* IN THE HIGH COURT OF DELHI AT NEW DELHI

ITA No. 1156/2007 & 1157/2007

% Judgment delivered on : 26.02.2009

INDIAN OIL PANIPAT POWER CONSORTIUM LIMITED, NEW DELHI ..... Appellant

Versus

INCOME TAX OFFICER ..... Respondent

Advocates who appeared in this case:

For the Appellant : Mr B.B. Ahuja, Sr. Advocate with Mr Sunil Magon, Advocate
For the Respondent : Ms Prem Lata Bansal & Mr Mohan Prasad Gupta, Advocate

CORAM :-

HON'BLE MR JUSTICE VIKRAMAJIT SEN
HON'BLE MR JUSTICE RAJIV SHAKDHER

1. Whether the Reporters of local papers may be allowed to see the judgment ? Yes
2. To be referred to Reporters or not ? Yes
3. Whether the judgment should be reported in the Digest ? Yes

VIKRAMAJIT SEN, J

1. These are appeals under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') preferred by the assessee against the Judgment dated 22.04.2007 passed by the Income Tax Appellate Tribunal (hereinafter referred to as the 'Tribunal') in ITA No. 2349/Del/03 and ITA No. 1573/Del/04 pertaining to Assessment Years 2001-02 and 2002-03 respectively.

2. The only issue which arose for consideration of the authorities below was as to the treatment which was to be accorded to the interest earned on monies received as share capital by the assessee which were temporarily put in a fixed deposit awaiting acquisition of land which had run into legal entanglements on account of title. The Assessing Officer had treated the interest received by the assessee in respect of the

aforementioned two years as 'income from other sources', whereas the Commissioner of Income Tax (Appeals) [hereinafter referred to as the 'CIT(A)'] had accepted the stand of the assessee that the interest was in the nature of capital receipt which was liable to be set off against pre-operative expenses. In a further appeal to the Tribunal by the Revenue the Tribunal reversed the decision of the CIT(A). The Tribunal was of the view that the facts obtaining in the present case were similar to those which arose in the judgment of the Supreme Court in the case of ***Tuticorin Alkali Chemicals and Fertilizers Ltd vs CIT; (1997) 227 ITR 172***. The assessee being aggrieved is in appeal before us.

3. We have heard the learned counsel for the parties at length. Following substantial question of law arises for our consideration:

> *"Whether the Tribunal misdirected itself in law in holding that interest which accrued on funds deployed with the bank could be taxed as income from other sources and not as capital receipt liable to be set of against pre-operative expenses?"*

We are called upon to really decide as to whether given the facts obtaining in the assessee's case it would be covered by the line of cases which follow the ratio of the decision of the Supreme Court in ***Tuticorin Alkali Chemicals*** *(supra)* or those which follow the ratio of the Supreme Court in the case of ***CIT vs Bokaro Steel Ltd; (1999) 236 ITR 315***. At the outset we must note that the Supreme Court in the case of ***Bokaro Steel Ltd*** *(supra)* has noticed the judgment of the Supreme Court in ***Tuticorin Alkali Chemicals*** *(supra)*. Therefore, in these circumstances it would be incumbent to note the following brief facts as recorded by the authorities below:

3.1 The assessee company was incorporated on 06.10.1999 in pursuance of a joint venture entered into between Indian Oil Corporation and Marubeni Corporation of Japan. The joint venture was

conceived to set up a power project at Panipat in the state of Haryana. It was expected that the project would be set up by the end of the financial year 2000-01. In order to effectuate the purpose for which joint venture was conceived, share capital was contributed by Indian Oil Corporation and Marubeni Corporation of Japan which included Rs 20 crores by way of additional share capital.

3.2 To be noted that the assessee had taken a stand before the Assessing Officer that these funds were required primarily for purchase of land and development of infrastructure. However, due to legal entanglements with respect to title of land, which the Haryana Government was to acquire for the assessee, in the interregnum, the funds acquired by way of share capital were put in a fixed deposit with the Tokyo Mitsubishi Bank by the assessee.

