

THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 07.01.2016

+ **ITA 1011/2015**

PR COMMISSIONER OF INCOME TAX ... Appellant

versus

FACOR POWER LTD ... Respondent

Advocates who appeared in this case:

For the Appellant : Mr Zoheb Hossain for Mr Rohit Madan

For the Respondent : None

CORAM:-

HON'BLE MR JUSTICE BADAR DURREZ AHMED

HON'BLE MR JUSTICE SANJEEV SACHDEVA

JUDGMENT

BADAR DURREZ AHMED, J (ORAL)

1. This appeal under Section 260A of the Income Tax Act (hereinafter referred to as 'the said Act') has been filed by the revenue being aggrieved by the order dated 10.06.2015 passed by the Income Tax Appellate Tribunal, New Delhi in ITA 4300/Del/2012 pertaining to the assessment year 2009-10.

2. The revenue has proposed the following questions which, according to the revenue, are substantial questions of law which need to be determined by this Court :-

- A. Whether the mode and manner of raising funds on which interest is earned, whether by way of loan or through share capital, is a material consideration in deciding the taxability of interest earned on such funds as income from other sources?
- B. Whether the earning of interest on surplus funds make it inextricably linked with setting up of the power project?
- C. Whether the judgment in *Tuticorin Alkali Chemicals and Fertilizers Ltd v. CIT* (1997) 227 ITR 172 (SC) is applicable to the present case and whether the judgment of this Hon'ble Court in *Indian Oil Panipat Consortium Ltd* is distinguishable from the facts of the present case?
- D. Whether the Hon'ble ITAT has failed to consider the judgment of this Hon'ble Court in *CIT v. Madhya Bharat Energy Corporation Ltd* (ITA No. 950/2008 dated 11.07.2011) wherein it was held that interest earned on FDs cannot be set off as pre-operative expenses?

3. The facts are that the assessee company was incorporated on 24.08.2005 to carry on in India or elsewhere the business to generate, receive, produce, improve, buy, sell etc. electric power by establishing thermal power plants, atomic power plants etc.. In the year under consideration, no business activity was carried out by the assessee as the project was under implementation.

4. On scrutiny, the assessment proceedings under Section 143(3) of the said Act were initiated. The Assessing Officer had noted that the

assessee had received an amount of ₹ 70,75,843/- from State Bank of Mysore as interest on fixed deposits but that the said amount was not declared in the return of income as 'income from other sources'. It was also noted by the Assessing Officer that the assessee had reduced the said interest amount from the capital work in progress and, therefore, the assessee was required to provide an explanation as to why the said interest income should not be treated as 'income from other sources'.

5. The assessee submitted that it had earned interest on FDRs which were placed with the bank as margin money for procurement of various capital goods for setting up of the power project. The Assessing Officer did not accept the explanation offered by the assessee and made an addition of ₹ 70,75,843/- as 'income from other sources'.

6. Being aggrieved, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals). Since the Assessing Officer had placed reliance on the Supreme Court decision in the case of **Tuticorin Alkali Chemicals and Fertilizers Ltd v. CIT: (1997) 227 ITR 172 (SC)**, the assessee sought to distinguish the said decision on the basis of facts and placed reliance on the decision of a Division Bench of this Court in the case

of *Indian Oil Panipat Power Consortium Limited v. Income Tax Officer:*
315 ITR 255.

7. After considering the submissions made on the part of the assessee and the material on record, the Commissioner of Income Tax (Appeals), by virtue of his order dated 14.05.2012, allowed the assessee's appeal and deleted the said addition. The relevant portion of the Commissioner of Income Tax (Appeals)'s order reads as under:-

