

IN THE INCOME TAX APPELLATE TRIBUNAL
SPECIAL BENCH : AHMEDABAD

BEFORE SHRI D.K.TYAGI, JUDICIAL MEMBER,
SHRI.N.V.VASUDEVAN, JUDICIAL MEMBER
AND SHRI.A.K.GARODIA, ACCOUNTANT MEMBER

ITA No.2654/AHD/2004
Assessment year : 2001-02

Sardar Sarovar Narmada Nigam Ltd., Block No.12, First Floor, New Sachivalaya Complex, Gandhinagar. PAN : AACCS 6704L	Vs.	The Assistant Commissioner of Income Tax, Gandhinagar Circle, Gandhinagar.
APPELLANT		RESPONDENT

Appellant by	:	Shri S.N. Soparkar and Ms. Urvashi Sodhan, Advocates
Respondent by	:	Shri Satish Kumar Gupta, CIT (DR)

Date of hearing	:	20.07.2012
Date of Pronouncement	:	07.09.2012

ORDER

Per Bench

The circumstances leading to the above appeal by the Assessee against the order of Commissioner of Income-tax(Appeals) ["CIT(A)"], Gandhinagar, Ahmedabad dated 02.07.2003 being referred for consideration by a Special Bench by the Hon'ble President are as follows.

2. The Assessee is a Company. The Government of Gujarat established the assessee Corporation as a wholly-owned Government Company under

the provisions of the Companies Act, 1956 to take the execution of Sardar Sarovar Project - an inter-state multi-purpose project of four States viz. Madhya Pradesh, Maharashtra, Gujarat and Rajasthan with a terminal major dam on the river Narmada in Gujarat. The Government of Gujarat executed a part of the project and on being advised, it decided to form a Nigam and it passed a resolution vide the Government of Gujarat, Narmada Development Department's Resolution No. NMD/1073(86)/ 33(2)/H dated 21-3-1988, which reads as under:

"PREAMBLE:

With a view to execute the works of the Sardar Sarovar (Narmada) Project, the State Government has decided to set up a Public Limited Company namely the Sardar Sarovar Narmada Nigam Limited. The proposed Sardar Sarovar Narmada Nigam Limited will have its head office at Gandhinagar and its main objects would be to execute the works of the Sardar Sarovar (Narmada) Project.

RESOLUTION:

The Government is, therefore, pleased to set up the Sardar Sarovar Narmada Limited with its registered office at Gandhinagar with an authorized share capital of Rs. 2,000 crores to be divided into 2 crores shares of Rs. 1,000/- each. The entire capital will be scribed by the Government and accordingly the Nigam will be a wholly owned Government Company. The Company should be registered as Public Limited Company under the Companies Act, 1956...."

3. Thereafter, the assessee Corporation was incorporated under the Companies Act, 1956 on 24th March, 1988. The Registrar of Companies ("ROC"), Gujarat issued Certificate of Incorporation. The assessee Corporation, thereafter, was granted Certificate of Commencement of Business by the ROC, Gujarat on 9th May, 1988. On formation of the assessee Corporation, the Government of Gujarat, Narmada Development

Department vide Resolution No. MPC/1088/23/K, dated 31-3-1988 transferred en-bloc the entire staff and officers of the Circles and office other heads etc. working under the control of Narmada Development Department to the assessee Corporation. Further, the Government of Gujarat also transferred assets of Sardar Sarovar Narmada Project to assessee Corporation and to effect that transfer, the Government of Gujarat also passed a G.R.No. COR-1488-H dated 27th October, 1988.

4. When the execution of the Project was transferred to the Corporation total works of Rs. 750 crores were under execution. During the year 1988-89 new tenders of the estimated cost of Rs. 352 crores were invited and during the Financial year 1989-90 further tenders of the estimated cost of Rs. 163.92 crores had been invited and so on, till the end of the accounting year 1999-2000.

5. The estimated cost of the Project was Rs. 6406 crores as cleared by the Planning Commission in October, 1988 based on 1986-87 price level. The World Bank had agreed to provide aid of 450 million Dollars for the Project. Further Yen Credit of Rs. 150 crores under OECF will also be available for the Project. This external aid was to be received by the Government of Gujarat through Government of India. About Rs. 1502 crores was expected as share from participating states i.e. Maharashtra, Madhya Pradesh and Rajasthan leaving balance of about Rs. 4204 crores. The expenditure of about Rs. 750 crores has already been incurred on the Project. As per the compressed construction schedule of the Project of 10-12 years the above amount may escalate by 8% annual to Rs. 6000 crores. Considering the likely allocations

from the Government of Gujarat and additional funds available due to the liberalized policy of the Government of India on external aid, it was estimated that there would be a net gap of only Rs. 1000 crores. This amount was planned to be raised through Deposits, Debentures, Bond, Kisan Vikas Patras and Non-Resident Indian Investments. It was expected that the servicing of the borrowed money would be possible from the returns which was expected to start generating sometime in 1993-94.

6. During the year 1988-89, the Government of Gujarat made total share capital contribution of Rs. 650.10 crores of which Rs. 533.10 crores is in the form of assets transferred to the Corporation and the balance amount of Rs. 117 crores was received in cash. Against this, the Corporation has allotted equity shares of Rs. 563.50 crores. Further equity shares of Rs. 53.50 crores were allotted in April, 1989. The allotment of the equity shares against the balance amount of Rs. 33.10 crores was to be made on receipt of the report of the Committee appointed to give details regarding the categories of the assets transferred by the Government of Gujarat.

7. No profit and loss account was prepared by the assessee in any of the years (AY 1989-90 to 2000-01) and in Note No. 7 forming part of the accounts in the Annual Report 1988-89 it was mentioned as follows:

"(a) No Profit and Loss Account for the period from 24th March, 1988 to 31st March, 1989 has been prepared as the Projects of the Company are under construction and the Company's operation of supply of water and power has not commenced by 31st March, 1989.

(b) Most of the items classified under incidental expenditure during construction, according to the Company, are relating to the Project and it is therefore the intention of the Company to capitalize the same as and when commercial operations commence."

8. The position of the project executed and establishment of infrastructure continued upto the previous year relevant to the A.Y. 2000-2001. In the Directors' report for the year ended 31st March, 2000 it was observed in the "Highlight of the Project" as "The Sardar Sarovar (Narmada) Project being implemented by your Corporation is a unique multi-purpose project, participated by four states i.e. Gujarat, Madhya Pradesh, Maharashtra and Rajasthan. The project is the largest water resources development project in India and reportedly one of the three largest in the world. The length of the main concrete gravity dam is 1,210 meters and the height is 163 meters from the deepest foundation level. The gross storage capacity of the reservoir is 9,500 million cubic meters (7.70 MAF) and live storage capacity is 5,800 million cubic meters (4.72 MAF). The reservoir will be extending about 2.14 kms. Upstream covering a surface area of 370 sq.km. A 460 Kms. Long concrete lined main canal is being constructed on the right bank from the reservoir upto Rajasthan border having a capacity of 1,133 cumecs at the head and 71 cumecs at the tail i.e. at the Gujarat Rajasthan border. There will be 42 branches off-taking from the main banks"

9. The Directors' report further mentioned under head 'Dam and Appurtenant Works' as "Excavation and concrete works are two major components of the Main Dam works. Upto March, 2000 a total of 63.28 lacs cubic meters excavation and 58.50 lacs cubic meters concrete works has been done, which constitute 98.88 & 85.78% respectively of the total work to be carried out." Similarly, under the head 'Hydro Power' it was mentioned that "9.85% open excavation and 91.55% underground excavation for the River

Bed Power House have been completed. Of the two hydropower stations planned in the project the Canal Head Power House of 250 MW is completely ready for commissioning. As soon as the dam height reaches 110M, it would start generating power. Imported turbo Generator sets from Japan are to be installed in River Bed Power House. Two units have already reached the dam site and their installation has started and will be completed in May, 2003. As per planning, remaining sets will be installed from May, 2003 one by one at interval of four months."

10. Again under head "Narmada Main Canal" it was observed that "The construction of Narmada Main Canal (NMC) upto Mahi river crossing (i.e. reach 0 to 144 kms.) is in completion stage. Total 767.23 LCM earthwork (99.17% of revised qty.) 150.55 lsm lining (99.98% and 20.96 LCM structured concrete (97.66%) are completed upto March, 2000. The Narmada Main Canal works from 144 kms. To 264 kms. Reach (i.e. from Mahi river crossing to Saurashtra Branch Canal off-take) are in progress. Total 633.89 LCM excavation (96.35%, 12.19 LSM lining (95.28%) and 4.73 LCM (92.38%) structural concrete are completed upto March, 2000. The works of six major canal siphons on major rivers i.e. Shedhi, Saidak, Mohar, Watrak, Meshwo and Sarbarmati are in progress and on Khari is completed." While in the Report under head 'Distribution System' it is stated that "Phase-I-"Sardar Sarovar (Narmada) Project Command under Phase-I (i.e. area under NMC ch. 0 to 144 km) covers culturable command area of 4.47 lac Ha. Between the rivers Narmada & Mahi. The survey, investigation, planning, designing and estimating of distribution system upto 40 Ha. Block has been completed. The work of Distributaries and some minors are nearly completed. Out of

remaining works distributaries & minors 41 works amounting to Rs. 262 crores have been awarded. For remaining works tenders are being invited." Phase-II – "The planning of distribution system in the C.C.A. of 3.85 lacs Ha. In Phase-II area is completed. In remaining area of 10 lac Ha. In Phase-II, the same is under progress. The work of above distribution system are yet to be taken up. The distribution of Shedhi Branch Canal (44,128 Ha. C.C.A.) is completed upto Minor level (except lining in minors). The sub-minors & field channels of the SSP will be constructed through Water Users' Association under farmers' Participatory Irrigation Management (PIM)."

11. Auditors' qualified the report and in reply to the Auditors' remark on accounts, (item 4) the Board of Directors replied that "The Company is not a contractor. Therefore, Accounting Standard-7 is not applicable to the Company. No revenue has been generated during the year from the normal activities of the Company. Therefore, Accounting Standard-9 (Revenue Recognition) is also not applicable to the Company. All other Accounting Standards have been complied with to the extent they are applicable to the Company." The expenses and income are not carried to Profit & Loss account, but are shown in the Balance Sheet under the Head "Incidental Expenditure Pending Capitalisation". There are expenses minus income.

12. Pending project completion /construction, the money available with the assessee, out of capital contribution by the Govt. of Gujarat and also the borrowings, which could not be utilized for construction immediately, became surplus and was invested in short-term deposits with the banks and the assessee earned interest thereon in all these years.

13. In the background of the facts as stated above, the Tribunal had to decide the appeals of the Assessee and C.O. of the Revenue in ITA No. 349/Ahd/2001, 2106 to 2108, 2729 to 2735, 3057/Ahd/2003 and 899/Ahd/2004 and C.O.No.56/Ahd/2003 for AY 89-90 to 2000-01. The assessee did not file return of income for the aforesaid assessment years presumably because it had not prepared any Profit & Loss Account as stated in note 7 to the Annual Accounts of the year 1998-99, its project being under construction and operations of supply of water and electricity had not commenced. It adjusted all the expenditure and income to work-in-progress account. Pursuant to the notice Under Section 148, the assessee filed return of income for the years under consideration, claiming all expenditure incurred by it as business expense, even though in the books of account, the expenditure was capitalized and carried and debited to work-in-progress. The assessee corporation/Nigam contended that it was incorporated with the sole purpose of construction of dam, canals and power houses and there is no provision to continue to operate, once construction is complete and, therefore, the Nigam was carrying on the construction business, and therefore, the moment it had put first bricks for construction and started its first activity with regard to construction, it has commenced its business activity. As a consequence it claimed that the all revenue expenditure incurred by it for the purpose of carrying on its business have to be allowed as deduction. If it is so allowed as claimed by the Assessee, then the result of computation under the head "Income from Business" would be a loss. Even if interest income is taxed under the head "Income from other sources", the loss under the head "Income from Business" will be set off against "Income from other sources"

and if so set off, admittedly there would be no total income which will be chargeable to tax. As already stated, the Assessee deposited funds raised by it by issue of bonds etc., which were lying idle in banks and earned interest on such deposits. The Assessee also claimed that the interest it paid to the bond holders should be allowed as a deduction against interest that it earned on deposits u/s.57(iii) of the Act. On the above issues raised by the Assessee, the Tribunal rendered its decision against the Assessee.