3.3 The assessee earned interest in the sum of Rs 1,65,75,906/- in assessment year 2001-02 and Rs 1,54,62,098/- in the assessment year 2002-03. As mentioned hereinabove the Assessing Officer applied the ratio of the judgment of the Supreme Court in ***Tuticorin Alkali Chemicals*** *(supra)* and the judgment of the Supreme Court in the case of ***CIT vs Autokast Ltd; (2001) 248 ITR 110*** and held that the interest which accrued to the assessee was assessable under the head "income from other sources" and could not be set off against pre-operative expenses as claimed by the assessee.

3.4 Aggrieved by the order the assessee preferred an appeal to the CIT(A). The CIT(A) examined the facts in detail. It is pertinent to note that the CIT(A) in paragraph 4 of his Order dated 06.02.2003 categorically found that the funds were placed in fixed deposit so that liquidity was ensured and money would remain available when required for purchase of land and infrastructure development and hence the interest earned was ***'inextricably linked'*** with the setting up of the

power plant. Based on this line of reasoning the CIT(A) applied the judgment of the Supreme Court in ***Bokaro Steel Ltd.*** *(supra)* and allowed the claim of the assessee by directing the Assessing Officer to delete the addition and consider the same for capitalization towards pre-operative expenses.

3.5 The Tribunal in an appeal preferred by the Revenue, by virtue of the impugned judgment, has reversed the decision of the CIT(A).

4. It is important to note that the Tribunal without holding that the finding of fact of the CIT(A), that the interest earned was 'inextricably linked' with the setting up of the power plant reversed the decision of the CIT(A) by making a bald observation that the "deposit of share capital has no or very remote connection with setting up of plant and machinery". The Tribunal further observed that it was an independent income earned in a similar fashion as was the case in ***Tuticorin Alkali Chemicals*** *(supra).*

5. In our opinion the Tribunal has misconstrued the ratio of the judgment of the Supreme Court in the case of ***Tuticorin Alkali Chemicals*** *(supra)* and that of ***Bokaro Steel Ltd.*** *(supra)*. The test which permeates through the judgment of the Supreme Court in ***Tuticorin Alkali Chemicals*** *(supra)* is that if funds have been borrowed for setting up of a plant and if the funds are '***surplus***' and then by virtue of that circumstance they are invested in fixed deposits the income earned in the form of interest will be taxable under the head "income from other sources'. On the other hand the ratio of the Supreme Court judgment in ***Bokaro Steel Ltd.*** *(supra)* to our mind is that if income is earned, whether by way of interest or in any other manner on funds which are otherwise 'inextricably linked' to the setting up of the plant, such income is required to be capitalized to be set off against pre-operative expenses.

5.1 The test, therefore, to our mind is whether the activity which is taken up for setting up of the business and the funds which are garnered are inextricably connected to the setting up of the plant. The clue is perhaps available in Section 3 of the Act which states that for newly set up business the previous year shall be the period beginning with the date of setting up of the business. Therefore, as per the provision of Section 4 of the Act which is the charging Section income which arises to an assessee from the date of setting of the business but prior to commencement is chargeable to tax depending on whether it is of a revenue nature or capital receipt. The income of a newly set up business, post the date of its setting up can be taxed if it is of a revenue nature under any of the heads provided under Section 14 in Chapter IV of the Act. For an income to be classified as income under the head "profit and gains of business or profession" it would have to be an activity which is in some manner or form connected with business. The word "business" is of wide import which would also include all such activities which coalesce into setting up of the business. See ***Mazagaon Dock Ltd vs CIT & Excess Profits Tax; (1958) 34 ITR 368 (SC)***, and ***Narain Swadeshi Weaving Mills vs Commissioner of Excess Profits Tax; (1954) 26 ITR 765 (SC)***. Once it is held that the assessee's income is an income connected with business, which would be so in the present case, in view of the finding of fact by the CIT(A) that the monies which were inducted into the joint venture company by the joint venture partners were primarily infused to purchase land and to develop infrastructure – then it cannot be held that the income derived by parking the funds temporarily with Tokyo Mitsubishi Bank, will result in the character of the funds being changed, in as much as, the interest earned from the bank would have a hue different than that of business and be brought to tax under the head 'income from other sources". It is

