

THE HIGH COURT OF DELHI AT NEW DELHI

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Judgment delivered on: 23.04.2013

+ ITA 528/2012

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COMMISSIONER OF INCOME TAX-IV

.....Petitioner

versus

**M/S DHOOMKETU BUILDERS &
DEVELOPMENT PVT. LTD.**

.....Respondents

Advocates who appeared in this case:

For the Petitioner : Mr N. P. Sahni, Sr. Standing Counsel.
For the Respondent : Mr Ajay Vohra with Ms Kavita Jha, Mr Vaibhav Kulkarni
and Mr Somnath Shukla, Advocates.

CORAM:-

HON'BLE MR JUSTICE BADAR DURREZ AHMED

HON'BLE MR JUSTICE R.V.EASWAR

JUDGMENT

R.V.EASWAR, J

1. These are two appeals filed by the revenue, both relating to the assessment year 2006-07 and they are directed against the common order dated 30.11.2011 passed by the Income Tax Appellate Tribunal, Delhi Bench 'B' in cross appeals filed by the revenue and the assessee.

2. The brief facts giving rise to the appeals are these. The assessee is

a company incorporated on 22.08.2005 and according to its memorandum of association, it was to carry on the business of real estate development, including purchase and sale of land. It is a 100% subsidiary of DLF Ltd. which is also engaged in the same business. In the return filed, the assessee declared a loss of ₹1,17,12,473/- under the head “business” which represented the difference between the interest of ₹62,28,333/- received from NGEF Ltd. of Bangalore on the earnest money of ₹186 crores deposited with it and the interest of ₹1,79,37,534/- paid to DLF Ltd. from whom the assessee had obtained a loan of ₹186 crores. The interest income and payment arose in the following circumstances. The official liquidator of the Karnataka High Court floated a tender for sale of 140 acres of land belonging to NGEF Ltd. which had apparently gone into liquidation. In order to participate in the tender, the assessee obtained a loan of ₹186 crores on 29.11.2005 from its holding company i.e. DLF Ltd. and on the same day deposited the aforesaid amount as earnest money in response to the tender floated by the official liquidator. The assessee was, however, not successful in purchasing the land and, therefore, the earnest money was returned to it with interest of ₹62,28,333/-. On the amount borrowed from DLF Ltd. the assessee was

liable to pay interest of ₹1,79,37,534/-. The difference between the interest received and the interest paid was claimed by the assessee as loss under the head “business”. This is the basis on which the return of income was filed.

3. Since this was the first year of the existence of the assessee-company, the assessing officer examined as to when the assessee could be said to have set-up its business within the meaning of section 3 of the Income Tax Act, 1961. It is necessary to notice that the first previous year of an assessee who claims to carry on business commences from the date on which the business is set-up and ends on the 31st day of March immediately following. The assessing officer was of the view that since the assessee was not successful in acquiring the land from NGEF Ltd., it cannot be said that the business was set-up in the relevant accounting year. He also noted that the tax auditors in their tax audit report stated that the assessee had not commenced any business activity and, therefore, the accounting standards on “segment reporting” were not applicable. According to the assessing officer, the mere act of participating in the tender and making the earnest money deposit did not amount to acts that can be said to have resulted in the setting up of real estate business. In

this view of the matter and after referring to some authorities, he assessed the interest income of ₹62,28,333/- under the head “income from other sources”. He also did not allow the interest of ₹1,79,37,534/- paid by the assessee to DLF Ltd. against the interest income. Since there was no computation of any income under the head “business” there was no question of permitting the assessee to carry forward any business loss as claimed in the return.

4. The assessee appealed against the assessment before the CIT (Appeals) who after a detailed examination of the facts and the rival stands, agreed with the assessing officer that the real estate business cannot be said to have been set-up in the relevant previous year. He accordingly rejected the assessee’s claim for computation of the business loss at ₹1,17,12,472/- and carry forward of the same to the succeeding years. However, he held that the interest paid to DLF Ltd. should be allowed as deduction under section 57(iii) of the Act while computing the income under the residual head, subject to the condition that there will be no carry forward of the deficiency under the residual head to the subsequent years. He thus decided the appeal partly in favour of the assessee.