14. On the question whether the Assessee can be said to have set up its business, the Tribunal held as follows:

“23.3 Now the question is that when the assessee corporation can be said to have set up or commenced its business. The assessee is not engaged in any business of construction of dams or power-house for others. It has to construct the dam for own self so as to regulate and supply of water and electricity. Constructed portion of the project is not its stock in trade but capital asset. Where the construction is part of stock in trade it might be said that it started its business activity the moment it put in the first brick to continue the taken over project. In case of construction of capital asset or infrastructure it could not be said to have or commenced the business. It is normally when it is ready to provide or produce the (SIC). The assessee Corporation being engaged in constructing infrastructure, the dam, in this case, cannot be said to have set up its business or it had commenced business. At best it can be said that it had taken steps to provide the infrastructure. It is only when the infrastructure is ready to exploit, it can be said to be started and/or set up its business or commenced its business. Let us examine the cases relied upon by the parties on these issues.”
(emphasis supplied)

15. The Assessee had advanced arguments to the effect that the entries in the books of accounts whereby the Assessee capitalized all expenses to work-in-progress should not be held against the Assessee. On the aforesaid argument, the Tribunal held as follows:

“23.15 No doubt it is true that these two decisions say that the accounting entries would not be decisive, but in this case it is not

only the accounting entries but even the provisions of law are contrary to the claim of the assessee. The assessee has not commenced/set up its business and therefore any expenditure before setting up/commencement of business cannot be allowed as deduction. The project of the assessee was under construction in all the previous years and the construction has not been to such an extent as to enable one to say that it was ready to commence its business or that it had set up its business.

23.16 The Certificate of Incorporation as a Company and/or Certificate of Commencement of Business in 1998, do not establish anything except the fact that the assessee can operate as a company or it is authorized or permitted to commence the business. Whether the company has commenced its business or not depends upon the activities it carries on and not on what it can do or authorized to do. It had engaged in activities during these years only in construction of dams, which is the infrastructure with which it has to conduct its business on completion. No doubt, it is true that it had completed a major part of the mega project, but it has not completed the dams to such an extent that it can be exploited for starting supply of water and/or electricity nor it can be said to have set up the business or commenced its business.

23.17 The objects clause contained in the Articles and Memorandum of Association and also an authority of what assessee can do, but here also it does not establish that the assessee corporation was doing or had started its business, in light of the decision of the Supreme Court in the case of Bengal & Assam Investors Ltd. [supra] and Oriental Investment Co. [supra] wherein it was observed that the object clause is a relevant consideration but not conclusive. It is a matter of fact that whether it had actually commenced its business or had set up the same and that is to be determined by the activity it is engaged in. Mere engagement in construction of the dam by itself is not an activity of business or reaching a stage immediately prior to the commencement and setting up of the business to be carried out, when the construction is complete and reach a stage to be exploited.

16. On the question whether interest income is taxable under the head "Income from other sources" and whether the interest paid on funds borrowed by the Assessee which were lying idle with the Assessee and which were invested in deposits with Banks which yielded interest income, can be claimed

as expenditure in earning interest income u/s.57(iii) of the Act, the Tribunal held as follows:

“24.2 The assessee, the Id. Counsel submits, is not claiming any adjustment of that expenditure under Section 56 nor set off Under Section 70 nor 71 of the Act, but it claims a deduction under Section 57 of the interest on the borrowed money, which has been utilized for the purpose of earning interest income, and as such, interest would be allowable as deduction in view of the decision of Supreme Court in case of Rajendra Prasad Moody, 115 ITR 569 (SC). The Supreme Court, in the case of Tuticorin Alkali Chemicals, though specifically observed that there was no claim by the assessee for its allowability under Section 57 of the Act, but at the same time it held that such interest could have been deductible while computing the business income but that was not the case of the assessee, and the claim of adjustment was denied under Section 56, 70 and 71 of the Act. **In our opinion, therefore, interest which pertains to the borrowings made not for the purposes of making deposits in the bank but made for the purposes of constructing the project which is under completion, eventhough which have been utilized for making short term deposit for earning interest cannot be allowed as deduction as the same could not be said to have been incurred for making or earning income from interest within the meaning of Section 57 of the Act.**” (emphasis supplied)

17. In this appeal which relates to AY 2001-02, similar issues as was decided by the Tribunal in AY 89-90 to 2000-01 came for consideration before the AO. The Assessee took a stand before the AO that the main object for the formation of the company was to construct dams and canals etc., and the business has commenced from the very first year of incorporation of the Assessee. The AO held that the Assessee was not a contractor and therefore the contention that on formation and beginning of construction activities, it cannot be said that the business of the Assessee has commenced.

18. The Assessee claimed before the AO that receipts by way of rent, tender fees, miscellaneous recovery, interest etc., are incidental and inextricably

linked with the project and hence have to be set off against the sums that have to be capitalised and cannot be brought to tax as “Income from other sources”. In this regard the Assessee relied on the decision of the Hon’ble Supreme Court in the case of *CIT Vs. Bokaro Steels Ltd. 236 ITR 315 (SC)*. The Assessee took a plea before the AO vide its letter dated 12.12.2003 that the facts as it prevailed in AY 01-02 are different from the earlier years and submitted as follows:

“We would like to submit that during the year under consideration we have started the activity of supplying water to the people through our canal from the Narmada Dam. We invite your attention to our Director’s report. Which is part of our annual report filed with your goodself and there on records. However, relevant extract from the Director’s report are reproduced for your ready reference:

“Gujarat has faced three consecutive scarcities in last three years. In wake of the acute water crisis that prevailed in many regions of the state during the last summer, an emergency water supply from Narmada river was executed. Sardar Sarovar Project, for this emergency supply, put to use its facilities created so far and started the deliverance of water through its partial completed Narmada Main canal. The water from the SSP reservoir was pumped out through installation of 90 water pumps and maintained continuous flow of on an average more than 1000 cusecs through the Narmada Canal upto ch. 149 km. Thereafter, the Gujarat Water Supply and Sewerage Board (BWSSB) arranges further delivery of water to remote interior areas – specifically Saurashtra. This supply arrangement started on 21st February, 2001 and lasted upto 8th June, 2001. In all 421 villages and 29 towns of five districts of Ahmedabad, Bhavnagar, Rajkot, Amreli and Junagadh received this water during the summer.”

Apart from the above, the Assessee also submitted vide its letters dated 3rd/4th Feb.2004 and 8.3.2004 that the Assessee generated income from supply of water. Later it turned out that the water charges received were not for water

released by Narmada Canal but were for the water supplied from Shedhi Branch canal which belonged to the Government of Gujarat and which was transferred to the Assessee on 19.3.1987 for rotational water supply. These water charges were subsequently transferred back to Government of Gujarat. The facts with regard to supply of water on an emergency basis by using the facilities already created by the Assessee viz., partially completed Narmada Main Canal, as stated in the earlier paragraph of this order are not disputed.

19. The AO without referring to the contentions of the Assessee in the earlier paragraph of this order and after referring to the fact that the Assessee had not earned income from supply of Narmada water as the said income belonged to the Government of Gujarat for supply of water through Shedhi branch canal which was transferred to Government of Gujarat, concluded that the Assessee has not commenced its business. The AO thereafter referred to the decision of the Hon'ble Supreme Court in the case of *Tuticorin Alkalies, Chemicals & Fertilizers Ltd. 227 ITR 172 (SC)* and held that interest income earned by the Assessee has to be brought to tax under the head "income from other sources". Thereafter the AO held as follows:

"It is seen that the assessee has earned the following interest income during the year:

Interest on deposits with Banks	: Rs. 1,90,86,976/-
Interest on deposits	: Rs.24,22,36,641/-
Other interest	: Rs. 49,27,591/-

	Rs. 26,62,51,208/-

During the course of scrutiny, it was found that other interest of Rs.49,27,591/- included interest from contractors amounting to Rs.49,22,091/- and miscellaneous income of Rs.5,500/-. The assessee during the course of scrutiny has, vide its letter dated 12/12/2003, stated as under:

“ Interest from contractors and miscellaneous interest were earned during the course of execution of the project and the same being incidental to and inextricably linked with the setting up of the project and therefore, it goes to reduce the cost of the project and cannot be treated as revenue receipt liable to tax. In any event, we have to state that advances are paid to the contractors as per terms of the contract and on which interest is paid by the contractors and such interest is duly accounted for in the books of account. It is submitted that interest from contractors should be set off against the project cost as held by Hon’ble Supreme Court in the case of Bokaro Steel Ltd reported in 236 ITR 315.”

The assessee’s contention is carefully considered and the interest from contractors is allowed in view of the Hon’ble Supreme Court’s decision in the case of Bokaro Steel Ltd. reported in 236 ITR 315. But the miscellaneous interest earned is not covered by this judgement and the same is added to the total income of the assessee.

8. The assessee has earned Rs. 12,88.066/- on account of profit on sale of assets and the assessee has submitted the details of the same and since it is inextricably linked with the project it has to be set off against the cost of project. The same is allowed in view of Hon’ble Supreme Court’s decision in the case of Bokaro Steel Ltd. reported in 236 ITR 315.

9. The assessee Company has claimed loss of Rs. 7,88,35,58,652/- in the return of income filed. However, as the assessee has not commenced the business during the assessment year under consideration, the same has not been allowed in view of Hon’ble Supreme Court’s decision in the case of Tuticorin Alkalies Chemicals & Fertilisers Vs CIT (Supra).

10. Subject to the above remarks, total income of the assessee is computed as under:

Income from other sources:

Interest on deposits with Banks	:Rs. 1,90,86,976/-
Interest on deposits	:Rs.24,22,36,641/-
Miscellaneous interest	:Rs. 5,500/-

TOTAL INCOME	Rs.26,13,28,117/-

20. Before CIT(A) the Assessee submitted that the business of the Assessee commenced and therefore revenue expenditure have to be allowed as deduction. On the above plea, the CIT(A) followed the order of CIT(A) for AY 90-91 wherein it was held that business of the Assessee would commence only when the water starts flowing from the canals and/or when power houses start generating electricity. Following the same, the CIT(A) rejected the plea of the Assessee. Before CIT(A) the Assessee raised a specific plea that water had started flowing from canals and drinking water was supplied and therefore business has commenced. On the above plea, the CIT(A) held as follows:

“ The claim of the appellant that mere flow of water through Narmada Canal amounted to commencement of business hardly has any merit. The reference made by the Id. counsel for the appellant to the observations of the Assessing Officer in earlier years in this regard is not of much relevance. This is evident from the elaborate findings on the issue in this regard in the appellate order for the assessment year 1990-91, which have been reproduced in para-3.2 above. **Mentioning of flow of water from Narmada Canal cannot be viewed in isolated manner to conclude that business of the appellant had started. The whole activity of the appellant has to be seen in totality and the composite observations in the appellate order for assessment year 1990-91. It is an admitted position that the appellant did not release any water on commercial basis for irrigation. What was relevant for the purpose of Income-tax Act was whether the appellant engaged in any business activity. From the facts on record, it is obvious that the appellant did not engage in any commercial activity. The purpose of release of water is not guided by any commercial venture and therefore it cannot be said that the appellant started business activity in the previous year.** The reliance placed by the Id. counsel for the appellant on the decision of Hon'ble Gujarat High Court in the case of Ashima Syntex Ltd. (251 ITR 133) hardly has any relevance to the case of the appellant. This is for the reason that in that case, the business was already existing and machinery was purchased and installed for expansion of manufacturing business. Further, there was a trial production of fabrics from the machinery. In the appellant's case, there was no expansion of an already existing business and the appellant was

also not a manufacturer so that there could be claim of final production. As such, the case of the appellant was not comparable with that of Ashima Syntex Ltd. Similar was the position with regard to the decision of the Hon'ble ITAT Ahmedabad in the case of Bollard Oilfield Pvt. Ltd. Vs. ACIT (58 TTJ 767 Ahd.) as relied upon by the ld. counsel for the appellant. In that case also the assessee was a manufacturer and there was a trial run resulting into production of samples. There is no production of samples in the case of the appellant. The status of the appellant was akin to that of an assessee engaged in building up a turnkey project which was nearing completion but whole project of the appellant was yet to be declared as completed and commence commercial activity. Therefore even it cannot be said that the appellant had set up the business. The following Judicial pronouncements, which are, though not exactly comparable with that of the appellant, but are relevant in the sense that with a comparable status as that of the appellant, an assessee cannot be said to have started business activities:

- 1) Honble Madras High Court in the case of K. Sampath Kumar Vs. CIT (158 ITR 25) held that mere purchase and erection of machinery does not amount to starting of business.
- 2) Hon'ble Bombay High Court in the case of CIT Vs. Forging & Stamping (P) Ltd. (119 ITR 616) held that mere installation of machinery and its trial run cannot amount to setting up business.
- 3) Hon'ble Gujarat High Court in the case of Addl. CIT Vs. Speciality Paper Ltd. (133 ITR 879) held that if after the Installation of plant and machinery, it is found that assessee could not go into commercial production, business cannot be said to have been set up.
- 4) Honble Bombay High Court in the case of Bhodilal Mengharaj & Co. (P) Ltd. Vs. CIT (119 ITR 968) held that where factory had been erected but power connection had not been received, business could not be considered to have been set up.

From the foregoing, I therefore find that the Assessing Officer was justified in rejecting the claim of the appellant. These two grounds of appeals are also therefore rejected." (emphasis supplied)

21. Before CIT(A) the Assessee claimed that interest income of Rs.26,13,28,117/- which was assessed under the head "Income from other Sources" ought to have been assessed under the head "Income from

Business". It was also claimed that interest expenses incurred by the Assessee ought to have been considered as expenses incurred in earning interest income and allowed as deduction u/s.57(iii) of the Act. The above plea of the Assessee was rejected by the CIT(A) by following the order of CIT(A) for AY 90-91 wherein it was held as follows:

"8.4 I have carefully considered the relevant facts and find that none of the above claims of the Id. counsel for the appellant were in accordance with provisions of law. In view of the observation of the Hon'ble Supreme Court in the case of Tuticorin Alkali Chemicals & Fertilizers Limited reported in 227 ITR 172 reproduced in the preceding para, it was obvious that there was no overriding title of anybody diverting the income at source and therefore the interest income was taxable at the point when it was earned. It was not dependent upon its destination or the manner of its utilization.

8.5 Coming to the other claims of the Id. counsel for the appellant, it is apparent that all interest expenses on borrowed funds and other expenses were incurred for the capital work in progress of the project and therefore were to be considered only towards the cost of the project. This principle has been affirmed by the Apex Court both in the cases of Tuticorin Alkali Chemicals & Fertilizers Limited reported in 227 ITR 172 and CIT Vs. Bokaro Steel Ltd. reported in 236 ITR 315. The claim of the Id. counsel for the appellant that the interest income was inextricably linked with the project also does not find support from the decision Apex Court In the case of CIT Vs. Bokaro Steel Ltd. reported in 236 ITR 315. In this decision also, the Apex Court held that the ratio laid down earlier in the case of Tuticorin Alkali Chemicals & Fertilizers Limited reported In 227 ITR 172 continued to hold good wherein it was held that if money was borrowed for business purpose and was temporarily used to generate interest income, such interest income was taxable for the reason that the assessee was free to utilise such income whichever way he liked. It was clearly stated by the Apex Court that merely because the assessee utilised it to repay the interest, the interest income could not be categorised as capital receipt. In a similar manner, as the various expenses were basically incurred by the appellant Corporation for the capital work in progress of the project, no part of the same can be allowed as deduction against the Interest income. I am, therefore, of the view that the action of the Assessing Officer in this regard was fully justified and no interference was called for in the matter. These grounds of appeal are accordingly rejected."(emphasis supplied)

22. The Assessee also took a stand before CIT(A) that it was an authority within the meaning of Sec.10(20A) of the Act and therefore its income is exempt from tax. On the above plea the CIT(A) held as follows:

“6.2 I find that there is no adjudication by the Assessing Officer on this issue in the assessment order. It is therefore not ascertainable whether the appellant made such a claim during the course of assessment proceedings. However, this was purely a legal issue and similar ground of appeal was preferred by the appellant in Asst. Year 90-91 and the same was rejected in accordance with the following observations in para 9.4 of the appellate order for Asst. Year 90-91 as reproduced below:

“9.4 I have carefully considered the relevant facts and find that the Id. counsel for the appellant has argued the matter on similar lines as before the Assessing Officer. The appellant Corporation has not come forward with any evidences to the effect that it was an authority constituted in India as referred to u/s. 10(20A) of the I.T. Act as it was not an authority constituted in India as referred to u/s.10(20A) of the I.T. Act. It has also been brought on record by the Assessing Officer that the facts of the appellant Corporation were totally different than the case of Gujarat Industrial Development Corporation which was constituted under the Gujarat Industrial Development Act, 1962 by the Government of Gujarat. With the facts available on record, I find that the Assessing Officer was justified In his action of not treating the income of the appellant exempt u/s.10(20A) of the I.T. Act as it was not an authority constituted In India as referred to u/s. 10(20A). The Action of the Assessing Officer Is therefore confirmed. This ground of appeal is accordingly rejected.”

23. Aggrieved by the order of the CIT(A), the Assessee preferred the present appeal before Tribunal raising the following grounds of appeal.

“ The appellant being dissatisfied with the order of Commissioner of Income-tax (Appeals), Gandhinagar, Ahmedabad presents; this appeal against the same on the following amongst other grounds, which are without prejudice to each other.

1. The learned CIT(A) has erred in confirming the order of the assessing officer that business of the appellant has not commenced. It is submitted that in the facts and circumstances of

the case, business of the appellant has commenced from the first year of construction and it was continued during the year. It be so held now.

2.0 The learned CIT(A) has erred in holding that activity of the appellant company was of preoperative nature and the commencement of the business would start only when the appellant company starts exploitation of the project. It be so held now.

2.1 The learned CIT(A) has erred in not following decision of CIT(A) in its own case for A.Y. 1989-90 wherein on identical facts it was held that business has commenced. It be so held now.

2.2 The learned CIT(A) has erred in not appreciating the fact that the appellant is an infrastructure company and it is engaged in construction and operation of infrastructure facility and business commences right from the stage of construction. It is submitted that it be so held now.

2.3 The learned CIT(A) has erred in holding that Supreme Court decision in the case of Tutikorin Alkalies reported in 227 ITR 172 is squarely applicable. It is submitted that in the facts and circumstances of the case, the business has commenced and therefore, the said judgment is not applicable. It be so held now.

3. The learned CIT(A) has erred in not appreciating the facts that during the year, water has started flowing from Canals and drinking water was supplied and therefore, business has commenced during the year. It be so held now.

4. The learned CIT(A) has erred in not giving direction to the learned A.O. to compute the income under the head "Profit and gains of Business or Profession". It is submitted that expenditure and income shown under the head "Incidental expenditure pending capitalization" were in the nature of business expenditure and the learned CIT(A) ought to have given direction to the learned A.O. to compute the income under the head "Profit and gains of Business or Profession". It be so done now.

5. The learned CIT(A) has erred in not allowing depreciation on Canals and other assets which are used during the year for supply of water. It is submitted that direction be given to learned A.O. to allow the depreciation.

5.1 The learned CIT(A) has failed to appreciate that appellant is entitled for depreciation even if the assets are used on trial run. It is submitted that even on that consideration depreciation ought to have been allowed. It be so done now.

6.1 The learned CIT(A) has erred in confirming the order of the assessing officer treating the interest income from banks on statutory deposits of Rs.1,90,86,976 as liable to tax under the head "Income from Other Sources". The appellant submits that in the facts and circumstances of the case, interest income was incidental to the business carried on and ought to have been held as business income. It be so held now.

6.2 The learned CIT(A) has erred in confirming the order of the assessing officer treating income of Rs.24,22,36,641 as liable to tax under the head "Income from Other Sources", The appellant submits that in the facts and circumstances of the case, the income was in the nature of business income and ought to have been treated as such. It be so held now.

7. The learned CIT(A) has erred in confirming miscellaneous interest amounting to Rs.5,500/- as liable to tax under the head "Income from Other Sources". The appellant submits that in the facts and circumstances of the case, the income was in the nature of business income and ought to have been treated as such. It be so held now.

8. Without prejudice to above, appellant submits that the interest income received on statutory deposits as well as on other deposits were inextricably linked with the project and therefore, ought to have been reduced from the cost of the project. It be so held now.

9. The learned CIT(A) has erred in not allowing deduction u/s. 57(iii) of the Act while computing income under the head "Income from Other Sources". It is submitted that administrative expenses, vehicles expenses, interest expenses, printing and stationery, salaries, depreciation etc. as debited under the head "Incidental Expenditure Pending Capitalisation" ought to have been allowed as deduction u/s. 57 of the I.T. Act while computing income under the head "Income from Other Sources". It be so held now.

10. The learned CIT(A) has erred in confirming order of Assessing Officer in not granting exemption u/s. 10(20A) of the Act. It is submitted that in the facts and circumstances of the case, CIT(A) ought to have granted the exemption. It be so held now.

11. The learned CIT (A) erred in confirming the order of Assessing Officer in charging interest u/s. 234B of the Act for Rs.4,52,17,930. It is submitted that no interest ought to have been charged. It be so done now.

Your appellant prays for leave to add, alter, omit and/or to amend any grounds before the final hearing of the appeal."

24. Originally a Division Bench heard the appeal on 24.3.2010. On the issue raised by the Assessee in Gr.No.9 viz., administrative expenses, vehicles expenses, interest expenses etc., which were debited in the books of accounts as “Incidental Expenditure Pending capitalisation” ought to be allowed as deduction u/s.57 of the Act while computing income under the head “income from other sources”, the Division Bench found that in Assessee’s own case for AY 89-90 to 2000-01 the Tribunal had by its order dated 31.8.2004 disallowed similar claim of the Assessee. The order of the Tribunal is since reported as *JCIT Vs. Sardar Sarovar Narmada Nigam Ltd. 93 ITD 321 (Ahd.)*. The Division Bench found that in subsequent decisions viz., *ACIT Vs. Torrent Gujarat Biotec Ltd. In ITA No.3139 & 3140/Ahd/1996 for AY 93-94*, the Tribunal by its order dated 5.6.2009 had taken a contrary view on the question whether interest expenditure on funds borrowed pending utilisation for the purpose for which it was borrowed, if it yields interest income on its deployment in deposits, whether would be allowed as deduction as expenditure incurred for earning interest income. The Division Bench also found that the decision in the case of *Torrent Gujarat Biotec (supra)* was followed in another case by the Tribunal in *Jhagadia Copper Ltd. ITA No.3741/Ahd/2007 order dated 13.11.2009*. The Division Bench therefore made a reference to the Hon’ble President of the Tribunal for constitution of a Special Bench to decide the following question:

1. “Whether, interest expenditure incurred by the assessee on amount though borrowed for the purpose of business but pending such utilization, is actually utilized for earning interest income, can such interest expenditure be held as expended for the purpose of earning interest income in view of the provisions of section 57 (iii) of the Act or not?”

