

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 13.06.2019

CORAM :

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

TCA.No.322 of 2019
and CMP.No.12046 of 2019

M/s. India Metal One Steel Plate
Processing Private Limited,
Chennai - 600 006. ... Appellant

Vs.

The Deputy Commissioner of Income
Tax, Corporate Circle - 2 (2)
121, Mahatma Gandhi Road,
Chennai - 600 034. ... Respondent

* * *

Prayer : Tax Case Appeal filed under Section 260A of the
Income Tax Act, 1961, against the order of the Income Tax
Appellate Tribunal Chennai 'A' Bench, dated 27.11.2018 in
I.T.A.No.3497/CHNY/2016 for the assessment year 2012-13. against
the order of Commissioner of Income Tax (Appeals) - 6, Chennai
in ITA 185/CIT (A) - 6/15-16 dated 18.10.2016 for assessment
year 23.03.2015 passed under section 143(3) of the Income Tax
Act 1961, by the Deputy Commissioner of Income Tax Corporate
Circle - (2) Chennai made in ITA.No. 185/CIT (A) - 6/2015-2016
in PAN No. AACC 159598.

For Appellant : Mr. SP.Chidambaram

For Respondent : Mr.Karthick Rengathan, SSC
assisted by Mr.S. Rajesh

JUDGMENT

(Judgment of the Court was delivered by T.S.Sivagnanam,J)

This appeal filed by the assessee under Section 260 A of
the 'Income Tax Act, 1961' (hereinafter referred to as the Act)
is directed against the order dated 27.11.2018 passed by Income
Tax Appellate Tribunal, Chennai 'A' Bench (for short, the
Tribunal) in ITA.No.3497/CHNY/2016 for the Assessment Year 2012-
13.

2. The assessee has raised the following substantial questions of law:

"1) Whether, in law, the Tribunal was right in holding that interest earned on short term deposits out of equity funds for purchase of assets, prior to commencement of business, is not a capital receipt but is taxable as "Income from Other Sources"?

2) Whether, in law, the Tribunal was right in not allowing the expenditure for earning interest income?

3) Whether, in law, the Tribunal having held that interest income should be considered as a revenue receipt chargeable to tax, then the Tribunal ought to have consequentially held that the expenditure of Rs.2,55,75,842 debited to Profit & Loss Account should be allowed as a deduction? and

4) Whether, in law, the Tribunal was right in not appreciating that since the interest is directly related to the manufacturing facility, it should be added to the Capital Work in Progress?"

3. We have heard Mr.SP.Chidambaram, learned counsel appearing for the appellant/assessee and Mr.Karthick Renganathan, learned Senior Standing Counsel assisted by Mr.S.Rajesh, learned counsel for respondent Revenue.

4. The short issue, which is required to be decided in this case, is as to whether the interest earned by the assessee on short term deposits out of equity funds for purchase of assets prior to commencement of business, is a capital receipt or it is taxable as 'Income from Other Sources'.

5. The Assessing Officer found that such interest is taxable under the head 'Income from Other Sources', which finding was confirmed by the Commissioner of Income Tax (Appeals), [hereinafter referred to as the CIT(A)] and further affirmed by the Income-Tax Appellate Tribunal. On a perusal of the Assessment Order, the orders passed by CIT(A) and that of the Tribunal, we have no hesitation to hold that the two Authorities below and the Tribunal, proceeded on the legal principle without making an in-depth study on the facts situation. The settled legal principle is that the law has to be applied to the facts of the given case and not in the reverse.

6. We find that such an exercise has not been undertaken by the Assessing Officer at the first instance, as a result of which the matter was proceeded solely based upon the interpretation of the law laid down by the Hon'ble Supreme Court in various decisions. We are of the firm view that the fact situation is required to be considered and the Assessing Officer has to then apply legal principle laid down in various decisions and come to a conclusion. We find that such an exercise has not been done in this case.