“7.3 **Decision**

I have considered the submission of the appellant and observation of the ASSESSING OFFICER. It is seen that appellant company was in the process of setting up a power project in Orissa. For that appellant had acquired land in F.Y. 2007-08 and spent Rs. 68.62 lacs on purchase of land etc. During the F.Y.2008-09, appellant company has taken money from share holders as additional share capital in October 2008 for the purpose of acquiring capital assets for setting of the power plant. The money so received was put in FDRs for a temporary period of 3 months till the orders for machinery were placed. In the month of December, appellant awarded contract to M/s Thyssan Krupp Industries Pvt. Ltd for purchase of boiler for Rs.7500 lacs. The appellant gave advance of Rs.50,00,000/- to said company. In the month of January the appellant gave order for STG Set for Rs.3510 Lacs and paid advance of Rs.130 lacs to M/s BHEL. In the month of May 2009, appellant further gave contract to M/s Paharpur Cooling Towers for Rs. 1017 lacs and paid advance of Rs. 10 lacs. These facts established that amount raised as

additional share capital from share holders and put in the FDRs was inextricably linked with acquisition of plant and machinery by the appellant company. The additional share capital raised was for purpose of acquiring capital assets which was temporarily put in the Fixed Deposits. The appellant had spent substantial money in acquisition of land in F.Y. 2007-08 and for that purpose it has spent Rs.68.62 lacs. This shows that the funds raised by the appellant from share holders were not idle but the same were meant for acquisition Of capital assets. In view of the above it is held that funds raised by the appellant company were inextricably linked with acquisition of the capital assets. The interest received from such funds which were put in FDRs for temporary period was in the nature of capital receipts and such receipts was required to be set off against the preoperative expenses. In this regard reliance is placed on the decision of Hon'ble Delhi High Court in the case of *Indian Oil Panipat Power Consortium Ltd. vs ITO [2009]1315 ITR 0255 (DEL).*

INCOME OR CAPITAL — INTEREST - INTEREST EARNED PRIOR TO COMMENCEMENT OF BUSINESS ON FUNDS BROUGHT IN BY WAY OF SHARE CAPITAL FOR SPECIFIC PURPOSE - IS CAPITAL RECEIPT - LIABLE TO BE SET OFF AGAINST PRE-OPERATIVE EXPENSES-INCOME-TAX ACT.

The assessee-company was incorporated in pursuance of a joint venture entered into between Indian Oil Corporation and M of Japan to set up a Power Project. In order to effectuate the purpose for which the joint venture was conceived, share capital was contributed by these two corporations which included Rs.20 crores by way of additional share capital. The Assessing Officer treated the interest earned on monies received as share capital by the assessee temporarily placed in a fixed deposit awaiting acquisition of land which had run into legal entanglements on

account of title as "Income from other sources". The Commissioner (Appeals) accepted the stand of the assessee that the interest was in the nature of a capital receipt which was liable to be set off against pre-operative expenses. The Tribunal reversed this order. On appeal:

Held, allowing the appeals that the funds in the form of share capital were infused for the 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 be classified as "Income from the other sources". Since the income was earned in a period prior to commencement of business it was in the nature of a capital receipt and was required to be set off against pre-operative expenses.

Tuticorin Alkali Chemicals and Fertilizers Ltd. vs CIT19971 227 ITR 172(SC) distinguished.

The facts of the case laws relied upon by the ASSESSING OFFICER were different, therefore, the same are not applicable to the case of the appellant. The additional share capital raised by the appellant was linked with acquisition of capital assets, therefore, interest received from such capital is capital receipt and same can be adjusted against preoperative expenses. Therefore, the addition made by the ASSESSING OFFICER of Rs.70,75,843/-treating the interest income as "income from other sources" is deleted.

8. **Ground No. 5 & 6:-** These grounds of appeal are general in nature, therefore, do not require adjudication.

9. In the result, the appeal is partly allowed.”

8. Being aggrieved by the decision of the Commissioner of Income Tax (Appeals), the revenue preferred the said appeal (ITA 4300/Del/2012) before the Income Tax Appellate Tribunal on the following grounds:-

“1. The Learned CIT (A) has erred on the facts and circumstances of the case and in law in treating the interest income of Rs. 70,75,843/- received on account of bank deposit as capital receipt instead of treating it as income under head other sources and there by overlooking the ratio laid down in the case of Tuticorin Alkali Chemicals and Fertilizers Ltd.

