned counsel for the assessee.

20. In ground No.5, assessee has pleaded that learned Assessing Officer has erred in not restricting the transfer pricing adjustment in proportionate to the value of impugned international transaction with the A.E. The brief facts of the case are that assessee has shown the value of international transaction with the A.E. at Rs.54,35,71,422. Learned TPO has also taken cognizance of this figure in paragraph No.3 of the order passed under sec. 92C(a)(iii) of the Act. He has determined the PLI at 6.96%. According to the TPO, the assessee must have earned this much of the profit on the international transaction in respect of import of telecommunication equipments with the A.E. Learned TPO has observed that assessee has shown the operating profit at Rs.19,88,92,822. This amount was computed @ 2% of the total cost. Learned TPO has computed the profit on that very cost figure by adopting the rate of 6.96% which gave an amount of Rs.69,26,44,252. He made the addition of the difference at Rs.49,37,51,430. The learned counsel for the assessee submitted that the total value of the imported items considered by the TPO in paragraph 3 is Rs.54,35,71,422. Learned TPO ought to have restricted the adjustment qua the value of the imported equipments and not on the total cost which bears the cost of equipments procured from unrelated parties. Learned DR has raised two objections. He submitted that this issue was not raised before the TPO or before the learned DRP. This has been raised for the first time in the ITAT. He further made a reference to Annexure 14 available at page 235 of the paper book which is annexed with the transfer pricing study report of the assessee. In this annexure, assessee itself has worked out total expenditure of Rs.974,57,48,266 and shown ALP at 2% of this figure. Assessing Officer has just replaced the rate of PLI and worked out the difference. There is no error in the working of the Assessing Officer. On due consideration of the facts and circumstances, we are of the view that this issue effects the taxability of the assessee. Therefore, we permit the assessee to raise this plea before the ITAT for the first time. According to the assessee, in the total expenditure, certain cost relates to the equipments procured directly from the unrelated parties upon which no adjustment will be made. Since specific details are not available on the record, learned TPO took into consideration the value of imported items from the A.E. at Rs.54,35,71,422. while noticing the facts. Therefore, in our opinion, ends of justice would meet if we remit this issue to the file of the Assessing Officer for readjudication. We make it clear that we uphold the determination of PLI at 6.96% as adopted by the learned TPO. The only limited issue under this ground, we are remitting to the Assessing Officer is the quantification of the arm's length price. Learned Assessing Officer shall carry out this exercise after providing an opportunity of hearing to the assessee. Accordingly, ground Nos. 1 to 8 are rejected except ground No.5 which is partly allowed for statistical purposes.

21. Ground No.9 is general in nature. In this ground, assessee has submitted that learned DRP has erred in concurring with the finding of the learned Assessing Officer without appreciating the submissions filed by the assessee. This ground was taken regarding corporate issues. It is general in nature and it does not require any specific finding to be recorded, hence it is rejected.

22. In ground no.10, assessee has pleaded that learned Assessing Officer has erred in recognizing excess revenue to the extent of Rs.55,46,10,230 on account of project with BSNL. Without prejudice to this ground, assessee has further pleaded that Assessing Officer has erred in recognizing revenue under the BSNL contract which would increase the profit margin even though the profit margin under this contract has already been determined by the learned TPO. At the cost of repetition, it is observed that assessee had entered into a contract with BSNL for supply of telecommunication

network system on a turnkey basis. Under the contract, it was responsible for planning, engineering, supply, installation, testing and commissioning of GSM based cellular mobile network across north east and southern telecommunication region in India. The assessee has recognized the revenue under the project as per percentage completion method. The actual cost of contract upto 31.3.2006 was Rs.200,322,34,055/-. The assessee has estimated the revenue at Rs.1603,25,61,432/-. It has reduced an amount of Rs.44,36,24,596/- on account of AMC revenue. It has further reduced a sum of Rs.38,09,31,081/- under the head 'other revenue'. Assessing Officer in the draft assessment order has called for the following information :-

> "1. To provide the project report with BSNL on the basis of which total cost and revenues to the projects were recognized/project was awarded by BSNL to Nortel.
>
> 2. To give details of Gross BSNL - current year project cost shown at 12,867,518,097/-. Also to give supporting ledger copies.
>
> 3. Also, to give nature and breakup of the deferred costs and why the same has been reduced from costs.
>
> 4. Also to explain - Annexure-1 of submission dated 09.11.2009 - how the total sales have been distributed - Show working."

23. In response to the query of the Assessing Officer, assessee has submitted certain details. However, according to the Assessing Officer, those are not sufficient. He rejected the contentions of the assessee by observing as under:-

> "9.9 However, it was seen that from the total revenue recognizable the assessee company has sought to reduce the following:-
>
> 1. AMC revenue reduction 443,624,597
>
> 2. Revenue reduction on account of reduction of revenue on In East Zone 131,869,433
>
> 3. Revenue reduction on account of towers 45,458,385
>
> 4. Revenue reduction due to tax impact for Non E1 1v-Booked in Q4 61,056,749
>
> 5. Revenue reduction due to tax impact for Non E1 Inv. 87,250,681
>
> 6. Revenue reduction due to tax impact on HePA 10,435,743
>
> 7. Additional tax due to non compliance of E1 Process 26,776,059

8. Additional sales tax on sale of electrical supplies BSNL. 18,084,031 Revenue recognizable 824,555,678 9.10 Thus, as can be seen from the above, the total revenue recognizable was taken to be derecognized to the extent of Rs.82,455,678/- by the assessee company for computing the revenue recognizable on a percentage completion method. Thus, as indicated above percentage completion of 84.06% (as worked out above) was applied on a total estimated revenue for BSNL project of Rs.15,208,005,754/- instead of revenue recognizable of Rs.16,032,561,432/- thus derecognizing revenues to the extent of Rs.824,555,678/-. Except for the narrations as indicated above no justification was given by the assessee company despite repeated opportunities of submitting all documents in support of their contentions by repeated hearings of the case u/s 142(1)/143(2) of the Act. Books of accounts were also called for in a CD form, which was also not provided.

