

**IN THE INCOME TAX APPELLATE TRIBUNAL
BENCH 'B' NEW DELHI**

**ITA Nos.2337 & 4337/Del/2010
Assessment Years: 2006-07 & 2007-2008**

**DEPUTY COMMISSIONER OF INCOME TAX
CIRCLE-11(1), NEW DELHI**

Vs

**M/s ENERGY INFRASTRUCTURE INDIA LTD
NO 5 E BLOCK, LOCAL SHOPPING COMPLEX
MASJID MOTH, GREATER KAILASH-II, NEW DELHI
PAN NO:AAACW1044R**

C L Sethi, JM K G Bansal, AM

Dated: January 7, 2011

Appellant Rep by: Ms Y S Kakkar, Sr. DR

Respondents Rep by: Shri Akash Singhal, CA & Shri Navin Jain

ORDER

Per: C L Sethi:

These two appeals, filed by the revenue, are directed against two separate orders dated 9.03.2010 and 30.07.2010 passed by the learned Commissioner of Income-tax (Appeals), pertaining to the assessment years 2006-07 and 2007-08 respectively.

ITA No.2337/Del/2010

2. We shall first take up the appeal pertaining to the assessment year 2006-07. In this appeal, the only ground raised by the revenue is as under: -

“On the facts and circumstances of the case and in law, Ld. CIT(A) has erred in deleting the disallowing of set off of interest income of Rs.33,10,000/- against the pre-operative expenses expended by the appellant.”

3. In this case, the return of income was filed on 30.11.2006 declaring total loss of Rs.17,49,09,303/-. The case was selected for scrutiny by the Assessing Officer. During the course of assessment proceedings, it was noticed by the AO that the assessee has deducted a sum of Rs.33,10,000/- from the pre-operative expenses. The aforesaid sum of Rs.33,10,000/- represents the interest income earned on deposits lying with various banks. The Assessing Officer observed that the funds lying with the banks are out of the funds received by the assessee as advance against equity from the foreign collaborator. The assessee was, therefore, asked to explain as to why the interest income of Rs.33,10,000/- has not been shown separately chargeable to tax under the head “Income from other sources” and instead it has been reduced from the pre-operative expenses. The assessee submitted its reply that the assessee company had given certain bank guarantee worth Rs.9 crore to statutory bodies namely, Gujarat Maritime Board and Gail India Ltd. in connection with the setting up of LPG Project Import Terminal at the Okha Gujarat and the fixed deposits were kept under lien with Banks for issuing the above said bank guarantee; the assessee had earned interest on these fixed deposits which were reduced from the pre-operative expenses incurred during the year since the interest income was received in precommencement period and was directly connected with the setting up of the project. In support of the assessee's claim, the assessee relied upon the decision of Hon'ble Supreme Court in the case of *Karnal Cooperative Sugar Mills Ltd., 243 ITR 2* and in the case of *Bokaro Steel Ltd = 236 ITR 315*, where it has been held that any amounts which are inextricably linked with the process of setting up of its Plant and Machinery, such receipts will go to reduce the cost of its assets as these receipts are of capital nature and cannot be taxed as income chargeable to tax.

4. The aforesaid explanation of the assessee was considered by the AO but the same was not found acceptable to him. The AO then concluded his view as under: -

“The assessee has received advance against share capital from the holding company. The said money has been deposited in bank. The findings given by the Supreme Court in the case of Tuticorin Alkalies Chemicals & Fertilizers Ltd. - 227 ITR 172 are

clearly applicable to the facts of the case. In the said case, it has been held by the Hon'ble Supreme Court that interest on deposits is to be taxed as income from other sources and it cannot be set off against pre-operative expenses. Accordingly, the sum of Rs.33,10,000/- is brought to tax as income from other sources."

5. Being aggrieved, the assessee preferred an appeal before the CIT(A).

6. Before the CIT(A), the assessee submitted detailed submissions which read as under: -

"a) The Appellant Company was in the process of setting up a Liquefied Petroleum Gas (LPG) import terminal at Okha, Gujarat. The appellant company had started a Market Seeding Program from 1st December, 2002. The Market Seeding Program involves manufacture and direct purchases of LPG in bulk and also, filling of LPG in cylinders and sale to customers through a distribution channel. The direct income/expenses pertaining to the above Market Seeding Program have been considered in the Profit and Loss Account while the indirect expenses are allocated to the Market Seeding Program and the Project to the extent this expenditure benefited each activity. The Project expenses are carried forward, pending capitalization upon the commencement of Project Operation. This fact was mentioned by way of note no. B(1) of Schedule 16 to the audited balance sheet as at March 31, 2006.

b) The Company has given certain Bank Guarantees worth Rs.9 Crores to Statutory bodies viz Gujarat Maritime Board and Gail India Ltd in connection with the setting up a LPG Project Import Terminal at the Okha, Gujarat.

c) The Fixed Deposits kept under lien with Banks for issuing the above said Bank Guarantees have earned interest during the Assessment Year which has been reduced from Preoperative Expenses incurred during the year since the interest income is received in precommencement period and is directly connected to the setting up of the Project.

d) In the present case, the assessee contends that as per the law laid down by Supreme Court in CIT v. Karnal Co-op. Sugar Mills Ltd. 243 ITR 2 and in Bokaro Steels Ltd., 236 ITR 315, the interest was capital receipt and should go to reduce the cost of the asset.

