



Global Business Tax Alert

Sharp Insights

The Supreme Court dismissed the Special Leave Petition of the Revenue in the case of Sardar Sarovar Narmada Nigam Ltd. (CC No. 3018/2017) filed against the order of the High Court wherein the High Court held that in a project where different activities are integral part of the business, the taxpayer's business shall be considered to have been set-up when first of the activities has commenced.

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Background

- Sardar Sarovar Narmada Nigam Ltd. ('the taxpayer'), a wholly-owned government company was established for the execution of the Sardar Sarovar Project
- As the project was under construction, the taxpayer did not file the returns of income for assessment years 1989-90 to 2000-01.
- On initiation of proceedings by the tax officer, the taxpayer filed its return of income for the said years, claiming the expenditure incurred by it as business expense, even though in the books of accounts the expenditure was capitalized and carried to work-in-progress.
- The tax department filed an appeal before the Tribunal against the order of the CIT(A) which had upheld the contentions of the taxpayer.
- The Tribunal observed that the taxpayer was not engaged in the business of construction of dams or power house for others but was constructing the dam for itself so as to regulate supply of water and electricity. The constructed portion of the project was not its stock-in-trade but a capital asset.
- Based on this fact, the Tribunal held that in case of construction of a capital asset or infrastructure, when the infrastructure is ready to be used, the taxpayer could be said to have started and/or set up its business or commenced its business.
- The Tribunal noted that the project of the taxpayer was under construction in all the previous years. Although major part of the project was completed, the taxpayer had not completed the dams to such an extent that it could be initiated for starting to supply water and/or electricity. Thus, the Tribunal held that the taxpayer could not be said to have set up the business or commenced its business.
- Further, as regards the alternate claim of the taxpayer for allowing deduction of interest on borrowing under section 57 of the Income-tax Act, 1961 ('the Act'), the Tribunal held that even though the taxpayer has utilized the interest for making short-term deposit for earning interest, it could not 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.
- Aggrieved by the decision of the Tribunal, the taxpayer filed an appeal before the Gujarat High Court.

Ruling of the Gujarat High Court

- The High Court held that in determining when the business has been set up or commenced, it is necessary to know what constitutes the business of the taxpayer. It needs to be ascertained what activities constitute such business.
- The very object for which the taxpayer has been set up, is to construct a dam across the river Narmada, to create a canal system emanating from the reservoir and to set up the hydro power plant. The said activities mentioned in the object clause of the Memorandum of Association do not contemplate a single activity.
- It would be wrong to uphold that only on completion of work of entire canal, the taxpayer's business can be said to have been set-up.
- Relying on its earlier decision in case of CIT v. Sardar Sarovar Narmada Nigam Ltd. (37 taxmann.com 344) it held that in a big project like Sardar Sarovar, there are bound to be different stages where different activities take place. These activities are an integral part of the business and when they are set-up phase wise, the tax

payer cannot be deprived the benefits of fiscal legislation in disregard of the well-settled principles on the issue. Accordingly, the High Court held that the taxpayer has set-up its business.

- As regards the expenditure of interest paid on borrowings raised by the taxpayer for the purpose of construction of dam, the High Court held that the same would be allowable deduction since the purpose of the expenditure is manifest and there is a clear connection between expenditure and the interest income. Thus, the expenditure is a part of the business expenditure of the taxpayer.

Special Leave Petition before the Supreme Court

- The Supreme Court has dismissed the special leave petition filed by the Revenue against the aforesaid ruling of the High Court.

Conclusion

- It is important to understand what constitutes the business of the taxpayer to determine when the business can be considered to have been set-up. If construction is part of the business activities, then business can be said to be commenced or set up when the first brick is put up at the construction site.
- This decision would help in deciding when a business could be considered as set-up or commenced.

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