9.11 As indicated in Para 9.5 above, the assessee company was specifically asked to produce all details, ledger copies, explanations and justifications for working the basis of the total estimated revenues and cost. In response only a mathematical working was enclosed without giving justifications, ledger copies, basis. No reasons were given to justify the derecognizition of revenues as indicated above.

9.12 The assessee company was being asked continuously since query u/s 142(1) dated 10.07.2009 to justify the claim of revenue recognition on the basis of percentage completion method along with other issues. Repeated opportunities were given to the assessee company by fixing cases for hearing on 22.07.09, 10.08.2009, 20.08.2009, 03.09.2009, 15.09.2009, 23.09.2009, 06.10.2009, 08.10.2009, 15.10.2009, 28.10.2009, 09.11.2009, 18.11.2009 and thereafter final show cause was issued vide query dated 19.11.2009 fixing dated for compliance on 23.11.2009. As sufficient opportunities have been provided to the assessee company to support its claim on revenue recognition, the same is decided on the basis of the material brought on record by the assessee during the course of the assessment.

9.13 As regards, AMC revenue reduction of Rs.443,624,597/-, it was claimed that since the software upgrades/patches were to be provided post contract, revenue in respect of the same was not included in the estimated revenue under BSNL contract. This argument of the assessee is not acceptable on two accounts:

(1) No copy of the Agreement with BSNL was produced despite repeated opportunities which could show the veracity of the claim and (2) AMC for an initial period is always in-built into the cost and hence on matching principal needs necessarily to be provided in the revenues. As such the reduction of AMC revenues is not acceptable and hence rejected.

9.14 So far as the other items which are reduced from the revenues recognizable is concerned, no justification, details, supporting documents, ledger copies were provided despite specifically being asked for on these issues and repeated opportunities provided during the course of assessment

proceeding. No books of accounts as asked for vide final show cause dated 19.11.2009 were provided. As such, the de-recognition of revenues totaling Rs.82,45,55,678/- was disallowed under the Calculation of Revenue to be recognized under BSNL project was done as under:

> Calculated of revenue to be recognized under BSNL project Description Amount (INR) as per Amount determined assessee Total estimated revenue for BSNL Project (K) 15,208,005,754 16,032,561,432 Recognizable revenue based on % completion 12,783,569,472 13476971139 (J*K) = L Less : Revenue recognized till last year (M) 5,060,879,020 5,19,96,70,457 Revenue recognized during current year 7,722,690,452 827,73,00,682 (N=L-M) 9.15 Thus, Revenues recognized during Current Year is worked out at Rs.827,73,00,682/- as against Rs.772,26,90,452/- shown by the assessee.

The difference being Rs.55,46,10,230/- is added to the total income of the assessee."

24. The assessee has submitted that a sum of Rs.44,36,24,597 represents AMC revenue which relates to revenue from post contract customer support to BSNL, which includes the provisions for software upgradation or patches required for maintenance of the system supply. As per the agreed arrangement such upgradation shall be implemented free of cost at each site for a seven years by Nortel India. According to the assessee, Assessing Officer has observed that AMC for initial period is always built into the cost and hence matching principles need necessarily to be provided in the revenue. According to the assessee, AMC is a post contract customer support and, therefore, AMC cost is separately recognized by Nortel India rather than being built into the project cost. Before learned DRP, it is submitted that AMC revenue is a post contract customers support. It should not be included for computing revenue recognizable under BSNL Project but if the proposal made by the Assessing Officer is being accepted, following the concept of matching revenue with the cost then even the cost relating to AMC revenue have been deferred by Nortel India and a deduction should be allowed on account of deferment of such cost. The learned counsel for the assessee submitted that the assessee has given the break up of cost. It has also given the estimated figure as to how revenue has been recognized on project completion method, such calculations have been reproduced by the Assessing Officer in the final assessment order on page NOs. 16 & 17 of the assessment order. He emphasized that the learned Assessing Officer failed to take note of the fact that AMC is a separate revenue and it would be a cost to the assessee which required to be reduced from the project cost. It should not be recognized as revenue. Learned DR on the other hand pointed out that the Assessing Officer has directed the assessee to file the AMC contract but assessee failed to file such contract. In the advance purchase order, placed on record by the assessee on page Nos. 360 of the paper book, it has been provided in clause 17 that supplier shall enter into a year wise comprehensive annual maintenance contract for three years to be signed at the end of warranty period. Learned Assessing Officer restrained the assessee from excluding such revenue on the failure of assessee for submitting the relevant details.

