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2024:DHC:9833-DB

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

% Judgement delivered on*:* 20.12.2024

\+ **ITA 1174/2018**

PR. COMMISSIONER OF INCOME TAX-4 ..... Appellant

versus

INTERNATIONAL COAL VENTURES PVT. LTD ..... Respondent

Advocates who appeared in this case

For the Appellant : Mr Sanjay Kumar, Advocate.

For the Respondent : Mr Divyanshu Agarwal and Mr Aneesh Mittal, Advocates

CORAM:
HON'BLE THE ACTING CHIEF JUSTICE
HON'BLE MS. JUSTICE SWARANA KANTA SHARMA

JUDGMENT

VIBHU BAKHRU, ACJ.

INTRODUCTION

1. The Revenue has filed the present appeal under Section 260A of the Income Tax Act, 1961 (hereafter *the Act*) impugning an order dated 06.04.2018 (hereafter *the impugned order*) passed by the learned Income Tax Appellant Tribunal [hereafter *the Tribunal*] in ITA No.4606/Del/2017 captioned *International Coal Ventures P. Ltd. v. Income-tax Officer Ward*

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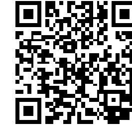

12(3), New Delhi, whereby the respondent's appeal under Section 253 of the Act, was allowed.

2. The respondent (hereafter *the Assessee*) had filed the aforesaid appeal (ITA No.4606/Del/2017) against the decision of the Commissioner of Income Tax (Appeals) [hereafter *CIT(A)*], whereby the Assessee's appeal against the assessment order dated 25.03.2015 in respect of the assessment year (AY) 2012-13, was rejected.

3. The controversy involved in the present appeal relates to the addition of ₹31,18,900/- made by the Assessing Officer (hereafter *the AO*) to the declared income of the Assessee. The Assessee had filed its Income Tax Return for the relevant AY 2012-13 declaring its income as NIL. During the course of the assessment proceedings, the AO noticed that the Assessee had earned an amount of ₹11,45,92,550/- in respect of the funds received from its promoters. The Assessee had also paid interest to its promoters amounting to ₹11,14,73,651/-. According to the AO, the difference between the interest earned and interest paid was chargeable to tax as 'income from other sources'. Accordingly, the AO passed the assessment order determining the Assessee's total income at ₹31,18,900/-.

4. Aggrieved by the same, the Assessee filed an appeal before the CIT(A) claiming that it was entitled to set off the interest earned against the amounts capitalized as 'Capital Work-in-Progress' (*CWIP* in short). The CIT(A) rejected the said contention holding that the interest was in the nature of 'revenue receipt' and not a 'capital receipt' and therefore, it was required to be accounted for and taxed accordingly. The CIT(A) concluded

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that the amount earned on short term deposits was chargeable to tax under the head 'income from other sources' in terms of Section 56 of the Act. The CIT(A) was also of the view that the AO had erred in permitting a deduction in respect of amount paid by the Assessee to promoters as interest, for determining the net amount that was chargeable to tax under Section 57(iii) of the Act. The CIT(A) held that a deduction under Section 57(iii) of the Act was not permissible in respect of the interest payable on funds received from the Assessee's promoters as that expenditure could not be considered as incurred 'wholly or exclusively' for the purpose of earning interest income from short term deposits. Accordingly, the CIT(A) determined the Assessee's taxable income at ₹11,58,59,615/-.

5. The Assessee assailed the CIT(A)'s order dated 17.05.2017 before the learned ITAT, which was allowed in terms of the impugned order. The learned ITAT held that the Assessee had received funds from its promoters in furtherance of its business for acquiring a coal mine overseas. Therefore, the Assessee was entitled to set off the interest paid against the interest received and the balance receipt against CWIP. The learned ITAT held that the interest earned from the deposit was not chargeable to tax under the head income from other sources and accordingly, set aside the order of the CIT(A) as well as the AO.

