

Deemed commencement of business if assessee started integral activities constituting its business

Summary – The High Court of Gujarat in a recent case of Sardar Sarovar Narmada Nigam Ltd., (the Assessee) held that where State of Gujarat set up a Nigam for execution of Sardar Sarovar Project and one of purposes of setting up Nigam was to supply water through canal and during previous year when State faced scarcities of drinking water assessee had supplied drinking water through its partially completed main canal, it could be said that business had been set up during previous year.

Facts

- The assessee, a Nigam, was set up by the Government of Gujarat. The very objects of the Nigam were to construct a dam across the river Narmada and to create canal system emanating from reservoir called the Sardar Sarovar and to set up power house at the foot of the dam and at the canal head. The Gujarat State faced scarcities of drinking water in earlier years and the assessee, for this emergency supply, put to use its facilities created so far and started on 21-2-2001 the deliverance of water through its partially completed Narmada main canal. The assessee in response to notice issued under section 148 filed the return of income for the assessment year 2001-02 and claimed deduction of all the revenue expenditure incurred by it after 21-2-2001 as business expenditure. It took the stand that its business had already commenced on 21-2-2001, as activity to supply water to people of the State from Narmada dam had already commenced.
- The Assessing Officer did not accept the stand of the assessee and disallowed the claim of deduction.
- On appeal, the Commissioner (Appeals) held that the business of the assessee had not been set up during the previous year relevant to the assessment year under consideration. The business of the assessee would commence only when the water would start flowing from the canals and/or when power houses would start generating electricity. He, therefore, rejected the appeal of the assessee.
- On second appeal, the Tribunal constituted a Special Bench and allowed the appeal of the assessee. It concluded that the business of the assessee was set up on 21-2-2001, when water was supplied through the main canal and all revenue expenditures after such date shall have to be allowed as deduction.
- On appeal to High Court:

Held

- As far as the constitution of Special Bench of Tribunal is concerned, the main issue raised before the Tribunal was as to whether the business of the assessee can be said to have been set up during the previous year relevant to the assessment year under consideration. The Tribunal was of the opinion that such question is a mixed question of law and facts and, therefore, its answer would depend on the facts that prevailed during the previous year relevant to the assessment year under

consideration. One is in agreement with the findings of the Tribunal that this essentially is a mixed question of law and facts.

- Section 3 defines previous year which is the financial year immediately preceding the assessment year. Till the business is held to be set up, all expenses are held to be capital in nature. Therefore, under the heading 'Income from business' the assessee may not be entitled to any computation.
- It is a stand of the revenue that the business of the assessee has not been set up inasmuch as the work of construction of canal has not been completed and, therefore, there would be no computation of income under the heading 'Income from business'. What amounts to setting up of a business and whether commencement is sufficient for the purpose needs closer examination.
- The very object for which the Nigam has been set up is to construct a dam across the river Narmada and to create canal system emanating from reservoir called the Sardar Sarovar and to set up power house at the foot of the dam and at the canal head. To promote and facilitate navigation in the Narmada river and also for irrigation and water supply in the State and for utilization of water from Sardar Sarovar as well as for managing, developing, exchanging, etc. the land, property and resources, some objects are set out in the memorandum of association of the assessee.
- What is to be regarded is as to whether the business of the assessee has been set up or not to enable it to avail the benefits under the Income-tax Act. This being essentially a mixed question of law and facts needs to be decided primarily on the basis of facts and circumstances of each case. In a given case, for the Court to consider whether the business has been set up or not, the nature of business of assessee, whether the same comprises of integrated activities and whether all these activities collectively would go to make the business, shall need to be examined in light of the object clause of the memorandum of association and other material available on the subject.
- The annual report of the assessee for the financial year 2000-01 highlighted progress of the project and the activities could be divided into three categories: (1) Dam and appurtenant works, (2) Hydro power and (3) Narmada main canal. As far as the first activity is concerned, excavation and concrete works should be considered major components of the main dam works. The major portion was excavated and concrete work was done up to March, 2001. Open excavation and underground excavation for River Bed Power House and Canal Head Power House with its auxiliaries and ancillaries is said to have been completed. The power house is also connected with Gujarat Electricity Board grid at 220 KV voltage level. As far as Narmada main canal phase-1 is concerned, it is almost completed and main canal work from 144 kms. to 264 kms., i.e., from Mahi River crossing to Saurashtra Branch Canal off take is in progress. As far as branch canal and distribution system is concerned, Phase-I is said to have been completed up to March, 2001. The second phase is also completed up to March, 2001. The Director's report is indicative of drinking water having been supplied during scarcity period through partially completed Narmada main canal.
- The activities mentioned in the object clause of memorandum of association do not contemplate a single activity. Under the fiscal legislation when it is vital to determine what is the business of the assessee and what are the activities which constitute such business, it can be noted that execution

of the Sardar Sarovar Project comprises of a dam across the river Narmada, canal system as also the power house at the foot of the dam and at the canal head and all other works. It cannot be said that such objects could be achieved without contemplating different stages of completion. It would be wholly wrong to uphold the contention of the revenue that only on completion of work of entire canal, the assessee's business can be said to have set up.

- The HC observed that in a project like Sardar Sarovar, there are bound to be different stages where different activities take place and those activities being integral parts of the business and when they are set up phase vice, assessee cannot be deprived of benefits of fiscal legislation in disregard to well settled principles on the issue by adopting over technical approach. For determining as to when the business can be said to have been set up, the flow of the water from Narmada canal in the given circumstances needed to be viewed as an integral and inseparable activity of the business of the assessee.
- The test in such events will have to be applied which must appeal to the common sense. It is apparent from the record that the assessee supplied water through its main canal. One of the purposes of setting up the Nigam is to supply the water through the canal and even if the entire stretch of canal is yet to come into existence, in a project of this big a size, it will surely be not right to hold that the business of the assessee has not been set up.
- The construction of dam and canal are essential and inseparable parts of the activity which would necessarily precede other activities. When each one of the activities essential and vital, combined together, constitutes business of the assessee and this being a continuous process, all the activities which go to make a business need not be started simultaneously in order to hold that the business has commenced. Those of the activities which form integral part of entire term business when preceded other activities, no fault can be found in the approach of the Tribunal when it held the business to have been set up without the same being commenced.
- Therefore, the appeal of the revenue was dismissed.