25. The next item pointed out by the learned counsel for the assessee for exclusion from the revenue is an amount of Rs.13,18,69,433. He submitted that this revenue relates to equipment not supplied and returned by the BSNL. The next item is of Rs.4,54,58,385. This revenue relates to 246 towers

which were cancelled by the BSNL. Thus according to the assessee, this revenue never accrued to the assessee and it ought not be included in the estimated revenue, simultaneously corresponding cost of Rs.4,01,36,000 was also deferred on the principles of matching cost with the revenue. The sales-tax of Rs.20,36,02,262 was booked separately by the assessee. He pointed out estimated revenue is arrived at on the basis of PO value which includes sales-tax also. Since, sales tax is not revenue in the hands of the assessee, the same is to be reduced to arrive net estimated revenue of the assessee. The learned counsel for the assessee further placed on record computation of percentage completion of the contract and the revenue under this project. Learned DR on the other hand relied upon the order of the Assessing Officer.

26. We have duly considered the rival contentions and gone through the record carefully. The assessee has made reference to page No. 458 of the paper book wherein details of estimated cost under this project has been filed by the assessee. In these details, it has pointed out the cancellation of tower under the P.O. representing a sum of Rs.401,36,000. According to the assessee, this figure has totally been ignored. Similarly, additional cost pointed out by the assessee has also not been gone into. The learned counsel for the assessee thereafter made reference to page No.465 of the paper book which exhibits details of deferred cost. On due consideration of all these material, we find that Assessing Officer refused to reduce the revenue alleged to be representing AMC and other amounts claimed by the assessee on the basis that assessee failed to submit requisite details which can enable the Assessing Officer to cross-verify this claim. We also find that assessee has filed details in different tabular form which are based on its own calculation. For example, the major amount it wants it to exclude is AMC value amounting to Rs.44,36,24,597. The assessee has not placed on record AMC contract, how that revenue has been calculated. Learned DRP in its order has observed that certain basic details were not submitted by the assessee, hence it is quite difficult to work out comprehensive figure. The operative force of assessee's argument is to persuade the revenue authorities to accept whatever claim it is making. It is highly deplorable. Therefore, it is quite difficult for us to record a specific finding about exclusion or inclusion of the specific amount. We have gone through the objections of the assessee submitted before the learned DRP under ground of objection 4, annexure B-

5. In those objections, the assessee has nowhere taken the figure of Rs.13,18,69,433 on the ground that equipments of this much value were returned back by the BSNL. Similar is the cancellation of towers and also the sales-tax. Considering this aspect, we deem it appropriate to set aside the order of the learned DRP as well as of the Assessing Officer and remit this issue to the file of the Assessing Officer for readjudication. The assessee shall provide the necessary details and the working of estimated revenue. It shall also provide the basis of such working which could be crossed verified logically by the learned Assessing Officer otherwise this exercise would be futile. It is also pertinent to note here that before learned DRP assessee has submitted that it has deferred the AMC cost but did not provided any supporting evidence how it was recognized how it was deferred. Learned Assessing Officer shall decide the issue afresh in accordance with law without getting influenced by our observations. Ground No.10 is partly allowed.

27. In ground No.11, grievance of the assessee is that Assessing Officer has erred in disallowing the deduction in respect of provisions for warranty amounting to Rs.14,42,47,994. The brief facts of the

case are that the assessee company has made a provision for warranty of Rs.14,42,47,994 in relation to the project undertaken by it for BSNL. The assessee has debited the above amount in the profit and loss account. Learned. Assessing Officer vide order sheet entry dated 15.10.2009 directed the assessee to justify the stage for recognition of warranty expenses and to give its working so as to arrive at the figure of provisions for warranty claimed by it. In response to the query of the Assessing Officer, it was submitted by the assessee that provisions for warranty has been made by it @ 3.5% of the value of imported equipment for BSNL project. This percentage has been adopted by the assessee on the basis of the rates experienced by the Notel Group Companies in the Asia Pacific Region on sale of similar or same- equipments. Thus, according to the assessee, it was in accordance with standard practice applied for several years (since the late 1990) in the Asia Pacific Region for the GSM business line. According to it, BSNL was the first big GSM contract for Nortel India, it was prudent for the assessee to use the warranty percentage used by Nortel Group for the other countries in the Asia Pacific Region. It emphasized that percentage was worked out on the average warranty usages pattern observed by Nortel Group Companies in Asian countries, namely, Pakistan, Singapore and Thailand etc. The average utilization rate in the past has been in the range of 3.3% to 3.6%. Learned Assessing Officer requested the assessee to furnish copy of warranty agreement with the BSNL and to provide the details of usage of warranty in case of BSNL project for all years. Learned Assessing Officer further observed that vide order sheet entry dated 9.11.2009,he directed the assessee specifically to provide following details:

> "(a) Copy of warranty agreement (also asked for vide Order Sheet dated 15.10.2009);
>
> (b) Cost of GSM equipments supplied to BSNL with supporting bills/vouchers (for evidencing the basis of the sales figure to BSNL);
>
> (c) To give a copy of the ledger account showing cost of imported equipments supplied to South Zone & East Zone;
>
> (d) To give a copy of the so called empirical study of the Nortel group on the basis of which 2.5% of cost of sales have been taken as the basis for provision for warranty failing which show cause why not the entire provision for warranty be disallowed as being made without any scientific basis particularly in view of the fact that the installation project was not completed during the year, the project was not functional, as such they cannot be any claim for warranty".

