* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ ITA 357/2010

Reserved on : 16th December, 2010

% **Date of decision: 11th March, 2011**

Commissioner of Income Tax, Delhi-IV ..... Appellant
Through: Mr.Sanjeev Sabharwal, Sr. Standing Counsel

versus

Jaypee DSC Ventures Ltd. ..... Respondent
Through: Ms. S. Krishnan, Advocate

CORAM:
HON'BLE THE CHIEF JUSTICE
HON'BLE MR. JUSTICE MANMOHAN

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

DIPAK MISRA, CJ

The present appeal preferred under Section 260A of the Income Tax Act, 1961 (for brevity 'the Act') was admitted on the following substantial question of law:

> "Whether in the facts and circumstances of the case the Income Tax Appellate Tribunal was justified in deleting the addition of Rs.16,36,039/- on the ground that interest earned by the assessee on the fixed deposit receipt being capital in nature cannot be assessed as income from other sources solely on the foundation

that the fixed deposit was made for submitting performance guarantee to the National Highways Authority of India?"

2. The facts giving rise to the present appeal are that the respondent – assessee filed its return of income for the assessment year 2003-04 on 21st September, 2003 declaring nil income. An order of assessment was framed under Section 143(3) on 29th March, 2006 determining the total income at Rs.16,38,039/-. The assessing officer treated the amount of interest income which had been set off against the project expenses as income from other sources and disallowed the same to be set off against the cost incurred on the project expenses. It is not in dispute that the assessee had furnished performance guarantee in favour of NHAI to get the contract awarded in its favour and to procure the said guarantee, it had kept the amount in a fixed deposit in the bank. The project was on BOT (Build-Operate-Transfer) basis where the promoters were required to bring in their own funds along with borrowed funds from bank/financial institutions for construction of the project. It is contended that the furnishing of bank guarantee had direct nexus with the carrying on of the project and, therefore, the said set off deserved to be allowed.

3. It was contended before the assessing officer that the interest on margin money against the said bank guarantee is inextricably linked and intrinsically connected with the execution of the contract awarded to the assessee company and hence, the interest so received is only incidental to the very execution of the project. The bank guarantee was an operational and compelling requirement on the part of the assessee company and, therefore, the interest earned on the margin sum was an incident directly connected with the construction of the road project.

4. The assessing officer placed reliance on the decision rendered in ***Tuticorin Alkali Chemicals and Fertilizers Limited v. CIT*****, [1997] 227 ITR 172 (SC)** and came to hold that the interest received by the company on the bank deposit was taxable as income under the head 'income from other sources'. It was opined by the assessing officer that the expenditure made deserved to be set off against interest income which had a direct nexus with the earning of the same but in the case of the assessee, as the project expenses did not have even remote proximity with the earning of interest, the same could not be allowed to be set off against the interest income.

5. Being aggrieved by the aforesaid order, the assessee preferred an

appeal before the CIT(A) and the Appellate Authority, after referring to the clauses in the agreement and the decisions rendered in ***SISCO v. CIT, 240 ITR 24 (Madras), Philips Carbon Block Ltd. v. CIT, 130 ITR 205 (Cal), Additional CIT v. Madras Fertilizer Ltd., 120 ITR 1399 (Madras), CIT v. Jose Thomas, 253 ITR 553 (Kerala), CIT v. Parekh Brothers, (2002) 258 ITR 43 (Kerala), Rani Paliwal v. CIT, 268 ITR 221 (P&H) and Pandiyan Chemicals v. CIT, 262 ITR 268 (SC)***, came to hold that the appellant had raised the margin money from its own funds available with other organizations and deposited with its bankers with a view to obtain the performance guarantee in favour of NHAI for procuring the project of converting the Delhi Gurgaon Section NH-8 into 8 Lane Highway on BOT basis and, therefore, the interest income earned by the assessee on the deposit of margin money for obtaining the performance guarantee in favour of NHAI was income from other sources and the same could not be allowed to be set off against project expenses.

