

(1995) 03 RAJ CK 0031

In the Rajasthan High Court

Case No : Income Tax Reference No. 58 of 1986

Commissioner of Income Tax

APPELLANT

Vs

Manglam Cement Ltd.

RESPONDENT

Date of Decision : 22-03-1995

Acts Referred:

Income Tax Act, 1961 — Section 28, 56, 57

Citation : (1996) 217 ITR 369 : (1995) 3 WLC 158 : (1995) 2 WLN 8

Hon'ble Judges : V.K. Singhal, J;V.G. Palshikar, J

Bench : Division Bench

Advocate : G.S. Bafna, for the Appellant; N.M. Ranka, for the Respondent

Judgement

V.K. Singhal, J.—On the request of the Revenue, the following two questions of law arising out of the order of the Income Tax Appellate Tribunal, Jaipur, dated May 7, 1985, have been referred u/s 256(1) of the Act in respect of the assessment year 1979-80 :

"1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in holding that interest received of Rs. 2,58,089 on short-term deposits with banks was not taxable u/s 56 of the Income Tax Act, 1961 ?

2. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was justified in holding that interest received of Rs. 2,58,089 on short-term deposits with banks was to be reduced from the interest payments while capitalising the various expenditure to capital account ?"

2. The facts of the case are that the assessee is a limited company and was incorporated on October 27, 1976. The certificate of commencement of business was issued by the Registrar of Companies on January 19, 1977, and the company was granted the consent by the Controller of Capital Issues on July 27, 1978. The prospectus for the raising of capital from the public was issued on November 18, 1977. The loans were obtained from the financial institutions as well as from other parties for the purchase of capital equipment and for setting

up the business of the company, which was manufacturing cement. The company has paid interest on all its borrowings. Besides the loan, the company has also received the application money for issue of share certificates and the application money so received was deposited with the bank as short-term deposit besides part of the borrowings. On such deposit, the company earned an interest of Rs. 2,58,089. On the other hand, the amount of interest paid by the company on its borrowings was Rs. 14,32,072. The amount of Rs. 2,58,089 was deducted from the interest paid and the balance amount of interest was treated as part of the capital cost of the building, plant and machinery, etc. The submission of the assessee was that since construction activities were going on, all the expenditure and receipt of money go either to increase the cost of the capital assets or reduce them and as such the interest received should be adjusted from the interest paid. The Income Tax Officer held that the interest income earned by the assessee on deposits with the bank has nothing to do with the construction activities and as such is taxable income from other sources u/s 56. The contention of the assessee that the interest amount paid should be set off against the income earned, was also negated by the Income Tax Officer on the ground that Section 57 of the Act permits the deduction only of such expenditure which has been incurred by the assessee in earning the interest. Since the borrowings by the company were for the purpose of construction and has no relation with the earnings of interest with the deposit, the Income Tax Officer was of the view that the interest paid cannot be deducted u/s 57. However, a sum of Rs. 10,000 was allowed which was considered as relatable to the earning of the income of interest as there were certain administrative expenses incurred by the company.

3. The appeal before the Commissioner of Income Tax (Appeals) was rejected and the order of the assessing authority was confirmed. In the second appeal, before the Income Tax Appellate Tribunal, again the contention was raised that till the construction is complete, the entire activities of the company are centred on construction alone and, therefore, the interest paid or received goes to increase the cost of capital assets or reduce it and, therefore, that cannot be taxed as income "from other sources".

4. The submission of Mr. Bapna, on behalf of the Revenue, is that the deduction which has been provided u/s 57 could alone be allowed in respect of an income which is "from other sources". Since the payment of interest in respect of the capital expenditure is not an allowable deduction, therefore, the interest received on short-term deposit cannot be allowed as a deduction and is taxable u/s 56 of the Act.

5. Mr. Ranka, learned counsel for the respondent, submitted that the Orissa High Court, in the case of Commissioner of Income Tax Vs. Electrochem Orissa Ltd., has considered this matter and has not agreed with the view taken by the Madras High Court in the cases of Commissioner of Income Tax Vs. Tamil Nadu Industrial Development Corporation Ltd., and Commissioner of Income Tax Vs.

Seshasayee Paper and Boards Ltd., in which the Madras High Court has taken the view that unless the assessee had established its factory, there would be no question of computing its business income during the year and the interest earned by the assessee could be assessed separately under the head "Other sources". The decision of the Andhra Pradesh High Court in the case of Commissioner of Income Tax Vs. Nagarjuna Steels Ltd., was taken into consideration where the surplus fund was kept on short-term deposits and the interest so earned was considered to be set off against the interest paid by the assessee on the loans obtained and the balance interest was considered to be capitalised. The interest received on the short-term deposit was held not assessable as revenue receipt. The view taken by the Andhra Pradesh High Court was followed by the Orissa High Court in this case.