28. In response to the above query, the assessee has submitted that there is no separate agreement entered with the BSNL in respect of warranty. In the advance purchase order (APO), a provision for warranty has been made at clause 8 of the agreement. Thus, warranty liability is incurred by the assessee at the point of sales to make good any defect or damage that may occur in future during the warranty period. With regard to the quantification of the warranty, it was pointed out that it has been quantified @ 3.5% of the sales and it is on the basis of its experience in Asia Pacific Region in this line of business. It was further submitted that when the equipment is sold to BSNL under warranty, the liability is incurred at the point of sales to make good any defect or damage. Thus, it is not a contingent liability rather liability has accrued. Learned Assessing Officer did not find merit in

this explanation of the assessee on the ground that it is general in nature, assessee failed to submit full supporting evidence in support of its claim. Hence, on 19.11.2009, he again issued a notice under sec. 142 of the Income-tax Act, 1961. In this notice, he called for the details exhibiting usage of warranty in case of BSNL project for all years. He called for the so called empirical study of the Nortel Group demonstrating its experience of warranty expenses at 3.5% of cost of sales in this area. He also called for cost of GSM equipment to BSNL with supporting bills and vouchers, copy of the ledger account showing cost of imported equipments supplied to South Zone and East Zone. Assessing Officer thereafter issued a final show- cause notice on 23rd November 2009. Learned Assessing Officer has rejected the claim of assessee by observing as under:

> "(i) No copy of the Warranty Agreement with BSNL was filed.

Instead a copy of the Advance Purchase Order raised by BSNL on Nortel India was attached. As per this document it was stated that the "Warranty shall be as per Section-III clause-108 Section JV of the tender document. No Tender Document was filed. Even as per this APO PARA 8.2 laid down as under:

> "The Warranty of the store Equipments supplied for each service area should be for a period of minimum 12 months from the date of commissioning of the complete network in that service area (Telecom Circle)"

As indicated above, the warranty period of 12 months would commence from the date of the commissioning of the complete network in that service area. Since, during the subject assessment year such commissioning did not take place the warranty claims could not have arisen during the year. As such the provision made for warranty was not as per the APO.

(ii) Copy of the so called empirical study of the Nortel Group on the basis of which 3.5% of the cost of sales have been taken as basis for the provision for warranty was not provided despite repeated opportunities during the course of the assessment proceedings. It may be mentioned that similar opportunities were provided to the assessee during the course of the assessment proceedings for the assessment year 2005-06. As such, it is held that there is no such report at all and as such the claim at 3.5% is without any basis.

(iii) No bills and vouchers were produced for the cost of GSM Equipments to BSNL.

(iv) No copies of the ledger accounts showing cost of imported equipments supplied to South zone and East Zone were produced despite specific requirement.

(v) No warranty expense was actually incurred during the year under consideration.

5.8 Since the assessee company had failed to produce any working to justify that the provision was made on a scientific basis and that no actual expenses had actually been incurred in respect of the same, the provision for warranty to the extent of Rs.14,42,47,994 was proposed to be disallowed in the draft assessment order.

5.9 The assessee filed its objections on this issue before the DRP-II, Delhi vide order dated 30.08.2010, D.R.P.II also observed that the assessee failed to furnish the relevant documents/evidence/detailed working of the provision for warranty even before them. The assessee failed to establish that the provision had been made on a scientific basis and that the liability for the warranty has arisen during the relevant year. It was further observed that the commencement of the warranty depended upon commissioning of complete network in the telecom circle, which itself was an uncertain event. The objections of the assessee were accordingly rejected. In doing so, D.R.P-II also distinguished the ratio as laid down in the Hon'ble Delhi High Court order in the case of CIT vs. Vinitec Corporation Pvt. Ltd. (2005) 278 ITR 0337 and the Apex Court decisions in Rotork Controls India Pvt. Ltd. (2009 TIOL 64) and Bharat Earth Movers (245 ITR 428) in that before allowing claim of the provision for warranty, it was necessary that various conditions such as formation of reliable estimate of obligation and arising of liability must be satisfied. 5.10 As has been discussed in the preceding paragraph, the assessee company has failed to produce any working to justify that the provision was made on a scientific basis . Further the fact that the assessee company has made a provision for warranty for the year to the extent of Rs.14.42 crores as against an actual incurring of the expense of Nil against the account during the year proves the point that the provision made is highly excessive. No actual expenses have been actually incurred by the assessee company towards warranty claim during the year and the provision made has not been proved to be made on a scientific basis and is certainly excessive. It is also held that as the provision has been made on the BSNL sales and the project was not completed during the year, as such there could not have been any claim against the warranty. The entire provision for warranty to the extent of Rs.14,42,47,994 is therefore disallowed and added to the taxable income of the assessee company.

Penalty u/s 271(1)(c) of the Act is also being initiated separately for filing inaccurate particulars and concealment of income".

29. The learned counsel for the assessee while impugning the order of Assessing Officer contended that no doubt no separate warranty agreement was entered by the assessee with BSNL but warranty clause is available in the APO. He made reference to clause 8 of the APO at page 364 which reads as under:

> "8. WARRANTY Warranty shall be as per Section-III Clause-10 and Clause 108 of Section IV of the tender document.
>
> The warranty of the Stores/Equipment supplied for each service area should be for a period of minimum 12 months from the date of commissioning of the complete network in that service area (Telecom Circle).
>
> During the warranty the supplier shall perform all the functions as enunciated under the AMC free of cost. All the penalty clauses shall be applicable during the period of warranty also in case of failure on part of supplier.
>
> Replacement under warranty clause shall be made by the supplier free of all charges at site including freight, insurance and other incidental charges".