5. Both the assessee and the revenue filed cross appeals before the Tribunal, the assessee contending that its business in real estate had been set-up on 29.11.2005 when it deposited the earnest money pursuant to the tender floated by the official liquidator of the Karnataka High Court on behalf of NGEF Ltd. and, therefore, it was entitled to the computation of the business loss at ₹1,17,12,473/- and carry forward of the same and the revenue contending that the CIT (Appeals) ought not to have allowed deduction in respect of the interest paid to DLF Ltd., while computing the income under the head “income from other sources”. The Tribunal in the common order passed on 30.11.2011 first addressed itself to the question arising in the assessee’s appeal, namely, whether the business in real estate development was set-up during the relevant accounting year. After examining the rival contentions and after referring to a few relevant authorities, it agreed with the assessee’s contention in the following words: -

“8. Adverting to the facts of present case, we find that business of assessee is development of real estates. It has participated in a tender floated by the official liquidator Karnataka High Court. To our mind, the participation in the tender is starting of one activity which enable the assessee to acquire the land for development. The actual development of the land is immaterial for construing that business of the

assessee has been set up. The revenue authorities have erred in not appreciating these facts rather considering the concept whether the assessee has a surplus fund which has been invested by it and it had earned interest income on such funds. The investment of ₹186 crores was not as a deposit out of surplus fund rather it was earnest money paid by the assessee for the purchase of land. Thus, assessee has demonstrated that its business was set up during the accounting period relevant for this assessment year. The observations of the auditor are with regard to commencement of business and not set up of the business. In the light of participation in the tender such observations would not be a decisive factor. Thus, considering the facts and circumstances, we are of the opinion that income of the assessee has to be assessed under the head “business income” and consequently loss computed by the Learned First Appellate Authority at ₹1,17,12,473 deserves to be permitted for carry forward.

9. In the result, the appeal of the assessee is allowed and that of the revenue is dismissed.”

6. In the view taken by the Tribunal, it allowed the appeal of the assessee and dismissed that of the revenue.

7. The revenue is in appeal and the main contention put forth on its behalf is that the mere act of depositing earnest money while participating in the tender floated by the official liquidator of the Karnataka High Court and the act of borrowing monies from the DLF Ltd. for the purpose cannot be construed as acts constituting setting-up of the business of real estate development and that until the assessee actually acquires any land

for the purpose of carrying on its business as per the objects clause of memorandum of association, the business cannot be said to have been set-up within the meaning of section 3 of the Act. On the other hand, the contention of the assessee is that the business was set-up the moment the assessee took steps to participate in the tender on 29.11.2005 and deposited the earnest money and it is a matter of irrelevance that it was not successful in acquiring the land. It was pointed out that the fact that the assessee's attempts to acquire the land did not fructify is not a relevant test for the purpose of finding out whether the business was set-up. It is contended that the setting-up of the business could be either simultaneous with or anterior to the commencement of the business and in this case the moment the assessee borrowed money and deposited them with NGEF Ltd. and thus participated in the tender, it had taken the steps that constitute the setting-up of the business.

8. On a careful consideration of the issue in the light of the facts and the rival contentions, it seems to us that the decision of the Tribunal is based on the relevant tests that have been handed down judicially for the purpose ascertaining as to when a business can be said to have been set-up. The question as to when a business can be said to have been set-up is

