
(2012) 10 DEL CK 0334

In the Delhi High Court

Case No : ITA No's. 817, 819, 822, 899 and 900 of 2011

CIT

APPELLANT

Vs

RIO TINTO India Pvt. Ltd.

RESPONDENT

Date of Decision : 05-10-2012

Acts Referred:

Income Tax Act, 1961 — Section 143(3), 37, 37(1)

Citation : (2012) 9 AD 115 : (2013) 212 TAXMAN 139

Hon'ble Judges : S. Ravindra Bhat, J; R.V. Easwar, J

Bench : Division Bench

Advocate : Rashmi Chopra, for the Appellant; Nageshwar Rao and Ms. Sayaree Basu Mallik, for the Respondent

Final Decision : Dismissed

Judgement

Mr. Justice S. Ravindra Bhat

1. The present common judgment will dispose of five appeals. The following common question of law arises for consideration:

Did the Tribunal fall into error in holding that the assessment order for AY 1998-99 was conclusive on the issue of date of commencement of the assessee's business for the purpose of determining its tax liability.

The brief facts necessary to decide the case are that the assessee was incorporated on 19.12.1996 to provide technical services for and give technological support to the Indian mining industry. It claimed commencement of business with effect from 01.07.1997. Upon examination of its income tax returns, the AO directed certain queries with regard to the income and expenditure claimed by it. In reply, by its letter dated 24.01.2001, the assessee claimed that it commenced business on 01.07.1997 and that its Bangalore office was functional in April 1997 for which capital was received in that year. It further stated that in July 1997, personnel were recruited and that discussions with clients for rendering consultancy services were initiated prior to July 1997. It was

also seeking opportunities to provide services for mining and related projects in India. The assessee claimed as expenditure, incurred under several heads - travel and conveyance, consultancy expenses, salary, wages, bonus, postage, telephone and telex, business promotional expenses and rent. It claimed that being a service provider, it needed good infrastructure and personnel with expertise in the field. Consequently, it had to make its presence felt in the market and expenses were mainly incurred for business promotion purposes during that year. The assessee entered into a contract with CIDCO and filed a copy of the same and also mentioned about another contract with RIO TINTO Orissa limited w.e.f. 01.06.1996.

2. The AO, by his order dated 01.02.2001, confirmed the assessment for the concerned Assessment year 1998-99 after considering the assessee's expenses. The AO concluded as follows:

5.2 The submissions of the assessee were considered. The assessee itself had submitted that such a heavy expenditure was incurred as the year under consideration is the first year of operations of the assessee and that the company had to prove in the market that it had sufficient infrastructure to provide services. From the reply of the assessee, it is inferred that such expenditure was incurred primary to kick start the business, hence, benefit of enduring nature was likely to be obtained. Therefore, such expenditure cannot be allowed as a revenue expenditure as such expenditure has been incurred by the assessee to create an infrastructure for facilitation of future business, hence, benefit of enduring nature was imposed to be derived. However, it cannot be denied that some expenses would be required under the stated heads for running the day-to-day business of the company. Therefore, 20% of these sums of (total Rs. 3,77,15,537/-) i.e. Rs. 5,43,707/- is allowed while computing the total income of the assessee company. The balance amount of Rs. 3,01,74,830/- is disallowed as expenses of capital nature.

3. The assessee carried the matter in appeal to the CIT (Appeals), who accepted its contentions and held that the individual items of expenses though substantial were incurred on business operations at the initial stage and were, therefore, revenue in nature. The reasoning of the appellate commissioner is found in the following extract of his order, allowing the assessee's appeal:

..... Substantial expenses have been incurred on account of postage, telephone, telex, travelling and conveyance, business promotion, rent, consultancy etc. The genuineness of the expenditure or its relation to the business of the appellant has not been doubted during the assessment proceedings. The individual items of expenses though substantial in amount have been incurred on business operations in the initial stages and are revenue in nature. These have not resulted in the creation of an asset of enduring benefit. The nature of expenses incurred are such that the benefits derived therefore cannot be said to be yielding an advantage of enduring benefit. No specific items in the nature of capital expenses have been pointed out in the assessment order. The legal

position as laid down in various decisions of the Hon'ble Courts, particularly the observations of the Apex Court in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, as cited above indicates that where the expenditure has been incurred in connection with the efficient day to day running of business activities, the same is to be regarded as revenue expenditure. The quantum of expenditure is not the test for determination of whether or not any expense is deductible. The disallowance of 80% of total expenditure by the assessing officer is on adhoc basis without specifying and establishing that any enduring benefit has arisen to the appellant. The addition of Rs. 3,01,74,830/- made in the assessment is without any proper basis and unsupported by concrete and sufficient material. The same is therefore ordered to be deleted. This ground of appeal is therefore decided in favour of the appellant.