well-settled that an income received by the assessee can be taxed under the head "income from other sources" only if it does not fall under any other head of income as provided in Section 14 of the Act. The head "income from other sources" is a residuary head of income. See S.G. ***Mercantile Corporation P. Ltd vs CIT, Calcutta; (1972) 83 ITR 700 (SC)*** and ***CIT vs Govinda Choudhury & Sons.; (1993) 203 ITR 881 (SC).***

5.2 It is clear upon a perusal of the facts as found by the authorities below that the funds in the form of share capital were infused for a specific purpose of acquiring land and the development of infrastructure. Therefore, the interest earned on funds primarily brought for infusion in the business could not have been classified as income from other sources. Since the income was earned in a period prior to commencement of business it was in the nature of capital receipt and hence was required to be set off against pre-operative expenses. In the case of ***Tuticorin Alkali Chemicals*** *(supra)* it was found by the authorities that the funds available with the assessee in that case were 'surplus' and, therefore, the Supreme Court held that the interest earned on surplus funds would have to be treated as 'income from other sources'. On the other hand in ***Bokaro Steel Ltd*** *(supra)* where the assessee had earned interest on advance paid to contractors during pre-commencement period was found to be 'inextricably linked' to the setting up of the plant of the assessee and hence was held to be a capital receipt which was permitted to be set off against pre-operative expenses.

6. There is another perspective from which the present issue can be examined. Under Section 208 of the Companies Act, 1956 a company can pay interest on share capital which is issued for a specific purpose to defray expenses for construction of any work and which cannot be

made profitable for a long period subject to certain restrictions contained in Section (2) to (7) of Section 208. This section was specifically noted by the Supreme Court in Challapalli Sugars Ltd vs CIT (1975) 98 ITR 167. The Supreme Court went on to observe at page 175 as follows:

> *"We have already referred to section 208 of the Companies Act which makes provision for payment of interest on share capital in certain contingencies. Clause (b) of sub-Section (1) of that section provides that in case interest is paid on share capital issued for the purpose of raising money to defray the expenses of constructing any work or building or the provision of any plant in contingencies mentioned in that section, the sum so paid by way of interest may be charged to capital as part of the cost of construction of the work or building or the provision of the plant. The above provision thus gives statutory recognition to the principle of capitalizing the interest in case the interest is paid on money raised to defray expenses of the construction of any work or building or the provision of any plant in contingencies mentioned in that section even though such money constitutes share capital. The same principle, in our opinion, should hold good if interest is paid on money not raised by way of share capital but taken on loan for the purpose of defraying the expenses of the construction of any work or building or the provision any plant. The reason indeed would be stronger in case such interest is paid on money taken on loan for meeting the above expenses."*

6.1 In our view the situation in the instant case is quite similar except here instead of paying interest on funds brought in for specific purpose interest is earned on funds brought in by way of share capital for a specific purpose. Could it be said that in the former situation interest could have been capitalized and in the later situation it cannot be capitalized. To test the principle we could extend the example, that is, would our answer be any different had assessee passed on the interest to the respective shareholders. If not, then in our view the only conclusion possible is that interest earned in the present circumstances ought to be capitalized.

7. In view of the discussion above, in our opinion the Tribunal misdirected itself in applying the decision of the Supreme Court in

Tuticorin Alkali Chemicals *(supra)* in the facts of the present case. In our opinion on account of the finding of fact returned by the CIT(A) that the funds infused in the assessee by the joint venture partner were inextricably linked with the setting up of the plant, the interest earned by the assessee could not be treated as income from other sources. In the result we answer the question as framed in favour of the assessee and against the Revenue. These appeals are allowed and the impugned judgment is set aside.

VIKRAMAJIT SEN, J.

RAJIV SHAKDHER, J.

February 26, 2009
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