a question of fact to be ascertained on the facts and circumstances of each case and considering the nature and type of the particular business and no universal test or formula applicable to all types of businesses can be laid down. In recognition of this position the Indore Bench of the Madhya Pradesh High Court in **Precision Electricals And ... vs Commissioner Of Income-Tax** : (1989) 176 ITR 453 has held that the question as to when the business of the assessee had commenced is a question of fact and if the Tribunal as, after appreciating the entire material on record, found that the business of the assessee was set-up on a particular date, it would be a finding of fact from which no question of law can be said to arise. The attempt, therefore, should be to see as to whether the Tribunal had taken note of the appropriate circumstances and applied the proper tests in arriving at the conclusion which it did. The *locus classicus* on the question as to when a business can be said to have been set-up is the judgment of the Bombay High Court speaking through Chief Justice Chagla, in **Western India Vegetable Products Ltd. v. CIT** : (1954) 26 ITR 151. The following pithy observations are worth quoting: -

“It seems to us, that the expression ‘setting up’ means, as is defined in the Oxford English Dictionary, ‘to place on foot’ or ‘to establish’, and in contradiction to ‘commence’. The distinction is this that when a business is established and is

ready to commence business then it can be said of that business that it is set up. But before it is ready to commence business it is not set up. But there may be an interregnum, there may be an interval between a business which is set up and a business which is commenced and all expenses incurred after the setting up of the business and before the commencement of the business, all expenses during the interregnum, would be permissible deductions under sec. 10(2).”

9. The Tribunal has observed that having regard to the business of the assessee, which is the development of real estates, the participation in the tender represents commencement of one activity which would enable the assessee to acquire the land for development. If the assessee is in a position to commence business, that means the business has been set-up. The acts of applying for participation in the tender, the borrowing of monies for interest from the holding company, the deposit of the borrowed monies on the same day with NGEF Ltd. as earnest money were all acts which clearly establish that the business had been set-up. The commencement of real estate business would normally start with the acquisition of land or immoveable property. When an assessee whose business it is to develop real estates, is in a position to perform certain acts towards the acquisition of land, that would clearly show that it is ready to commence business and, as a corollary, that it has already been

set-up. The actual acquisition of land is the result of such efforts put in by the assessee; once the land is acquired the assessee may be said to have actually commenced its business which is that of development of real estate. The actual acquisition of the land may be a first step in the commencement of the business, but section 3 of the Act does not speak of commencement of the business, it speaks only of setting-up of the business. When the assessee in the present case was in a position to apply for the tender, borrowed money for interest albeit from its holding company and deposited the same with NGEF Ltd. on the same day, it shows that the assessee's business had been set-up and it was ready to commence business. The learned senior standing counsel for the revenue would, however, state that till the land is acquired, the business is not set-up. The difficulty in accepting the argument is that an assessee may not be successful in acquiring land for long period of time though he is ready to commence his business in real estate, and that would result in the expenses incurred by him throughout that period not being computed as a loss under the head "business" on the ground that he is yet to set-up his business. That would be an unacceptable position. The other argument of the learned standing counsel for the revenue that the tax auditors of the

assessee have themselves pointed out that the assessee is yet to commence its business is also irrelevant because of the distinction between the commencement of the business and setting-up of the same.

10. We do not feel constrained to refer to the authorities cited by both the sides on the question of setting-up of a business except the judgment of the Bombay High Court (*supra*) because as we have already observed, the question is essentially one of fact depending upon the nature of the business and none of the authorities cited by both the sides was directly on the question as to when a real estate business can be said to have been set-up. Under section 260A of the Act, an appeal lies to the High Court only on a substantial question of law. The finding of the Tribunal in the present case is a finding of fact and it cannot be said that the finding was without any basis or material. Moreover, the Tribunal did take note of the distinction between the commencement of a business and setting-up of a business and applied the test laid down by the Bombay High Court (*supra*) which decision has been noticed by us to have formed the bedrock of almost all the authorities cited before us.

11. In the above circumstances, we do not think that any substantial

question of law arises out of the order of the Tribunal. We accordingly dismiss the appeals filed by the revenue with no order as to costs.

R.V.EASWAR, J

BADAR DURREZ AHMED, J

APRIL 23, 2013

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