

IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

ITA No. 238 of 2009 (O&M)

Date of Decision: 28.8.2015

Commissioner of Income Tax-II, Chandigarh

....Appellant.

Versus

M/s Essar Commvision Ltd. (now HFCL Infotel Ltd.), Mohali

...Respondent.

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

**CORAM:- HON'BLE MR. JUSTICE AJAY KUMAR MITTAL.
HON'BLE MR. JUSTICE RAMENDRA JAIN.**

PRESENT: Ms. Urvashi Dhugga, Advocate for the appellant.

Mr. Ravi Shankar, Advocate for the respondent.

AJAY KUMAR MITTAL, J.

1. Delay of 753 days in re-filing the appeal is condoned.
2. This appeal has been preferred by the revenue under Section 260A of the Income Tax Act, 1961 against the order dated 24.5.2006 (Annexure A-3) passed by the Income Tax Appellate Tribunal, Chandigarh Bench 'A', Chandigarh, in ITA No. 539/Chandi/2004, for the assessment year 1998-99, claiming the following substantial question of law:-

Whether the Tribunal in the facts relevant to the case and in law was right in allowing set off, of interest

income earned on the fixed deposits kept for arranging bank guarantees, towards the cost of capital assets?

3. A few facts necessary for adjudication of the instant appeal as narrated therein may be noticed. The assessee is engaged in the business of providing telecommunication services and filed its return of income on 27.11.1998 declaring the income at ₹ 12 lacs. The Assessing Officer framed the assessment under Section 143(3) of the Act vide order dated 30.8.2000 (Annexure A-1) at ₹ 75,00,960/- by holding that the interest earned on the fixed deposit relating to pre-operative period constitutes income assessable under the head 'Income from other sources' and such income could not be set off against the pre-operative expenses, the assessing officer assessed the interest amounting to ₹ 62,93,942/- under the head 'Income from other sources' for which he drew support from **Tuticorin Alkali Chemicals and Fertilizers Ltd. v. Commissioner of Income-Tax, Madras, (1997) 227 ITR 172** and **Commissioner of Income-Tax Vs. Coromandal Cements Ltd., 234 ITR 412 (SC)**. Feeling aggrieved, the assessee filed an appeal before the Commissioner of Income Tax (Appeals) [for brevity "the CIT(A)"]. The CIT(A) vide order dated 2.3.2001 (Annexure A-2) allowed the appeal and deleted the interest income of ₹ 62,93,942/-. Reliance was placed upon judgments of the Apex Court in **Karnal Cooperative Sugar Mills Ltd. v. Commissioner of Income-Tax (1998) 233 ITR 531 (P&H)** and in **Commissioner of Income-Tax v. Bokaro Steel Ltd. (1999) 236 ITR 315 (SC)**. Being dissatisfied, the revenue filed an appeal before the Tribunal who vide order dated 24.5.2006 (Annexure A-3) following its

earlier order dated 14.11.2005 in the case of the assessee for the assessment years 1999-2000 and 2000-01 in ITA Nos. 614-15/Chandi/2003 upheld the order of the CIT(A) and dismissed the appeal. Hence, the present appeal.

4. Learned counsel for the revenue submitted that the assessee was required to explain the purpose for which the interest income has been utilized. It was urged that in view of Supreme Court judgment in **Tuticorin Alkali Chemicals and Fertilizers Ltd. v. Commissioner of Income-Tax (1997) 227 ITR 172**, the Tribunal had erred in deciding the issue in favour of the assessee. Reliance was placed upon the following judgments also in support of her contention:-

- (i) **Commissioner of Income-Tax v. Dr. V.P. Gopinathan, (2001) 248 ITR 449 (SC);**
- (ii) **Commissioner of Income-Tax v. Derco Cooling Coils Ltd. (1992) 198 ITR 375 (AP);**
- (iii) **Commissioner of Income-Tax v. Manglam Cement Ltd., (1996) 217 ITR 369 (Raj);**
- (iv) **Commissioner of Income-Tax v. Pandian Chemicals Ltd. (1998) 233 ITR 497 (Mad);**
- (v) **Commissioner of Income-Tax v. Autokast Ltd., (1998) 229 ITR 789 (Ker.);**
- (vi) **Southern Herbals Ltd. v. Settlement Commission (IT&WT) and another, (2003) 261 ITR 681 (Kar.);**

5. The primary issue that arises for consideration in this appeal is whether the interest earned by the assessee on the fixed deposits

kept for managing bank guarantees during pre-operative period would reduce the cost of the capital assets.