2. "Whether on the facts and circumstances of the case, interest expenditure incurred on borrowed funds which were actually utilized for earning of interest income is to be allowed as deduction from the gross interest receipts or not for computing the income assessable under section 56 of the Act?"

25. The Hon'ble President constituted Special Bench as recommended by the Division Bench. Subsequently by a letter dated 31.12.2010 the Assessee thorough its Advocate Urvashi Shodhan, requested the Hon'ble President that the Special Bench should hear the entire appeal rather than the question referred for consideration by the Division Bench.

26. The Hon'ble President after due consideration of the request of the Counsel for Assessee in letter dated 31.12.2010 by order dated 7.3.2011 directed that Gr.No.1 to 9 raised by the Assessee should be heard by the Special Bench. Thus the entire appeal is now for consideration before the Special Bench.

27. At the outset, the learned DR submitted that the order of the Hon'ble President referring the entire appeal for consideration by the Special Bench as against the questions referred to by the Division Bench was passed without notice to the Department. According to him the appeal of the Assessee, in so far as it relates to grounds other than the one referred for consideration by a Special Bench by the Division Bench, has already been decided by the Tribunal in Assessee's own case in the earlier assessment years and therefore there is no reason for referring the issues raised in those grounds for consideration by a Special Bench. According to the learned DR, consideration by the Special Bench of those issues other than the question referred to Special Bench by the Division Bench would be virtually reviewing

the earlier order of the Tribunal. He sought time to make application to the President to reconsider his order referring the entire appeal for consideration by the Special Bench. In this regard, it was also submitted that as against the order of the Tribunal on those issues, the Assessee has already preferred appeal before the Hon'ble Gujarat High Court and the same is pending consideration by the Hon'ble High Court. It was his submission that in the circumstances, reference of the entire appeal for consideration by the Special Bench would require reconsideration and for this purpose, the Revenue should be afforded opportunity to make appropriate application to the Hon'ble President of the Tribunal.

28. The learned counsel for the Assessee on the other hand submitted that the question whether Business of an Assessee had been set up during the previous year relevant to a particular assessment year is a question of fact to be decided on the facts and circumstances prevailing in a particular assessment year and therefore the earlier order of the Tribunal cannot hold good for all assessment years. It was his submission that reference of the entire appeal to a special bench would therefore not amount to review of the earlier order of the Tribunal. The above submission was made by him without prejudice to his submission that the Hon'ble President in exercise of his administrative powers is entitled to refer any case for consideration by a Special Bench. It was also submitted that no party to a proceeding can be allowed to challenge the order of President of the Tribunal referring a case for consideration by a Special Bench. In this regard reliance was placed on the following decisions:

- (i) *Bai Sonabai Hirji Ajiary Trust v. Income Tax Officer 93 ITD 70 (Mum) (SB)* wherein it was held that once the President, Tribunal, has constituted the Special Bench and has referred the question to the Special Bench, the Special Bench is bound to decide the issue under s. 255(3) of the IT Act. In view of the above facts, the technical objection raised by the learned CIT Departmental Representative is rejected.
- (ii) *Deputy Commissioner of Income-tax v. Shree Lalit Fabrics (P.) Ltd. 41 ITD 119 (Chandigarh)* wherein it was held it is not open to any party to challenge the constitution of the Special Bench. For the purpose of constituting a Special Bench the President may either act suo motu or at the instance of one of the parties or on a reference made by a Division Bench or a Single Member Bench in this regard.

29. We have considered the preliminary objection raised by the Id. DR and are of the view that the same cannot be accepted. The power of Hon'ble President of the ITAT to constitute a Special Bench *suo motu* by an administrative order is no longer *res judicata* and has been settled by the Hon'ble Supreme Court in the case of ITAT v. DCIT 218 ITR 275 (SC). The Hon'ble Apex Court held as follows:

“ A mere look at sub-section (1) of section 255 of the Income-tax Act, 1961, shows that it is the administrative function of the President to constitute Benches from amongst the members of the Tribunal for exercising the powers and functions of the Appellate Tribunal. Similarly, sub-section (3) empowers the President for disposal of any particular case to constitute a Special Bench consisting of three or more members, one of whom shall necessarily be a Judicial Member and one an Accountant Member. The functions entrusted under sub-sections (1) and (3) of section 255 to the President of the Appellate Tribunal are obviously administrative functions. They have nothing to do with the exercise of any judicial power. Under sub-section (5), the Appellate Tribunal can regulate its own procedure and the procedure of Benches and for that purpose can frame appropriate regulations. In exercise of that power the Income-tax Appellate Tribunal has framed regulations. In terms of regulation 98A, the concerned Bench which is seized of the matter may in exercise of its judicial functions in an appropriate case make a reference to the President to constitute a Special Bench. The exercise of that function by the Bench of the Tribunal hearing the matter is of course a judicial function but so far as the President's power under sub-section (1) read with sub-

section (3) of section 255 to constitute Benches or for that matter Special Benches is concerned, the said power is an administrative power. A reference by the members under regulation 98(A) by passing a judicial order is not the only mode and manner in which the President can be moved to constitute a Special Bench. Even independent of such a reference on the judicial side, the President can, in an appropriate case even suo motu, move in the matter and constitute a Special Bench on appropriate and germane grounds. It is, however, true that the President in exercise of his administrative powers under section 255(3) cannot just constitute a Special Bench without rhyme or reason. Such an administrative exercise can be demonstrated to be unreasonable, capricious or mala fide on a given set of facts.

The High Court in the exercise of its power under article 226 of the Constitution cannot sit in appeal or judgment over the administrative decision of the President of the Appellate Tribunal who might have felt that the case was of all-India importance and was required to be decided by a larger Bench of the Tribunal of three members. Such an administrative order is not open to scrutiny under article 226 of the Constitution of India except in extraordinary cases wherein the order is shown to be a mala fide one.”

30. Further, it is not open to the revenue to challenge the constitution of Special Bench before us. Nevertheless, we find that the primary argument of the assessee on the question whether business of the assessee has been set up during the previous year relevant to AY 2000-01, is based mainly on facts as it prevails in the previous year relevant to assessment year 2001-02. As we have already observed, the question whether the business of the assessee can be said to have been set up during the previous year is a mixed question of both, law and facts, and therefore dependent on the facts that prevailed during the previous year relevant to assessment year 2001-02. It is open to the Tribunal to come to the conclusion as to whether the business of the assessee was set up during the previous year. We are, therefore, of the view that there would

be neither a review of the decision rendered by the Tribunal in assessee's case for the A.Y. 1989-90 to 2000-01. We are also conscious of the fact that the aforesaid decision of the Tribunal for the earlier years are pending for consideration by the Hon'ble High Court of Gujarat. We would, therefore, confine ourselves to the issues raised by the assessee in the grounds of appeal, keeping in mind the facts and circumstances as it prevailed in the assessee's case during the previous year relevant to A.Y. 2001-02.

31. We have already set out the various grounds of appeal raised by the assessee. Ground Nos. 1, 2, 2.1, 3 & 4 relates to the issue which deals with the question as to whether in the facts and circumstances of the case, it can be said that the business of the assessee has commenced. On the above issue, the Id. counsel for the assessee drew our attention to the decision of the CIT(Appeals) in assessee's case for the A.Y. 1990-91, wherein the CIT(A) had held that the business of the assessee would commence only when the water starts flowing from the canal and/or when power houses start generating electricity. Without prejudice to the contention of the assessee that the business of the assessee commenced from the A.Y. 1989-90 itself when the Assessee took over construction of the project, the construction of which had already been started by the State Government, the Id. counsel for the assessee submitted that at least during the previous year relevant to A.Y. 2001-02, the business of the assessee should be held to have commenced. In this regard, the Id. counsel for the assessee drew our attention to the Directors' Report wherein it was clearly mentioned that Gujarat faced three

consecutive water scarcities and the emergency water supply from Narmada River was executed and the Sardar Sarovar Project (“SSP”) was used for such supply through the partially completed Narmada main canal. Our attention was drawn to the fact that water from SSP reservoir was pumped out through installation of 90 water pumps and maintained continuous flow of an average more than 1000 cusecs through the Narmada canal upto Channel 149 Km. The GWSSB arranged further delivery of water to remote interior areas. The above supply arrangement was between 21.02.01 and 08.06.01. Pointing to the above details given in the Directors’ Report which is part of the Annual Report, the Id. counsel for the assessee submitted that in accordance with the stand of the revenue as reflected in the order of the CIT(A) for the A.Y. 1990-91, water has started flowing in the canals and therefore, business of the assessee should be treated as having commenced.

32. Our attention was also drawn to page 9 of the CIT(A)’s order, wherein the CIT(A) extracted the order of the CIT(A) for the A.Y. 1990-91 wherein it was observed that business of the assessee would commence only when water starts flowing from the canals and/or when power houses start generating electricity. The Id. counsel pointed out that the above finding of the CIT(A) for the A.Y. 1990-91 has been endorsed by the CIT(A) in the impugned order for the A.Y. 2001-02. It was the submission that despite clear evidence of water having flown through the Narmada canal, the revenue has still not chosen to consider the business of the assessee as having been set up/commenced. The Id. counsel for the assessee drew our attention to the show cause notice dated 16.01.04 issued by the AO in the course of

assessment proceedings, wherein the AO has taken the following stand on the findings of the CIT(A) in the earlier assessment years.

“...You had vide para-4 page 4 of your submission stated that the CIT(A) has held-

“I am inclined to agree with the observations of the Assessing Officer that the business of the appellant would commence only when water starts flowing from the canals and/or when power houses start generating electricity., This finding of the Assessing officer is accordingly confirmed. This ground of appeal is therefore rejected”

In the absence of revenue out of water supply the release of water to a small sector of the entire project should be considered as trial process and the observations made by CIT(A) in A.Y.1990-91 is not squarely applicable in your case. You are, therefore requested to furnish supporting records/documents to justify your claim of commencement of business.”

33. It was submitted by the Id. counsel that when flow of water through Narmada canal was achieved by the assessee, the revenue has now taken a stand that there should be revenue generation out of supply of water. According to the Id. counsel for the assessee, this has been an inconsistent stand which the revenue should not be permitted to take.

34. Our attention was also drawn to the fact that the findings of the AO with regard to supply of water from Shedhi branch canal are totally irrelevant and what is relevant is the supply of water through the Narmada main canal as mentioned in the Directors' Report, which fact is not disputed even by the revenue. The Id. counsel for the assessee drew our attention to page 26 of the paperbook, wherein the assessee made his position very clear that the supply of water from Shedhi branch canal was distinct and separate from the supply of drinking water done by the assessee through Narmada canal from

February, 2009. The following are the relevant observations of the aforesaid letter.

“At the out set we would like to submit that on verification of the complete details it was seen that the income is received in respect of supply of water from Shedhi Branch Canal, which has been transferred to the NIGAM for rotational water supply. The activities of supply of water and collection of charges are carried out by the NIGAM on behalf of the Govt. of Gujarat and the income was subsequently transferred to the Govt. and do not belong to the NIGAM. We would further like to submit that the receipt of water charges was in respect of supply of water during the 1997 to 1999. The current financial year was declared as a ‘draught year ‘ and no water was supplied during the financial year 2000-01. With the above clarification, the details called for are furnished hereunder:

1. Revenue set up is consisting of sub divisional office headed by Dy. Executive Engineer under which a technical supervisor i.e. Asstt. Engineer/Additional Asstt. Engineer and work assistants are working for supply of water and collection of water charges from the farmers. After collection Dy. Executive Engineer deposits the amount of water charges with Division Offices, which is headed by Executive Engineer.
2. A detailed note explaining process of supply of water is enclosed at Annexure “A”.
3. As regards basis of water charges, we are sending herewith copy of GIR dated 10th April, 1981 issued by the Govt. of Gujarat.
4. As submitted earlier, current financial year i.e. 2000-01 was a drought year and no water was supplied for irrigation. However, as submitted earlier supply of drinking water was started from February, 2001.”

