



TAX

Lull vs. Cessation: Supreme Court Defines “Carrying on Business” for Non-Residents

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Introduction

In the significant judgment of *Pride Former S.A. v. Commissioner of Income Tax & Anr.*^[1] the Supreme Court of India has provided crucial clarification on the concept of “carrying on business,” particularly for non-resident companies. The central question was whether a company, during a period without active contracts or a permanent establishment in India, could still be considered to be carrying on its business and consequently be eligible to claim deductions for business expenditure under Section 37 and carry forward unabsorbed depreciation under Section 32(2) of the Income Tax Act, 1961. The Court’s decision overturned the High Court of Uttarakhand’s order and has major implications for how business continuity is assessed in the modern, globalised economy.

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Factual Matrix

The appellant, Pride Former S.A., is a non-resident company incorporated in France, engaged in oil drilling activities. It had a history in India, having been awarded a 10-year drilling contract from 1983 to 1993. The dispute concerned the “interregnum” period, specifically the Assessment Years 1996-1997, 1997-1998, and 1999-2000. During this time, the appellant did not have an active drilling contract. However, it was not dormant; the company continued to maintain business correspondences with ONGC from its offices in Dubai and France and also submitted a bid for oil exploration in 1996. These efforts eventually culminated in a new contract being awarded in October 1998.

For the relevant assessment years, the appellant filed ‘NIL’ income returns. The only income credited was interest received on income tax refunds. Against this income, the appellant claimed deductions for business expenditures, such as administrative charges and audit fees, and also claimed a set-off for unabsorbed depreciation on assets brought forward from earlier years.

Rulings of Lower Authorities

The Assessing Officer (AO) disallowed both the business expenditure and the carry forward of unabsorbed depreciation. This decision was upheld by the CIT (Appeals). The core reasoning of the revenue authorities was that the appellant was not “carrying on any business” during the relevant period.

The Income Tax Appellate Tribunal (ITAT) however, reversed these findings. The ITAT held that a “temporary lull in business for whatever reason cannot be termed as cessation of business”. It found that the evidence, including the 1996 correspondence with ONGC and the submission of a new tender, proved that the assessee had not completely gone out of business. Citing the Bombay High Court’s decision in *Hindustan Chemical Works Ltd. V. CIT*^[2], the ITAT highlighted the “marked distinction between ‘lull in business’ and ‘going out of business’”. The Tribunal concluded that the period between 1993 and 1998 was one of “temporary discontinuance only”.

The ITAT also dismissed the revenue’s contention that the appellant was out of business because it had filed an affidavit denying a “permanent establishment” (PE) in India. The Tribunal noted this affidavit was filed in the specific context of claiming a concessional tax rate on interest income and that an assessee can be in business “de hors’ the permanent establishment”. Thus, the ITAT allowed the set-off of expenses under Section 71 and the carry-forward of depreciation under Section 32(2).

The Department then appealed to the High Court of Uttarakhand. The High Court reversed the ITAT’s order. While it agreed with the legal proposition that a “mere lull” does not mean cessation, it held that since the assessee had “neither permanent office, nor any other office in India, nor any contract was in execution,” it could not be said to be in business in India.

Issue Before the Supreme Court

‘Whether, in the facts of the case, the appellant can be said to have been carrying on business during the relevant period, so as to avail deduction of business expenditure under Section 37(1) read with Section 71 of the Act, and carry forward unabsorbed depreciation of previous years under Section 32(2) of the Act?’.

Supreme Court’s Analysis and Reasoning

The Supreme Court allowed the appeals, comprehensively dismantling the High Court’s reasoning. The Court began by noting that eligibility for both Section 37(1) deductions and Section 32(2) carry-forward (under the proviso then in effect) required the appellant to demonstrate that it was “carrying on business” in India during the relevant period.

The Court held that the appellant’s *conduct* was paramount. The “ample materials... on record,” such as the “continuous business correspondences with ONGC” and the unsuccessful 1996 bid, clearly demonstrated an “intention to carry on business” when viewed from the “standpoint of a prudent businessman”. The mere “failure to procure the drilling contract” did not amount to a cessation of business. The Court explicitly upheld the ITAT’s finding, stating the Tribunal “rightly noted” this was a “lull in business and not a complete cessation”.

The judgment reinforced the wide import of the word “business,” citing *Narain Swadeshi Weaving Mills v. Commissioner of excess Profits Tax*^[3]. It also leaned on the precedent in *CIT v. Malayalam Plantations Ltd.*^[4], which established that the expression “for the purpose of business” is much wider than “for the purpose of earning profits”. It can include “many other acts incidental to the carrying on of a business,” such as “measures for preservation of business”. The appellant’s actions of corresponding with ONGC and bidding for new work were precisely such incidental acts.

Most significantly, the Supreme Court ruled that the High Court “erred” and “misdirected itself” by linking the concept of “carrying on business” with the existence of a “permanent establishment” (PE). The Court declared this view “wholly fallacious”. It clarified that under the charging provisions of the Act (Sections 4, 5(2), and 9(1)(i)), a non-resident is liable to tax on income from any “business connection in India”. “None of these provisions make it mandatory for a non-resident assessee to have a permanent establishment in India to carry on business”. The issue of a PE, the Court stated, is relevant for availing benefits under a Double Tax Avoidance Agreement (DTAA), which was not the consideration in this case.

Finally, the Court observed that in an “era of globalisation,” the High Court’s restrictive view was “wholly anachronistic” and ran counter to India’s commitment to “ease of doing business”.

Conclusion and Author’s Opinion

For the aforesaid reasons, the Supreme Court allowed the appeals, set aside the judgment of the High Court, and revived the orders passed by the ITAT. The Assessing Officer was directed to pass fresh Assessment Orders in accordance with the ITAT’s findings.

This judgment is a decision that provides much-needed clarity and adopts a pragmatic, commercially-aware approach to tax law. In our opinion, the Supreme Court’s decision is commendable. It rightly distinguishes between temporary inactivity and permanent cessation, a difference that is fundamental to the realities of project-based or cyclical industries like oil and gas. By delinking the factual existence of a business from the legal fiction of a “Permanent Establishment” (for DTAA purposes), the Court has removed a significant, and arguably incorrect, hurdle for non-residents. This verdict champions the *intention* and *conduct* of the assessee over the rigid, and at times myopic, requirement of a physical office or an active contract. It reinforces that efforts to preserve a business, maintain client relationships, and bid for new work are integral parts of “carrying on business.” This decision not only aligns with global commercial realities and the “ease of doing business” narrative but also provides a robust precedent that will protect businesses from adverse tax consequences during unavoidable “lull” periods.

[1] Civil Appeal Nos. 4395-4397/2010

[2] 124 ITR 561

[3] (1954) 2 SCC 546

[4] (1988) 169 ITR 597 (SC), para 15

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