

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "G" NEW DELHI
BEFORE SHRI S.V. MEHROTRA : ACCOUNTANT MEMBER
AND
SHRI C.M. GARG : JUDICIAL MEMBER

ITA No. 5135/Del/2012

Asstt. Yr: 2005-06

Elan Equity Services Pvt. Ltd., Vs. ITO Ward-11(1),
24, Medha Apartments, New Delhi.
Mayur Vihar-1, Delhi.
PAN: AABCE 4021 F

(Appellant)

(Respondent)

Appellant by : Shri Sanjay Gupta CA
Respondent by : Smt. Shalini Verma Sr. DR

Date of hearing : 08-07-2014
Date of order : 14-08-2014.

ORDER

PER S.V. MEHROTRA, A.M.:

This appeal, by the assessee, is directed against order dated 13-07-2012 passed by the CIT(A)-XIII, New Delhi in appeal no. 55/11-12, confirming the penalty levied u/s 271(1)(c) of the I.T. Act relating to A.Y. 2005-06.

2. Brief facts of the case are that assessee, a registered broker of NSE, had filed its return of income declaring loss of Rs. 8,61,703/-. Besides this, the assessee company also claimed carry forward of unabsorbed depreciation of Rs. 5,95,522/-. The assessing officer noticed that during the year under consideration the assessee had no business activity and therefore he required

the assessee to explain as to why the interest earned should to be assessed as income from other sources and other expenses claimed should not be disallowed.

2.1. The assessee's response, as noted by assessing officer, was as under:

“The assessee is a registered broker of NSE and the membership of the NSE was obtained in the year February 2006. the assessee has performed trial run in the March 2006 itself, as trading is totally linked with the connectivity of the network. The first trading was started on 03-4-2006 (Monday) as 1st & 2nd April being holiday.

Further, vide letter dated 31-10-2008 the assessee company, stated that after getting the NSE certificate its business was set up and ready to commence. Thus, the business had commenced during the year under consideration. The assessee being a share broker of NSE and ahs to obtain certificate from the NSE which was obtained by the assessee on 16-01-2006. Since the assessee has completed all the formalities for carrying business but could not do any business as non availability of prospective clients.”

2.2. Considering the above reply, the assessing officer concluded that assessee company did not commence business during the year under consideration. He observed that process of setting up of business cannot be held as commencement of business. He concluded that business of the assessee company commenced from the first working day of next assessment year i.e. 3-4-2006. He accordingly taxed the interest income under the head income from other sources.

2.3. As regards the expenses claimed by the assessee out of ROC fees of Rs. 11,000/-, the assessing officer observed as under:

“The assessee company has claimed ROC fees of Rs. 11,000/-. The assessee company raised share capital during the year under consideration for which incurred expenses to pay to ROC. Normal expenses of Rs. 1,500/- are allowed and balance amount is disallowed as capital expenditure.

Further, in earlier year, i.e. year of formation of company, the assessee company had subscribed capital of Rs. 1,00,000/- on which it is entitled to expenses of Rs. 5,000/- under section 35D of the Act and these expenses are to be amortized in five instalments of Rs. 1,000/- each. Thus, expenses of Rs. 1,000/- are allowed and balance amount is disallowed as capital expenditure.”

2.4. The assessing officer computed assessee’s income as under:

“Interest income – as discussed		Rs. 2,84,694/-
Less: Filing fee – as discussed above	1,500	
Preliminary expenses –do-	1,000	
Audit fee	<u>11,000</u>	<u>Rs. 13,500/-</u>
Income from other sources assessed		<u>Rs. 2,71,194/-</u>

2..5. Assessing officer, accordingly, initiated penalty proceedings u/s 271(1)(c) of the Act.

2.6. In the penalty order, the assessing officer observed that assessee filed a very cryptic reply and stated that it had produced all the relevant information and there was no concealment of facts and it was further stated that the additions were made due to difference of opinion regarding date of commencement of business. The assessee had relied on the decision of Hon’ble Supreme Court in the case of Reliance Petro Products Pvt. Ltd. 189 ITR 322.

