

IN THE INCOME TAX APPELLATE TRIBUNAL
“SMC – C” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, JUDICIAL MEMBER

ITA No.2149/Bang/2018
Assessment year : 2015-16

HIPL India Private Ltd., No.2145/866, Toyota Kirloskar Motor Co. Road, Banandhur, Medanahalli Village, Bidadi, Ramanagar, Bangalore – 562 109. PAN: AADCH 4720L	Vs.	The Assistant Commissioner of Income Tax, Circle 3(1)(2), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri K.P. Srinivas, CA
Respondent by	:	Shri Rajendra Chandekar, Jt.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	21.08.2018
Date of Pronouncement	:	03.10.2018

ORDER

This appeal by the assessee is against the order dated 17.05.2018 of the CIT(Appeals)-III, Bengaluru relating to assessment year 2015-16.

2. The assessee is a company incorporated on 19.9.2014. As per the objects clause in the Memorandum of Association, the assessee was formed to pursue the following objects on its incorporation:-

- “1. To set - up, acquire and carry on the business, within India or abroad of developing, manufacture, procure, produce, trading, contracting, franchising, selling, buying, exporting, importing, repairing, maintaining, assembling, engineering service provider or otherwise dealing in all kinds of

appliances, equipments, devices, instruments, components, tools, accessories, sensors, controllers, apparatus, machinery, spare parts and other related appliances of heating elements and temperature control systems for any - domestic, commercial ,industrial application and Customer specific solutions.”

3. The Memorandum of Association (MoA) also specifies the following objects can be pursued by the assessee for furtherance of the objects stated above. One such object which is relevant for the present case is clause 14 of other incidental objects which reads as follows:-

“14. To do all or any of the above things as principals, agents, contractors, trustees or otherwise and by or through trustees, agents or otherwise and either alone or in conjunction with others and to do all such other things as are incidental or as may be conducive to the attainment of the main objects of the trust.”

4. The assessee filed a return of income for the AY 2015-16 declaring a loss of Rs.38,16,300. The computation of total income by the assessee was as follows:-

INCOME / LOSS FROM BUSIENSS & PROFESSION		(RS.)
Net Loss as per Profit & Loss Account		(47,14,272)
Add: Items Disallowed		
Interest on Tax (TDS)	1,252	
Any other amount not allowable under section 37*	8,43,090	
*Preliminary expenses (4/5 of total expense of Rs.10,53,863)		
Depreciation as per Companies Act	94,188	9,38,530
		(37,75,742)
Less: Items to be considered separately		
Depreciation as per Income Tax Act, 1961:	40,563	
Preliminary expense write off allowed as per income tax act		40,563
		(38,16,305)
Total income		(38,16,300)

5. It can be seen from the Profit & Loss (P&L) account of the assessee that the loss of Rs.47,14,272 was arrived at as follows:-

Particulars	Note No.	Period Ended
Revenue from Operations		-
Other Income	11	679,075
Total Revenue		679,075
Expenses:		
Depreciation and Amortisation of Assets		94,188
Other Expenses	12	5,299,159
Total Expenses		5,393,347
Profit (Loss) Before Tax		(4,714,272)
Tax Expense:		
Current Tax		-
Deferred Tax Liability (Asset)		-
Profit (Loss) for the period		(4,714,272)

6. It can be seen from the P&L account that assessee had revenue of Rs.6,77,075. Note 11 to the P&L account gives the break up of revenue which is as follows:-

<u>NOTE 11: Other Income</u>	<u>(Amount in Rs.)</u>
Commission Income	88,285
Foreign Exchange Fluctuation on account of restatement	580,641
Other	10,149
	<u>679,075</u>

7. The details of other expenses debited in the P&L account is given in Note 12 which reads as follows:-

<u>NOTE 12: Other Expenses</u>	<u>(Amount in Rs.)</u>
Audit Fees	20,000
Bank Charges	3,832
Communication Expense	34,256
Computer Repair & Maintenance	18,975
Conveyance, Tour and Travel	603,576
Exhibition Expenses	55,058
Holding Fees	337,281
n nn	1,726,11.9
Office Expense	98,682
Printing and Stationery	101,681
Preliminary Expenses	1,053,863
Rent Expenses	655,844
Rates & Taxes	522,312
Repairs & Maintenance to Building	<u>67,680</u>
	<u>5,299,159</u>

8. The AO was of the view that the business of the assessee was not set up and therefore revenue expenses which were claimed as deduction had to be capitalised as pre-commencement expenses and cannot be allowed as deduction. The following were the relevant observations of the AO in this regard.

“4. Prior Period Expense: On perusal of the details furnished by the assessee, it was revealed that the assessee company has debited Rs.53,93,347 towards expenses under the head- Other Expenses and Depreciation and amortization. Company was incorporated in Sep 2014. There are zero revenue from operation. The business has set up, however it has not commence operations. Therefore, the expenditure claimed can not be

allowed as revenue expenditures. The assessee vide order sheet dated 15.12.2017 was asked why prior period expense of Rs.53,93,347 should not be disallowed.

5. It was discussed with the AR of the company and admitted the same. The amount is therefore disallowed and added back to the total income.”