4. The revenue had carried the matter in appeal to the Income Tax Appellate Tribunal (ITAT), which dismissed it (ITA 240/Del/2002), by its order dated 30.11.2007. The Tribunal held as follows:

7. In the instant case the impugned expenditure was incurred on account of postage, telephone, telex, travelling and conveyance etc., the genuineness of which has not been doubted by the Assessing Officer. Undisputedly, the expenses have also not resulted into creation of any capital assets, nor it can be envisaged to have given any advantage of enduring benefit to the assessee. As the expenditure so incurred are revenue in nature irrespective of their quantum the same is liable to be allowed. Thus we do not find any infirmity in the order of CIT (Appeals) treating the expenses as revenue. Before parting with the matter it is pertinent to bring on record that we are upholding the order of CIT (A) for treating the expenditure as revenue expenditure, here we are not deciding the issue regarding date of setting up of business or commencement of business and allowability or otherwise of expenses accordingly.

5. For the succeeding years, the assessee had claimed substantial expenses which resulted in loss. As against this, it also disclosed service charges that were collected by it and were considerably lower than expenditure which it disclosed to the income tax authorities. The following chart would indicate the amounts received as services, charged towards the assessee's income and the expenses claimed by it which resulted in loss, for the relevant assessment years:

6. In respect of the subsequent assessment years, the AO and the CIT(A) was of the opinion that the loss claimed could not be allowed and that the evidence on record for all the relative periods did not establish that the assessee had ever started business and consequently the amounts spent were capital in nature since they related to the setting-up of business. Eventually, all these orders of the AO and the CIT(A), who had consistently affirmed the assessments and upheld the disallowances, were carried in appeal to the ITAT; they were disposed of by the impugned order.

7. In between, the authorities had sought to reopen the assessment proceeding

for the Assessment Year 1999-2000 on the ground that a large amount of external commercial borrowings were deposited to earn interest.

8. It was argued that there was no material on record in the proceedings before the income tax authorities at any point of time that any work was done or performed by the assessee. No evidence or details of the work done or the terms of agreement or compensation received, services offered were furnished; it could not, therefore, be concluded that the assessee had actually carried-on any commercial or business activity so as to earn income. Ms. Rashmi Chopra, learned counsel for the Revenue contended that the impugned judgment of the Tribunal cannot be sustained because it completely overlooked the circumstance that for the assessment year 1998-99, its (ITAT's) previous order had only upheld the CIT(A)'s order, treating the expenditure as revenue expenditure. Consequently, there was no question of a finding that the assessee had set-up business nor was there any positive conclusion about the date of commencement of business. It was also argued in this context that the personnel on whom expenditure was incurred were, in fact, not carrying-out business or promoting business of the assessee, but the business of the entities to which they were seconded. Reimbursement of such expenditure could not be said to constitute assessee's own business expenditure.

9. Learned counsel lastly argued that in order to claim relief, the assessee had to satisfy the test of commercial expedience, implicit in Section 37. In the present case, there was no warrant for the Tribunal to conclude that the expenses claimed by the assessee were properly incurred for the purpose of its business.

10. Learned counsel for the assessee relied heavily on the order made by the income tax authorities which culminated in the order of the ITAT dated 30.11.2000 in ITA 240/Del/2002 for the Assessment Year 1998-99. It was argued that the explanation sought for by the AO, directly related to the question whether the assessee had started its business in order to justifiably claim the expenses for that assessment year. The AO completed the assessment and confirmed the order u/s 143(3). Certain additions were made while finalizing the assessment. The relevant discussion by the AO in his order for that year would disclose that he had accepted the assessee's contention with respect to commencement or starting of business. Those determinations were not disturbed by the CIT (A) as well as the Tribunal. Thus, finality having been achieved in respect of the question of date of commencement of business, on account of merger of the findings of the AO with those of the Tribunal, the question of reopening or revisiting that issue did not arise.

11. Learned counsel argued that even though there is no inflexible rule that a view taken in proceedings under the Income Tax Act cannot be reopened for all times to come, at the same time, the Courts are alive as to the types of matters which can be re-agitated. He highlighted that the date of commencement of business is one such instance where the determination of the authorities have to be final, one way or the other, in respect of at least one year. Having regard to

this fact, the revenue's arguments doubting the assessee's business not having been commenced at all, is untenable.

12. Learned counsel for the assessee next argued that the entire question as to the nature of its business and expenditure incurred by it, had been repeatedly gone into by the authorities. Even though the service charges earned by the assessee were lower compared to its expenses, the Commissioner and the Tribunal, in respect of the subsequent assessment years, had examined the matter thoroughly. Learned counsel pointed-out that the agreement between the assessee and ACC-CRA Exploration Ltd was, in fact, a part of the record. This clearly mentioned that the services may be provided to or procured from its affiliated company as may be reasonably requested from the company, i.e. the client. It was also agreed that consultancy fee had to be paid based on the number of hours put in by the personnel, including the seconded personnel, which was the actual cost incurred by the service provider or its affiliated corporation. It was submitted that reimbursement of salary of such seconded personnel did not lead to any inference that the assessee had not carried-on business. It was also emphasized that the receipts, therefore, being in the nature of reimbursement were without the element of profit and that the deductions were made on cost basis.