7. To elaborate, on this issue, we refer to the following facts:

The assessee is engaged in the business of Manufacturing Steel Plate Processing and Fabrication for Heavy Machinery part and components. The assessee had filed his return of income for the Assessment year 2012-13. The return was duly processed under Section 143(1) of the Act on 10.05.2013. The assessee's case was selected for scrutiny and notice under Section 143(2) of the Act was issued on 14.08.2013. Subsequently, the case was heard and the assessee had submitted a written submission during the personal hearing on 18.03.2015. On a reading of written submissions, it is seen that the stand of the assessee is that the Company commenced commercial production from 1st of August 2012. As on 31st March 2012, the manufacturing facility of the assessee company was not ready and the business operations did not commence. The assessee had further stated that as the business was not set up, the company did not claim any expenditure in the tax return.

8. It was further stated that the assessee received funds from its shareholders as investment in share capital. These funds were for a specific purpose of acquiring plant and machinery and entering into a lease arrangement for the land used for manufacturing facility. That the funds had been clearly earmarked for finalization/acquisition of these capital purchases. The assessee stated that the lease arrangement for the land was signed in the last week of May 2011 and the plant and machinery were procured over a period of time and facility was set up. On account of time taken for the transaction, the share capital subscription received, was placed in short term deposits and then withdrawn as and when required by the assessee for capital purchases.

9. The assessee further stated that pending such purchases, the assessee had parked the funds with the banks in the form of fixed deposits for a short term period and deposits were generally placed for 7 days to 60 days and couple of

deposits were placed for 120 days and 180 days. Further, the assessee asserted that during the construction period, the assessee did not borrow any funds, but merely used the equity capital. Thus, the stand of the assessee is that the funds which were in Bank in the form of Fixed Deposit for a short term period, were inextricably linked with the process of setting up of the business, the interest income earned from short term deposits from Bank has been treated as capital in nature and to be set-off against the pre-operative expenses.

10. After setting out the above and other factual details, the assessee referred to various decisions of the Hon'ble Supreme Court and the other High Courts. The Assessing Officer noted the contentions pleaded in the written submissions on 18.03.2015. The same has been extracted in paragraph 3.2 of the Assessment Order dated 23.03.2015. However, the Assessing Officer has not discuss as to whether the stand taken by assessee as regards deployment of the funds, forming part of the fixed deposits, retained as short term deposits. The discussion in the Assessment Order commences from paragraph 3.3, the Assessing Officer has straight away referred to the decision of the Hon'ble Supreme Court in Tuticorin Alkali Chemicals & Fertilizers Ltd., Vs. Commissioner of Income Tax [1997] 93 TAXMAN 502 (SC). After referring to two paragraphs of the decision, the Assessing Officer held that in the light of the decision in Tuticorin Alkali Chemicals & Fertilizers case, before commencement of business, income has to be assessed as Income from Other Sources and it cannot be said that interest income is not taxable. Accordingly, the same was added back to the total income under the head 'Income from Other Sources' for the Financial Year 2011-12 relevant to the Assessment year 2012-13. To be noted, there was no discussion with regard to the stand taken by the assessee as to the reason for parking the funds in short term deposits with the bank. The assessee carried the matter on appeal to the Commissioner of Income Tax (Appeals) [CIT(A)]. We find from the Statement of Facts and Grounds of Appeal, the assessee reiterated that short term deposits were not made out of any surplus funds and hence, the related interest income therefrom cannot be treated as 'Income from other sources'. In the written submissions, the assessee reiterated that since the entire interest income was earned only on account of temporary deployment of funds as explained by them and not on account of surplus funds, no source of income had come into existence as on March 31st, 2012. Further, the details from Balance Sheet as on 31.03.2012 were referred to and reiterated that the entire funds, which were part of fixed deposits were deployed towards various capital assets. Though such stand of the assessee and the contentions raised by the assessee in the written submissions were referred to, CIT(A)

proceeded solely based on the decision of the Hon'ble Supreme Court in Tuticorin Alkali Chemicals & Fertilizers case and held that in the light of said decision there is no infirmity in the order of Assessing Officer. Such order has been challenged before the Income-Tax Appellate Tribunal reiterating the same stand taken before the Assessing Officer and CIT(A).