2.7. The assessing officer levied penalty of Rs. 4,31,126/- for the following reasons:

- (i) The assessee claimed entire expenses and depreciation for the complete year before setting up of its business, which is completely against the provisions of law and basic principle of accountancy.
- (ii) CIT(A) had held that date of grant of certificate of registration, as granted by NSE, should be taken as date of setting up of business as to carry on the business of stock and share broking. Without the grant of certificate of registration by NSE, business regarding stock and share broking cannot be said to be set up. There cannot be any difference of opinion as regards the date of commencement of business.
- (iii) There is no disclosure in the notes on account or in the audit report regarding the set up/ commencement of business during the year under consideration.
- (iv) It is a case of wrong deduction of the claim as made by the assessee and therefore in view of the decision of Hon'ble Delhi High Court in the case of CIT Vs. Escorts Finance Ltd. 183 Taxman 453, penalty u/s 271(1)(c) is leviable.
- (v) The assessee has not been able to substantiate its claimed made during the assessment proceedings, hence as well as in the appellate proceedings.

2.8. Before Id. CIT(A), the assessee submitted that it had not concealed any income as there was no item of receipt which was suppressed. The assessee had furnished all the particulars which were required to be submitted in this case. The assessee further pointed out that additions were made purely on difference of opinion on the issue of commencement of the business. The assessee further referred to the decision of Id. CIT(A) wherein

he had neither agreed with the conclusion of assessing officer in taking the date of commencement of business as 3-4-2006, nor agreed with the assessee taking the date of setting up of business on 25-4-2005 (the date on which application for the membership was submitted). On the contrary, he held that the date when certificate of registration as granted by NSE should be taken as date of setting up of business in the case of the business of the assessee. Thus, the assessee submitted that it was merely a case of difference of opinion and, therefore, no penalty can be levied. The assessee relying on the decision in the case of Reliance Petro Products (supra), pointed out that as in the said decision, in the present case also the details of the explanation filed by the assessee were not found to be inaccurate but only the assessing officer observed that assessee had advanced a wrong claim/ deduction. The assessee further pointed out that, in any view of the matter, the assessing officer had wrongly calculated penalty amount because depreciation was allowable as per the Act, since date of commencement of the business had been taken as 16-1-2006.

2.9. Ld. CIT(A) did not accept the assessee's contention for the following reasons:

- (i) The assessee is a registered share broker of National Stock Exchange.
- (ii) The date of setting up of the business will be the date on which registration was granted by NSE to the assessee for conducting share broking business.
- (iii) The registration by NSE was not granted during the year, therefore, business of stock and share trading cannot be said to be set up during the year. Therefore, the argument of the assessee that the

additions were made based on difference of opinion regarding the date of commencement of business, cannot be accepted.

- (iv) The assessee had not mentioned in the notes or in the audit report regarding setting up or commencement of business. Therefore, there was no full and complete disclosure also.
- (v) The claim made by the assessee was ex facie bogus, which was not sustainable at all.

2.10. Ld. CIT(A), inter alia, referred to the decision in the case of CIT Vs. Zoom Communication Pvt. Ltd., wherein Hon'ble Delhi High Court has held that if assessee made a claim, which is not only incorrect in law but is also wholly without any basis and explanation furnished by him for making such a claim is not found to be bona fide, explanation 1 to section 271(1)(c) would come into play and assessee will be liable to penalty.

3. Ld. Counsel for the assessee submitted that assessee had applied to NSE on 25-4-2005 which date was treated as the date of setting up of business and the expenses incurred thereafter were claimed as business expenses. The assessing officer, however, took the date of first dealing on the stock exchange, which was 3-4-2006 as the date of commencement of assessee's business. He, therefore, had disallowed the entire expenses claimed by assessee. Ld. CIT(A) took the date of grant of registration by NSE viz. 16-1-2006 as the date of setting up of business and allowed the expense thereafter. The entire dispute is in regard to the claim of expenses made for the period 25-4-2005 to 16-1-2006.

3.1. Ld. Counsel referred to page 33 & 34 of the PB, wherein application for obtaining membership for capital market and future and option segment

with NSE dated 25-4-2005 is contained. Along with the application various annexures were filed and the details of directors and dealers with supporting documents were furnished. The balance-sheet of 31-3-2005 with auditors report was also filed. The reference letter from HDFC bank was also furnished. The assessee had given all the details of its office premises etc. as per the requirement of SEBI. The SEBI vide its letter dated 16-1-2006 contained at pages 35 & 36 of the PB, granted the registration as a stock broker to the assessee company and, thereafter, the assessee became eligible to trade on stock exchange.