35. Our attention was also drawn to another letter dated 11.03.2004, wherein this issue was further elaborated by the assessee:-

“It appears that on the basis of above statement your good self has observed that as per own submissions business has not commenced since we have admitted that there was no supply of water during F.Y. 2000-01. In this connection we would like to submit that our said statement was in respect of supply of water for irrigation from Shedhi branch. However, in the said letter at Para 4 it is clearly submitted that supply of drinking water was started from

February, 2001. This makes it clear that there is no misrepresentation of the facts.”

36. The Id. counsel for the assessee submitted that the revenue’s objection is therefore that only on generation of income, it can be said that the business of the assessee has been set up/commenced. In this regard, our attention was drawn to page 5 of the Assessing Officer’s order, wherein the AO has made the following observations:-

“Thus, it is clear that the assessee has not earned income from water supply and the income which has claimed to have been earned from supply of Narmada water was in fact income which belong to Government of Gujarat from supply of water through Shedhi branch canal and which was transferred to Government of Gujarat.”

37. The Id. counsel drew our attention to the impugned order of the CIT(Appeals) wherein the CIT(Appeals) has in page 10 proceeded on the basis that the facts that prevailed in the previous year relevant to A.Y. 2001-02 were similar to the facts as it prevailed in the previous year relevant to A.Y. 1990-91. The Id. counsel vehemently submitted that the facts in the previous year relevant to A.Y. A.Y. 2001-02 were different and the CIT(A) has proceeded to decide the appeal of the assessee on a wrong premise. The Id. counsel thereafter drew our attention to the observations of the CIT(A) on the submissions of the assessee with regard to the flow of water from the canals and supply of drinking water by the assessee and the CIT(A)’s findings on such submissions at page 13 of his order. The relevant observations of the CIT(A) in this regard were as follows:-

“Mentioning of flow of water from Narmada Canal cannot be viewed in isolated manner to conclude that business of the appellant had started. The whole activity of the appellant has to be seen in totality and the composite observations in the appellate

order for assessment year 1990-91. It is an admitted position that the appellant did not release any water on commercial basis for irrigation. What was relevant for the purpose of Income-tax Act was whether the appellant engaged in any business activity. From the facts on record, it is obvious that the appellant did not engage in any commercial activity. The purpose of release of water is not guided by any commercial venture and therefore it cannot be said that the appellant started business activity in the previous year.” (emphasis supplied)

38. Pointing to the aforesaid approach of the Id. CIT(A), the Id. counsel for the assessee submitted that the object of the assessee was construction of canals for supply of water for irrigation and other purposes and construction of dams for generating power. The fact that the assessee supplied drinking water through canals constructed by it having not been disputed, it should be held that the assessee commenced its business. It was submitted by him that the fact that the assessee did not receive any consideration for the supply of water was totally irrelevant. In this regard, the Id. counsel drew our attention to the following decisions:-

- (i) *CIT v. Saurashtra Cements & Chemicals Ltd. 91 ITR 170 (Guj)*, wherein the Hon'ble Gujarat High Court on the question when the business of manufacture and sale of cement can be said to have commenced laid down certain principles.
- (ii) *Prem Conductors Pvt. Ltd. v. CIT 108 ITR 654 (Guj)*, wherein the Hon'ble Gujarat High court on the question whether business can be said to have commenced when there was actual production or earlier steps like securing orders.
- (iii) *Sarabhai Management Corporation Ltd. v. CIT 102 ITR 25 (Guj)*, wherein the Hon'ble Gujarat High Court laid down principles on when it can be said that the business has been set up.

Reference was also made to the following other decisions:-

- (a) *CIT Vs. Sarabhai Management Corpn. Ltd. Vs. CIT 192 ITR 151 (SC)*

(b) CIT Vs. Aavaram Ltd. 197 ITR 22 (Guj)

(c) CIT Vs. Western India Seafood (P) Ltd. 199 ITR 777 (Guj)

39. The Id. counsel also submitted that the CIT(A)'s reliance on the following decisions are erroneous:-

(1) *ACIT V. Speciality Paper Ltd. 133 ITR 879*. It was submitted that the aforesaid decision has been explained in *Hotel Alankar v. CIT 133 ITR 866*. Our attention was drawn to the following passage of the Hon'ble Gujarat High Court in the case of *Hotel Alankar (supra)* in this regard:-

“We are afraid that the learned counsel is reading more than what has been suggested in the test by the Supreme Court or by us in that *Speciality, Paper Ltd.'s* case. In the first place, it should be emphasised that whether a business has been set up or not is always a question of fact which has to be decided on the facts and in the circumstances of each case subject to the broad guidelines provided by the different decisions in that behalf. The decision in *Speciality Paper Ltd.'s* case turns on its own facts which were very eloquent and which we have enumerated in our decision. The company there had gone into a trial production and in the test and trial which they had taken for purposes of deciding whether they would be able to achieve the commercial production, and produce the product for which the business was set up, namely, of speciality paper, they found that the entire effort had misfired and unless some additional plant was erected and also the capacity raised, the company was not able to continue the business of production. It was in those facts that since the company could not achieve the quality or the quantity of the product for making it a commercial production that the Division Bench of this court held that in the peculiar facts and circumstances of that case the company could not have been said to have set up the business. In our opinion, therefore, that decision turns on its own facts and would not be of any assistance to the case of the revenue here.

It is always a question of fact whether in a given case a business has been set up or not, and in order to decide whether in a given case the business has been set up or not, the court has to consider what is the nature of the business, whether it comprises of integrated activities, whether the activities are such that they can be

undertaken at a time and such other relevant factors for purposes of determining as to whether in a given case it can be said that the business has been set up or not.”

It was thus argued that the decision in the case of Speciality Paper Ltd. (supra) ought to have been considered as applicable only to the peculiar facts of that case and as laying down no proposition of general nature.

- (2) It was further submitted that the decision relied by the CIT(A) in the case of *CIT v. Forging & Stamping Pvt. Ltd. 119 ITR 616* supports the case of the Assessee. In this regard, our attention was drawn to the fact that installation of machinery, obtaining of power connection and purchase of raw material by an assessee who wanted to carry on the business of manufacturing was held to have commenced even at the stage of obtaining power connection and purchase of raw material. It was his submission that the above decision supports the case of the assessee, rather than the case of revenue.

40. On the issue as to whether the business of the assessee can be said to have been set up/commenced, the Id. DR made the following submissions. He drew our attention to the Annual Report of the assessee for 2000-01 wherein the progress of the project has been highlighted by the assessee as follows:-

“DAM AND APPURTENANT WORKS

Excavation and concrete works are two major components of the Main Dam works. Upto March, 2001 a total of 63.34 lac cubic meters excavation and 59.51 lac cubic meters concrete works has been done.

HYDRO POWER

96.91% open excavation and 90.27% underground excavation for the River Bed Power House have been completed. The work of Canal Head Power House (CHPH) with its auxiliaries and ancillaries equipments is completed in all respect and is now ready for commissioning. The power house is also connected with Gujarat Electricity Board grid at 220 KV Voltage level. The generation at CHPH will start immediately as soon as the dam level reaches to EL 110.64 mt.

The turbine generators of RBPH are being supplied by M/s. Sumitomo Corporation, Japan and the material to the tune of 80% are received at site. The balance material is expected to be received by June 2002. The erection of the T.G. sets has been commenced since June 2000. As per present construction programme it is proposed to commission first unit of R.B.P.H. by March, 2003 and the remaining units at an interval of four months there after. The transmission lines for evacuation of power to Maharashtra State is completed and for Madhya Pradesh is in progress which is likely to be completed by January, 2002.

NARMADA MAIN CANAL

The Narmada Main Canal (NMC) Phase—I upto Mahi river is almost completed. Total 767.88 LCM earthwork (98.33% of Revised Qty), 150.85 LSM lining (99.83%) and 21.03 LCM structure concrete (98.4 1 %) are completed tip to March-2001.

The Narmada Main Canal works from 144 kms. to 264 kms. reach (i.e. from Mahi river crossing to Saurashtra Branch Canal off-take are in progress. Total 644.30 LCM excavation (92.01%), 126.10 LSM lining (97.87%) and 5.10 LCM (93.92%) structural concrete are completed upto March, 2001. Among structures across 7 main rivers crossing NMC in this reach 6 main river crossing structures are completed while one main river crossing (Mohar river) is in progress.

It is planned to complete one monolith of Mohar canal siphon alongwith remaining works of NMC by December 2001. Total 32.94 LCM excavation (94.22%), 1.30 LSM Lining (95.59%) and 8.91 LCM concreting (96.12%) are completed upto March, 2001.

Since March 2000, the work of MNC-Phase III i.e. from Ch. 264 Km. to Ch. 357 Km. (Works beyond Kadi) are in progress. Total 189.55 LCM excavation (72.50%), 8.36 LSM lining work (11.35%) and 0.75 LCM concrete work of structures (20.22%) of NMC Phase III have been completed. Since April-2000, among works of structure (canal siphon) three main river crossing NMC in this reach are in progress. Total 3.41 LCM excavation (39.06%), 0.14 LCM concrete work (6.70%) have been completed. The prequalification document have been approved for the works of NMC between Ch. 357 to 458 Km. (Upto Rajasthan border) and it is planned to take up these works during year 2001-2002.

BRANCH CANAL AND DISTRIBUTION SYSTEM

In Phase – 1 area.

Total 379.48 LCM earthwork (100%), 90.36 LSM lining (100.0%) and 471.44 THCNM structure concreting (100%) are completed upto March-2001.

In Phase II – area.

Total 89.97 LCM earthwork (93.08%) and 0.97 LCM concreting (88.99%) are completed upto March-2001. In Shedhi branch canal total 80.88 LCM earthwork (92.64%), lining 20.59 LSM (100%) and 0.92 LCM (98.02%) structure concrete are completed upto March, 2001.

The earthwork of Saurashtra Branch Canal (SBC) in reach 0 to 46 km. is completed and earth work of SBC from 46 to 88 km. and 103 km. to 104 km. is in progress. In addition to this the earth work of Narshipura, Vallabhipur and Maliya sub branch in first 30 kms. reach is completed. The work of structures on Saurashtra Branch canal upto 70 km. earthwork of Maliya and Vallabhipur branches in remaining reaches and work of structures across entire reach had been commenced since October, '97. Upto March-2001; total 487.64 LCM (95.25%) earthwork, 9.92 LCM (93.94%) concrete work of structures of SBC and sub-branches have been completed. It is planned to take up work of five pumping stations on SBC during 2001.

41. Pointing to the above, it was submitted by the Id. DR that none of the works undertaken by the assessee can be said to be completed. He also highlighted the fact that in the Directors Report the reference to drinking water supply during scarcity period has been admitted to be through partially completed Narmada Main Canal. It was submitted that the learned counsel for the Assessee's reliance on the Directors report to substantiate his contention that there was supply of water through the canals should be rejected as the Directors themselves refer only to partially completed Narmada Canal. Without prejudice to the above contention, it was further submitted that the supply of drinking water by the assessee through Narmada canal was only during the scarcity period and in any event, the supply was through partially completed canals and this factor alone cannot lead to the conclusion that the business of the assessee has been set up/commenced.

42. The Id. DR drew our attention to para 23.2 of the order of the Tribunal in assessee's own case for the A.Y. 1989-90 to 2000-01 in which the Tribunal after considering all the case laws which were cited by the Id. counsel for the assessee in the present appeal, still came to the conclusion that the business of the assessee has not been set up/commenced. Our attention was drawn to para 23.10 of the aforesaid order wherein the Tribunal duly considered the case of *Tuticorin Alkalies, Chemicals & Fertilizers Ltd. 227 ITR 172 (SC)* and held that the business of the assessee has not commenced and therefore there was no question of assessment of its profits & gains of business. Our attention was further drawn to para 23.22 of the aforesaid order wherein the Tribunal culled out the principles emanating from the decided cases that have to be borne in mind while considering the issue whether business of the assessee can be said to have commenced or set up.

