
(2012) 06 GUJ CK 0015
In the Gujarat High Court
Case No : Tax Appeal No. 99 of 2000

Gujarat Power Corpn. Ltd.

APPELLANT

Vs

ITO

RESPONDENT

Date of Decision : 26-06-2012

Acts Referred:

Companies Act, 1956 — Section 113, 208, 41

Citation : (2013) 354 ITR 201

Hon'ble Judges : Harsha Devani, J; Akil Abdul Hamid Kureshi, J

Bench : Division Bench

Advocate : J.P. Shah, for the Appellant; Sudhir M. Mehta, for the Respondent

Final Decision : Allowed

Judgement

Akil Kureshi, J.—This appeal is filed by Gujarat Power Corporation Ltd. (hereinafter to be referred to as "the assessee") challenging the judgment of the Tribunal dated 16-12-1999 rendered in ITA No. 1088 of 1994. At the time of admission of the appeal, a question of law was framed. However, with the consent of the learned advocates for the parties, we reframe such question as follows:

Whether a sum of Rs. 53.92 lakhs received by the assessee towards interest on short-term fixed deposits be treated as the income of the assessee company and can, accordingly, be taxed in its hands ?

2. The issue arises with respect of assessment year 1992-93 in following factual background.

3. The assessee company is promoted by the Government of Gujarat and the Gujarat Electricity Board with an object to augment power generating capacity in the State of Gujarat by attracting private sector partners or its own. The Government of Gujarat had sanctioned amounts of Rs. 1 crore and Rs. 4 crores towards equity share capital of the assessee company. Such amounts were transferred to the assessee company for allotment of shares. Such amounts were

shown in the balance sheet of the assessee company as amounts received from promoters to be adjusted towards share capital in due course. However, the assessee company could not commence the work for which it was incorporated. In the meantime, the amount received as contribution towards share capital was deposited in schedule banks in short-term deposits. From such short-term deposits, the assessee company earned the interest of Rs. 53.92 crores (sic-- lakhs) during the year 1991-92.

4. The assessee company contended that since such amount of interest was received from the contributions by the Government towards share capital which remained in the corporation in trust, the income did not belong to the assessee.

5. The assessing officer, however, objected to such treatment of the interest by the assessee company and called upon the assessee to justify the same. Before the assessing officer, the assessee contended that the funds were provided by the Government to the corporation for the purpose of allotment of the shares. Since the shares could not be allotted, the surplus funds were parked in fixed deposits with schedule banks. Interest of Rs. 53.92 lakhs received on such fixed deposits belonged to the Government and the same has, accordingly, been credited to the Government of Gujarat. The assessee referred to a letter dated 17-9-1992 received from the Government of Gujarat in which it was recorded that, "It was considered fair by both the sides that the interest income being generated by the use of these funds by the corporation should belong to and be received on behalf of the Government of Gujarat".

6. The assessee, before the assessing officer, further pointed out that the assessee showed such amount under the head of "Current liabilities" and such annual accounts were also approved by the board of directors in its meeting held on 22-9-1992.

7. The assessing officer, however, was not convinced. He held that such interest income was that of the assessee and should, accordingly, be taxed in the hands of the assessee itself. His grounds for forming such a belief were as under:

(i) That there was no condition when the share application money was given by the Government to the assessee that interest accruing on such amounts should be paid to the Government. The assessing officer noted that the letter dated 17-9-1992 from the Government of Gujarat was received after the end of the financial year.

(ii) That there is no provision in the Companies Act authorizing the shareholder or promoter to ask for payment of interest on the share application money.

(iii) The company had paid advance tax on such income. It was only latter on that the company had an afterthought. In the opinion of the assessing officer, this was to avoid payment of income tax.

(iv) The assessing officer relied on section 41 of the Companies Act which defines the term Membership of company to observe that no member can impose any

other condition after he has become member of the company.

(v) Referring to the provisions of section 208 of the Companies Act, the assessing officer held that such provision would debar payment of interest on share application money.

(vi) The assessing officer noted that the company had in the asst. yr. 1991-92, earned similar interest of Rs. 1,90,299 on the deposits made with the bank from the share capital money received by the company. On such income, the company had paid tax. In the current year also, the company had initially paid advance tax on such interest income, but later on changed its stand.