QUESTION OF LAW

6. In the aforesaid backdrop, the Revenue has preferred the present appeal projecting several questions of law. This court considered the same

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and *vide* order dated 03.09.2024 admitted the present appeal on the following question of law:-

> "Whether in the facts and circumstances of the case and in law the interest income earned on surplus fund deposited in the bank during pre-commencement of the business is liable to be taxed under Section 56 of the Income Tax Act, 1961?"

THE FACTS

7. The Assessee was incorporated as a company under the Indian Companies Act, 1956 on 20.05.2009. The Assessee is, essentially, a joint venture company and was formed as a special purpose vehicle by five public sector undertakings namely, Steel Authority of India Limited (SAIL), Coal India Limited (CIL), Rashtriya Ispat Nigam Limited (RINL), National Mining Development Corporation Limited (NMDC), and National Thermal Power Corporation Limited (NTPC). The Assessee was incorporated with the purpose of ensuring adequate and dependable coal supply for its promoter companies. It was proposed that the Assessee would acquire resources including a coal mine overseas to secure supply of coal to its promoters. During the financial year relating to AY 2012-13, the Assessee was actively pursuing a proposal to acquire and develop a coal mine overseas. The notes to the final accounts of the Assessee indicate that the Assessee had received equity contribution of ₹2.00 Crores from SAIL, ₹1.00 Crore from RINL, and ₹1.00 Crore from NMDC. In addition, the accounts reflected an advance of ₹156 Crores from RINL. The accounts also indicated that the Assessee had received a sum of ₹1,81,28,800/-, ₹23,92,296/-, and ₹24,58,199/- as reimbursement of expenses from SAIL, RINL, and CIL respectively.

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8. Apparently, the funds received were kept in a short term fixed deposit yielding interest. The Assessee claimed that it had called funds from shareholders and promoters for the purpose of acquisition of a coal mine overseas. At the material time, the transaction for such acquisition was at an advanced stage. On 29.06.2011, the Assessee received a sum of ₹157 Crores from RINL as call money. Out of the aforesaid sum, an amount of ₹1.00 Crore was accounted for share application money and the balance was reflected as borrowing and was kept in a fixed deposit with a bank.

9. During the previous year relevant to AY 2012-13, the fixed deposits yielded the interest of ₹11,45,19,580/-. The Assessee claimed that it had also incurred ₹4,48,78,068/- on day-to-day expenses as well as for preparation of the project report.

10. Written submissions were filed by the learned counsel for the Assessee setting out certain facts, which were not controverted. Therefore, for the purpose of present appeal, we consider it apposite to recount the same.

11. The Assessee had claimed that its promoters (SAIL, RINL, CIL, NMDC, and NTPC) had subscribed to 7,00,000 shares of ₹10/- each totaling to ₹70,00,000/- at the time of its incorporation. Additionally, the Assessee had received share application money of ₹97,50,000/- during the financial year ending on 31.03.2010, which was its first year in existence. In the next financial year 2010-11, the Assessee's share capital money increased to ₹9.80 Crores – ₹2.80 Crores subscribed by SAIL; ₹1.40 Crores subscribed

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by RINL; ₹1.40 Crores subscribed by NMDC; ₹2.80 Crores subscribed by CIL; and ₹1.40 Crores subscribed by NTPC.

12. During the financial year 2010-11 relevant to AY 2011-12, the Assessee received interest of ₹11,45,92,550/- and out of the aforesaid sum, paid interest of ₹11,14,73,651/-. The said interest was on fixed deposits, which in turn were made from the funds received from RINL. The Assessee claims that no interest was paid to its promoters in respect of amount contributed as share capital, but the interest earned on the said amount amounting to ₹12,67,065/-, was reduced from the pre operative expenditure incurred by the Assessee. Resultantly, the net amount reflected in the account as CWIP was reduced to ₹4,36,11,003/- at the end of the accounting year.