43. The Id. DR also referred to the order of the assessment wherein the AO has reiterated the reasons given in the earlier assessment years to come to the conclusion that the business of the assessee has not commenced.

44. In the rejoinder, the Id. counsel for the assessee submitted that the completion of the canal as mentioned in the Directors' Report shows that different stages of completion have been attained. It was submitted that the revenue's stand that only on completion of canal upto the desired destination there would be setting up/commencement of business is erroneous. The fact that the assessee completed construction of the canals from one point to another point itself is sufficient to hold that the business of the assessee has commenced. This submission was without prejudice to the contention that

one of the object of the Assessee being to supply water through canals, was achieved during the previous year. In this regard, he also drew our attention to the Annual Report wherein the progress of construction has been duly highlighted. He also drew our attention to the fact that the revenue expenses pending capitalisation as per the books as on 31.03.2000 was Rs.2390.71 crores, whereas the same as on 31.03.2001 was Rs.3281.35 crores. These items of expenses are revenue expenses which in the event of the Tribunal coming to the conclusion that the business of the assessee has commenced, have to be allowed as deduction while computing income from business. He pointed out that the expenses incurred during the previous year which were revenue in nature if held to be allowable as deduction would be much more than the interest income that the assessee earned. If the revenue expenses are allowed as deduction then there would be loss under the head "Income from Business". Such loss has to be set off against the interest income. In that event there would be no taxable income and the other issues raised in the grounds of appeal would not require adjudication.

45. The Id. counsel for the assessee and the Id. DR addressed arguments on the other grounds of appeal. We deem it appropriate to consider the issue of commencement of business as a preliminary issue and only in the event of that issue going against the assessee, the other grounds of appeal would require consideration. With these observations, we will now proceed to consider the rival submissions on the question whether the business of the assessee can be said to have been set up/commenced during the previous year relevant to A.Y. 2000-01.

46. We have given a very careful consideration to the rival submissions made before us. As we have already mentioned, we will consider the issue as to whether the Assessee had set up/commenced its business during the previous year relevant to AY 01-02, in the light of the facts that prevailed during the previous year relevant to AY 01-02. The above issue arises because of the requirement of the law that profits and gains of new business can be computed only when the business is set up. Sec. 3 of the Income Tax Act, 1961 (the Act) provides 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.”

The previous year for a business newly set up will be the period beginning with the date of setting up of the business. Till such time the business is set up, all expenses even if in the nature of revenue expenses will have to be capitalized. There will be no computation of income under the head "Income from Business" in respect of such business for the period before the business is set up. It is because of the above provision, the revenue is taking a stand that the business of the Assessee has not been set up and therefore there can be no computation of income under the head "Income from Business". As we have already seen there are no receipts of business during the previous year. If the business is held to be set up during the previous year,

then there has to be computation of income under the head "Income from Business". If such computation is done then all revenue expenses have to be allowed as deduction. Since there are no receipts of business the expenses so allowed will result in loss under the head "Income from Business". Such loss will be available for set off against income under any other head of income u/s.71 of the Act.

47. Another aspect which is required to be kept in mind is that there is a clear distinction between a person commencing a business and a person setting up a business and for the purposes of the Indian Income-tax Act. In *Western India Vegetable Products Vs. CIT 26 ITR 151 (Bom)*, the Hon'ble Bombay High Court held that the setting up of the business and not the commencement of the business that is to be considered. The facts of the case before the Hon'ble High Court were that the assessee company was incorporated on the 29th of December, 1945, and it obtained a certificate of commencement of business on the 20th of April, 1946. The business of the assessee company was that of running an oil mill. The assessee company was assessed to tax on its business profits for the assessment year 1947-48 and it claimed various expenses as allowable deductions aggregating to Rs. 27,884-11-9. The view taken by the Income-tax Officer was that the assessee company had only commenced business when it purchased the groundnut mill on the 1st of November, 1946, and therefore he disallowed all the expenses which were incurred prior to the 1st of November, 1946. The Tribunal took the view that the first purchase of raw material for the purposes of being crushed in the mill which was to be erected was made at the end of September, 1946. They also took the view that some time must have been

taken in making arrangements for the purchases and therefore the material date they fixed was the 1st of September, 1946, and they disallowed the expenses previous to the 1st of September, 1946, and allowed expenses subsequent to that date. The Hon'ble Court held that it is only after the business is set up that the previous year of that business commences and any expense incurred prior to the setting up of a business would not be permissible deduction. 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. There may however be an interval between the setting up of the business and the commencement of the business and all expenses incurred during that interval would be permissible deductions. The following observations of the Hon'ble Court on the expression "set up" found in Sec.3 of the Act need to be kept in mind for a decision in this case.

"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 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 Section 10(2)."

48. The above decision came up for consideration before the Hon'ble Supreme Court in the case of *CWT Vs. Ramaraju Surgical Cotton Mills Ltd.* 63 ITR 478 (SC). The facts of the case were that the board of directors of the company, which was formed in 1939, for the purpose of carrying on the

business of manufacturing absorbent cotton wool, resolved in March, 1955, to establish a new spinning unit, for which the industrial licence was obtained in August, 1955. The respondent-company placed orders for the necessary spinning machinery and plant in January and February, 1956. Construction of buildings was begun in March, 1956, and completed by December, 1957. Installation of the machinery and plant was completed by stages commencing from June, 1957. A licence from the Inspector of Factories for working the factory unit was obtained in June, 1958. Time to complete the project was extended by the Government up to March, 1959. In its assessment to wealth-tax for the year 1957-58, the company claimed that in computing its net wealth on the valuation date, viz., September 30, 1956, an amount of Rs. 1,43,727, which was laid out in setting up the new unit should be deducted in accordance with the provisions of section 5(1)(xxi) of the Wealth-tax Act, 1957: The question that fell for determination depended on the interpretation of section 5(1)(xxi) of the Act read with the second proviso to that clause which are reproduced below :

"5(1)(xxi) that portion of the net wealth of a company established with the object of carrying on an industrial undertaking in India with the meaning of the Explanation to clause (d) of section 45, as is employed by it in a new separate unit set up after the commencement of this Act by way of substantial expansion of the its undertaking....

Provided further that this exemption shall apply to any such company only for a period of five successive assessment year commencing with the assessment year next following the date on which the company commences operations for the establishment of such unit."

A reference was made to the decision of the Hon'ble Bombay High Court in the case of Western India Vegetable Products Ltd. (supra). The Hon'ble

Supreme Court in *63 ITR 478 (SC)* after referring to the aforesaid decision of the Hon'ble Bombay High Court held:

“ In the case before us, the proviso does not even refer to commencement of the unit. The criterion for determining the period of exemption is based on the commencement of the operation for the establishment of the unit. These operation for establishment of the unit cannot be simultaneous with the setting up of the unit, as urged on behalf of the Commissioner, but must precede the actual setting up of the unit. In fact, it is operation for establishment of a unit which ultimately culminate in the setting up of the unit.

On this interpretation, it is clear that in this case the claim put forward by the respondent for exemption has been rightly held to be allowable by the High Court. In the statement of the case and in its appellate judgment, the Tribunal did not specifically record any finding as to the date when the unit was ready to go into business and to start production. In the appellate order, it was mentioned that, according to the respondent, the unit was set up only when the Inspector of Factories issued a licence to the respondent for working the factory, which was in June, 1958. In the statement of the case, the facts recited show that the construction of the factory buildings was completed by December, 1957, and the erection of the spinning machinery and plant was completed in several stages commencing from June, 1957. On these facts, the High Court, and we consider rightly, proceeded on the basis that the unit was completed and became ready to go into business only after 1st April, 1957, when the Act had already come into force. Consequently, the condition laid down in the principal clause of section 5(1)(xxi) was satisfied, and the company became entitled to exemption in respect of the value of the assets used up in setting up this unit.

49. It can thus be seen that the decision in the case of *Western India Vegetable Products (supra)* was referred to by the Hon'ble Supreme Court in the case of *Ramaraju Surgical Cotton Mills Ltd. (supra)* but the conclusion of the Hon'ble Supreme Court rested on the interpretation of the provision of Sec.5(1)(xxi) of the Wealth Tax Act, 1957 and the second proviso to the said provision.

50. In the case of *CIT v. Sarabhai Sons P Ltd. 90-ITR-318 (Guj)*, the Hon'ble Gujarat High Court had to deal with a case where the assessee, a

private limited company, decided to start a new business for the manufacture of scientific instruments and communication equipment. It placed orders for machinery and equipment in January, 1966, and some of the machinery was received in February, 1966. It also placed orders for raw materials and stores and took on lease premises from an industrial estate. These preparations went on and in July, 1966, the machinery was installed and production was commenced. The assessee claimed to deduct a sum of Rs. 16,237 spent in connection with the new business during the period ending March 31, 1966, for the assessment year 1966-67. The Hon'ble Gujarat High Court held that on the facts, **that the new business could not be said to be ready to discharge the function for which it was established, namely, the manufacture of scientific instruments and communication equipment until the machinery necessary for the purpose of manufacture was installed.** Obtaining land on lease, placing orders for machinery and raw materials were merely operations for the setting up of the business. In the present case, the business could not be said to be set up until July, 1966, when the machinery had been installed and the factory was ready to commence business. Revenue expenditure incurred before that date would not be a permissible deduction in the assessment for the assessment year 1966-67. The Hon'ble Court referred to the Supreme Court decision in the case of CWT v. Ramaraju Surgical Cotton Mills Ltd. Discussed the issue as under:-

"Now, the question as to when a business can be said to be set up is no longer a matter of doubt or debate. It is concluded by a decision of the Supreme Court in CWT v. Ramaraju Surgical Cotton Mills Ltd. We shall presently refer to that decision but before we do so, it is necessary to refer to one other decision and that is the decision of the

Bombay High Court in Western Indian Vegetable Products case. The Bombay High Court pointed out in this case that there is a clear distinction between a person commencing a business and a person setting up a business and for the purpose of Section 2(11) which was the section of the Indian IT Act, 1922, corresponding to Section 3(1)(d) of the IT Act, 1961, what is required to be considered is the setting up of a business and not the commencement of a business. It is only when a business is established and is ready to commence business that it can be said of that business that it is set up. Before it is ready to commence business, it is not set up. This view taken by the Bombay High Court was approved by the Supreme Court in CWT v. Ramaraju Surgical Cotton Mills Ltd.”

The Hon'ble Gujarat High Court thereafter held that the observations of the Hon'ble Supreme Court lay down the test which must be applied for the purpose of determining when a business can be said to be set up.