30. He further submitted that warranty liability is incurred at the point of sales to make good any defect or damage that may occurs in future during the warranty period. According to the assessee, revenue pertaining to the sales of equipment are recognized on the percentage completion basis corresponding warranty expenses to the cost needs to be allowed on the basis of matching principles. He relied upon the decision of Hon'ble Supreme Court in the case of Rotork Controls India Pvt. Ltd. Vs. CIT reported in 114 ITR 62. He pointed out that in this case, Hon'ble Supreme Court has considered a large number of cases on this issuer, namely, Calcutta Company Ltd. Vs. CIT reported in 37 ITR 1, Metal Box Co. of India Ltd. 73 ITR 53 and Bharat Earth Movers Vs. CIT, Karnataka reported in 245 ITR 428. He also relied upon the orders of the ITAT in the case of Hero Honda Motors vs. JCIT reported in 95 TTJ 782, JCIT vs. Sony India reported in 4 SOT 30. He further submitted that the assessee has produced the details exhibiting the warranty utilization for the Asia Pacific Region for the year 2006 which was brought to the notice of learned Dispute Resolution Panel also. He made a reference to page 359 of the paper book-2. On the other hand, Learned DR relied upon the order of the Assessing Officer. He pointed out that as per APO, the warranty period of 12 months would commence from the date of the commissioning of the complete network in that service area. In the present year, such commissioning did not take place, therefore, warranty claim could not have arisen during the year. Thus, the provision is not as per APO. He also pointed out that the learned Dispute Resolution Panel has observed that warranty liability depends commissioning of the complete network in the entire circle which itself is an uncertain event. With regard to the alleged empirical study report available at page 359 of the paper book is concerned, he submitted that these details do not goad any authority to draw any logical conclusion.

31. We have duly considered the rival contentions and gone through the record carefully. The assessee has made a provision for warranty. It has debited that provision in the P & L account and claimed the deduction. Such deduction can be allowed as an business expenditure. In order to claim any expenditure, not being expenses described in sec. 30 to 36 and not being in the nature of capital expense or personal expense laid out and spend wholly and exclusively for the purpose of the business, one's claim has to be examined under residuary provisions of sec. 37 of the Act. Hence, in order to be eligible for an expense under this section, one has to fulfill the conditions, (i) the expenditure must not be governed by the provisions of sec. 30 to 36; (ii) expenditure must have been laid out wholly and exclusively for the purpose of the business of the assessee; (iii) the expenditure must not be personal in nature and (iv) the expenditure must not be capital in nature. The expression "wholly" employed in section 37 refers to the quantum of expenditure while the word "exclusively" refers to the motive, objective and purpose of the expenditure. Hon'ble Supreme Court in the case of Rotork Controls India Pvt. Ltd. has considered this issue and observed that present value of a contingent liability, like the warranty expense, if properly ascertained and discounted on accrual basis then it can be an item of deduction under sec. 37. Hon'ble Court has explained the expression "what is a provision". According to the Hon'ble Court, a provision is a liability which can be measured only by using a substantial degree of estimation. A provision is recognized when an enterprise has a present obligation as a result of past event; (b) it is probable that an out flow of resources will be required to settle the obligation and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognized. On an analysis of a large number of judgement, Hon'ble Supreme Court concluded that if the historical trend demonstrates that a large number of sophisticated goods were being manufactured and sold

by an assessee in the past and in the past if the facts established indicate that defects existed in some of the items manufactured and sold, then the provision made for warranty in respect of those large number of sophisticated goods would be entitled to deduction from the gross receipts under section 37 of the Income-tax Act, 1961. Hon'ble Court further observed that it would all depend on the data systematically maintained by the assessee. Hon'ble Supreme Court thereafter explained the concept of product warranty by giving an example on page 72 of the report. The discussion made by the Hon'ble Court as under:

> "13. In this case we are concerned with Product Warranties. To give an example of Product Warranties, a company dealing in computers gives warranty for a period of 36 months from the date of supply. The said company considers following options :
>
> (a) account for warranty expense in the year in which it is incurred; (b) it makes a provision for warranty only when the customer makes a claim; and (c) it provides for warranty at 2 per cent of turnover of the company based on past experience (historical trend). The first option is unsustainable since it would tantamount to accounting for warranty expenses on cash basis, which is prohibited both under the Companies Act as well as by the Accounting Standards which require accrual concept to be followed. In the present case, the Department is insisting on the first option which, as stated above, is erroneous as it rules out the accrual concept. The second option is also inappropriate since it does not reflect the expected warranty costs in respect of revenue already recognized (accrued). In other words, it is not based on matching concept. Under the matching concept, if revenue is recognized the cost incurred to earn that revenue including warranty costs has to be fully provided for. When Valve Actuators are sold and the warranty costs are an integral part of that sale price then the appellant has to provide for such warranty costs in its account for the relevant year, otherwise the matching concept fails. In such a case the second option is also inappropriate. Under the circumstances, the third option is most appropriate because it fulfils 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. Therefore, all the three conditions for recognizing a liability for the purposes of provisioning stands satisfied in this case. It is important to note that there are four important aspects of provisioning. They are - provisioning which relates to present obligation, it arises out of obligating events, it involves outflow of resources and lastly it involves reliable estimation of obligation. Keeping in mind all the four aspects, we are of the view that the High Court should not to have interfered with the decision of the Tribunal in this case".