13. As stated above, at the material time, the Assessee was at an advanced stage of the acquisition of a coalmine overseas and it had accordingly, called for the funds from the shareholder / promoters. Whilst, RINL had paid a sum of ₹157 Crores, the other promoters had not done so. In the meanwhile, the proposal for acquisition of coal mine overseas did not fructify and was aborted. Therefore, the other promoters/shareholders of the Assessee withheld further contributions. The amounts received from RINL were kept in a fixed deposit with a bank instead of returning the same to RINL as the Assessee was hopeful that another proposal may fructify. Subsequently – since the proposal for acquisition of the coalmine which was being pursued was abandoned – the Assessee refunded the amount of ₹156 Crores received from RINL. Since the Assessee had earned interest on the said amount received from RINL, it also decided to pay interest to RINL.

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14. It is material to note that RINL confirmed that the amount received by it was accounted for as income in its hand and tax was paid on the same.

REASONS AND CONCLUSIONS

15. It is the Assessee's case that income by way of interest is not chargeable to tax under the head 'income from other sources' as it was inextricably linked to acquisition of coal mine – a capital asset. The Assessee claims that the amount of interest payable on the funds borrowed for acquiring such asset is required to be added to the total cost of the asset. Similarly, interest on such funds, which were temporarily kept in an interest-bearing account pending utilization, was liable to be adjusted from the cost of such asset.

16. The Assessee claims that this question is squarely covered by the decision of this court in ***Indian Oil Panipat Power Consortium Limited, New Delhi v. Income Tax Officer***[1].

17. The aforesaid contentions are countered by the Revenue. Mr Sanjay Kumar, appearing for the Revenue contends that the learned ITAT had erred in proceeding on the basis that the facts of the case are similar to the facts in the case of ***CIT, Bihar II, Patna v. Bokaro Steels Limited***[2] and the Supreme Court in ***Tuticorin Alkali Chemicals and Fertilizers Limited, Madras v. CIT, Madras***[3].

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[1] Neutral Citation: 2009: DHC:655-DB
[2] (1999) 236 ITR 315
[3] (1997) 227 ITR 172

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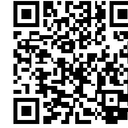

18. He submitted that the learned ITAT had erred in not appreciating that the funds invested by the Assessee in fixed deposits, were surplus funds; therefore, interest on the said funds was chargeable to tax under the head 'income from other sources'.

19. It is apparent from the above that the controversy essentially, relates whether the interest received on the fixed deposits is a 'capital receipt' and, therefore, not chargeable to tax under the head 'income from other sources'.

20. There is no cavil as to the essential facts required to address the aforesaid controversy. Undisputedly, the Assessee had received funds, which were to be used for acquisition of coal mine overseas, but the said proposal did not go through. Therefore, the funds received by the Assessee from RINL were refunded. During the period when the funds were available with the Assessee, the same were deposited in a fixed deposit yielding interest. Since the Assessee had earned interest on the funds, which were not utilized, it also decided to pay interest on the said amount.

21. It is also not in dispute that the funds were called by the Assessee in anticipation of acquiring a capital asset (a coalmine), which was not acquired. The accounting treatment of capitalizing expenses during the pre-operative stage of setting up a business, rests on the rationale that the cost incurred for setting up the profit-making apparatus is required to be accounted for as the value of that asset. Such expenditure is incurred for bringing the undertaking into existence. Thus, it would not be apposite to treat such pre operative expenses as revenue expenses since it cannot be matched with the revenue receipts. More importantly, the amount incurred

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for construction or acquisition of the asset would necessarily have to be accounted as the cost of that capital asset. However, this principle applies only in cases where substantial time is required to construct the asset or bring the asset to use. The financial costs for such assets are thus considered as a part of the intrinsic value of the said asset.

22. It is material to note that there is a distinction between the price of an asset and its cost. On the same principle the amounts received which are directly linked to the acquisition or construction of the asset, are required to be reduced from the capital cost of the said asset. In one sense, such receipts mitigate the cost of the capital asset. And, it is essential to reflect the correct cost of the asset.