11. On a reading of the order of the Tribunal, we find that the Tribunal concurred with CIT(A) and extracted substantial portion of the order passed by CIT(A) and held that CIT(A) was right in applying the decision of the Hon'ble Supreme Court in Tuticorin Alkali Chemicals & Fertilizers and held that interest earned by the assessee on the investment of share capital in call deposits before the commencement of its production could be assessed separately under the head 'Other sources'.

12. A Division Bench of this Court in the case of Commissioner of Income-Tax Vs. VGR Foundations reported in [2008] 298 ITR 132 considered the decision in Tuticorin Alkali Chemicals & Fertilizers case and made certain observations with regard to whether share application money will fall in to the category of 'Borrowed Funds'. At this juncture, it would be beneficial to refer to paragraph 5 of the said judgment:

"In our opinion, in view of the above clear cut ruling by the Supreme Court it is necessary to give a finding of fact in regard to monies that were kept in deposit from out of the share application monies. In the light of the Supreme Court decision in Tuticorin Alkali Chemicals and Fertilizers Ltd. [1997] 227 ITR 172, it is only in the event of interest earned from out of deposits made from borrowed funds that it would be in the nature of income. Share application monies do not fall into the category of borrowed funds and do not involve payment of interest. In effect share application monies, etc., are gathered for being used in setting up of an industry, unit, purchase of assets, and so on. Till such time the money is required for deferment of various items, obviously the money has to be kept in deposit with a bank. Keeping the money in current account would not yield any interest income. In can, therefore, be seen that it is during the course of construction that the monies are kept in deposits with the bank. In these circumstances in the light of the Supreme Court decisions in the case of Bokaro Steel Ltd.

[1999] 236 ITR 315, Karnal Co-operative Sugar Mills Ltd. [2000] 243 ITR 2 and Karnataka Power Corporation [2001] 247 ITR 268, the claim of the assessee is reasonable and deserves to be accepted. We accordingly uphold the claim of the assessee and delete the addition of interest made to the income. The legal plea was not insisted upon."

13. In the above decision, the Division Bench held that the share application money are gathered for being used in setting up of an industry, unit, purchase of assets and so on and till such time the money is required for deferment of various items, obviously the money has to be kept in deposit with the bank. Therefore, it held that share application monies did not fall into the category of borrowed funds and did not involve payment of interest.

14. The Hon'ble Supreme Court in Commissioner of Income Tax Vs. Bokaro Steel Ltd. reported in [1999] 236 ITR 315 (SC) held as follows:

"7. The appellant, however, relied upon the decision of this Court in Tuticorin Alkali Chemicals & Fertilizers Ltd.'s case (supra). That case dealt with the question whether the 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, the 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 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. In the case of Challapalli Sugars Ltd. v. CIT [1975] 98 ITR 167, this Court examined the question whether interest paid before the commencement of production by a company on amounts borrowed for the acquisition and installation of plant and machinery would form a part of the actual cost of the asset to the assessee within the meaning of that expression in Section 10(5) of the Indian Income-tax Act, 1922 and whether the assessee will be entitled to depreciation allowances and development rebate with reference to such interest also. The Court held that the accepted accountancy rule for determining cost of fixed assets is to include all expenditure necessary to bring such assets into existence and to put them in working condition. In case money is borrowed by a newly started company which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalised and added to the cost of the fixed assets created as a result of such expenditure. By the same reasoning if the assessee receives any amount which are inextricably linked with the process of setting up its plant and machinery, such receipts will

go to reduce the cost of its assets. These are receipts of a capital nature and cannot be taxed as income.