6. Being dissatisfied with the order passed by the first appellate authority, the assessee preferred an appeal before the tribunal and the tribunal took note of the rivalized submissions and came to opine that the assessee had received interest on the FDRs and the said interest had been reduced from the project

expenditure which are subject to pending allocations; that the assessee had commenced the operation of the construction of the project; that furnishing of bank guarantee was the sine qua non for initiation of the project and only on furnishing the bank guarantee, could the assessee enter into the contract for construction of the project; that it is not a case where surplus funds have been utilized to earn the interest income; and that it was not the unutilized and surplus money which was deposited by the assessee to earn interest but on the contrary, the activity of depositing money was incidental to the business of the assessee as FDRs were required to be kept to enter into the agreement for commencement of the project and, hence, FDRs with the bank were made with the definite purpose and the interest earned by the assessee on the FDRs must go to reduce the pre-production expenses. The tribunal also opined that the interest earned by the assessee on the FDRs has intrinsic and inseggregable nexus with the work undertaken and, therefore, the interest earned by the assessee is capital in nature and shall go towards adjustment against the project expenditure and the same cannot be assessed as income from other sources. Being of this view, the tribunal allowed the appeal preferred by the assessee.

7. We have heard Mr. Sanjeev Sabharwal, learned counsel for the

appellant - revenue and Mr. S. Krishnan, learned counsel for the assessee - respondent.

8. Questioning the legal acceptability of the order passed by the tribunal, it is contended by Mr. Sabharwal that the order of reversal passed by the tribunal is absolutely vulnerable as the first appellate authority has scrutinized the facts in keen detail and expressed the view that the interest earned from the fixed deposit receipts was not inseparably connected with the business activity of the assessee and was being commercially utilized prior to the award of the contract. It is his further submission that furnishing of performance guarantee in terms of the agreement by no stretch of imagination can be regarded to be an inalienable part of business as the factual matrix would show that the assessee had raised the margin money from its own funds available with other organizations and deposited with its bankers to obtain the performance guarantee. The learned counsel would further submit that the interest earned by the raised capital in fixed deposit receipts has to be detailed as independent source of income not connected with the construction activities or business of the assessee. The learned counsel has proponed that the tribunal has failed to appreciate that commencement of commercial production and furnishing of performance guarantee are at two different

stages and, hence, procuring the award for the projects is inconsequential.

9. Resisting the aforesaid submissions, it is urged by Mr.S. Krishnan, learned counsel for the respondent, that the very award of the contract to the assessee rested on providing of performance guarantee in terms of the agreement and, therefore, there is an inextricable link between the furnishing of the performance guarantee and the execution of the contract. The pre-requisite of the performance bank guarantee was instrumental in initiation of the project itself, the completion of which could only pave the path of revenue generation for the assessee and, under these circumstances, it could not be treated as simply utilizing the idle and surplus funds in a different manner. It is further contended that furnishing of bank guarantee at the pre-operative or pre-commencement period cannot be given emphasis totally brushing aside the real crux that submission of performance guarantee is sine qua non for the purpose of entering into business and to sustain the business expediency.

10. At the very outset, we think it appropriate to reproduce the clauses from the concession agreement which deals with performance security:

> "5. **PERFORMANCE SECURITY**
>
> 5.1 The concessionaire shall for due and faithful performance of its obligation during the construction

> period provide to NHAI a bank guarantee from any bank in the form set forth in Schedule – 'F' (the 'Performance Security') for a sum equivalent to Rs.150 million (Rupees One thousand and Fifty million) on or before the date of this Agreement. Till such time the Concessionaire provides to NHAI the Performance Security pursuant hereto, the Bid Security shall remain in full force and effect. Failure of the Concessionaire to provide the Performance Security in accordance with this Clause 5.1 shall entitled NHAI to terminate this Agreement in accordance with the provision of the Clause 32.2 without being liable in any manner whatsoever to the Concessionaire and to appropriate the Bid Security as Damages.
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> 5.2 The performance security shall be released by NHAI to the Concessionaire upon contribution of the Equity by the shareholders and upon the Concessionaire having expended on the project and paid out an aggregate sum of not less than 50% (fifty percent) of the total Project Cost as certified by Statutory Auditors of the Concessionaire and provided the Concessionaire is in default in due and faithful performance of its obligations under this Agreement, the Performance Security shall be continued till the default is cured."