3.2. With the background of these facts, Id. Counsel submitted that the claim of assessee in respect of various expenses claimed for the period from 25-4-2005 to 15-1-2006 could not be said to be a mala fide claim because assessee had complied with all the requirements for obtaining the membership of NSE on 25-4-2005. therefore, the assessee's business had been set up and only the commencement of business was awaited which also became clear on 16-1-2006.

3.3. Ld. Counsel referred to the decision of the ITAT in the case of Whirlpool of India Ltd. v. JCIT 114 TTJ 211 and pointed out that in this case assessee had, by placing all the facts before assessing officer, taken the position that the business was set up on 1-11-1995 with which assessing officer did not agree. This does not amount to furnishing of any inaccurate particulars of income. In this case the company was engaged in rendering financial services and the Tribunal concluded that it was possible to say that the business was set up when the directors are appointed; staff, such as, regional and branch managers are appointed and their salaries were paid;

computers are acquired and installed and the company is ready to commence business. It was held that it cannot be said that business was set up only when the bank account was opened on 1-2-1996 because prior thereto the company, though it did not have a bank account, was incurring the expenditure through K. India Ltd. or E Machinery Ltd. The Tribunal had, inter alia, observed as under:

“The assessee is a financial company authorized to advance loans for interest to facilitate customers to purchase consumer durables, though the business is not limited to advancing monies for acquiring consumer durables. In the case of a company engaged in rendering financial services, it is possible to say that the business is set up when the directors are appointed, staff such as regional and branch managers are appointed and their salaries are paid, computers are acquired and installed and the company is ready to commence business.”

3.4. The assessee in its written submissions made before the Id. CIT(A), as contained at page 25 onwards of the PB, inter alia, has submitted as under:

“As per object clause of the memorandum of association of the assessee, the main object of the assessee was to carry on the business of stock and share broking. The Company was incorporated on 24.11.2004 under the Indian Companies Act, 1956 with authorized Capital of Rs. 200 Lacs being minimum capital for the companies obtaining membership of Stock Broker. To carry on the business activities it has to be registered with National Stock Exchange (NSE) and/or Bombay Stock Exchange. The assessee decided to get registered with NSE. There are certain requirements such as qualified persons, minimum area and the Net worth etc to be complied with for getting registered. As per the requirement of minimum two qualified persons and minimum Net worth of Rs. 100 lacs besides deposit of Rs 125 lacs. The assessee issued capital of Rs. 150 Lacs and appointed two qualified persons on the board and applied for the Membership of NSE on 25.04.2005. NSE vide its letter dated 14.06.2005 asked to complete certain formalities which were complied with. After interviewing and the necessary formalities issued letter in the month of Sep, 2005 for deposit of Rs 127 lacs and the same was deposited in NSE

on 08.11.2005. Finally NSE issued membership certificate on 16.01.2006 and asked to furnish bank guarantee of Rs 25.00 lacs. To carry out activities equipment such as VSAT, Servers has to be installed and the same was dispatched on 07.03.2006 by NSE. The assessee has claimed revenue expenditure of Rs 1146396.88 which was incurred after applying for the membership i.e after setting up of the Business. The above significance of dates can be summarized as follows:

S.No.	Particulars	Dates
1.	Incorporation of the Company	24-11-2004
2.	Application for Empanelment with NSE	25-04-2005
3.	Letter for further formalities	14-06-2005
4.	Letter for Interview	05-08-2005
5.	Demand Advise	02-09-2005
6.	SEBI Registration	28-10-2005
7.	Receipt of Deposit of Rs. 127 Lacs	08-11-2005
8.	Certificate of Registration	16-01-2006
9.	SEBI Registration for Capital Market	20-01-2006
10.	SEBI Registration for Future & opinion	24-01-2006
11.	Deposit of Bank Guarantee	07-02-2006
12.	Activation of Vsat	21-02-2006
13.	Dispatch of VSAT	07-03-2006
14.	Enablement for Trading in F&O Segment	14-03-2006
15.	First Transaction	03-04-2006

Dictionary meaning of Setting Up is creation, foundation, establishment, development, production, institution, constitution, formation, inception, origination . Further formation means The act or process of forming something or of taking form. By going through the dictionary meaning setting up means to act or process of forming. The assessee has started process of obtaining membership of the exchange on 25.04.2005 the date on which application was submitted.

4. Ld. DR submitted that mere filing of an application with the SEBI for grant of membership cannot be taken to be the date for setting up of business because by mere filing of the application with the SEBI it cannot be held that the assessee was ready to commence business.