Further the clouds over the law relating to treatment of receipts before business is set up could be said to have been finally cleared with the decision of Supreme Court in Bongaigaon Refinery and Petrochemicals Ltd. V. CIT[2001] 251 ITR 329 following the law laid down in CIT V. Bokaro Steel Ltd [1991] 236 ITR 315 (SC), CIT V. Karnal Cooperative Sugar Mills Ltd. [2000] 243 ITR 2 (SC) and CIT V. Karnataka Power Corporation [2001] 247 ITR 268 (SC). Such receipts to the extent to which they get capitalized will go to reduce the capital investment and therefore the book value of assets for the purpose of depreciation.

The Supreme Court in this Order also emphasized in last line of para 3 that.. is, therefore, not possible now to take any view different from that taken in Bokaro Steel Ltd.'s case [1999] 236 ITR 315 (SC).

e) Interest to the extent of Rs.3960 thousand which is related to interest income other than interest on margin money has been recognized and included as income during the year.

f) In the earlier years i.e. Assessment Year 2001-2002 and 2002-2003, on the same issue i.e. interest on fixed deposits kept with bank as margin money, for guarantee issued for project, the assessee has made claim by making an application under section 154 for set-off of interest income with pre-operative expenses which was rejected by the assessing officer (AO). There after the Tribunal had also rejected the same, on the ground that additional/new claim cannot be made under section 154. However the Hon'ble ITAT has made the following observations in its order at para 4.4:-

"...Further there is no dispute in this case that facts on record clearly show that the assessee had received the interest on FDRs kept on lien with the bank in connection with setting up of the project and the interest had been received in the pre commencement period which as per the judgments of the Hon'ble Supreme Court (supra) is a capital receipt and not taxable."

g) Further, in the assessment year 2004-05, the AO in his order under section 143(3), has allowed the interest income to be setoff against pre-operative expenses.

h) Hence the above mentioned interest receipt is of capital nature and cannot be taxed as Income and has to be reduced from the capital cost of the assets as held by the Supreme Court in aforesaid cases."

7. After considering the AO's order, assessee's submissions and the facts and circumstances of the case, the learned CIT(A) decided the matter in favour of the assessee. The CIT(A) noted the facts that the assessee company was engaged in the process of setting up of a Liquefied Petroleum Gas (LPG) import terminal at Okha, Gujarat. It has received advance from the holding company. The setting up of the LPG Project was in progress and the company was required to give bank guarantee worth Rs.9 crore to statutory bodies namely, Gujarat Maritime Board and Gail India Ltd. in connection with the setting up of the LPG Project Terminal at Okha, Gujarat. For the purpose of issuing bank guarantee, the company made fixed deposit with the bank out of the fund received from the holding company and kept the fixed deposit under lien with the banks as margin money. The interests earned on the fixed deposits kept under lien were reduced from preoperative expenses incurred during the year. The learned CIT(A) has referred to the following decisions: -

(1) *Tuticorin Alkali Chemicals & Fertilizers Ltd. Vs. CIT - (1997) 227 ITR 172 (SC)* which has been relied upon by the AO.

(2) *CIT vs. Bokaro Steel Ltd., - 236 ITR 315 (SC)* relied upon by the assessee.

(3) *CIT vs. Karnataka Power Corporation, 247 ITR 268 (SC)* relied upon by the assessee.

(4) *Bongaigaon Refinery & Petrochemicals Ltd. Vs. CIT, 251 ITR 351*, relied upon by the assessee.

(5) *CIT vs. VGR Foundations, - 298 ITR 132 (Madras)*.

(6) *Karnal Co-operative Sugar Mills Ltd., 243 ITR 2 (SC)*.

8. After narrating the above mentioned facts and decisions, the learned CIT(A) decided this issue by observing as under: -

"4. In the present case, the appellant had utilized its funds being advance against share capital received from the holding company in the fixed deposits kept as margin money with bank. And in the earlier assessment years on the same issue, the observation made by the Tribunal and the AO in the AY 04-05 has himself allowed the same. Thus, from the above discussion, the observations made by the Tribunal on merits, the action of the AO in the A.Y. 2004-05 and respectfully following the decision given by the Madras High Court in case of CIT v VGR Foundations -(298 ITR 132) on a similar issue, decisions of the Supreme Court in the case of CIT v. Bokaro Steel Ltd. - [1999] 236 ITR 315, in CIT v. Karnal Cooperative Sugar Mills Ltd. [2000] 243 ITR 2 (SC), Karnataka Power Corporation[2001] 247 ITR 268, the claim of the appellant of setting off the interest income from the expenses incurred prior to the commencement of business is allowable."

9. The learned DR supported the AO's order and submitted that the interest earned on fixed deposit made out of the share capital contributed by the promoters is assessable as income from other sources as held by the Hon'ble Supreme Court in the case of Tuticorin Alkali Chemicals & Fertilizers Ltd. (supra).

