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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Decided on: 26th March, 2019.

+ W.P.(C) 6782/2018

INDIAN RAILWAY STATIONS DEVELOPMENT
CORPORATION LTD.

..... Petitioner

Through: Mr. G.C. Srivastava & Mr. Suvinay
Kumar Dash, Advs.

versus

PR. COMMISSIONER OF INCOME TAX-IV

..... Respondent

Through: Mr. Sanjay Kumar, Std. Counsel.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE PRATEEK JALAN

S. RAVINDRA BHAT, J. (OPEN COURT)

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1. The writ petitioner seeks the intervention of this Court to set aside an order of the Principal Commissioner of Income Tax [CIT] under Section 264 of the Income Tax Act, 1961. The petitioner is aggrieved by the assessment order made by the Assessing Officer (AO) for the assessment year (AY) 2013-2014, wherein the AO disallowed three items of expenditure claimed as deduction, i.e., depreciation, preliminary expenses, and employees' remuneration.

2. The assessee/petitioner company was incorporated under the old Companies' Act on 12.04.2012 as a joint venture company of Indian Railway Construction Company Ltd. (IRCON) and Rail Land Development Authority (RLDA); these two entities held equity shareholding in the proportion of 51% and 49%, respectively. The assessee declared loss to the

tune of ₹44,70,035/-. Upon scrutiny, the AO also observed that the assessee claimed expenditure amounting to more than ₹1.92 crores, but had not claimed any business income from its activity. An amount of ₹85,83,365 shown in the P&L accounts, was held to be income from other sources. The assessee therefore preferred a revision petition filed under Section 264, which was declined.

3. The assessee in furtherance of its claim before the CIT had urged that it had, in fact, set up a business inasmuch as various preliminary steps had been taken by it which included the appointment of key personnel, preparation of draft model Development Agreement and initiation of process to tender financial and advisory services. The CIT however rejected the assessee's claim for revision affirming the view of the AO. The relevant extract of the CIT's revisional order, is reproduced below:-

“8. It is clear that the assessee company is providing services. As it was established by the government for specific purpose of developing old stations, merely allotment of stations for feasibility studies would not mean that it has necessary infrastructure particularly technical and financial expertise available with it from the date itself.

In fact, the assessee company follows a model where it has some key persons supervising on its rolls. However, the entire major services are outsourced to consultants - technical and legal. Unless (i) the key persons of the assessee company have been appointed who can decide how to go about tendering, selecting the consultants and advisors are in place; (ii) the draft model development agreement is finalized (iii) financial and bid advisory services are appointed and (iv) at least one of the consultants for Architectural and technical feasibility studies is appointed; in my considered view; the business is not established.

As far as the certificate of commencement from the ministry of Corporate Affairs is concerned, this is given an application by

the company and actual establishment of setting up of business is not a criteria for them.

Now, I will proceed to decide when the above key elements of the business were available to the assessee.

(a) Appointment of key persons on its Rolls:

<i>Mr. S.P. Mahi as Chief Executive Officer</i>	<i>Joined on November 12th 2012.</i>
<i>Mr. Parag Verma as Chief Operating Officer</i>	<i>Joined on July 13th 2012</i>
<i>2. Mr. B.B. Walecha as Manager, Confdl.</i>	<i>Joined on June 25th 2012</i>
<i>3. Ms. Suman Sofat, as Asst. Officer (Fin.)</i>	<i>Joined on July 13th 2012</i>
<i>4. Mr. Vijay Kr. Sharma, as Dy. Manager Civil</i>	<i>Joined on September 19th 2012</i>
<i>5. Mr. Davendra Sohaya, Manager Civil</i>	<i>Joined on September 25th 2012</i>
<i>6. Mr. Raj Kumar, Asst. Manager (Finance)</i>	<i>Joined on September 27th 2012</i>
<i>7. Mr. Ankita Gaur, As Architect</i>	<i>Joined on September 26th 2012</i>
<i>8. Mr. Ashish Mishra as Company Secretary</i>	<i>Joined on October 1st 2012</i>

(b) The draft model development agreement was finalized

*The work of “Preparations of Legal Project Document” was assigned to legal consultants only on 24.08.2012. Realistically it is taken that even **the draft legal Project Documents** would have taken more than two months to be finalized (**as there are five types of such documents in the suite**), therefore, this part of basic business requirement is taken to be in place on 31.10.2012.*

(c) Financial and bid advisory services are appointed

The awards and appointment of financial and bid advisory services was made only in April, 2013 after the tenders were invited on 17.12.2012.