6. We have considered over the matter. The provisions of Section 56 provide that income of every kind, which is not to be excluded from the total income under this Act shall be chargeable to Income Tax under the head "Income from other sources", if it is not chargeable to Income Tax under any of the heads specified in Section 14, items (A) to (E). Section 32 provides depreciation in respect of buildings, machinery, plant or furniture owned by the assessee and used for the purposes of the business or profession on actual cost. The words "actual cost" were interpreted by the apex court in the case of Challapalli Sugar Ltd. Vs. The Commissioner of Income Tax, A.P., Hyderabad, and it was interpreted that the expression "actual cost" should be construed in a commercial sense and in accordance with the normal rules of accountancy, it includes all expenditure necessary to bring the assets into existence and put them in working condition. The interest paid on borrowed money was considered as part of the cost of plant and machinery. Section 14 provides for the computation of total income in different heads. The "income from other sources" has been separately given from the profits and gains of business or profession. The charge has been created by Section 4 in respect of the total income of the previous year.

7. The Delhi High Court in the case of Commissioner of Income Tax Vs. Modi Rubber Ltd., has considered a case where the business was not commenced and the money which was received from the shareholders towards share capital was deposited in the bank. The interest on deposits so earned was not considered as incidental to the business and was not related to the activity of construction of the factory, and as such was considered as not part of the cost of construction of the factory. The interest from bank deposit was considered to have arisen out of an independent source when the business had neither been set up nor commenced.

8. In MADHYA PRADESH STATE INDUSTRIES CORPORATION LTD. Vs. COMMISSIONER OF Income Tax, M.P., the Madhya Pradesh High Court observed that where the share money received by the company which was not immediately required and was deposited in certain banks as call deposits, the deposit of share capital in the bank was not considered to be an act of money-

lending business and was considered as "income from other sources" and liable to be considered u/s 56 of the Act.

9. In *Nalnikant Ambalal Mody Vs. Commissioner of Income Tax, Bombay*, it was observed by the apex court that whether an income falls under one head or the other, had to be decided in accordance with the notions of practical men and the question under which head an income comes cannot depend on when it was received. The provisions of Section 14 make it clear that all the different sources of income which have been treated under the Act separately and when the income from interest received on short-term deposit falls under the head "Income from other sources" then it has to be treated separately under such head.

10. In *Commissioner of Income Tax Vs. Seshasayee Paper and Boards Ltd.*, referred to above, the Madras High Court has considered the claim of adjustment of interest payable on loans against the interest received on call-deposits in bank. The factory was not established and, therefore, it was observed that there is no question of computation of business income in that year. The High Court came to the conclusion that the interest earned by the assessee on investments/call-deposits could be assessed separately under the head "Other sources" and could not be adjusted against the interest paid to the financial institutions in respect of the loans obtained. The Karnataka High Court in the case of *Commissioner of Income Tax Vs. Cap Steel Ltd.*, came to the conclusion that the capitalisation of the interest on loan could be of gross interest and not of the net interest. In *Commissioner of Income Tax Vs. Derco Cooling Coils Ltd.*, the Andhra Pradesh High Court came to the conclusion that the interest received from bank deposits out of share capital money could be brought to tax as the same may or may not be utilised for the purpose of setting up of the plant. The very idea of set-off connotes that there is a nexus or correlation between the item of receipt and the item of expenditure. It is not permissible to set off an item of receipt from out of an item of expenditure unrelated to the former or incurred in a different connection.

11. In *Traco Cable Company Ltd. Vs. Commissioner of Income Tax*, the Kerala High Court has opined that in a case where business had not commenced and the amounts were not immediately required for any business, the receipt of income by interest was only incidental or consequential on the deposit. It was not the business which was carried on by the company in respect of deposit of share capital and the expenditure was not incurred for the purpose of making or earning the interest received by the company on the deposit of the share capital. The office and establishment expenses unconnected with the earning of the company or keeping the company alive were held not permissible u/s 57 of the Act.

12. The Patna High Court in *Commissioner of Income Tax Vs. Bihar Alloy Steels Ltd.* came to the conclusion that there was no evidence to show that the interest paid on borrowings was for earning bank interest. The interest on deposits

constituted an income and was assessable as "income from other sources".

13. In ADDITIONAL COMMISSIONER OF Income Tax, MADRAS-I Vs. MADRAS FERTILISERS LTD., there was a condition of agreement for agreeing that the loan amount shall be deposited till utilisation for construction or purchase of capital goods in the same bank. The interest received on the deposit was considered by the Madras High Court as income and was not liable to be adjusted u/s 57(iii) of the Act.

14. In Smt. Padmavati Jaikrishna Vs. Additional Commissioner of Income Tax, Gujarat, it was held by the Supreme Court that the interest paid on money borrowed for the purpose of meeting the liability of income tax/wealth-tax was a personal liability and was not expenditure for earning income.