23. It is relevant to refer to the Accounting Standard 16[4]. The said Standards applies to a 'qualifying asset', which is defined as an asset that takes substantial period to get ready for its intended use or sale. The AS-16 also explains that the substantial period of time as contemplated under the standard, primarily depends upon the circumstances of each case. However, ordinarily, the same should be considered as twelve months unless a shorter or longer period is justified in the facts and circumstances of the case. It also explains that for estimating this period 'the time which an asset takes technologically or commercially, to get ready for its intended use or sale' is required to be considered.

24. The relevant extract of said AS-16 is reproduced below: -

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[4] AS-2016: The said standard was notified under the Companies (Accounting Standard Rules) 2016 under the Companies Act, 1956 and has been renotified being as part of the Companies (Accounting Standard Rules) 2021 under the Companies Act, 2013.

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"**Recognition**

6. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

7. Borrowing costs are capitalised as part of the cost of a qualifying asset when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.

***

10. ***To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.***

11. The financing arrangements for a qualifying asset may result in an enterprise obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditure on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any income earned on the temporary investment of those borrowings is deducted from the borrowing costs incurred."

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25. It is also relevant to refer to the following extract of the India Accounting Standard (Ind AS) 23, which has been notified by Ministry of Corporate Affairs.

> "12. To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.
>
> 13. The financing arrangements for a qualifying asset may result in an entity obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditures on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred."
>
> [emphasis added]

26. Accounting treatment of various items are guided by an overarching principle that final accounts should reflect the true and fair view of the reported entity. In order for a capital value of an asset (which takes a considerable time to bring it to intended use) to be fairly disclosed on historical cost basis, it would be essential to subsume within the cost of the said asset all elements of expenditure, which directly contribute to the cost of that asset.

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27. It is for this reason that general administrative cost of an entity which cannot be attributed to a particular asset is not construed as the cost of that asset. But the expenditure that is directly linked to construction or acquisition of a qualifying asset, is required to be treated as a part of its cost.

28. In ***Challapalli Sugar Limited v. CIT***[5], the Supreme Court considered an appeal arising from the decision of the Andhra Pradesh High Court on the question to the effect, whether interest payment is an element of actual cost of plant and machinery and whether depreciation and development rebate are admissible with reference to the said amount. The said issue arose in the context of Section 10(2) of the Indian Income Tax Act, 1922 (hereafter *the Act of 1922*) which provides that the profits or gains would be computed after making the deductions specified in said section. Clause (vi) of Section 10(2) of the Act of 1922 concerns the allowance on account of depreciation which was to be computed on the written down value of the asset.

29. It was contended before the Supreme Court that interest on the monies for acquiring or installing the plant and machinery for the period before the commencement of production is required to be included in the actual cost of plant and as such capitalized. The contentions advanced before the Supreme Court are encapsulated in paragraph no.10 of the said decision and same is set out below: -

> "**10.** In appeal before us Mr Palkhivala on behalf of the assessees in the three appeals has argued that interest for the period before the commencement of production on money borrowed for the purpose of acquiring and installing the machinery and plant should be included

[5] (1975) 98 ITR 167

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in the actual cost of the plant and as such capitalised for the purpose. As against that, Mr Desai on behalf of the Revenue has supported the view taken by the Andhra Pradesh High Court. After hearing the learned Counsel for the parties, we are of the opinion that the submission made by Mr Palkhivala is well-founded."

30. In the aforesaid context, the Supreme Court held as under: -

> "**14.** In finding the answer to the question mentioned above, we have to bear in mind that it arises in the context of profits or gains of business and the permissible deductions on account of depreciation and development rebate relating to the machinery and plant of the assessee. As the expression "actual cost" has not been defined, it should, in our opinion, be construed in the sense which no commercial man would misunderstand. For this purpose it would be necessary to ascertain the connotation of the above expression in accordance with the normal rules of accountancy prevailing in commerce and industry**.** The word "cost", as observed on p. 424 of Simon's *Taxes D* Third Edition, is not synonymous with "price". Other items of expenditure, such for instance as freight or warehouse charges or insurance, must in certain cases be added to the price. The matter has been dealt with in *Accountancy by Pickles,* 1955 Ed. on p. 944 under the head "Payment of interest on Construction Capital" as under:
>
> > "In the ordinary course of affairs no dividends may be paid unless such dividends are paid out of profits: interest on debentures (being a charge is, however, payable whether profits are earned or not). Where company raises share capital and out of the proceeds defrays the expenses of the construction of any works or buildings or provision of plant which cannot be made profitable for a lengthened period the company

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may pay interest on so much of that share capital as is paid up for the period and may charge to capital the sum paid by way of interest, provided that the restrictions imposed under Section 65 of the Companies Act, 1948 are complied with."