5. We have considered the rival submissions and have perused the record of the case. The company was incorporated on 24-11-2004 under the Indian

Companies Act with the authorized capital of Rs. 2,00,00,000/- being minimum capital for the company obtaining membership of stock broker. As per the object clause of memorandum of association of the assessee, the main object of the assessee was to carry on the business of stock and share broker. To carry on the business activity, it has to be registered with NSE and/ or Bombay Stock Exchange. There are certain requirements, such as, qualified persons, minimum area and the net worth etc. to be complied with for getting registered. As per the requirements, minimum two qualified persons and minimum worth of Rs. 1,00,00,000/-, besides deposit of Rs. 1,25,00,000/-, was required. To comply with this, the assessee issued capital of Rs. 1,50,00,000/- and appointed two qualified persons on the Board and applied for the membership of NSE on 25-4-2005. NSE vide its letter dated 14-6-2005 asked to complete certain formalities which were complied with. After necessary formalities were completed, NSE issued letter in the month of September 2005 for deposit of Rs. 1,27,00,000/- and the same was deposited in NSE on 8-11-2005. Finally, NSE issued membership certificate on 16-1-2006 and asked to furnish bank guarantee of Rs. 25,00,000/- to carry out activities equipment such as VSAT, servers had to be installed and the same was dispatched on 7-3-2006 by NSE.

5.1. From the above uncontroverted factual aspects it is evident that from the date of incorporation of company itself, the assessee's intention was to obtain the membership of stock exchange and in order to pursue that object the assessee had to comply with various legal requirements. It is true that assessee could not commence the business without registration being granted but the fact of overwhelming legal requirements to be complied with by assessee before getting the registration cannot be over looked.

5.2. The assessee's claim is that from the date it filed application with NSE viz. 25-4-2005 it had set up its business and only the formal registration from NSE was awaited. In the backdrop of these facts the assessee's submission is that it was highly debatable whether the date of set up should be taken as 25-4-2005 considering the requirement to be fulfilled or only after the formal registration is granted by NSE should the business be taken as set up. The submission is that it is highly debatable issue.

5.3. We find considerable force in this submissions of the assessee because though it is true that assessee could not commence the business but at the same time it cannot be ignored that from incorporation the intention of the assessee was for obtaining NSE membership and various formalities had to be fulfilled before application for registration could be made. In this regard we may refer to the following observations of ITAT Delhi Bench in the case of Whirlpool of India Ltd. (supra) observing in para 3 as under:

"3. Section 3 of the Income Tax Act defines "previous year" and it says that the first previous year commences from the date of "setting up of the business". It is well-settled that there is a difference between the date of setting up of a business and the date of commencement of the business and this distinction has been brought out by the Bombay High Court in *Western Vegetable Products Ltd. v. CIT*(1954) 26 ITR 151 (Born) by observing that when a business is established and is ready to commence business then it can be said that it has been "set up" , but before it is ready to commence business it is not "set up". There may be an interregnum between the date of setting up of the business and the date of actual commencement of the business, under the Act all Expenses incurred after the date of setting up are allowed as a deduction under section 28. This decision has been applied by the Hon'ble Delhi High Court in its recent judgment, 17-9-2007 in ITA Nos." 1687 and 1688 of 2006 in the case of *CIT v. Hughes Escort Communications Ltd.* (reported at (2007) 213 CTR (Del) 45'Ed.) (copy of the judgment filed before us) and it has been held that where the business has been set up, though the same has not been commenced, the expenditure incurred after the date of setting up has