- (d) *At least one of the consultants for Architectural and technical feasibility studies is appointed*

The first consultant was appointed on 01.02.2013 after issuing tender notice on 18.09.2012.

9. *Therefore, in my considered opinion, the entire set up key persons of the assessee company have been appointed who can decide how to go about tendering, selecting the consultants and advisors were in place only on 12.11.2012; (ii) the draft model development agreement is finalized in end of October 2012 (iii) financial and bid advisory services were not appointed even till the end of the previous year and (iv) the first consultant for Architectural and technical feasibility studies was appointed only on 01.02.2013; in my considered view, the business was not set up till the end of the previous year.*

10. *In view of the above, no expense can be allowed u/s 37(1) of the Act. Only amortization of certain preliminary expenses is permitted u/s 35D of the Act and debit of these are allowed after commencement of business as per the provisions of that section. Hence, I refuse to revise the impugned order dated 15.01.2016, passed under section 143 (3) of the Act, on the grounds raised by the Assessee Petitioner. The petition is decided accordingly."*

4. It is contended by Mr. G.C. Srivastava, learned counsel for the petitioner that the Principal Commissioner's view is erroneous in law. It is urged that the assessee, as an SPV, does not engage itself in procuring material or goods or even manufacturing unit, rather, is engaged in providing services. These services involve taking various steps towards the ultimate aim of preparing separate project plans for the railway stations which need to be developed. The project plans are, in fact, coterminous with the development and its finalisation for each of the station.

5. It is emphasised that the preliminary steps involving appointment of management and key personnel were completed during the assessment year and that process for engaging other services, such as financial and bid advisory service were, in fact, commenced.

6. In these circumstances, the claim for deduction against expenditure towards employees' remuneration, depreciation and such like expenditure fell within business expenditure, and had to be allowed. In support of this contention learned counsel for petitioner relies on the Division Bench judgment of this Court in *Commissioner of Income Tax vs. Hughes Escorts Communications* (2007) 311 ITR 253, *Commissioner of Income-tax-IV vs. Dhoomketu Builders and Development Private Limited* (2013) 368 ITR 680 and *Carefour WC & C India Pvt. Ltd. vs. Deputy Commissioner of Income Tax* (2015) 368 ITR 692. Counsel emphasizes that unlike manufacturing units, there cannot be a clear cut line between commencement and setting up of a service entity and that the initiation of the preliminary steps, *ipso facto*, in some circumstances is conclusive of this fact.

7. The Revenue counsel, Mr. Sanjay Kumar contend that the facts presented before the AO and CIT(A) clearly show that there was no business activity, but rather business inactivity. It is emphasized that even though the key personnel were engaged, nothing further was done or achieved. It is urged, as stated in the counter affidavit, that the following facts are relevant:-

“(i) the entire set up key persons of the petitioner company that were appointed, who could decide how to go about tendering, selecting the consultants and advisors, were only in place on 12.11.2012;

(ii) the draft model development agreement was finalized in end of October 2012

(iii) financial and bid advisory services were not appointed even till the end of the previous year and

(iv) the first consultant for Architectural and technical feasibility studies was appointed only on 01.02.2013.”

8. It was submitted that until something substantial in regard to the business plan and development of railway stations actually crystallized, the assessee could not have been said to have commenced or set up its business or be engaged in part of its business.

9. The commercial activity the petitioner is, undoubtedly, engaged in is setting up as an SPV providing services. These services are of specific kind, i.e., preparation of development plans and projects for the development of railway stations. The Indian Railways apparently conceived the idea of setting up the petitioner as a special purpose vehicle to re-develop its railway stations. Each of the railway stations, therefore, as part of its plan needs to be bid for separately and each station needs to be presented with a development plan. Not only was the SPV/petitioner required to draw a development plan but also engaged itself in the entire project.