11. In ***Rajputana Trading Co. Ltd. v. Commissioner of Income-Tax, West Bengal, [1969] 72 ITR 286 (SC)***, it was held that when there is a fairly direct and proximate relationship between the income as deemed to be arising under Section 10(2A) and the speculative business which the assessee was carrying on, it would be most illogical and irrational to treat the so-called profit as having a neutral source and not springing out of the said business.

12. In ***Snam Progetti S.P.A. v. Additional Commissioner of Income-Tax, New Delhi-II and others, [1981] 132 ITR 70 (Delhi),*** it was held that nexus with the activities cannot be overlooked more so where the income is attributable to or derived from the targeted activity.

13. In ***Tuticorin Alkali Chemicals and Fertilizers Ltd*** (supra), a three-judge Bench of the Apex Court was dealing with the issue where the company had surplus funds in its hands and in order to earn income out of the surplus funds, it invested the amount for the purpose of earning interest. The company had borrowed funds, which was not immediately required by the company and the same was kept invested in short term deposit with banks. In that context, the Apex Court held as follows:

> "It is difficult to follow this reasoning. If a person borrows money for business purpose but utilises that money to earn interest, however temporarily, the interest so generated will be his income. This income can be utilised by the assessee whichever way he likes. He may or may not discharge his liability to pay interest with this income. Merely because it was utilised to repay the interest on the loan taken by the assessee, it did not cease to be his income. The interest earned by the assessee could have been used for many other purposes. If the assessee purchased a house or distributed dividend or paid salary to its employees with the money received as interest, will the interest amount be treated as not his

> income? This is not a case of diversion of income by overriding title. The assessee was entirely at liberty to deal with the interest amount as he liked. The application of the income for payment of interest could not affect its taxability in any way."
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> [Emphasis added]

14. In ***Commissioner of Income-tax v. Bokaro Steel Ltd., [1999] 236 ITR 315 (SC),*** the Apex Court was dealing with the situation wherein a government company, during the period of construction of plant, had advanced monies to contractors on which it was earning interest and received charges from quarters let out to the employees. It also received hire charges on plant let out to the contractors and received royalty on stones removed from its land. In that factual backdrop, their Lordships referred to the decision in ***Tuticorin Alkali Chemicals and Fertilizers Ltd.*** (supra) and analysed the facts and came to opine thus –

> "That case dealt with the question whether investment of borrowed funds prior to commencement of business, resulting in earning of interest by the assessee would amount to the assessee earning any income. This court held that if a person borrows money for business purposes, but utilises that money to earn interest, however temporarily, the interest so generated will be his income. This income can be utilised by the assessee whichever way he likes. Merely because he utilised it to repay the interest on the loan taken, will not make the interest income as a capital receipt. The department relied

> upon the observations made in that judgment (at page 179) to the effect that "if the company, even before it commences business, invests surplus funds in its hands for purchase of land or house property and later sells it at profit, the gain made by the company will be assessable under the head 'capital gains'. Similarly, if a company purchases rented house and gets rent, such rent will be assessable to tax under section 22 as income from house property. Likewise, a company may have income from other sources.... The company may also, as in that case, keep the surplus funds in short-term deposits in order to earn interest. Such interest will be chargeable under section 56 of the Income-tax Act". This court also emphasised the fact that the company was not bound to utilise the interest so earned to adjust it against the interest paid on borrowed capital. The company was free to use this income in any manner it liked. However, while interest earned by investing borrowed capital in short-term deposits is an independent source of income not connected with the construction activities or business activities of the assessee, the same cannot be said in the present case where the utilisation of various assets of the company and the payments received for such utilisation are directly linked with the activity of setting up the steel plant of the assessee. These receipts are inextricably linked with the setting up of the capital structure of the assessee-company. They must, therefore, be viewed as capital receipts going to reduce the cost of construction."
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> [Underlining is ours]

