Exp. incurred by assessee engaged in business of setting-up of new hotel was allowable u/s 37(1): ITAT

Summary – The Mumbai ITAT in a recent case of Samsara Hospitality (P.) Ltd., (the Assessee) held that where assessee-company engaged in business of setting up of new hotels, after getting approval from FIPB, made downstream investments in a hospitality venture and formed JV which had started construction, it could be concluded that assessee had set up business and, thus, expenditure incurred by it in said process had to be allowed as business expenditure

Facts

- The assessee-company was in the business of setting up of new hotels, investment in hotel project. It derived income comprising of interest income on debentures and gain on redemption of short-term mutual fund investment. The assessee filed its return claiming deduction of certain expenditure.
- The Assessing Officer took a view that expenditure incurred by assessee was in the nature of pre-operative expenditure and, thus, deduction could not be allowed in respect of same under section 37(1).
- The Commissioner (Appeals) confirmed the order of Assessing Officer.
- On second appeal:

Held

- There is difference between actual commencement of a business and setting up of a business. It is only after the business is set up, that the expenses incurred in the business can be claimed as permissible deduction under section 37. For the commencement of a business, there must be in place some income-generating asset or income-earning structure. In some cases, there may a gap or an interval between setting up and commencement. When the business is set up is a mixed question of law and fact and depends upon the line, nature and character of the business or professional activity. For example, for manufacturing business, purchase of new material or electricity connection may be the relevant point to determine the setting up. But, in the case of a property dealer, the moment he puts up a chair and table or starts talking, his business is set up.
- The word trade, even though not defined in the Act, is used to denote operations of a commercial character by which a trader provides to a customer for reward, some kind of goods or services. In other words, when the trader starts providing such goods and services, the business is said to have commenced but the same may not hold good for setting up of a business, which is a stage before the commencement. To set up a business, the following activities become relevant preparation of a business plan; establishment of a business premises; research into the likely markets or profitability

of the business; acquiring assets for use in the business; and registration as an entity and under the local laws, etc.

- The list of activities is not exhaustive and the facts of each case have to be considered. A trader before the actual purchase would possibly interact and negotiate with manufacturers, landlords, conduct due diligence to identify prospective customers, spread awareness, *etc*. These are all an integral part and parcel of the business of a trader. The activities continue even post-first sale/purchase. When the first steps are taken by a trader, the business is set up, commencement of purchase and then sales is post-set up.
- The Assessing Officer and the Commissioner (Appeals) had taken note of expenditure incurred only, they had dealt with the concept of setting up of business and commencement of business. After getting approval from FIPB the assessee had made downstream investments of Rs. 22.3 crores in a Hospitality Venture, that for acquisition of a plot of land it had provided Rs. 20 crores as application money in a JV, that had started consultation and preparing feasibility reports. The accrual or receipt of income is not the only criteria to decide the taxability of the assessees. Business is a complex commercial activity and it takes quite a long time to start the practical operations. Therefore, such an issue has to be decided after considering the surrounding circumstances.
- In the instant case, the Assessing Officer and the Commissioner (Appeals) have held that expenses incurred were of pre-operative period. Besides, the assessee is a company and it has to incur certain expenses for functioning of corporate entity. After considering the cumulative effect of all these factors, it is opined that the assessee had set up the business and that expenditure incurred by it had to be allowed as business expenditure - except for the expenditure incurred on account of ROC charges for increase in authorised capital. Thus, ground is allowed in favour of the assessee, in part.