10. The MoU entered between the petitioner's promoters i.e. IRCON and RLDA, *inter alia*, states certain provision which are as follows:-

“2. BROAD SCOPE OF WORK AND REVENUE STREAM OF THE SPV

2.1 The scope of the Project(s) will be to develop/redevelop the existing/new railway station(s) which will consist of upgrading the level of passenger amenities by new constructions/renovations including redevelopment of the station buildings, platforms surfaces, circulating area to better standards so as to serve the need of the passengers. Details are given in the succeeding paragraphs.

2.2 SPV shall be responsible for design, construction, financing, maintenance, generation and collection of revenues

through identified passenger amenities, retail and such other commercial activities at the station in such a manner that each Project becomes financial viable.

2.3 Implementation of Projects will be through self financing mechanism in which the scope and parameters of a Project will be selected in such a manner that the capital and running cost of the Project is financed through the future Project revenues (one time and/or recurring) itself together with a specified minimum return on capital deployed. Depending upon the Business Plan for each project, the SPV will implement the Projects primarily through Developer or by mobilizing of funds through mechanisms such as equity, debt, subordinate debt, government grants/annuity or other similar means including its own resources.

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3.0 RESPONSIBILITIES OF SPV

3.1 The SPV will initially prepare the Overall Business Plan. Later on, station specific Feasibility Study and Business Plan shall be prepared for the identified railway stations assigned to the SPV by MOR through RLDA. The overall Business Plan will also suggest broad commercial terms and conditions of the agreement to be entered into between the SPV & the Developer, SPV & zonal Railway for maintenance work, SPV & facility management agency and between the SPV & RLDA, standards of redevelopment, alternative models of funding, alternative business and implementation models, O&M strategy, general technical parameters etc.

The SPV shall however take up only financially viable Projects.

3.2 Feasibility Study and Station Specific Business Plan will include identification of the requirement of up-gradation/construction of new assets, estimation of revenue earning potential of each project, estimation of construction and maintenance costs, field/geotechnical surveys, preparation of master plan for the redevelopment of station, identification of land areas/spaces that can be used for commercial development, development of alternative financial models, land valuation, project implementation mechanism, phasing

and construction methodology, specific technical details, tender drawings, draft of station specific maintenance contract to be entered with zonal railway etc. The output of this study should enable the SPV to proceed ahead with the invitation of bids for appointment of Developer for the station.

3.3 Rehabilitation of identified structures/ encumbrances at the Project site: Railway's assistance shall be sought in removal of encroachments and religious structures, if any on the project site.

3.4 Designing, financing and constructing each Project and maintaining the identified components during the specified period including subcontracting the Project work. Maintaining the station areas handed over to the zonal railway, if the zonal railway so desire, through a separate contract to be executed with the zonal railway.

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7.0 PROJECT TERM

The rights assigned by RLDA to the SPV in respect of each Project shall continue till the expiry of lease period mentioned for each project from the date of assignment. After the expiry of this period all the rights shall get reverted/transferred to RLDA/Railway.

11. The extract of the CIT's order makes it clear that during the assessment year the assessee had, in fact, engaged all key personnel. The Chief Executive Officer (CEO) took charge sometime in the beginning of November, 2012. It finalised a tender for obtaining financial bid and tender advisory service on 17.12. 2013 and the first consultant was appointed on 01.02.2013. As to what is setting up of a business, the judgment in *Hughes Escorts Communications* (supra) interestingly deals with this question and had held as follows in :-

“10. A plain reading of the above provision shows that for a new business the previous year is the period beginning with

the date of setting up of the business. As explained by the Bombay High Court in Western India Vegetable Products Limited once it is known what the business of an assessee is:

“ . . . the important question that has got to be considered is from which date are the expenses of this business to be considered permissible deduction and for that purpose the section that we have got to look to is section 2(11) and that section defines the ‘previous year’ and for the purpose of a business the previous year begins from the date of the setting up of the business. Therefore, it is only after the business is set up that the previous year of that business commences and in that previous year the expenses incurred in the business can be claimed as permissible deductions. Any expenses incurred prior to the setting up of a business would obviously not be permissible deductions because those expenses would be incurred at a point of time when the previous year of the business would not have commenced...”