It is further observed:

"The interest so paid is 'capitalised', that is to say, it is treated as part of the cost of construction being added thereto (similarly to legal expenses of acquiring property or brokers' charges on purchasing investments)."

In Spicer & Peglers *Practical Auditing*, 11th Edn. it is observed on pp. 190-191 under the head "Interest Payable Out of Capital During Construction":

"Interest on debentures issued for a similar purpose can be charged to capital during the period of construction (*Hinds* v. *Buenos Ayres Grand National Tramways Co. Ltd.* [(1906) 2 Ch D 654])."

In *Higher Book-Keeping & Accounts* by Cropper Morris & Fison, Seventh Edn., it is observed as under:

"Capital expenditure over a long period must perforce involve the question of interest as an additional cost. If the work were undertaken by an independent contractor he would, of course, take interest into account when preparing the estimates on which to base his tender. The final cost of construction work is made up of the cost of machinery, materials, labour, supervision, and establishment charges, plus interest on the capital employed which, but for its employment in that way, would be invested in good securities, paying a reasonable rate of interest."

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Section 208 of the Companies Act, 1956 (Act 1 of 1956) deals with payment of interest on share capital in certain contingencies. Sub-section (1) of that section reads as under:

> "(1) Where any shares in a company are issued for the purpose of raising money to defray the expenses of the construction of any work or building, or the provision of any plant, which cannot be made profitable for a lengthy period, the company may—
>
> > (*a*) pay interest on so much of that share capital as is for the time being paid up, for the period and subject to the conditions and restrictions mentioned in sub-sections (2) to (7); and
> >
> > (*b*) charge the sum so paid by way of interest, to capital as part of the cost of construction of the work or building or the provision of the plant."

Exercise of power under sub-section (1) is, however, subject to certain restrictions which have been enumerated in the remaining sub-sections of the section, one of which requires that no such payment shall be made without the previous sanction of the Central Government. In *Statement on Auditing Practices*, issued by the Institute of Chartered Accountants of India (1974) it is observed in para 2.5 as under:

> "2.5 Fixed assets should be valued at cost and depreciation should be written off on a proper and consistent basis. Cost includes all expenditure necessary to bring the assets into existence and to put them in working condition. By way of illustration the following may be mentioned:

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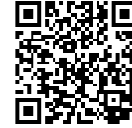

(*i*) Legal charges and stamp duties in the case of land,

(*ii*) Architect's fees in the case of buildings,

(*iii*) Wages, salaries and installation expenses in the case of machinery, and

(*iv*) Interest on borrowings to the extent specified in para 2.22."

Relevant part of para 2.22 reads as under:

"2.22 The question often arises as to whether interest on borrowings can be capitalised and added to the fixed assets which have been created as a result of such expenditure. The accepted view seems to be that in the case of a newly started company which is in the process of constructing and erecting its plant, the interest incurred before production commences may be capitalised. 'Interest incurred' means actual interest paid or payable in respect of borrowings which are used to finance capital expenditure. In no circumstances, should imputed interest be capitalised, such as interest on equity or preference capital at a notional rate. Interest on capital during construction paid in accordance with the provisions of Section 208 of the Companies Act, 1956, may, however, be capitalised as permitted by that section. Interest on monies which are specifically borrowed for the purchase of a fixed asset may be capitalised prior to the asset coming into production, i.e. during the erection stage. However, once production starts, no interest on borrowings for the purchase of machinery (whether for replacement or renovation of existing plant) should be capitalised."