6. In order to effectively, adjudicate the controversy involved herein it would be advantageous to refer to various judgments on the subject as heavy reliance has been placed thereon by both the parties.

7. A Division Bench of this Court in **Karnal Sugar Mill Ltd's case (supra)** was considering the issue where the cooperative society was formed for running sugar mills and production had not started. The assessee had kept part of share capital as fixed deposit to open a letter of credit under agreement for purchase of machinery. The question arose as to the nature of taxability of receipt of interest on such fixed deposit. It was held by this Court that the interest was not assessable as income from other sources as it was directly related to acquisition of the asset and would reduce the cost of the asset. The relevant conclusion reads thus:-

“In the case of the assessee before us, it has already been seen that money was deposited, to open a letter of credit under the terms of the agreement with the supplier of the machine. It was, therefore, not a case where surplus share capital money lying idle and unused had been deposited in the bank. Here the money was deposited out of necessity for the purpose of acquiring an asset. The plea of the Department that unutilised and surplus money had been deposited by the assessee, does not appear to be correct. The assessee's plea that money had been deposited so as to open a letter of credit has not been controverted.

Therefore, the activity of depositing money out of the share capital was an activity incidental to the acquisition of the asset. It was not a case where surplus share capital money was deposited with the bank because it was lying unutilised and idle. The assessee deposited the money with the bank with a definite purpose to execute an agreement for the purpose of acquiring the machine. There is, however, no evidence on record to show that the fixed deposit has been made by the assessee out of the borrowings. It was the share capital which was deposited. The question, therefore, arises as to whether the deposit of the share capital money was made because the assessee did not for the time being, require the money for its business. The assessee purchased fixed deposits in the course of an activity directly relatable to the acquisition of an asset. There is, thus, a direct nexus between the purchase of the machinery and the deposit of money in the -bank. This nexus shall bring about a presumption in the assessee's favour that the money was deposited not without a purpose but with the object of acquiring a machine from the supplier. Such interest income being directly relatable to the terms of the contract for acquiring a business asset should go to reduce the cost of the asset. As has been seen, the Supreme Court in **CIT v. U. P. State Industrial**

Development Corporation [1997] 225 ITR 703 took notice of the activity of underwriting shares and the earning of the underwriting commission and brokerage from such activity. It was held that as the underwriting commission had been earned by the assessee in the course of taking over certain shares, such commission shall go to reduce the cost of the shares acquired by the assessee and could not be taken into the profit and loss account. Since, the assessee had subscribed certain shares out of the underwritten shares, the commission relating to those shares went towards the cost and no income was earned by the underwriter. Following the ratio laid down by the Supreme Court in **CIT v. U. P. State Industrial Development Corporation [1997] 225 ITR 703**, it has to be concluded, in the present case, that the interest income earned by the assessee was directly relatable to the activity of acquiring an asset from a supplier in whose favour a letter of credit was opened after paying money in fixed deposits. Since, the two activities, namely, deposits made in the bank and the acquisition of machinery have a direct nexus, the interest income has to be associated with the cost of the asset so acquired. It was not a case of deposit of surplus money, entirely unconnected with any other activity of the assessee. The deposit of share capital money with the bank had a definite purpose and

object. In this light, the interest earned by the assessee shall go to reduce the cost of the asset acquired out of the transaction.”

8. An appeal carried by the revenue against the aforesaid pronouncement was dismissed by the Apex Court in **Commissioner of Income Tax v. Karnal Cooperative Sugar Mills Ltd. (2000) 243 ITR 2** with the following observations:-

“Leave granted.

2. In the present case, 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 has been earned. 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**, will not be attracted. The more appropriate decision in the factual situation in the present case is in **CIT v. Bokaro Steel Ltd.** The appeal is dismissed. There will be no order as to costs.”

9. In **Bokaro Steel Ltd.'s case (supra)**, a two Judges Bench of the Apex Court was considering the case of an assessee who had received rent from its contractors for housing workers and staff employed by the contractor for the construction work of the assessee. The assessee had received hire charges for plant and machinery which were given to the contractor by the assessee for use in the construction work of the assessee. Interest was also received from advances made to contractors for facilitating the construction work. After referring to the judgment in **Tuticorin Alkali Chemicals and Fertilizers Ltd.'s case (supra)**, it was concluded that the receipts of the assessee were inextricably linked with the setting up of capital structure of the assessee-company and therefore, these receipts, which were recovered in pre-operative period were capital receipts and shall reduce the cost of construction.