9. Aggrieved by the aforesaid addition, the assessee preferred an appeal before the CIT(Appeals). The contention of the assessee was that its business has been set up and therefore all revenue expenses should be allowed as a deduction and total income of the assessee as declared in return of income should be accepted. The assessee pointed out the following facts which goes to show that its business was set up:-

1. It had earned commission income during the relevant previous year. It acted as a commission agent in respect of sale of its principal's products. Under clause 14 of the Objects incidental to main objects, the business of assessee also includes business of acting as commission agent. Since there was income from business of commission agency, it can be said that assessee has set up its business during the previous year.
2. Its directors undertook travel for the purpose of the trading segment of the assessee's business. Though no business actually resulted on account of such travel, the fact remains that attempts were being made by the assessee to do trading in appliances, equipments, etc.
3. The assessee took the premises on lease for the purpose of commencement of its business of manufacturing which was also used for the purpose of its trading activity. The assessee filed copy of lease deed in respect of premises taken on lease by the assessee. The lease deed is dated 11.11.2014 and the lease was for a period of 3 years w.e.f. 10.11.2014. The recitals in the lease deed were as follows:-

“**WHEREAS**, the Lessor is the owner of the property measuring total area of 7200 sq. ft., of Building more particularly specified in Schedule. (Hereinafter collectively referred to as the 'demised premises').

AND WHEREAS, the Lessee is in manufacturing business. The Lessee requires an Industrial shed for manufacturing Industrial heaters and heating systems.

AND WHEREAS, the Lessor has expressed his intention to lease the demised premises to the Lessee for manufacturing Industrial heaters and heating systems.

AND WHEREAS, the Lessor has represented that he has absolute right and title to grant lease of the demised premises to the Lessee with an exclusive right to use the same for use by the Lessee.

AND WHEREAS, relying on the aforesaid and other representations of the Lessor, as herein contained, the Lessee is desirous of taking on lease and the Lessor is desirous of granting the lead of the demised premises, for the purposes as enumerated above.”

10. Based on the above submissions, the assessee pleaded before the CIT(A) that the business has been set up and therefore all revenue expenses had to be allowed as a deduction.

11. The CIT(A) however did not accept the plea of the assessee for the following reasons:-

“4.4 The main object of the appellant company is to engage in the business of manufacturing or trading in all kinds of appliances, equipment, devices, instruments etc related to heating elements and temperature control systems. A perusal of the above details of expenditure and the audited financials of the company shows that the company is not having any employees, which would have been required to carry out day to day activities after setting up of the business. There are no plant and machinery other than one computer and some office equipment to carry out manufacturing activities. The appellant has not brought on record

the details of any activity carried out by it, which could be considered as setting up of the business by it. It is not shown that the appellant has obtained necessary licenses and approvals from the regulatory authorities for carrying out its activities. There is no purchase of raw material or trading goods for purpose of carrying out manufacturing/trading activity. Thus the expenses incurred by the appellant are pre-operative and preparatory expenses which were incurred prior to setting up of business and prior to coming into an existence an altogether new source of income. So these expenses cannot be allowed as revenue expenditure. The reliance of the appellant on different decisions is found to be misplaced as none of them was rendered on similar facts as in the case under consideration.”

12. Aggrieved by the order of CIT(Appeals), the assessee is in appeal before the Tribunal.

13. I have heard the rival submissions. The Id. Counsel for the assessee brought to my notice the facts which were stated before the CIT(A) and also placed reliance on certain judicial pronouncements. The Id. DR relied on the order of CIT(A).

14. I have considered the rival submissions. The legal position with regard to expenses claimed prior to setting up of business and the sequence of point of time when the business can be said to have been set up as follows:-

The definition of the previous year as contained in Section 3(1) of the Act, which is relevant for the present case reads as follows:-

3. *‘Previous Year’ Defined.* – For the purposes of this Act, previous year means the financial year immediately preceding the assessment year:

Provided that, in the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on

which the source of income newly comes into existence and ending with the said financial year.”

According to this section, it is setting up of the business and not the commencement of the business that is to be considered. A business is commenced as soon as an essential activity of that business is started. Thus, a business commenced with first purchase of stock in trade, the date when the first sale is made is not material in that respect. Similarly, a manufacturer has to undertake several activities in order to bring to produce financial goods and he commences his business as soon as he undertakes first of such activities (Commissioner of Income Tax vs. Saurashtra Cement and Chemical Industries Ltd. 1973 (91) ITR 170 Gujrat).

15. The Hon'ble Delhi High Court in the case of *CIT v. ESPN Software India P. Ltd. (2009) 184 Taxman 452 (Del)* explaining the position with regard to the time when a business can be said to have been set up held that it is a finding based on facts of each case. In that case, the business of assessee was distribution of ESPN programming services and the fact of assessee entering into the agreement acquiring license to distribute in India ESPB programme was held to be the point of time when the business was set up. The Court held that if essential activity in the course of carrying on of business is started, then the business must be said to have been set up.

16. Applying the aforesaid principle to the facts of the present case, I am of the view that the three circumstances pointed out by the assessee before the CIT(A) viz., receipt of agency commission, travel by directors to explore the possibilities of getting business and taking the premises on lease for the purpose of manufacturing activity would be sufficient to come to the conclusion that business of assessee had been set up during the relevant previous year. Consequently, the assessee would be entitled to claim all the revenue expenses as deduction in computing its total income.

I am therefore of the view that the claim made by the assessee for deduction should have been allowed by the revenue authorities. I accordingly direct the AO to allow the deduction.

17. In the result, the appeal by the assessee is allowed.

Pronounced in the open court on this 3rd day of October, 2018.

Sd/-

(N.V. VASUDEVAN)
Judicial Member

Bangalore,
Dated, the 3rd October, 2018.

/ Desai Smurthy /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Senior Private Secretary
ITAT, Bangalore.