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15. It would appear from the above that the accepted accountancy rule for determining the 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 which have been created as a result of such expenditure. The above rule of accountancy should, in our view, be adopted for determining the actual cost of the assets in the absence of any statutory definition or other indication to the contrary.

16. We have already referred to Section 208 of the Companies Act which makes provision for payment of interest on share capital in certain contingencies. Clause (*b*) of sub-section (1) of that section provides that in case interest is paid on share capital issued for the purpose of raising money to defray the expenses of constructing any work or building or the provision of any plant in contingencies mentioned in that section, the sum so paid by way of interest may be charged to capital as part of the cost of construction of the work or building or the provision of the plant. The above provision thus gives statutory recognition to the principle of capitalising the interest in case the interest is paid on money raised to defray expenses of the construction of any work or building or the provision of any plant in contingencies mentioned in that section even though such money constitutes share capital. The same principle, in our opinion, should hold good if interest is paid on money not raised by way of share capital but taken on loan for the purpose of defraying the expenses of the construction of any work or building or the provision of any plant. The reason indeed would be stronger in case such interest is paid

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on money taken on loan for meeting the above expenses."

[emphasis added]

31. The later decisions rendered by the courts are required to be understood in the light of the concept of cost of an asset as explained above.

32. Mr Sanjay Kumar, stoutly relied upon the decision in ***Tuticorin Alkali Chemicals and Fertilizers Limited, Madras v. CIT, Madras***[3]**.** The appellant in that case was incorporated on 03.12.1971 for the purpose of manufacturing heavy chemicals such as ammonium chloride and soda ash. The trial production of its factories commenced on 30.06.1982. It had prior to its trial production period had borrowed the funds from various banks and financial institutions. A part of the borrowed funds were not immediately required and kept in short term deposits. It also deposited certain sum with Tamil Nadu Electricity Board. During the previous year ending on 30.06.1981 (relevant to AY 1982-83), the appellant received interest totaling to ₹2,92,440/-, which was disclosed by the appellant in its return as income from other sources. It also disclosed the business loss of ₹3,21,802/- and after setting off interest income against the business loss, the appellant sought to carry forward the net loss of ₹29,360/-. However, subsequently, the appellant revised its return and claimed ₹3,21,802/- as its business loss. The interest received amounting to ₹2,92,440/- was set off against the pre-production expenses, which also included interest and financing charges in respect of the borrowed funds. During the relevant previous year, the assessee incurred ₹1,13,06,068/- as interest, which it capitalized along with pre-production expenses.

33. The Supreme Court was of the view that the funds in the hands of the appellant were surplus funds, and therefore, any amount earned from investing such funds, would be in the nature of a revenue receipt and was required to be taxed accordingly. The Court did not accept the contention that interest earned is required to be set off from the interest paid on borrowed funds. This is clear from the following extract of the said decision.

> "22. In the case before us, the Company had surplus funds in its hands. In order to earn income out of the surplus funds, it invested the amount for the purpose of earning interest. The interest thus earned is clearly of revenue nature and will have to be taxed accordingly. The accountants may have taken some other view but accountancy practice is not necessarily good law."

34. It is material to note that the decision in ***Tuticorin Alkali Chemicals and Fertilizers Limited, Madras v. CIT, Madras***[3] rested on the conclusion that interest was earned on surplus funds. There is no cavil that interest on surplus funds – funds which are not inextricably linked to the cost of asset – would be required to be accounted for as a revenue receipt.

35. In a later decision, in ***CIT, Bihar II, Patna v. Bokaro Steels Limited***[2] the Supreme Court considered a case where during the course of construction of a plant, the assessee (Bokaro Steel Limited) had accounted for certain receipts on various counts by reducing the capital cost of the steel plant, which was being constructed. It is material to note that in the said case, the assessee had received certain amounts including the rent charges for housing workers and staff at the site including amenities granted to such

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staff. Hire charges for plant and machinery that was given to contractor by the assessee for use in the construction work, and interest from the advances made to contractor for the purpose of facilitating the construction work. These receipts were sought to be taxed under separate heads. However, the Supreme Court explained that said receipts were 'intrinsically connected' with the construction of the steel plant and therefore, they were rightly adjusted to reduce the cost of construction. It is also material to note that the Supreme Court also approved the decision of this court in ***Additional Commissioner of Income Tax, New Delhi v. Indian Drugs and Pharmaceuticals Limited***[6]***,*** whereby this court had held that receipts from sale of tender forms, supply of water, electricity, sale of stones, boulders, grass and trees during the course of construction of a factory were capital in nature and thus, were required to be reduced from the capital cost of the factory.