10. In **Commissioner of Income Tax v. Karnataka Power Corporation (2001) 247 ITR 268 (SC)**, a three Judge Bench of the Supreme Court was considering the issue where the assessee received interest and hire charges from contractors which were claimed as capital receipt reducing the capital cost. The Tribunal and the High Court decided the matter in favour of the assessee against which the revenue went in appeal to the Supreme Court. The Supreme Court upheld the view of the Tribunal and the High Court following its earlier decision in the case of **Bokaro Steel Ltd's case (supra)**.

11. In **Bongaigaon Refinery and Petrochemicals Ltd. v. CIT (2001) 251 ITR 329 (SC)**, the assessee received interest income, income from guest house, charges for equipment and recoveries from the contractors on account of water and electricity supply. The High

Court, following the decision of the Supreme Court in the case of **Tuticorin Alkali Chemcials and Fertilizers Ltd.'s case (supra)** held that the above receipts are taxable in the assessee's hand. The Supreme Court while considering the issue held that the income was received by the assessee during formative period towards renting of guest house, charges for equipment and recovery from contractors towards water and electricity supply and they are covered by the decision of the Supreme Court in **Bokaro Steel Ltd's case (supra)** and, therefore, these receipts will go to reduce the cost of construction. A relevant extract from the decision of the Supreme Court is quoted as under:-

“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 (SC)**, 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. (supra)** has been followed by a two-judge Bench of this Court in **CIT v. Karnal Cooperative Sugar Mills Ltd. (2000) 243 ITR 2 (SC)** and by a three-Judge Bench in **CIT v. Karnataka Power Corporation (2001) 247 ITR 268 (SC)**. 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

light of the judgment in Bokaro Steel Ltd's case (supra). It is, therefore, not possible now to take any view different from that taken in Bokaro Steel Ltd's case (supra)."

12. It may also be noted that in the case of the assessee itself in **ITA Nos. 616 and 617 of 2006 (Commissioner of Income Tax, Chandigarh-I v. M/s HFCL Infotel Limited, Mohali)** decided on 9.7.2007 for the assessment years 1999-2000 and 2000-01, the identical issue was held in favour of the assessee in view of the judgments of the Apex Court in **Karnal Cooperative Sugar Mills Ltd. and Bokaro Steel Ltd. cases (supra)** against which the Special Leave Petition (Civil) No. 17019 of 2008 was dismissed by the Apex Court on 6.1.2009.

13. Adverting to the judgment of the Apex Court in **Tuticorin Alkali Chemicals and Fertilizers Ltd.'s case (supra)** on which heavy reliance has been placed by the learned counsel for the revenue, therein the assessee had taken loans from banks and financial institutions for the purpose of setting up factories whereas surplus borrowed funds which were not required by the assessee was kept invested in the short term deposit with banks. The interest income on those surplus short term deposit with the banks was held to be assessable as 'Income from other sources' under Section 56 of the Act by a three Judges Bench of the Supreme Court. This judgment was followed by the Supreme Court in **Coromondal Cements Ltd.'s case (supra)**. However, the situation herein is distinguishable inasmuch as in the present case, the assessee had earned interest income on the fixed deposits kept for arranging bank guarantees in the formative period and not that the surplus funds were utilized for earning additional interest income. In **Gopinathan's case**

(supra), interest had accrued from fixed deposit in bank and there was loan taken against security of fixed deposit. The interest on loan was held to be not deductible under Section 57(iii) of the Act. The factual matrix herein is different and thus, this decision also has no applicability. Regarding other pronouncements on which revenue had placed reliance as referred to in para 4 above of different High Courts, suffice it to notice that the issues there were either similar to the one raised in **Tuticorin Alkali Chemicals and Fertilizers Ltd.'s case (supra)** as they are based following the said decision or are on individual fact situation involved in those cases. Thus, they also do not advance the contention of the revenue.

14. In view of the above, the substantial question of law is answered against the revenue and in favour of the assessee. Accordingly, finding no merit in this appeal, the same is hereby dismissed.

(AJAY KUMAR MITTAL)
JUDGE

August 28, 2015
gbs

(RAMENDRA JAIN)
JUDGE