to be allowed as deduction. But the question as to when it can be said that a business is "set up" must largely depend on the facts of each case and the nature of the business. There can be no hard and fast~ rule by which it can be determined as to when the business was set up. In the judgment of the Bombay High Court cited supra, it was a case of a manufacturing concern. It was held that the business was set up when the first order of purchase of raw material was placed and not when the factory was started (at a later point of time). In CIT v. Sarabhai Sons (P) Ltd. (1973) 90 ITR 318 (Guj), the Gujarat High Court was dealing with a company established for the manufacture of scientific instruments. It was held that the purchase of land, placing of orders for machinery and raw materials were merely operations for the setting up of the business and the business was actually set up only when the machinery was installed and the factory was ready to commence business. In Prem Conductors (P) Ltd. v. CIT 1976 CTR (Guj) 324 : (1977) 108 ITR 654 (Guj), the Gujarat High Court held that even securing orders by a manufacturing concern in advance of production can amount to setting up of the business. In CIT v. Sarabhai Management Corpn. Ltd. (1991) 192 ITR 151 (SC), the Supreme Court, affirming the view of the Gujarat High Court in Sarabhai Management Corporation Ltd. v. CIT (1976) 102 ITR 25 (Guj) held that in the case of a company formed for leasing of property it could not be said that the business was not set up till the first lease took place; the earlier part of the activities, namely, engaging staff, buying the equipment and making the staff familiar with the same are all part of the business and the business can be said to be set up even earlier. A case of marine processing industry was dealt with by the Gujarat High Court in CIT v. Western India Sea Foods (P) Ltd. (1993) 199 ITR 777 (Guj). There, it was held that the act of acquiring a godown in the month of August in anticipation of the arrival of fish in the waters in the month of October was held to amount to setting up of the business. The Madras High Court was dealing with the case of a company formed for selling property time-share in CIT v. Club Resorts (P) Ltd. (2006) 287 ITR 552 (Mad). It was held that the acts of appointing staff for canvassing sales of the property timeshares, renting of office premises, etc. amounted to setting up of the business even though the construction of the property was yet to begin. A case of a hotel hospitality industry was considered again by the Gujarat High Court in Hotel Alankar v. CIT (1982) 133 ITR 866 (Cuj). While recognizing that the question whether a business is set up or not was essentially one of fact and that it would largely depend upon the facts of each case and the nature of the business; the High Court noted that in the case of a hotel (boarding and lodging house) due weight must be given to the fact that it cannot commence its activities overnight. It was pointed out that the business of boarding and lodging would necessarily comprise of variegated activities commencing from the stage of acquisition of a proper and suitable building making it more suitable for the hotel business, purchasing linen, cutlery, furniture, etc., appointing staff of managers, cooks, bearers and ultimately reaching the stage of

receiving customers and that it would be de hors commercial sense to hold that one would be reaching the stage of having set up the business only when one reaches the stage of receiving customers. It was ultimately held that where there are several integrated activities to be undertaken serially, one forming the foundation for the other, it can be said that the business was 'set up' when the first of such activities was undertaken. It was ultimately held that the business was set up when the building was acquired and was placed at the disposal of the firm. In ITO v. M Voradarajan (1989) 34 TTJ (Mad) 247 : (1989) 30 ITD 414 (Mad), the Madras Bench of the Tribunal held in the case of a sole-selling agent that his business could be said to have been set up once he obtained the sole-selling agency and it could not be said that it was set up only when he obtained the first business.”

5.4. The question, whether a business can be said to have been set up, is dependent on the facts of each case and largely on the nature of business proposed to be undertaken. In the present case the nature of business proposed to be undertaken was such that without complying with various requirements, the assessee could not make application for registration. The application could be made to SEBI only when the assessee had fulfilled/complied with basic conditions necessary for grant of registration. Therefore, it cannot be disputed that there can be one point of view that the business had been set up after all the necessary formalities had been fulfilled for making the assessee eligible for filing the application with SEBI. Only the permission for commencement of business was awaited. The business was ready for commencement subject to grant of registration. Therefore, in our opinion, under such circumstances it cannot be said that assessee's explanation of claiming expenses for the period 25-4-2005 to 15-1-2006 could be branded as mala fide. The assessee having complied with all the requirements was sanguine of getting registration and therefore treated its business as being set up from the date of making application. Further, the assessee's intention since beginning was to act as member of NSE also has

to be given due weightage. Considering the highly debatable nature of its claim we are of the opinion that penalty is not leviable in this case. Moreover, the assessee having filed all the relevant information along with the return, it cannot be said that assessee had concealed particulars of its income to attract penalty u/s 271(1)(c). In coming to this conclusion we are fortified by the ratio of decision of Hon'ble Supreme Court in the case of Reliance Petro Products Ltd. v. CIT 322 ITR 158. In view of above discussion, the penalty levied u/s 271(1)(c) is deleted.

6. In the result, assessee's appeal is allowed.

Order pronounced in open court on 14-08-2014.

Sd/-
(C.M. GARG)
JUDICIAL MEMBER

Sd/-
(S.V. MEHROTRA)
ACCOUNTANT MEMBER

Dated:14-08-2014.

MP

Copy to :

1. Assessee
2. AO
3. CIT
4. CIT(A)
5. DR