36. We consider it apposite to refer to the following extract of the decision in ***CIT, Bihar II, Patna v. Bokaro Steels Limited***[2]: -

> "5. We will take the first three heads under which the assessee has received certain amounts. These are, the rent charged by the assessee to its contractors for housing workers and staff employed by the contractors for the construction work of the assessee including certain amenities granted to the staff by the assessee. Secondly, hire charges for plant and machinery which was given to the contractors by the assessee for use in the construction of the assessee and thirdly, interest from advances made to the contractors by the

[6] (1983) 141 ITR 134

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assessee for the purpose of facilitating the work of construction. The activities of the assessee in connection with all these three receipts are directly connected with or are incidental to the work of construction of its plant undertaken by the assessee. Broadly speaking, these pertain to the arrangements made by the assessee with its contractors pertaining to the work of construction. To facilitate the work of the contractor, the assessee permitted the contractor to use the premises of the assessee for housing their staff and workers engaged in the construction activity of the assessee's plant. This was clearly to facilitate the work of construction. Had this facility not been provided by the assessee, the contractors would have had to make their own arrangements and this would have been reflected in the charges of the contractors for the construction work. Instead, the assessee has provided these facilities. The same is true of the hire charges for plant and machinery which was given by the assessee to the contractors for the assessee's construction work. The receipts in this connection also go to compensate the assessee for the wear and tear on the machinery. The advances which the assessee made to the contractor to facilitate the construction activity of putting together a very large project was as much to ensure that the work of the contractors proceeded without any financial hitches as to help the contractors. The arrangements which were made between the assessee-Company and the contractors pertaining to these three receipts are arrangements which are intrinsically connected with the construction of its steel plant. The receipts have been adjusted against the charges payable to the contractors and have gone to reduce the cost of construction. They have, therefore, been rightly

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held as capital receipts and not income of the assessee from any independent source.

6. In the case of CIT v. Indian Drugs and Pharmaceuticals Ltd. ([1983] 141 ITR 134), the Delhi High Court considered a case where the work of construction of the factory of the assessee was in progress and production had not commenced. Receipts from sale of tender forms and supply of water and electricity to the contractors engaged in construction as also receipts on account of sale of stones, boulders, grass and trees were held to be receipts not from independent sources but were considered as inextricably linked with the process of setting up of business. These were directly related to the capital structure of business and were held to be capital in nature. We agree with this view taken by the Delhi High Court."

37. In a subsequent decision rendered by this Court in ***Indian Oil Panipat Power Consortium Limited, New Delhi v. Income Tax Officer***[1] a Coordinate Bench of this court considered the question whether the funds deployed with the bank could be taxed as income from other sources and not as a capital receipt to be set off against preoperative expenses, in the facts of that case. In that case, the assessee (Indian Oil Panipat Power Consortium Limited, New Delhi) was incorporated on 06.10.1999 as a joint venture between Indian Oil Corporation and Marubeni Corporation of Japan. The said joint venture company was to set up a power project at Panipat in the state of Haryana. For the said purpose, share capital was contributed by Indian Oil Corporation and Marubeni Corporation of Japan. The assessee's case was that the funds were required to be used for purchase of land and development of infrastructure. However, there were some issues for

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acquisition of land from Haryana Government, and the assessee placed the funds received by way of share capital, in a fixed deposit with the Tokyo Mitsubishi Bank. The said deposit yielded interest, which was taxed by the AO as income from other sources by referring to the decision of the Supreme Court in ***Tuticorin Alkali Chemicals and Fertilizers Limited v. CIT***[3]. On an appeal preferred by the assessee, the CIT(A) found that the interest was inextricably linked with setting up of the power plant and following the decision in ***CIT, Bihar II, Patna v. Bokaro Steels Limited,***[2] the interest received was treated as capital receipt towards reduction of the capital cost of the asset.

