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The set-up date of a business is the date on which its first essential activity is initiated

In brief

In the case of Dhoomketu Builders and Development Pvt. Ltd.¹ (the assessee), the Delhi High Court (the HC) upheld the Income-tax Appellate Tribunal (the Tribunal) ruling that the date of set-up is the date of initiation of one of its first essential activity in order to commence the business.

Facts

- The assessee was engaged in the business of real estate development. As per its memorandum of association (the MoA), it was to carry out the real estate development business including purchase and sale of land.

- The assessee borrowed a loan from its parent company and deposited the same in response to a tender floated by the official liquidator (OL) of NGEF Ltd, to purchase land. However, the assessee was unsuccessful in obtaining the tender.
- The assessee had earned interest income on the deposit made and also made interest payment on the loan borrowed from its parent company, which resulted in a net loss. Loss was claimed as a business loss and the same was carried forward.
- The assessing officer (the AO) contended that the assessee had not set up its business and classified the interest income under the head, 'income from other sources'. Furthermore, the AO disallowed the interest expense since the business was not yet set-up.

¹ CIT v. Dhoomketu Builders and Development Pvt. Ltd. [TS-190-HC-2013(DEL)]

- On appeal, the Commissioner of Income-tax (Appeals) (the CIT(A)) allowed the interest expense as deduction under 'income from other sources' and denied the assessee's contention for carrying forward the losses. On further appeal, the Tribunal ruled in the assessee's favour. The revenue filed an appeal before the HC.

Issue before the High Court

Whether the assessee's business had been set up only from the date of acquisition of land for real estate development, or at the time of participation in the tender for purchase of land.

Revenue's contentions

- The assessee's business could not be said to be set up until the assessee acquired land for carrying out its business in accordance with the object clause of its MoA.
- Participating in the tender process to purchase land and making the deposit did not constitute setting up of business.
- Furthermore, the assessee's tax audit report stated that the assessee had not yet commenced its business.
- Hence, the income earned by way of interest has been assessed under 'income from other sources' and there would not be any benefit of carry-forward of loss under 'income from other sources'.

Assessee's contentions

- The real estate business had been set-up at the time of making the earnest money deposit to the OL of NGEF Ltd. and so the test of success in acquiring the land by way of tender was irrelevant.
- Furthermore, setting up the business could happen simultaneously or prior to commencement of the business.

High Court ruling

- The HC referred to the decision in the case of Precision Electricals and Electronics Pvt. Ltd.² wherein the Madhya Pradesh HC had held that when the business had commenced was a question of fact, and therefore no referable question of law could be said to arise.
- In the assessee's case, the HC took note of the following from the Tribunal's findings:
 - Upon participating in the tender process, one of the activities had been initiated for the development of real estate, which would enable the assessee to acquire the land for development.
 - Commencement of real estate business started with the acquisition of land and hence if the assessee started performing certain acts towards the acquisition of land, then business had been set up.
 - Actual development of the land was immaterial in determining the date of set-up.
 - The observation made in the tax audit report was with respect to commencement of business and not to its being set up.
 - Furthermore, interest earned was not on account of the deposit of surplus funds in the business, but it was out of the deposit from participating in the tender process to purchase land.
 - The activities of applying for participation in the tender process, borrowing and depositing money for the tender, clearly indicated that the assessee's business had been set up.
 - Interest income had to be assessed as business income and consequently, loss had to be carried forward.

² Precision Electricals and Electronics Pvt. Ltd. v. CIT [1989] 176 ITR 453 (MP)

- The HC also referred to the decision in the case of Western India Vegetable Products Ltd.³ wherein the Bombay HC had held that when a business was established and was ready to commence, then it could be said that business was set up.
- Considering the above, the HC held that the Tribunal's ruling was based on the relevant test to determine the date of set-up.
- In addition to the above, the HC held that since there was no substantial question of law involved for determination of set-up, the revenue's appeal was dismissed and the Tribunal's order was upheld.

Conclusion

This ruling reiterates that the business can be considered as set-up when the activity that is chronologically first and which must necessarily precede all other activities, is started. That is, the moment an essential activity is started, the business is considered to be set-up.

³ Western India Vegetable Products Ltd. v. CIT [1954] 26 ITR 151 (Bombay)

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Our offices

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Ahmedabad President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000	Bangalore 6th Floor, Millenia Tower 'D' 1 & 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000	Chennai 8th Floor, Prestige Palladium Bayan 129-140 Greams Road, Chennai 600 006, India Phone +91 44 4228 5000	Hyderabad #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600	Kolkata 56 & 57, Block DN. Ground Floor, A- Wing Sector - V, Salt Lake. Kolkata - 700 091, West Bengal, India Telephone: +91-033 - 2357 9101/4400 1111 Fax: (91) 033 - 2357 2754
Mumbai PwC House, Plot No. 18A, Guru Nanak Road - (Station Road), Bandra (West), Mumbai - 400 050 Phone +91-22 6689 1000	Gurgaon Building No. 10, Tower - C 17th & 18th Floor, DLF Cyber City, Gurgaon Haryana -122002 Phone : +91-124 330 6000	Pune GF-02, Tower C, Panchshil Tech Park, Don Bosco School Road, Yerwada, Pune - 411 006 Phone +91-20 4100 4444	For more information contact us at, <pwctr.knowledgemanagement@in.pwc.com< p=""> </pwctr.knowledgemanagement@in.pwc.com<>	

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