(2010) 09 KAR CK 0120

In the Karnataka High Court

Case No : IT Appeal No. 2860 of 2005 (A.Y. 1997-98)

CIT and Another — APPELLANT

Vs

Mfar Construction Ltd. — RESPONDENT

Date of Decision : 27-09-2010

Acts Referred:
Income Tax Act, 1961 — Section 37

Citation : (2010) 09 KAR CK 0120

Hon'ble Judges : Manjula Chellur, J;K. Govindarajulu, J

Bench : Division Bench

Advocate : M.V. Seshachala, for the Appellant; G. Sarangan and Vani H, for the Respondent

Final Decision : Dismissed

Judgement

1. The substantial questions of law raised in this appeal are as under:

1. Whether the appellate authorities were correct in holding that even when no business activity of the Assessee had commenced during the current assessment year which finding of the assessing officer has been accepted by both the appellate authorities that the expenditure incurred for setting-up of the construction business should be allowed as a deduction during the current assessment year itself ?

2. Whether the appellate authorities were correct in holding that even when the actual business activity has not commenced, any expenditure incurred by the Assessee can be allowed as a business expenditure ?

2. The revenue is before us in this appeal impugning the orders of the Tribunal in IT Appeal No. 1538 of 2002.

3. TheRespondentAssessee is a construction company and they had sought for certain revenue expenditure u/s 37 of the Income Tax Act (for short the Act) for the assessment year 1997-98. The assessing officer held that all the

expenditures claimed by theAssessee cannot be allowed as the Assessee had not yet commenced the work. Therefore, it rejected the claim of expenditure. Aggrieved by the said order, an appeal was preferred before the Commissioner (Appeals) and a detailed order came to be passed by the first appellate authority taking into consideration the date of incorporation of the company, date of commencement certificate issued by the RoC, entering into MoU between the Assessee and one Ramayya Builders, so also payment towards soil testing done by M/s. Geo Engineering, architect fee paid to one Mr. Anil Dubey, submitting tender application for construction of Embassy Heights on Magarath Road on 24-2-1997 and acceptance of tender and issuance of order dated 20-3-1997. According to the appellate authority any business would start with canvassing for orders, particularly in construction industry submitting tenders by itself is the commencement of business, therefore, he concluded that the revenue expenditure claimed by the Assessee had to be allowed and ultimately set aside the assessment order by allowing the claim made by the Assessee.

4. The revenue filed appeal before the Tribunal. The Tribunal after referring to the discussion made by the first appellate authority and based on the same material what the first appellate authority relied upon, ultimately concluded that there was no infirmity in the order of the Commissioner (Appeals). Aggrieved by the said orders, the present appeal is filed by the revenue.

5. The relevant fact that has to be taken into account is the basic structure of the business the Assessee was intending to do when it incorporated its company with the RoC. Certainly, there is a distinction between the setting up of business and commencement of business. Incorporation of the company on 26-4-1996 is the first step the company has taken to establish a public limited company. Later commencement certificate was issued by the RoC on 6-8-1996. Unless this commencement certificate was with the Assessee company, they could not even do any incidental activity of their construction work on behalf of the said company. Therefore, only after obtaining a commencement certificate on 6-8-1996, legally they are permissible or allowed to do the business.

6. Though the company said to have entered into MoU with Ramayya Builders for turnkey project on old Madras Road, for some reason said Ramayya Builders had backed out; it does not mean there was no expenditure before they had entered into MoU with the said Ramayya Builders. However, they had to spend money for the purpose of soil testing and mobilisation charges were also duly paid which is evident from the records. This was on 29-8-1996. In order to canvass their business, they had to do some advertisement with the assistance of architects as well, to see that their business got lot of boost. Therefore, on 15-11-1996, they had paid money to one Anil Dubey, an architect, who prepared the project for Ramayya Builders. Irrespective of failure of contract that was entered with Ramayya Builders, the money spent by them had to be held as expenditure which they could claim as revenue expenditure u/s 37.

7. So far as Embassy Heights--the construction of Embassy Heights tender came

to be submitted much earlier to the closing of the accounting year, 1997 i.e., on 24-2-1997. The tender was accepted on 20-3-1997, much prior to 31-3-1997.

8. The assessing officer though started the discussion of the material with a positive approach referring to each and every activity of the company starting with its incorporation, proceeded wrongly on the assumption that commencement of work does not include incidental work to the construction work of the company. According to the assessing officer, the incorporation, registration with sales-tax and professional tax authorities, payment of survey charges, payment of architects fee are not proof of commencement of business. This is an erroneous approach. So far as incorporation of a company, it may be the beginning of the business activity of the company but till it actually obtained commencement certificate of business from the RoC, with just incorporation of the company, it could not have done anything. Therefore, depending upon the nature of the work and who has undertaken the work, one has to look into the material placed and then come to conclusion what exactly would be the commencement of work. Setting-up of a business may require several factors like investment in a building and other permanent structures which cannot be integral part of a business though it could be incidental part of business. If integral part of business requires expenditure, it would mean without the said integral activity, the main business cannot be proceed with. Therefore, whenever such expenditure is claimed, the criterion would be what exactly is the nature of business the Assessee has undertaken and depending upon the nature of business, one has to see whether such expenditure was spent towards integral part of the business or not. When once it becomes integral part of business like the case on hand, expenditure towards soil testing, submission of tenders, payment of architect fee, etc. would be integral part of the business of the Assessee. Therefore, the Commissioner (Appeals) was justified in the present appeal in saying that commencement of business does not mean actual commencement of construction work but it means whatever is required to start the construction work prior to undertaking the construction work. If it is integral part, it has to be held as commencement of work. Therefore, the expenditure sought by theAssessee for the above activity was rightly held as integral part of the construction industry as the very nature of business in the construction needs such expenditure and without such expenditure they cannot proceed with the actual work they undertake. Therefore, the substantial questions which were raised in the above case are answered against the revenue.

In the result, the appeal is dismissed.