15. This court in Commissioner of Income Tax Vs. Rajasthan Land Development Corporation, (D. B. Income Tax Reference No. 136 of 1981), decided on April 5, 1994, has held as under (at page 603) :

"(i) interest on fixed deposits and other deposits before the commencement of the business is income from other sources ;

(ii) income from interest on deposits of surplus money during the construction period is also to be considered/treated as income from other sources ;

(iii) interest income in respect of surplus money, not required for business and deposited in bank or person, as idle money, for safe keeping, would be assessable as income from other sources. If the income from interest is from a fund which has been brought as surplus capital, it would be assessable as income from other sources ;

(iv) in respect of investment of surplus funds, there is divergence of opinion between different High Courts and this court, in the case of Murli Investments Co., held that if the surplus funds are invested instead of keeping them idle, the income by way of interest should be treated as income from other sources ;

(v) if the surplus funds emerge out of business carried on by the assessed which is regularly carried on by the assessee and then with the intention to carry on the business of lending of money or money-lending the loan is advanced, the income therefrom would be income from business. The intention has to be gathered with reference to all the activities of advancing money which should be permitted by the objects of the company and also by the resolution of the board of directors to carry on the business of money-lending or lending of money."

16. In Karnataka Forest Plantations Corporation Limited Vs. Commissioner of Income Tax and Another, it was held by the Karnataka High Court that the interest paid on borrowed money was not deductible from the interest earned on short-term deposit.

17. This court in Hamendra Singh Vs. Commissioner of Income Tax, in a case where the immediate purpose of taking a loan was to construct a house and fixed

deposits were made by way of security, it was held that the interest paid on the loans could not be said to be on the expenditure incurred wholly and exclusively for earning income from other sources and, therefore, not allowable.

18. In *H.H. Maharajakumari Meenakshideviavaru Vs. Commissioner of Income Tax, Karnataka*, the Karnataka High Court observed that the excess interest paid by the bank on fixed deposit on account of the premature termination of the fixed deposits cannot be adjusted. It was further observed that the interest paid back by the assessee had absolutely no connection with the interest earned by him up to the date of termination of fixed deposits.

19. The Bombay High Court in *Commissioner of Income Tax, Bombay City-II Vs. United Wire Ropes Ltd.*, held that the interest paid on the foreign exchange loan for import of steel wire rope plant and machinery cannot be set off against the interest received on short-term deposit of share capital raised by the assessee.

20. Section 57 provides for deduction from the income which is chargeable under the head "Income from other sources". The amount which has been received by way of interest on the short-term deposit undoubtedly falls in the category of "income from other sources". The deduction which is permissible from such sources of income has been provided u/s 57 only and it is nowhere provided that the interest so earned can be adjusted or reduced from the interest paid on the loan during the construction period. No doubt, it goes to reduce the burden of interest payable on loan but, in the absence of any provisions in the Act, the amount cannot be deducted. It cannot be said that the receipt is not an income, and once it is an income then it has to be dealt with in accordance with the provisions of the Act.

(i) From the various decisions and the provisions of law it is clear that the receipt by way of interest on short-term deposit is an income assessable under the head "Income from other sources".

(ii) That there is no provision u/s 57 for claiming the deduction of any interest paid on the borrowed capital for establishment of factory.

(iii) The actual cost for the purpose of depreciation includes the interest payable on the money borrowed and this is the gross payment of interest and not the net payment, i.e., after adjustment of any interest received on short-term deposit.

(iv) There is no provision under the Act under which the income received on short-term deposit is exempted or is liable to be adjusted against the interest paid on money borrowed for the capital expenditure.

(v) The assessee was not carrying on business during the relevant assessment year and, therefore, there was no occasion for determining the income from business.

(vi) The income received on short-term deposit on the surplus fund lying is "income from other sources" and not from "business".

(vii) There is no nexus between the receipt of the interest on the short-term deposit and payment of the interest on the loan borrowed for the capital expenditure.

(viii) u/s 57(iii) an expenditure must be laid out or expended wholly and exclusively for the purpose of earning "income from other sources".

21. In view of the above proposition of law, the income earned by the assessee falls under the category "income from other sources" and there is no evidence to show that it could be adjusted or could be set off against the interest paid on the money borrowed for the construction of the capital asset. It is the admitted position that the assessee was not carrying on money-lending business. In these circumstances, we are of the view that the Income Tax Appellate Tribunal was not justified in holding that the interest received of Rs. 2,58,089 on short-term deposits with the bank was not taxable u/s 56 of the Income Tax Act. We are further of the view that the interest so received on short-term deposits could not be reduced from the interest payments while capitalising the various expenditure on capital account.

22. The reference is answered accordingly in favour of the Revenue and against the assessee. No order as to costs.