(emphasis supplied)

15. While on this issue, it is relevant to take note of the decision of the Hon'ble Supreme Court in the case of Commissioner of Income Tax - IV, Ahmedabad Vs. Shree Rama Multi Tech Ltd. reported in [2018] 403 ITR 426 (SC), wherein the Court held as follows:

"12. The common rationale that is followed in all these judgment is that if there is any surplus money which is lying idle and it has been deposited in the bank for the purpose of earning interest then it is liable to be taxed as income from other sources but if the income accrued is merely incidental and not the prime purpose of doing the act in question which resulted into accrual of some additional income then the income is not liable to be assessed and is eligible to be claimed as deduction. Putting the above rationale in terms of the present case, if the share application money that is received is deposited in the bank in light of the statutory mandatory requirement then the accrued interest is not liable to be taxed and is eligible for deduction against the public issue expenses. The issue of share relates to capital structure of the company and hence expenses incurred in connection with the issue of shares relates to capital structure of the company and hence expenses incurred in connection with the issue of shares are to be capitalized because the purpose of such deposit is not to make some additional income but to comply with the statutory requirement, and interest accrued on such deposit is merely incidental."

16. In the decision of High Court of Delhi in the case of Indian Oil Panipat Power Consortium Ltd. Vs. Income Tax Officer reported in [2009] 181 Taxman 249 (Delhi), the Court noted the decision in Tuticorin Alkali Chemicals & Fertilizers Ltd and Bokaro Steel Ltd and held as follows:

"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 & Fertilizers Ltd. (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.'s (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."

17. The High Court of Delhi in the case of Commissioner of Income Tax Vs. Petronet LNG Ltd reported in [2011] 10 taxman.com 257 (Delhi) has decided a similar issue where the funds were parked with the bank and in the process, it generated the interest income and as to how such income should be treated. In the said case, the money was contributed by the four promoters in the form of share application money for which shares were to be allotted and the said money was to be utilized for the purpose of purchasing requisite plant and machinery and this application money was thus to be utilized for the purchase of capital assets. In the said case, pending purchase of said plant and machinery, money was primarily parked with the bank and in the process, it generated the interest income. Taking note of the decision in Indian Oil Panipat Power Consortium Ltd. Vs. ITO [2009] 315 ITR 254 (Delhi) and CIT Vs. Panem Coal Mines Ltd. [IT Appeal No.639 of 2008 dated 17.09.2009] it was held that if the interest earned on the funds which are to be utilized for purchase of capital asset/setting up of the business and that it is inextricably linked with the setting up of the business, said interest will not be treated as income under the head 'Income from other sources'.

18. One common thread which passes through all the above decisions is that the authorities and the Tribunal had made a fact finding exercise to ascertain as to whether there was an inextricable link with the setting up the business. As pointed out by us earlier, in the instant case, the Assessing Officer

did not examine such aspect though the assessee has specifically stated in the written submissions dated 18.03.2015.

19. In our considered view, the matter shall be considered afresh by the Assessing Officer steering clear of the factual position, record his finding on facts and then apply the legal principle. As we have found that such procedure was not followed in the instant case, we deem it appropriate to remit the matter back to the Assessing Officer for fresh consideration.

20. For the above reasons, the appeal filed by the assessee is allowed and the order of the Income Tax Appellate Tribunal Chennai 'A' Bench, dated 27.11.2018 in I.T.A.No.3497/CHNY/2016, is set aside and the matter is remitted back to the Assessing Officer for a fresh consideration, who shall take note of the above observations made by us in this judgment and proceed to decide the matter uninfluenced by any observations or findings recorded earlier. No costs. Consequently, connected miscellaneous petition is closed.

Sd/-

Assistant Registrar (Insp Cell)

//True Copy//

Sub Assistant Registrar

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TO

1. The Income Tax Tribunal,
Chennai 'A' Bench,
Chennai.

2. Deputy Commissioner of Income Tax,
Corporate Circle - 2 (2)
121, Mahatma Gandhi Road,
Nungambakkam
Chennai - 600 034.

+1cc to Mr.Karthik Ranganathan, Advocate, S.R.No. 48172
+1cc to Mr.S.P.Chidambaram, Advocate, S.R.No. 48907

TCA.No.322 of 2019
and CMP.No.12046 of 2019

RGN (CO)
GN (29/07/2019)