13. This Court has considered the submissions of the parties. The ITAT, after considering the previous order of the AO and the CIT (A), for the first year, Assessment Year 1998-99, concluded as follows in respect of Assessment Year 2001-02:

....the fact is that the assessee has taken all steps so as to enable it to carry on the business. This is clear because the office has been set up, infrastructure for running the office is in place, personnel have been employed and expenses have been incurred under various heads. This means that the assessee is in a position to carry on the business in case any business is received. The assessee has also shown a nominal receipt of Rs. 25,000/- as service charges. Thus, it is clear that the business has been set up. It is another matter that transactions with group companies have been conducted at cost+ zero basis. Therefore, various revenue expenses claimed by it have to be allowed u/s 37(1) even if no custom has been obtained from outside parties. Accordingly, we are of the view that income of the assessee has to be computed under the head "profits and gains of business or profession" in relation to expenses incurred after setting up of the business. In other words, the assessee is entitled to deduction of revenue expenses debited in profit and loss account on the basis of various provisions of the Act contained in chapter IV and depreciation on fixed assets as per Income Tax Rules.

14. For assessment year 1999-2000, reassessment proceedings were commenced. The Tribunal held that the reasons recorded for reopening the proceedings were justified. However, it followed its reasoning for the other year and dismissed the appeal on merits. Similarly, it held that the findings of the CIT (A) for the assessment years 2000-01, 2003-04 and 2005-06 had to be set-aside

since the issue had been concluded on the question of commencement of business. The disallowance of expenditure claimed was solely on the ground that the assessee had been unable to establish when it started the business.

15. The question as to when can it be said that the business commenced was considered by the Supreme Court in the decision reported as Commissioner of Wealth-tax Madras Vs. Ramaraju Surgical Cotton Mills Ltd., in the following words:

A unit cannot be said to have been set-up unless it is ready to discharge the function for which it is being setup. It is only when the unit has been put to such a shape that it can start functioning as a business or a manufacturing organization that it can be said that the unit has been set-up.

16. In this case, the precise question as to whether the business commenced in the Assessment Year 1998-99 engaged the attention of the Assessing Officer, who called for certain details from the assessee. Para 5.1 of his order for that year, reproduces details of the response received from the assessee which discloses as to when exactly it opened its offices and when it had commenced negotiations and entered into contracts for providing services and also that it had recruited personnel. Thereafter, the AO, accepting the assessee's submissions regarding commencement of business, confirmed the assessment u/s 143(3), allowing certain expenditure and disallowing others. That part of the order with regard to the commencement of business, as claimed by the assessee, was confirmed by the Commissioner (A) and later by the Tribunal in its order.

17. This Court notices the decision in Investment Ltd. Vs. Commissioner of Income Tax, Calcutta, ; that indicates that the findings in regard to the nature and character of investment for one year is good and cogent evidence for later assessment years. The revenue's arguments, seen from one perspective, appear to be sound and persuasive. There can be no absolute proposition that a question once decided is conclusive as regards the assessee and the revenue. However, certain fundamental questions or issues need to be finally settled in one year, and cannot be reopened having regard to their nature. One such is the date of commencement of the business.

18. In a previous decision of this Court, i.e., Commissioner of Income Tax Vs. ESPN Software India (P) Limited, , the question which arose for decision was the date from which the assessee could be said to have started its business. The Court, after noticing the definition of previous order u/s 3 held that "it is setting-up of business and not commencement that is to be considered." It further observed:

a business is commenced as soon as an essential activity of that business is started. Thus, a business commenced when the purchase of stock and trade, the date when the sale is made is not material in that respect.

19. This Court also followed the previous ruling of the Gujarat High Court in

Commissioner of Income Tax, Gujrat I Vs. Saurashtra Cement and Chemical Industries Ltd., . The Court further held importantly that "a finding regarding the date when the business was set-up is a finding of fact.". This Court is of the opinion that reasoning given by the AO in his order for the assessment year 1998-99 is clear and conclusive. It accepted the assessee's contentions with regard to having commenced business with effect from 01.01.1997. It was only on the basis of such a fundamental premise that income was assessed and certain disallowances were made. In these circumstances, it would be unfair for the revenue to contend for each successive assessment year that the assessee had to establish that it "commenced business." The evidence on record clearly shows that substantial services were being rendered and salaries etc. were disbursed even though on reimbursement basis. The mere fact that other service charges are meagre in nature would not, in any way, influence the decision as to whether business was commenced. Furthermore, in line with the decision of this Court in ESPN (supra) the question of date of commencement of business is one of fact. Having regard to these circumstances, it is held that the findings of the Tribunal in the impugned common judgment and order are sound and do not call for interference. The question of law is accordingly answered in favour of the assessee and against the revenue. The appeals are consequently dismissed.