32. In the light of Hon'ble Supreme Court's decision, let us examine the facts of the present case. According to the assessee, it is importing telecommunication equipments manufactured by its associate enterprises. These equipments are commissioned by the assessee. In the advance purchase order, a condition for providing warranty after commissioning these equipments has been provided in clause 8, which we have noticed in paragraph 29 of this order. From perusal of clause 8, it would reveal that possibility of damage and defects in the goods supplied by the assessee cannot be ruled out. The assessee is bound to make up the damage by replacement etc. According to the revenue, it is contingent liability, because the commissioning of the telecommunication network is uncertain. On the other hand, stand of the assessee is that since revenue is being recognized on percentage completion of the contract, the expenses in the shape of outflow of resources has to be allowed under the matching principles of accountancy. Assessing Officer has disallowed the claim of assessee on the ground it failed to produce concerned data which can enable the Assessing Officer to verify its claim logically, how it has made the provisions for warranty expenses. The assessee failed to provide alleged empirical study report of Asia Pacific Region. It is harping upon the details placed at page 359 of the paper book-II which was filed as Annexure 3 before the lower authorities. On going through these details, we find that assessee has submitted the cost of sales in US $ and usage in quarter 2, quarter 3 and quarter 4 of 2006. It pointed out that usage rate is 3.3%, 3.6% and 3.3% in these three quarters. But these details cannot goad any authority to reach any conclusion i.e. the basis of this claim that has to be pointed out by the assessee. These information are neither here nor there. It is self-styled declaration as is appearing in the provisions for the warranty. What is the basis for these details is missing. The systematic data based on past experience ought to have been filed by the assessee in support of provision made by it.

33. Since we have already set aside two issues to the file of the Assessing Officer for readjudication because complete information are not available on the record. We deem it appropriate to set aside this issue also to the file of the Assessing Officer for readjudication because it might be necessary for the assessee to make a provision for warranty as per clause 8 of the APO but it is the duty of the assessee to justify that claim on the basis of data systematically maintained by it, which suggests that the alleged contingent liability has been worked out on the basis of past experience and it is akin to a real event. Therefore, we allow this ground of appeal for statistical purposes and remit the

issue to the file of the Assessing Officer. The assessee shall submit requisite details and the issue will be adjudicated in the light of Hon'ble Supreme Court's decision in the case of Rotork Controls India Pvt. Ltd.(supra).

34. Ground Nos. 12 and 13 are inter-connected with each other. They read as under:

> "12. On the facts and circumstances of the case and in law, the learned A.O. has erred in not allowing deduction for expenses of Rs.12,493,042 which were claimed by the Appellant during the course of assessment proceedings.
>
> 13. On the facts and circumstances of the case and in law, the learned A.O. has erred in not allowing deduction for expenses of Rs.130,932,301 which were erroneously not charged to profit and loss account for subject assessment year and were hence claimed by the Appellant during the course of assessment proceedings".

35. The brief facts in respect of these grounds are that assessee had claimed a deduction for expenses amounting to Rs.400,96,607 under the head "prior period expenses". This claim was made in the financial statement on the ground that these expenses pertained to assessment year 2005-06 but had erroneously not being accounted for in the financial statement for assessment year 2005-06. According to the assessee, this aspect was duly verified during the course of assessment proceedings for assessment year 2005-06. Out of these total expenses of Rs.400,96,607, TDS on the expenses of 124,93,042 was required to be deducted which according to the assessee was duly deducted and deposited by the assessee during the financial year relevant to assessment year 2006-07. It claimed that in accordance with sec. 40(a)(ia), the deduction of this amount is to be claimed in the year in which TDS was paid. The assessee did not dispute with regard to disallowance its claim of balance amount of Rs.276,03,565. The claim was made by the assessee vide letter dated March 28, 2008 during the assessment proceedings. Assessing Officer has rejected the claim of assessee on the ground that this was not made in the return filed under sec. 139(1) or in the revised return under sec. 139(5) of the Act. Learned Assessing Officer made reference to the judgment of Hon'ble Supreme Court in the case of Geotze India Ltd. Vs. CIT reported in 284 ITR 0323. This issue has been disputed by the assessee in ground No.12.

36. The next item is of Rs.1309,32,301. The facts in respect of this item are that assessee has incurred expenses of Rs.1576,77,055 during the financial year relevant to assessment year 2006-07. However, the invoices were received by the assessee only after the close of the financial year i.e. after March 31, 2005. The assessee did not charge these amounts to the P & L account. It has disclosed such expenses as a 'prior period expenses' in the financial statement of Nortel India for subsequent financial year i.e. financial year relevant to assessment year 2007-08. The assessee has further submitted that out of the total expenses of Rs.1576,77,055 expenses amounting to Rs.267,44,754 were liable to deduction of tax at source. It has submitted that such tax was duly deducted and deposited in assessment years 2007-08 and 2008-09. Thus, the expenses to the above extent will be allowable in those assessment years as per sec. 40(a)(i) of the Income-tax Act, 1961. The assessee has claimed the balance amount of Rs.1309,32,301 in the present year. Such claim was made by the assessee during the assessment proceedings vide letter dated 6.10.2009. Assessing Officer

disallowed the claim of assessee by observing that such claim was not made in the return filed either under sec. 139(1) or under sec. 139(5) of the Act. He made reference to the decision of Hon'ble Supreme Court in the case of Geotze India Ltd. (supra)