38. On an appeal preferred by the Revenue, the learned ITAT accepted the CIT(A)'s finding that the interest earned was inextricably linked with setting up of power plant. Nonetheless, the learned ITAT rejected the assessee's claim by referring to the decision of the Supreme Court in ***Tuticorin Alkali Chemicals and Fertilizers Limited, Madras v. CIT, Madras***[3]**.** The assessee appealed the decision of the learned ITAT to this court. And, in the aforesaid context, this court 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

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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

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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 infrastructure. of 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

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> 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."

39. The aforesaid view has also been reiterated by this court in several decisions including ***Principal Commissioner of Income Tax-7 v. M/s Triumph Realty Pvt Limited***[7]; ***Principal Commissioner of Income Tax v. Facor Power Ltd***[8]; and ***The Pr. Commissioner of Income Tax-5 v. Jaypee Powergrid Limited*** [9].

40. In view of the above, the key issue is whether interest on funds deposited in the short-term fixed deposit can be construed as incidental to setting up the business – acquisition of a coal mine. Plainly, if the interest is earned on the amounts which were temporarily kept in fixed deposits in the course of acquisition of the coal mine to set up its business, the interest earned would require to be accounted for as the part of the capital value of the business/asset.

41. We may, however, add a caveat that this accounting treatment is or will be applicable only if the nature of the asset is such that requires time for construction or for putting it in use. Illustratively, the same would be applicable where the asset is to be constructed, developed or is of a nature

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[7] Neutral Citation: 2022:DHC:1159-DB
[8] (2016) 380 ITR 474
[9] Neutral Citation: 2023:DHC:8992-DB

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that requires considerable time to bring it to use. Illustratively, in case where a plant is being set up in a factory and the requisite funds for setting up the same are deployed for a period of time, the interest paid on the amount borrowed for the said purpose and interest earned on temporary deposits during the course of deployment are required to be accounted for as a part of the capital costs. However, this is not true for an off the shelf product. Illustratively, if a motor vehicle is purchased from borrowed capital, neither the interest paid nor the interest earned on the funds borrowed for payment of consideration of the same can be accounted for as a part of the cost of the said asset.

42. In the present case, there is no dispute that the Assessee was set up to acquire resources to ensure supply of coal. At the material time it was in the process of negotiation for acquiring a coal mine, to set up its business, and thus called for capital from its shareholders for the purpose of payment of the acquisition costs. It is the part of the said funds that were kept in the short-term fixed deposit in the bank for pending payment of the construction. However, the attempt to acquire the coal mine was aborted and thus the amounts borrowed were repaid to RINL. It is not disputed that the funds in question were not surplus funds of the Assessee, the same were called for and were earmarked for acquisition of a coal mine overseas. The said coal mine was to be the Assessee's undertaking as the Assessee was formed for the purpose of acquiring and operating a coal mine overseas.

43. In view of the above, we find merit in the Assessee's contention that the interest received on borrowed funds, which were temporarily held in

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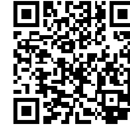

interest bearing deposit, is a part of the capital cost and is required to be credited to CWIP.

44. The question of law as framed refers to the funds deposited in interest bearing account as 'surplus funds'. However, as noted above, the funds in question were not surplus funds but funds that were called for and earmarked for a specific purpose of acquiring a coal mine. To that extent the use of the term 'surplus' in respect of the funds, in the question of law as framed, is not apposite and ought to be deleted. The question of law as so modified is answered in favour of the Assessee and against the Revenue.

45. The appeal is, accordingly, dismissed.

VIBHU BAKHRU, ACJ

SWARANA KANTA SHARMA, J

DECEMBER 20, 2024

M/'gsr'