15. In this context, we may refer with profit to ***Commissioner of Income-tax v. Karnal Co-operative Sugar Mills Ltd., [2000] 243 ITR 2 (SC)*** wherein the assessee had deposited money to open a letter of credit for the purchase of the machinery required for setting up its plant in terms of the assessee's

agreement with the supplier. It was on the money so deposited that some interest had been earned. In that factual backdrop, the Apex Court ruled thus:

> "This is, therefore, not a case where any surplus share capital money which is lying idle has been deposited in the bank for the purpose of earning interest. The deposit of money in the present case is directly linked with the purchase of plant and machinery. Hence, any income earned on such deposit is incidental to the acquisition of assets for the setting up of the plant and machinery. In this view of the matter the ratio laid down by this court in Tuticorin Alkali Chemicals and Fertilizers Limited v. CIT [1997] 227 ITR 172, will not be attracted. The more appropriate decision in the factual situation in the present case is in CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315 (SC)."

16. In ***Bongaigaon Refinary And Petrochemicals Ltd. v. Commissioner of Income-Tax, [2001] 251 ITR 329 (SC)***, the question that arose for consideration was whether the tribunal was justified in holding that the items of income derived by the assessee during the formation period for the main business were not taxable income but were to be adjusted against the project cost for the oil refinery and petrochemicals, the main business for which the company was set up. It is worth noting that the High Court had answered the issue in negative relying on the decision in ***Tuticorin Alkali Chemicals and Fertilizers Ltd.*** (supra). In that context, their Lordships opined thus:

> "That was a case in which the question related to interest earned by a company during its formative period by investments. This court has held in CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315, that it is so confined and did not apply where the receipts were directly connected with or were incidental to the work of construction of the assessee's plant. The decision in CIT v. BoKaro Steel Ltd. [1999] 236 ITR 315(SC) has been followed by a two-judge Bench of this court in CIT v. Karnal Co-operative Sugar Mills Ltd. [2000] 243 ITR 2 and by a three-judge Bench in CIT v. Karnataka Power Corporation [2001] 247 ITR 268. In fact, in the latter case, it was not disputed by the Revenue that the question that related to hire charges paid by contractors had to be answered in the light of the judgment in Bokaro Steel Ltd.'s case [1999] 236ITR 315(SC). It is, therefore, not possible now to take any view different from that taken in Bokaro Steel Ltd.'s case [1999] 236 ITR 315(SC)"

17. In ***Commissioner of Income-Tax v. Koshika Telecom Ltd. [2006] 287 ITR 479 (Delhi)***, the factual matrix was that the assessee was engaged in the business of operating cellular mobile telephone services. In terms of a licence awarded in its favour for operation of the said services in the States of Uttar Pradesh, Bihar, Orissa and West Bengal, the assessee was required to provide finance and performance bank guarantees to the Department of Telecommunications. The assessee arranged the said bank guarantees from the institutions which, in connection with the furnishing of the guarantees, required deposit of margin money from which he earned the income. The

tribunal treated it assessable as business income. While dismissing the appeal of the revenue, this Court expressed the following view:

> "The finding of fact recorded by the Commissioner of Income-tax (Appeals) and affirmed by the Tribunal is to the effect that the deposit of the margin money by the assessee with the banks was inextricably linked to the furnishing of the bank guarantees by the assessee to the Department of Telecommunications for obtaining a licence. That finding in our view concludes the controversy inasmuch as if the deposits were indeed inextricably linked to the business of the assessee, the question whether the income accruing on the said deposits would constitute business income stands answered by the decisions of Supreme Court in Bokaro Steel Ltd. [1999] 236 ITR 315) and Karnal Co-operative Sugar Mills' Ltd. [2000] 243 ITR 2. Both these decisions are in our view sufficient authority for the proposition that where the income in the nature of interest flows from deposits made by the assessee which deposits are in turn inextricably linked to the business of the assessee, the income derived on such deposits cannot be treated as income from other sources."