51. In *CIT Vs. Saurashtra Cement & Chemical Industries Ltd.* 91 ITR 170 (Guj), the facts were that a company was formed in 1956 for the manufacture and sale of cement. As part of its business the assessee obtained a mining lease for quarrying limestone and started the mining operations in 1958. It claimed the expenditure incurred for the purpose of extracting limestone as also depreciation and development rebate for the machinery installed for that purpose for the assessment years 1960-61 and 1961-62: It was held by the Hon'ble Gujarat High Court that the activities which constituted the business of the assessee were divisible into three categories, the first category consisted of the activity of extraction of limestone by quarrying the leased area of land. This activity was necessary for the purpose of acquiring the raw material to be utilised in the manufacture of cement. The second activity, comprised the activity of manufacture of cement by user of the plant and machinery set up for that purpose; and the third category consisted of selling manufactured cement. These three activities combined together constituted

the business of the assessee. The activity of quarrying the leased area of land and extracting limestone from it was as much an activity in the course of carrying on the business as the other two activities of manufacture of cement and sale of manufactured cement. This activity came first in point of time and laid the foundation for the second activity and the second activity when completed laid the foundation for the third activity. Hence, the assessee commenced its business when it started the activity of extraction of limestone. Since extraction of limestone commenced in 1958, the assessee was carrying on business during the relevant years of account. The expenditure incurred by the assessee in carrying on the activity of extraction of limestone as also depreciation allowance and development rebate in respect of machinery employed in extracting limestone were deductible in computing the trading profits of the assessee for the assessment years 1960-61 and 1961-62. The Hon'ble Court explained as to how the question as to when business can be set up has to be examined as follows:

“It is necessary in order to determine this question to consider what constituted the business of the assessee. Loosely, it may be said that the business of the assessee was manufacture and sale of cement. But in determining questions arising under fiscal legislation, loose use of expression often tends to confound the real issue. To determine what was the business of the assessee, we must consider what are the activities which constituted such business without being misguided by loose expressions of vague and indefinite import. The activities which constituted the business of the assessee were divisible into three categories: the first category consisted of the activity of extraction of limestone by quarrying leased area of land. This activity was necessary for the purpose of acquiring raw material to be utilised in manufacture of cement. The second category comprised the activity of manufacture of cement by user of the plant and machinery set up for the purpose; and the third category consisted of the activity of selling manufactured cement. These three activities combined together constituted the business of the assessee. Each one of these activities was as much essential for the purpose of carrying on the business of the assessee as the others. If the assessee ceased to carry on any one of these

activities, the business would come to an end. Each one of these activities constituted an integral part of the business of the assessee. Why then can it not be said that the assessee commenced its business when it started the first of these activities? The activity of quarrying the leased area of land and extracting limestone from it was as much an activity in the course of carrying on the business as the other two activities of manufacture of cement and sale of manufactured cement. The business could not in fact be carried on without this activity. This activity came first in point of time and laid the foundation for the second activity and the second activity, when completed, laid the foundation for the third activity. The business consisted of a continuous process of these three activities and when the first activity was started with a view to embarking upon the second and the third activities, it clearly amounted to commencement of the business. It may be that the whole business was not set up when the activity of quarrying the leased area of land and extracting limestone was started. That would be set up only when the plant and machinery was installed, the manufacture of cement started and an organisation for sale of manufactured cement was established. But, as pointed out above, business is nothing more than a continuous course of activities and all the activities which go to make up the business need not be started simultaneously in order that the business may commence. The business would commence when the activity which is first in point of time and which must necessarily precede the other activities is started.”

As can be seen from the aforesaid decision of the Hon'ble Gujarat High Court, it appears to be contrary to its own decision in the case of CIT v. Sarabhai Sons P Ltd. 90-ITR-318 (Guj). The two decisions were later explained by the Hon'ble Gujarat High Court in a later decision Sarabhai Management Corpn. Ltd. Vs. CIT 102 ITR 25 (Guj).

52. In Sarabhai Management Corpn. Ltd. Vs. CIT 102 ITR 25 (Guj) the facts were that the Assessee was a private limited company. The main object of the company was to acquire immovable property and to give it out either on leave and licence basis or on lease as residential or, in the alternative, business accommodation, with all appurtenant amenities including the amenities of storage, watch and ward facilities, canteens, refreshment rooms, etc. A bungalow together with the appurtenant compound at Ahmedabad was

purchased by the company on March 28, 1964, under a registered sale deed for over Rs. 8 lakhs. Thereafter, building repairs, rewiring, installation of lift, etc., were carried on by the company for the purpose of converting the residential accommodation to business and storage accommodation and to render the premises more serviceable to its prospective licensees or lessees. The assessee claimed that it was in a position to offer services to licensees on and from October, 1964, and, therefore, claimed that expenditure of Rs. 48,004, which was incurred by it between October 1, 1964, and March 31, 1965, was a business expenditure for the assessment year 1965-66. That expenditure consisted mainly of salaries to gardeners, servants and others, aggregating to Rs. 7,504.49 and Rs. 24,326.16 for building repairs and Rs. 13,074.92 for electric rewiring. Legal and stationery charges, registration, printing, stationery and conveyance charges amounted to Rs. 1,489. The Income-tax Officer, the Appellate Assistant Commissioner and the Appellate Tribunal all held that the company could not be said to have been ready to commence business prior to May 1, 1965, the day on which it gave on leave and licence part of the said building, and certainly not by October 1, 1964, and disallowed the deduction claimed. On a reference, the Hon'ble High Court held that that the business activities of the company could be said to fall into three broad categories. The first business activity was to acquire, either by purchase or by any other manner, immovable property, so that the property could be ultimately given out either on leave and licence basis or on lease to others together with the appurtenant services. The second category of the business activity was to put the building accommodation and lands and gardens into proper shape and set up the appurtenant services so that

ultimately the property could be given out on leave and licence basis. The third business activity was to actually give out accommodation on lease or on leave and licence basis. The property was acquired on March 28, 1964. Thereafter, for some time, various types of alterations and additions were being carried out and the activity of getting the property ready for its licensees and making it serviceable for its licensees was attended to and it was in the process of making this accommodation available to the intended lessees or licensees that the garden staff and other staff were engaged, pieces of equipment and gadgets, etc., were acquired by purchase or otherwise, lift was installed and ultimately with effect from May 1, 1965, a portion of the accommodation was actually given out on licence basis. Thus, though the company actually let out on leave and licence a portion of the building with effect from 1st May, 1965, the earlier and preceding part of its activities were also business activities to ensure that everything was in shape for the use of the occupier. Under the circumstances, at any rate from October 1, 1964, the assessee could be said to have commenced its business activity of the second category and, therefore, the assessee-company had commenced business on that date and all expenses incurred by the assessee between October 1, 1964, and March 31, 1965, namely, the amount of Rs. 48,004, could be said to have been incurred by it as business expenditure and should have been allowed as business expenditure. The Hon'ble Court also explained its decision in the case of CIT v. Sarabhai Sons P Ltd. 90-ITR-318 (Guj) in the following words:

“Mr. Kaji for the revenue has laid considerable emphasis on the decision of the Division Bench of this court in Commissioner of Income-tax v. Sarabhai Sons Pvt. Ltd. (1973) 90 ITR 318 (Guj). The Division

Bench there observed that there is a clear distinction between commencing a business and setting it up. For the purpose of section 3(1)(d) of the Income-tax Act, 1961, what is required to be considered is the setting up of a business. When a business is established and is ready to start business it can be said to be set up. The business must be put into such a shape that it can start functioning as a business or a manufacturing organization. It must be pointed out, as is clear from Sarabhai Sons Pvt. Ltd. (supra), that the main question before the Division Bench was whether on the finding of the Tribunal that the business of the assessee had been set up in the previous year was unreasonable or contrary to evidence or based on no evidence at all. Therefore, the main question which was considered by the Division Bench in that case was the question of appreciation of evidence on record and to find out whether there was evidence to support the conclusion that the business of the assessee had been set up in the previous year or whether the finding of the Tribunal that it had been set up in the previous year was unreasonable or contrary to evidence. The decision in Sarabhai Sons Pvt. Ltd.'s case (supra) has been explained by the same Division Bench in Commissioner of Income-tax v. Saurashtra Cement & Chemical Industries Ltd. (1973) 91 ITR 170, 178, 179 (Guj.) in these terms :

"That decision raised the question as to when a certain business carried on by the assessee could be said to have been set up : whether it was set up prior to 31st March, 1966, or subsequent to that date. "

and the Division Bench proceeded to observe :

"We fail to see how a decision given on one set of facts can bind us to reach a similar decision on a totally different set of facts. There is nothing in this decision which would deflect us from the view which we are otherwise inclined to take. "

The Hon'ble High Court thereafter preferred to follow its ruling in the case of CIT Vs. Saurashtra Cement Chemical Industries Ltd. 91 ITR 170 & 92 ITR 170 (Guj.)

53. In the case of Prem Conductors Pvt. Ltd.(supra), the facts were that the assessee-company was incorporated on November 4, 1963. The object of the company was to manufacture aluminium and copper conductors. For the

assessment year 1965-66, the company submitted its return for the period November 4, 1963, to December 31, 1964, showing a loss of Rs. 46,970, which loss was made up of expenses like salaries, postage, rates and taxes, printing, etc. For the assessment year 1966-67, for the period from January 1, 1965, to June 26, 1965, on which latter date the company actually started production, the company claimed a loss of Rs. 58,000. The department and the Tribunal disallowed the claim in respect of both the said losses in the view that the losses incurred before the commencement of production could not be allowed. On a reference by the Assessee the Hon'ble Gujarat High Court allowed the claim of the Assessee. The following were the relevant observations of the Hon'ble Court.

“For deciding when a company could be said to have set up its business, what the court has to consider is, in the light of the decisions in the cases of Commissioner of Income-tax v. Saurashtra Cement and Chemical Industries [1973] 91 ITR 170 (Guj) and Sarabhai Management Corporation Ltd. v. Commissioner of Income-tax [1976] 102 ITR 25 (Guj), whether the business of the assessee consists of different categories and whether the activity which was started earlier than the actual commencement of the production could be said to have been an essential part of the business activity of the assessee. The company can be said to have set up its business from the date when one of the categories of its business is started and it is not necessary that all the categories of its business activities must start either simultaneously or that the last stage must start before it can be said that the business was set up. The test to be applied is as to when a businessman would regard a business as being commenced and the approach must be from a commonsense point of view.”

54. Thus it can be said that the principles laid down in the cases of Commissioner of Income-tax v. Saurashtra Cement and Chemical Industries [1973] 91 ITR 170 (Guj), Sarabhai Management Corporation Ltd. v. Commissioner of Income-tax [1976] 102 ITR 25 (Guj) and Prem Conductors Pvt. Ltd. 108 ITR 654 (Guj.), would hold the field and has to be regarded as

the view of the jurisdictional High Court. We will now proceed to examine the facts of the Assessee's case for AY 00-01 keeping in mind those principles laid down by the Hon'ble High Court.

55. The Revenue authorities have proceeded on the basis of facts as contained in the Directors report to the shareholders of the Assessee in 13th Annual Report for the year 2000-01. The said report has been accepted as disclosing the real state of affairs both by the Assessee and the Revenue. We shall therefore proceed to decide the issue on the basis of the said report.

56. As we have already seen in the earlier part of this order, the Assessee was formed for the purpose of construction of canal for supply of water for all purposes and also construction of dam for generation of power and distribution of water through the canal. It is the claim of the Assessee that during the year under consideration it had started the activity of supplying water to the people through its canal from the Narmada Dam. The Assessee in this regard relied on its Director's report in the annual report for 2000-01, the relevant extract were as follows:

"Gujarat has faced three consecutive scarcities in last three years. In wake of the acute water crisis that prevailed in many regions of the state during the last summer, an emergency water supply from Narmada river was executed. Sardar Sarovar Project, for this emergency supply, put to use its facilities created so far and started the deliverance of water through its partial completed Narmada Main canal. The water from the SSP reservoir was pumped out through installation of 90 water pumps and maintained continuous flow of on an average more than 1000 cusecs through the Narmada Canal upto ch. 149 km. Thereafter, the Gujarat Water Supply and Sewerage Board (BWSSB) arranges further delivery of water to remote interior areas – specifically Saurashtra. This supply arrangement started on 21st February, 2001 and lasted upto 8th June, 2001. In all 421 villages and 29 towns of five districts of Ahmedabad, Bhavnagar, Rajkot, Amreli and Junagadh received this water during the summer."