10. The learned counsel for the assessee on the other hand, reiterated the contentions and submissions that were made before the authorities below and relied upon the various decisions that placed before the learned CIT(A).

11. We have heard both the parties and have gone through the orders of the authorities below. We have deliberated upon the position of law as emerged from the various decisions referred to by the learned CIT(A), which have been relied upon by both the parties before us.

11.1 In the present case, it is not in dispute that the assessee had received share capital from the holding company. The share capital received by the assessee was deposited with the bank. The assessee company was engaged in the process of setting up of the Liquefied Petroleum Gas import terminal at Okha, Gujarat. The project has not yet been completed and it is in the stage of completion. In the course of setting up of LPG Project the assessee was required to give certain bank guarantee worth Rs.9 crore to statutory bodies namely, Gujarat Maritime Board and Gail India Ltd. In order to avail the bank guarantee from the bank, the company had deposited its fund received from the holding company towards fixed deposit and

earned interest thereupon. The fixed deposits made with the bank were kept with the banks on lien as margin money against the guarantees issued by the bank. These facts have not been controverted by the department. Nothing has been brought on record to show and establish that the fixed deposits were not made in connection with obtaining bank guarantee from the bank, which were required to be furnished to the statutory bodies namely, Gujarat Maritime Board and Gail India Ltd. in connection with the setting up of the LPG Project Terminal at Okha, Gujarat. The interest earned on the fixed deposits which are relatable to the bank guarantee given by the bank in connection with the setting up of the LPG Project Terminal at Okha, Gujarat, has been reduced from the pre-operative expenses. The interest received by the assessee on other deposits, which are not connected to the setting up of LPG Project Terminal, has been offered to tax as income from other sources. These details have been submitted by the assessee before us, and we find that interest of Rs.33,10,000/- was earned on the fixed deposit, which was kept in lien for obtaining bank guarantee furnished to Gujarat Maritime Board and Gail India Ltd. in connection with the setting up of LPG Project Terminal at Okha, Gujarat. Therefore, on the facts and circumstances of the case, the decisions of Hon'ble Supreme Court in the cases of CIT vs. Karnataka Power Corporation (supra), CIT vs. Bokaro Steel Ltd. (supra) and CIT vs. Bongaigaon Refinery and Petrochemicals Ltd. (supra) are applicable to the present case. The decision of Hon'ble Supreme Court in the case of Tuticorin Alkali Chemicals & Fertilizers Ltd. (supra) is not applicable to the present case as it was rendered on different facts as so has been distinguished and analyzed by the Hon'ble Madras High Court in the case of VGR Foundations (supra). The Hon'ble Supreme Court in the case of Tuticorin Alkali Chemicals & Fertilizers Ltd. (supra) was considering investment of borrowed funds prior to a commencement of a business and held that interest earned was taxable. In the case of Bokaro Steel Ltd. (supra) it was a case of Government company which during the period of construction of the plant, had advanced the moneys to the contractors on which it was earning interest, received rent from quarters let out to employees, received hire charges on plant let out to contractors and received royalty on stones removed from the assessee's lands. The Hon'ble Supreme Court considered all these activities to be inextricably connected with the construction activity and accordingly held that interest received, rent received, hire charges and royalty, etc. would be reduced from the cost of the assets and it would not be treated as income. Similar view was expressed by the Hon'ble Supreme Court in the case of Bongaigaon Refinery and Petrochemicals Ltd.

(supra), Karnal Co-operative Sugar Mills Ltd. (supra) and Karnataka Power Corporation (supra).

12. For the foregoing reasons, we are, therefore, inclined to uphold the order of the CIT(A) in holding that the interest earned by the assessee on fixed deposits, which were kept as lien against bank guarantee required to be furnished to the statutory bodies namely, Gujarat Maritime Board and Gail India Ltd. in connection with the setting up of LPG Project Terminal at Okha, Gujarat, shall be reduced from the cost of the pre-operative expenses of the plant and shall not be assessable separately as income from other sources inasmuch as the interest earned is inextricably connected with the setting up of the LPG Project Terminal at Okha, Gujarat. The order of the learned CIT(A) is thus, upheld.

ITA No.4337/Del/2010

13. Now, we shall take up the appeal for the assessment year 2007-2008. In this appeal the ground raised is as under: -

“On the facts and circumstances of the case and in law, Ld. CIT(A) has erred in deleting the disallowing of Rs.39,96,000/- on account of interest income treating it as income from other sources.”

14. The facts and circumstances in the present assessment year are similar to that of the assessment year 2006-07 being connected to the interest income earned on fixed deposits made with the bank to obtain bank guarantee required to be submitted to the statutory bodies namely, Gujarat Maritime Board and Gail India Ltd. in connection with the setting up of LPG Project Terminal at Okha, Gujarat. In the light of the decision for the assessment year 2006-07, the order of the CIT(A) in this assessment year 2007-08 is upheld.

15. In the result, both the appeals filed by the revenue are dismissed.

16. This decision is pronounced in the Open Court on 7.1.2011.