2. The Learned CIT(A) has erred on facts and circumstances of the case and in law in allowing to adjust interest income against preoperative expenses, however assessee had no compulsion for making fixed deposit with the bank rather it was surplus money kept with the bank to earn interest.”

9. The Income Tax Appellate Tribunal concurred with the view of the Commissioner of Income Tax (Appeals) and held that the interest income earned by the assessee in the pre-commencement period could not be stated to be ‘income from other sources’. The Tribunal confirmed the finding of fact returned by the Commissioner of Income Tax (Appeals) that the amount raised as additional share capital from the shareholders and put in fixed deposits was inextricably linked with the acquisition of plant and machinery by the assessee. The Commissioner of Income Tax (Appeals) had also held on facts that the additional share capital raised was for the

purposes of acquiring capital assets which were temporarily put in fixed deposits. Advances had been made towards purchase of plant and machinery and orders had been placed. And, awaiting delivery, the funds were temporarily put in fixed deposits. It is in this sense that findings of fact were returned by both the Commissioner of Income Tax (Appeals) and Income Tax Appellate Tribunal that the interest earned on the FDRs was inextricably linked with the acquisition of plants and machinery by the assessee company.

10. After having heard the learned counsel for the revenue, we are of the view that no substantial question of law arises for our consideration. This is so because, in our view, the Tribunal has correctly placed reliance on the decision of this Court in *Indian Oil Panipat Power Consortium Limited (supra)*. The facts in that case were quite similar. In that case also monies had been received as share capital by the assessee which were temporarily put in fixed deposits awaiting acquisition of land which had run into legal entanglements on account of title. The question of law which was raised before the Division Bench was: –

“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 off against pre-operative expenses?”

The Division Bench considered the decisions of the Supreme Court in *Tuticorin Alkali Chemicals and Fertilizers Ltd (supra)* and *CIT v. Bokaro Steel Limited: (1999) 236 ITR 315*. The Division Bench held as under:-

“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."

11. From the above extract, it is evident that the test that is required to be employed 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 same. In the present case, findings of fact have been returned by the Commissioner of Income Tax (Appeals) and have been confirmed by the Income Tax Appellate Tribunal to the effect that the funds were inextricably connected with the setting up of the power plant of the assessee. The learned counsel for the revenue has also not been able to point out any perversity in such finding and, therefore, the factual findings have to be taken as those accepted by the Income Tax Appellate Tribunal which is the final fact finding authority in the income tax regime. That being the case, the decision of the Division Bench in *Indian Oil Panipat Power Consortium Limited (supra)* would squarely apply to the facts of the present case and the Tribunal was right in applying the same.

12. Before parting with this decision, we would, however, like to comment upon a contention which has been raised by the learned counsel for the revenue. He submitted that the Tribunal in the impugned order made an observation in paragraph 8 of the impugned order which gives an impression that if funds were obtained through raising share capital as distinct from borrowed funds, then the question of interest derived on placing those funds in a fixed deposit amounting to 'income from other sources' would not arise. Such an impression ought not to be gathered from the Tribunal's decision because the Supreme Court in *Tuticorin Alkali Chemicals and Fertilizers Ltd (supra)* had clearly stated that whether the funds are raised by issue of shares and debentures or through borrowing would not make any difference to the principles set out thereunder. The principle being that if the capital of a company is fruitfully utilised instead of keeping it idle, the income thus generated, will be of a revenue nature and not accretion of capital.

13. In the present case, there is a finding of fact that the money placed in the fixed deposit was inextricably linked with the setting up of the power plant. Thus, the revenue generated on account of interest on the said fixed deposits would be in the nature of a capital receipt and not a revenue

receipt. This case has been decided on the basis of this principle and not on the basis that the source of the funds was through raising of share capital and not through borrowings.

14. For the foregoing reasons, we do not find that there is any substantial question of law which arises for our consideration and the very issues which are sought to be raised in the present case had been squarely covered by the decision of this Court in *Indian Oil Panipat Power Consortium Limited (supra)*.

The appeal is dismissed.

BADAR DURREZ AHMED, J

**JANUARY 07, 2016
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SANJEEV SACHDEVA, J