The above facts as claimed by the Assessee are not disputed by the Revenue. The AO did not however consider the above claim of the Assessee but proceeded to discuss the supply of water from Shedhi Branch canal for which income was received but later refunded to the Government. From the order of the AO the only reason which one can cull out for rejecting the claim of the Assessee was that the supply of water through canals done by the Assessee was not for commercial exploitation as no revenue was earned by the Assessee on such supply of water. The following observations of the AO at page-5 of his order seem to suggest so:

“Thus, it is clear that the Assessee has not earned income from water supply and the income which has claimed to have been earned from supply of Narmada water was in fact income which belong to Government of Gujarat from supply of water through Shedhi branch canal and which was transferred to Government of Gujarat. Since the business of the Assessee has not commenced, the assessment is being completed as per the decision of the Supreme Court in Tuticorin Alkalies Chemicals & Fertilizers Ltd. 227 ITR 171.”

The order of the CIT(A) also proceed on the same lines. He followed the order of his predecessors in the earlier year. He has also observed as follows in his order:

“The claim of the appellant that mere flow of water through Narmada Canal amounted to commencement of business hardly has any merit. The reference made by the Id. counsel for the appellant to the observations of the Assessing Officer in earlier years in this regard is not of much relevance. This is evident from the elaborate findings on the issue in this regard in the appellate order for the assessment year 1990-91, which have been reproduced in para-3.2 above. Mentioning of flow of water from Narmada Canal cannot be viewed in isolated manner to conclude that business of the appellant had started. The whole activity of the appellant has to be seen in totality and the composite observations in the appellate order for assessment year 1990-91. It is an admitted position that the appellant did not release any water on commercial basis for irrigation. What was relevant for the

purpose of Income-tax Act was whether the appellant engaged in any business activity. From the facts on record, it is obvious that the appellant did not engage in any commercial activity. The purpose of release of water is not guided by any commercial venture and therefore it cannot be said that the appellant started business activity in the previous year.”

57. It is thus clear that there was supply of water through the Narmada canal as claimed in the Directors report. The question that would arise for our determination would be as to whether partially completed canals which were put to use by the Assessee for supply of water would be sufficient to hold that the business of the Assessee has been set up during the previous year, to be exact as on 21.2.2001 when the supply of water started as mentioned in the Directors report.

58. The total length of the main Narmada canal proposed to be constructed when the Assessee corporation was formed was 458 Kms. from the Dam reservoir upto Rajasthan border. The proposal also included construction of 42 branch canals from the main canal. The completion of construction of main canal achieved by the Assessee during the previous year as stated in the directors report shows that Narmada Main Canal (NMC) Phase—I upto Mahi river was almost completed. Total 767.88 LCM earthwork (98.33% of Revised Qty), 150.85 LSM lining (99.83%) and 21.03 LCM structure concrete (98.41 %) were completed up to March-2001. The Narmada Main Canal works from 144 kms. to 264 kms. reach (i.e. from Mahi river crossing to Saurashtra Branch Canal off-take) are in progress. Total 644.30 LCM excavation (92.01%), 126.10 LSM lining (97.87%) and 5.10 LCM (93.92%) structural concrete are completed upto March, 2001. Among structures across 7 main rivers crossing NMC in this reach 6 main river crossing structures were

completed while one main river crossing (Mohar river) was in progress. In Phase – 1 area. Total 379.48 LCM earthwork (100%), 90.36 LSM lining (100.0%) and 471.44 THCNM structure concreting (100%) were completed upto March-2001. In Phase II – area. Total 89.97 LCM earthwork (93.08%) and 0.97 LCM concreting (88.99%) are completed upto March-2001. In Shedhi branch canal total 80.88 LCM earthwork (92.64%), lining 20.59 LSM (100%) and 0.92 LCM (98.02%) structure concrete were completed upto March, 2001. The earthwork of Saurashtra Branch Canal (SBC) in reach 0 to 46 km. was completed as on the last date of the previous year.

59. With the above stage of completion of the main canal and branch canals, the Assessee could manage to supply water from Narmada river. The Directors report in this regard reads thus:

“Gujarat has faced three consecutive scarcities in last three years. In wake of the acute water crisis that prevailed in many regions of the state during the last summer, an emergency water supply from Narmada river was executed. Sardar Sarovar Project, for this emergency supply, put to use its facilities created so far and started the deliverance of water through its partial completed Narmada Main canal. The water from the SSP reservoir was pumped out through installation of 90 water pumps and maintained continuous flow of on an average more than 1000 cusecs through the Narmada Canal upto ch. 149 km. Thereafter, the Gujarat Water Supply and Sewerage Board (GWSSB) arranged further delivery of water to remote interior areas – specifically Saurashtra. This supply arrangement started on 21st February, 2001 and lasted upto 8th June, 2001.

In all 421 villages and 29 towns of five districts of Ahmedabad, Bhavnagar, Rajkot, Amreli and Junagadh received this water during the summer.

In all 6.25 lacs of rural population and 23.64 lakh urban population was provided with Narmada water during the summer. The total water pumped out during the season works out to be 258.58 MCM. In addition to this, water from Narmada Main Canal was released through canal escapes and village tanks were filled up wherever possible and thus mitigated water hardship faced by people and cattle in the surrounding region.”

60. The reference to the main canal having been partially completed should be taken as incomplete upto the desired destination. The Assessee could achieve supply of water through its completed canals upto a particular length. Would that not be sufficient to hold that the business of the Assessee has been set up? To answer the above query, we will have to now go back to the principles laid down in decided cases.

61. We have already seen that the Hon'ble Gujarat High Court in the case of Saurashtra Cement & Chemical Industries (supra) has laid down that business is nothing more than a continuous course of activities and all the activities which go to make up the business need not be started simultaneously in order that the business may commence. The business would commence when the activity which is first in point of time and which must necessarily precede the other activities is started. In our view the fact that through the completed canals the Assessee was able to supply water would be sufficient to hold that the Assessee was ready to serve the purpose for which it was formed. As held by the Hon'ble Gujarat High Court in the case of Prem Conductors (P) Ltd.,(supra) business can be said to have been set up from the date when one of the categories of business activities among various activities is started and it is not necessary that all the categories of its business activities must start either simultaneously or that the last stage must start before it can be said that the business was set up. The test to be applied is as to when a businessman would regard a business as being commenced and the approach must be from a commonsense point of view. In Sarabhai Management Corpn. Ltd., (supra) the Hon'ble Gujarat High Court has again

reiterated the principle that it is desirable to avoid thinking in a loose sense and clearly analyse the nature of the business activity of the assessee for the purpose of arriving at a conclusion as to when business of an Assessee can be set up.

62. The Objects clause of Memorandum of Association of the Assessee contain the following clauses:

(a) Object Clause 3(A)(1):

"To undertake execution of the Sardar Sarovar Project comprising a dam across the river Narmada in the Nadod Taluka of Bharuch district in the State of Gujarat, a canal system emanating from the reservoir called the Sardar Sarovar impounded by the construction of the said dam; power houses at the foot of the said dam and at the canal head and all other works incidental or ancillary to the said project in accordance with the direction of the Government of Gujarat."

(b) Object Clause 3(A)(9):

"To promote schemes to facilitate navigation in the Narmada river"

(c) Object Clause 3(A)(10):

"To promote Schemes for irrigation and water supply in the State for utilization of water from the Sardar Sarovar."

(d) Object Clause 3(A)(21):

"To alter, manage, develop, exchange, lease, mortgage, underlet, sell, give as gifts or otherwise dispose of, improve or deal with the land, property, assets and rights and resources and undertaking of the company or any part thereof for such consideration of the company may thing fit and in particular for shares, stocks, debentures, or securities of any other company having objects altogether or in part similar to those of this company".

(e) Object Clause 3(A)(26):

"To sell, improve, manage, develop, exchange, lease, mortgage, dispose of, turn to account or otherwise deal with all or any part of the property and rights of the company".

(f) Object Clause 3(A)(29):

"To let out on lease or on hire all or any of the property of the company either immovable or movable."

63. The Tribunal in the earlier assessment years after analyzing the objects clause of the Memorandum of Association, the audit notes, statements in the prospectus and other circumstances came to the conclusion that the assessee Corporation is to engage itself in all other work incidental or ancillary to the project. The Tribunal concluded that the ultimate aim of the project is to develop irrigation system and a network of hydro-electric power generation for consequential exploitation and such exploitation was incidental (i.e. liable to happen as a consequence) to the above project which would ultimately lead to generation of revenue. The Project includes the provision of infrastructure and operation and exploitation thereof for supply and distribution of water and electricity i.e. not only to construct the dams but to exploit the same.

64. The above conclusions of the Tribunal are in challenge by the Assessee in the appeal before the Hon'ble High Court against the order of the Tribunal. Even assuming the above findings to be true, if one were to apply the principles laid down by the Hon'ble Gujarat High Court in the decisions referred to in para 61 of this order (in particular in the case Sarbhai Management Corpn.Ltd.), it can be seen that the business of the assessee consists of different categories. Construction of dams and canals would be the activity which would precede the other activities and an essential part of the business activity of the Assessee. The company can be said to have set

up its business from the date when one of the categories of its business is started and it is not necessary that all the categories of its business activities must start either simultaneously or that the last stage must start before it can be said that the business was set up. The test to be applied is as to when a businessman would regard a business as being commenced and the approach must be from a commonsense point of view

65. As we have already seen one of the main object of the Assessee as per Clause 3(A)(10) of the Memorandum of Association is to "To promote Schemes for irrigation and water supply in the State for utilization of water from the Sardar Sarovar". We are of the view that in the light of the facts prevailing in Assessee's case, it can be said that the Assessee by supplying water through its main canal had in fact achieved the purpose for which it was established. One of the purpose for which the Assessee was set up was to supply water through canals. The canal was complete in respect of part of the stretch and that enabled supply of water through such canal to certain destinations. The fact that the entire stretch of canal up to the desired destination was not completed would not be sufficient to hold that the Assessee's business was not set up.

66. The flow of revenue from supply of water is not relevant as has been laid down by the Hon'ble Supreme Court in the case of *CIT Vs. Sarabhai Management Corpn. Ltd. 192 ITR 151 (SC)*. In our view, the AO as well as CIT(A) have misdirected themselves in this regard by laying emphasis on flow of revenue as a condition precedent for coming to a conclusion that business of the Assessee has been set up. In fact in the past the revenue has been

taking a stand that flow of water through the canal would be the point of time when the business of the Assessee can be said to be set up. When that happened, the revenue is taking a stand that there should be flow of revenue on supply of water and only then it can be said that the business of the Assessee has been set up. This apparent contradiction in the stand taken by the Revenue is not acceptable. In any event the question whether business of an Assessee is set up or not is a question which would depend on facts of a given case and the stand taken by the revenue regarding absence of flow of revenue would be irrelevant.

67. For the reasons given above, we hold that the business of the Assessee was set up on 21.2.2001 when water was supplied through the main canals and all revenue expenditure after that date have to be allowed as deduction. We have perused the details of Schedule-I to the Balance Sheet as on 31.3.2001 which gives the break of the incidental expenditure pending capitalization. The salary, wages, gratuity and allowances and other employee costs, rent electricity would be in the range of Rs.122 crores (Approx.). The interest and discount on deep discount bonds is Rs.566.99 crores and Rs.148.10 Crores respectively. The interest income sought to be brought to tax by the revenue in this assessment year is Rs.26,13,28,117/-. If business of the Assessee is held to be set up on 21.2.2001 then the proportionate expenses as set out above for the period from 21.2.2001 to 31.3.2001 would be much more than the interest income brought to tax. Therefore the other issues raised by the Assessee in its appeal, in our view, do not require any adjudication in view of our above conclusion on the commencement/setting up of business.

68. For the reasons given above, we allow the appeal of the Assessee as indicated above.

Order pronounced in the open Court on 7th day of September, 2012.

Sd/-	Sd/-	Sd/-
(A.K.GARODIA)	(N.V.VASUDEVAN)	(D.K.TYAGI)
ACCOUNTANT MEMBER	JUDICIAL MEMBER	JUDICIAL MEMBER

Ahmedabad,

Date: 07-09-2012

Ds/-

Copy to :

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

By Order

/True Copy/

Asstt. Registrar,
ITAT, Ahmedabad