37. The learned counsel for the assessee submitted that the ITAT in the case of Chicago Pnematic India Ltd. Vs. DCIT reported in 15 SOT 252 had considered a similar situation wherein judgment of Hon'ble Supreme Court in the case of Geotze India was also quoted by the department. These two amounts are directly effecting the tax liability of the assessee and, therefore, the admissibility of deduction ought to have been decided on merit by the Assessing Officer while examining the accounts. Learned DR on the other hand relied upon the order of Assessing Officer and submitted that once the assessee failed to claim deduction of any amount in the return filed by it or by way of a revised return as provided in sec. 139(5) of the Act. It cannot be permitted to claim the deduction of such amount. Learned Assessing Officer has rightly made a reference to the judgment of Hon'ble Supreme Court in the case of Geotze India.

38. We have duly considered the rival contentions and gone through the record carefully. The ITAT in the case of Chicago Pnematic India Ltd. has considered the judgment of the Hon'ble Supreme Court in the case of Geotze India and made a reference to the Circular of the Board issued way back in 1955. The discussion made by the ITAT reads as under:

> 49. The assessee claimed deduction in the original return of income. Though the assessee revised its original return, however, claim under sections 80HH and 80-I was not revised.

Subsequently, during the course of assessment proceedings, the assessee revised its claim, which the Assessing Officer did not take into cognisance as the assessee had not filed revised return to this effect. The learned CIT(A) also confirmed the action of Assessing Officer. Prima facie, the ratio of the decision of the Hon'ble Supreme Court in the case of Goetze (India) Ltd. (supra) is squarely applicable to the facts of the case because as per the law, the onus lies on the assessee to make right claim and such claim must be made within the framework of provisions of Act. However, this situation, though, it is perfectly in consonance with the position of law may result into genuine hardship to the assessees as the assessee would be left with the option only to proceed under section 264 that too in case they have not gone into appeal before the learned CIT(A) on the same issue or the learned CIT(A) has not admitted those issue. Other option would be to approach Central Board of Direct Taxes under section 119 of the Act for getting the specific relief. Both these options involve time as well as engagement of other administrative authorities which can be otherwise devoted to other important issues. This situation has compelled us to look into the duties of the assessing authorities rather than powers of assessing authorities because Government is entitled to collect only the tax legitimately due to it otherwise the tax not so collected would be violative of the Article 265 to the Constitution of India. In such pursuit, we have found that the CBDT as back as in 1955 issued Circular No. 14 (XL-35), dated 11th April, 1955 as to what should be a Departmental attitude towards refund and reliefs to the assessees. The subject circular is reproduced below for the purpose of ready reference :

"V. Miscellaneous - Refund and reliefs due to assessees - Departmental attitude towards - The Board have issued instructions from time to time in regard to the attitude which the Officers of the Department should adopt in dealing with assessees in matters affecting their interest and convenience. It appears that these instructions are not being uniformly followed.

2. Complaints are still being received that while Income-tax Officers are prompt in making assessments likely to result into demands and in effecting their recovery, they are lethargic and indifferent in granting refunds and giving reliefs due to assessees under the Act. Dilatoriness or indifference in dealing with refund claims (eithcr under section 48 or due to appellate, revisional, etc. orders) must be completely avoided so that the public may feel that the Government are actually prompt and careful in the matter of collecting taxes and granting refunds and giving reliefs.

3. Officers of the Department must not take advantage of ignorance of an assessee as to his rights. It is one of their duties to assist a taxpayer in every reasonable way, particularly in the matter of claiming and securing reliefs and in this regard the Officers should take the initiative in guiding a taxpayer where proceedings or other particulars before them indicate that some refund or relief is due to him. This attitude would, in the long run, benefit the department for it would inspire confidence in him that he may be sure of getting a square deal from the department. Although, therefore, the responsibility for claiming refunds and reliefs rests with assessees on whom it is imposed by law, officers should :--

(a)draw their attention to any refunds or reliefs to which they appear to be clearly entitled but which they have omitted to claim for some reason or other;

(b)freely advise them when approached by them as to their rights and liabilities and as to the procedure to be adopted for claiming refunds and reliefs;

(c)Public Relation Officers have been appointed at important centres, but by the very nature of their duties, their field of activity is bound to be limited."

The following examples (which are : by no means exhaustive) indicate the attitude which officers should adopt :--

"(a) Section 17(1) : While dealing with the assessment of a non-

resident assessee the officer should bring to his notice that he may exercise the option to pay tax on his Indian income with reference to his total world income if it is to his advantage.

(b) Section 18(3), (3A), (3B) and (3D) : The officer should in every appropriate case bring to the assessee's notice the possibility of obtaining a certificate authorising deduction of income-tax at a rate less than the maximum or deduction of super tax at a rate lower than the flat rate, as the case

may be. (c)Section 25(3) and 25(4) : The mandatory relief about exemption from tax must be granted whether claimed or not; the other relief about substitution, if not time-barred, must be brought to the notice of taxpayer.