18. In ***International Marketing Ltd. v. Income-Tax Officer, [2007] 292 ITR 504 (Delhi)***, following the law in ***Tuticorin Alkali Chemicals and Fertilizers Ltd.*** (supra), it was held that where the authorities below concurrently took the view that the assessee had not carried on any business during the relevant assessment year and that the interest earned by the assessee on surplus funds deposited with different companies was taxable as

income from other sources, the view taken could not be faulted with.

19. In ***Indian Oil Panipat Power Consortium Limited v. Income-Tax Officer, [2009] 315 ITR 255 (Delhi),*** this Court had posed the question regarding 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 and the CIT(A) had treated that the interest was in the nature of capital receipt which was liable to be set off against pre-operative expenses. The tribunal, relying on ***Tuticorin Alkali Chemicals and Fertilizers Ltd.*** (supra), dislodged the finding recorded by the first appellate authority. While dealing with the appeal of the assessee, the Bench referred to the decision in ***Bokaro Steel Ltd.*** (supra) holding thus:

> "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 [1997] 227 ITR 172 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. [1999] 236 ITR 315 (SC) 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."

20. Recently, in ***Commissioner of Income-tax v. Producin (P.) Ltd., [2010] 191 Taxman79***, the Apex Court was dealing with the issue whether the interest income received by the assessee on short-term fixed deposit constituted part of the total turnover of the assessee's business and also whether it formed a part of the total business income of the assessee. In that case, there was no dispute that the amount received by the assessee was from the amount he had invested in the FDR but there was no actual data whether the said amount was in terms of the agreement or contract of export, whether it was a part of the advance or whether it was part of the surplus at the hands of the assessee-company. In that factual backdrop, the Apex Court held thus:

> "3. At page 88 of the paper book the Tribunal holds that the interest income was generated by way of keeping the "advanced" received by the assessee in the course of its regular business activity. We do not know on what basis this observation has been made. It is not clear

> whether the contract between the parties was examined or not. The High Court while disposing of the matter has also not examined the factual basis. According to the Department, it was the case of surplus being invested in FDR whereas according to the assessee it was the case of advance having been received from the exporter which was invested in FDR for short duration.
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> 4. In view of the absence of factual matrix we are of the view that to decide the question as to whether the receipt fell under section 28 or under section 56 the matter needs to be remitted to the Tribunal for fresh consideration in accordance with law."

21. Keeping in view the aforesaid pronouncements in the field, the present controversy is to be adjudged. As is noticeable from the stipulations in the agreement, the performance guarantee by way of bank guarantee was required for faithful performance of its obligations. The non-submission of the guarantee would have entailed in termination of the agreement and NHAI would have been at liberty to appropriate bid security. That apart, the release of such performance security depended upon certain conditions. Thus, it is clearly evincible that the bank guarantee was furnished as a condition precedent to entering the contract and further it was to be kept alive to fulfill the obligations. Quite apart from the above, the release of the same was dependent on the satisfaction of certain conditions. Thus, the present case is not one where the assessee had made the deposit of surplus money lying idle

with it in order to earn interest; on the contrary, the amount of interest was earned from fixed deposits which was kept in the bank for furnishing the bank guarantee. It had an inextricable nexus with securing the contract. Therefore, we are disposed to think that the factual matrix is covered by the decisions rendered in ***Bokaro Steel Ltd.*** (supra), ***Karnal Co-operative Sugar Mills Ltd.*** (supra) and ***Koshika Telecom Ltd.*** (supra) and, accordingly, we hold that the view expressed by the tribunal cannot be found fault with.

22. Resultantly, we do not find any substantial question of law being involved in the present appeal and, accordingly, the same stands dismissed without any order as to costs.

CHIEF JUSTICE

MANMOHAN, J

MARCH 11, 2011
nm/dk/ks