11. *The Bombay High Court, which was in this case dealing with the corresponding provision of the Indian Income-tax Act, 1922, then explained the distinction between the concepts of ‘commencement’ and ‘setting up’ of business:*

“ . . . 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 contradistinction to ‘commence’. The distinction is 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 section 10(2). . . .” (P.158)

The above decision has been followed in a large number of decisions including this Court in L.G. Electronic (India) Ltd.'s case (supra)."

12. In *Dhoomketu Builders* (supra), the assessee which was in realty business, tendered for the purpose of land acquisition and obtaining a loan from its holding company which deposited it as earnest money. It could not acquire the land and hence, the earnest money was returned to it. Since this was the first assessment year, the AO was of the view that it had not commenced business because its commercial activity was aborted. This Court in its judgment turned down the Revenue's contentions, and held as follows :-

*"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 & Electronics (P.) Ltd. v. CIT* [1989] 176 ITR 453/[1988] 41 Taxman 108 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).”

13. In *Carefour* (supra) the assessee company was incorporated on 19.09.2007, for the purpose of carrying on trading activities involving wholesale trading of all kinds of goods. It claimed expenses as business losses. The AO rejected its claim for deduction on expenditure holding that they did not commence any business as they did not sell goods. This Court allowed and observed as follows:-

“11. On a reading of the above referred quotations, it is clear that it is only after the business is set up, that the expenses incurred in the business can be claimed as permissible deduction under Section 37 of the Act. For commencement of a business, there must be in place some income generating asset or income earning structure. In several cases, there is a gap or an interval between setting up and commencement. When the business is set up, is a mixed question of law and fact and depends upon the line, nature and character of the business/professional activity. For example, for manufacturing business, purchase of new material or

electricity connection may be relevant point to determine setting up but in case of a property dealer, the moment, he puts up a chair and table, or starts talking, his business is set up.

The present assessee was engaged and incorporated for carrying on trading activities in different commodities.

The word 'trade' even though not defined in the Act is used to denote operations of a commercial character by which a trader provides to customer for reward, some kind of goods or services. In other words, when the trader start providing such goods and services, the business is said to have commenced but the same may not hold good for set up of a business, which is a stage before the commencement. To set up a business, the following activities become relevant:-

“Preparation of a business plan; establishment of a business premises; research into the likely markets or profitability of the business; acquiring assets for use in the business; registration as an entity and under the local laws etc.’ The said list of activities are not exhaustive and facts of each case need to be considered. Indeed purchase of goods would amount to commencement of business, but before the said act, spade work and efforts to commence have to be undertaken. A trader before actual purchase would possibly interact and negotiate with manufacturers, landlords, conduct due diligence to identify prospective customers, spread awareness etc. These are all integral part and parcel of the business of a trader. The said activities continue even post first sale/purchase. When first steps are taken by a trader, the business is set up, commencement of purchase and then sales is post set up.”

14. The common thread of reasoning, which runs through these decisions cited by the assessee, is that in these cases there is no bright line that can be determinative as to when business commences. In case of the service sector, where the entity has involved itself in various kinds of steps, some of which are preliminary to setting up the main substantial commercial venture, the

linkage between these preliminary steps and nature of the ultimate activity may be a relevant factor to be taken into account. Therefore, *Carefour* dealt with this trading related aspect and stated that even certain kinds of preliminary steps, such as engaging in negotiation or employment of personnel, could be relevant even though actual activity might not be involved.

15. Keeping this principle in mind, this Court is of the opinion that the petitioner's activity, which it claims to be preliminary steps towards the fulfillment of the purpose, which is embodied in the MoU and extracts of which have been reproduced above, clearly indicates that it had set up its business and that these steps were for the ultimate fulfillment of its purposes, which was the preparation of development plans leading to the projects.

16. The Principal Commissioner of Income Tax, in the impugned order, was plainly wrong in holding otherwise. For the aforesaid reasons, we are of the opinion that this writ petition is to succeed. The impugned order of the CIT, as well as the AO are set aside. The matter is remitted to the AO to give tax effect and to ensure that the deduction claims are appropriately granted. The writ petition is allowed in the above terms.

S. RAVINDRA BHAT, J.

PRATEEK JALAN, J.

MARCH 26, 2019

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