(d) Section 26A : The benefit to be obtained by registration should be explained in appropriate cases. Where an application for registration presented by a firm is found defective, the officer should point out the defect to it and give it an opportunity to present a proper application.

(e)Section 33A : Cases in which the Income-tax Officer (now Assessing Officer) or Assistant Commissioner (now Deputy Commissioner) thinks that an assessment should be revised, must be brought to the notice of the Commissioner of Income- tax.

(f)Section 35 : Mistakes should be rectified as soon as they are discovered without waiting for an assessee to point them out. (g)Section 60(2) : Cases where relief can properly be given under this sub-section should be reported to the Board." In this Circular, the Board has recognised the fact that responsibility for claiming refunds and reliefs rests with the assessee. AS IMPOSED BY LAW even then the Board has directed the officers to draw the attention of the assessees in respect of any refunds or reliefs to which they are eligible, which they have not claimed for some reason or the other. The Board has also given few examples in this regard and has specifically clarified that, these examples are not exhaustive. Further, the Board also issued Circular F. No. 81/27/65-IT(B), dated 18th May, 1965 defining the duties of P.R.Os. in providing assistance to the public . In this circular, the Board has also advised the P.R.O. to visit the Government/commercial establishments to provide them assistance in filing correct returns and making eligible claims. These Circulars issued by the Board almost 4-5 decades before cast a duty on the assessing authorities to collect only the legitimate tax. Starting from late 1980s, the Government has focussed as voluntary compliance by the assessees and, therefore, Government has reduced the number cases selected for compulsory scrutiny and has also reduced the tax rates. This policy of the Government has resulted into higher tax revenues and simplification of laws. It is a settled position that the Circulars issued by the Board are binding on the subordinate income- tax authorities and if C.B.D.T. issues directions which arc beneficial to the assessees although the same may not be directly in consonance with the provisions of law, even then these instructions have to be given effect and adhered to by the concerned authorities. Thus, there is a strong case for reciprocity to be shown by the Revenue Authorities while completing assessments and to avoid administrative hardships to the assessee. As far as the decision of the Hon'ble Apex Court in the case of Goetze (India) Ltd. (supra) is concerned, there is no dispute that the same is binding on everybody concerned. In the said decision, the Hon'ble Apex Court has also ruled that Appellate Tribunal may adjudicate the issue if a claim is made by any party subject to satisfaction of prescribed rules, hence, even the Hon'ble Apex Court has not barred the assessee raise it's legal claim before Appellate Authorities. However, such process would result into undue hardships, delay and multiplicity of proceedings. The Hon'ble Apex Court, on numerous occasions has laid the proposition that the Assessing Authorities are bound to compute the correct income only and collect only legitimate tax, hence, merely for a procedural lapse or technicalities, in our opinion, the assessee should not be compelled to pay more tax than what is due from him. Therefore, this situation has necessarily to be looked upon from the angle of duties of Assessing Authorities as stated earlier, CBDT is the Apex body for tax administration and it can also issue

directions which are for the benefit of the assessee's though such directions may not be inconsonance with the provisions of law, hence, if a circular is now issued directing the assessing authorities to grant reliefs/refunds while completing the assessment proceedings, even though such circular may be at variance with the law, as pronounced by the Hon'ble Supreme Court, but the same would be binding on the subordinate income-tax authorities. In our opinion, therefore, circulars of same nature which have been already issued would not become irrelevant or can be ignored. Admittedly, the circular issued in 1995 has not been withdrawn, hence, it has got binding force on the subordinate authorities even as on date. Accordingly, we hold that the Assessing Officer is bound to assess the correct income and for this purpose, the Assessing Officer may grant reliefs/refunds suo motu or can do so on being pointed out by the assessee in the course of assessment proceedings for which assessee has not filed revised return, although, as per law, the assessee is required to file the revised return. Having stated so, in our view, the learned CIT(A), having co-terminus powers with the powers of Assessing Officer and the fact that appellate proceedings are the continuation of original proceedings, should have entertained the claim of assessee and allowed if other conditions of the provisions of the law were satisfied. In this view of the matter, we accept both the grounds of the assessee and direct the learned CIT(A) to consider the claim of the assessee at the revised figures on merits and decide the same according to the provisions of sections 80HH and 80-I of the Act after hearing the assessee. Thus, this ground of the assessee stands accepted".

39. Respectfully following the order of the Co-ordinate Bench, we entertain these grounds of appeal and remit these issues to the file of the Assessing Officer for verification and readjudication.

40. In ground No.14, assessee has pleaded that learned Assessing Officer has erred in initiating penalty proceedings under sec. 271(1)(c) of the Act against the assessee. This ground is pre-mature in nature. No arguments were advanced by the learned counsel for the assessee. The defence of the assessee qua the penalty under sec. 271(1)(c) of the Act would be entertained in the penalty proceedings, if any, commenced by the Assessing Officer which is a separate proceedings. Hence, this ground of appeal is rejected.

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

Decision pronounced in the open court on 02.03.2012.

Sd/-	Sd/-
(G.E. VEERABHADRAPPA)	(RAJPAL YADAV)
PRESIDENT	JUDICIAL MEMBER

Dated: 02/03/2011
Mohan Lal

Copy forwarded to:

1) Appellant

2) Respondent

3) CIT

4) CIT(Appeals)

5) DR:ITAT

ASSISTANT REGISTRAR