8. The assessment order dated 18-11-1993 was carried in appeal by the assessee. The Commissioner (Appeals) allowed the appeal of the assessee by his order dated 28-2-1994, relying on the decision of the Tribunal in the case of (1982) 2 ITD 515 . The Commissioner (Appeals) placed heavy reliance on the letter of the Government dated 17-9-1990 which, in his opinion, clarified the situation for all practical purposes in favour of the assessee since the letter recorded that both the sides agreed that the interest income was received by the appellant on behalf of the Government and should, therefore, belong to the State of Gujarat.

9. The Revenue carried the matter further in appeal before the Tribunal. The Tribunal by the impugned judgment dated 16-12-1999, allowed the Revenues appeal. Before the Tribunal, the assessee produced additional documents which included above noted letter dated 17-9-1992 received by the appellant from the Government of Gujarat, as also a detailed communication dated 21-9-1993 from the assessee to the assessing officer during the course of assessment proceedings. The assessee also produced the Government resolutions and correspondence with respect to placing the said funds of a total of Rs. 5 crores at the disposal of the assessee for allotment of shares to the Government. To such correspondence, we will make a detailed reference at a later stage.

10. Before the Tribunal, the assessee reiterated its stand and contended that the income was generated from deposits of the share money received from the Government since the shares could not be allotted. The assessee relied on the Governments letter dated 17-9-1992 and also placed heavy reliance on the Tribunals decision in case of Gujarat Narmada Valley Fertilizers Co. Ltd. (supra).

11. The Tribunal, however, did not accept the contentions of the assessee and proceeded to allow the Revenues appeal. The Tribunal was of the opinion that undisputedly, the fund received from the State of Gujarat towards allotment of share capital was utilized by the company for making short-term deposits with the schedule banks, from which it earned interest income of Rs. 53.92 lakhs. The Tribunal was of the opinion that once the promoter made its contribution towards share capital, there was no provision under the Companies Act that any income earned on such contribution, even prior to the issuance of the share certificates, would belong to the shareholder. In the opinion of the Tribunal, the provisions of

the Companies Act mandatorily require the company to issue share certificates and deliver the same to the shareholders within the time specified in section 113 of the Companies Act. Any default in doing so would result into penal consequences. Non-issuance of share certificates would not alter the intrinsic character of the funds belonging to the company after contribution of share capital made by the promoters. The Tribunal relied on the decision of the Apex Court in case of Tuticorin Alkali Chemicals and Fertilizers Ltd., Madras Vs. Commissioner of Income Tax, Madras, and held that the decision in case of Gujarat Narmada Valley Fertilizers Co. Ltd. (supra) was rendered prior to the decision in case of Tuticorin Alkali Chemicals & Fertilizers Ltd. (supra).

12. Before us, learned counsel, Shri J.P. Shah, for the appellant vehemently contended that the Tribunal committed an error in allowing the Revenues appeal. He submitted that the amount received from the State of Gujarat towards share capital, was invested in short-term fixed deposits since the purpose for which such amount was received could not be fulfilled. Nevertheless, the amount could be stated to have been held by the assessee in trust. Any income generated from such amount must belong to the State of Gujarat. He relied on the communication dated 17-9-1992 received from the State of Gujarat by the assessee company. Counsel placed heavy reliance on the decision of the Tribunals case in case of Gujarat Narmada Valley Fertilizers Co. Ltd. (supra). He also relied on the decision of the Bombay High Court in case of Commissioner of Income Tax, Bombay City I Vs. Tanubai D. Desai, wherein in a case where the solicitor was holding clients moneys and had earned interest in the process, the Division Bench of Bombay High Court held that the assessee-solicitor was holding such moneys in quasi-trust on behalf of his clients and he held such moneys in a fiduciary capacity, and the income of interest derived from such moneys was also held by him in such fiduciary capacity. Such income, therefore, did not belong to the assessee.

13. On the other hand, learned counsel Shri Sudhir Mehta for the Department opposed the appeal contending that in the original agreement between the assessee and the State of Gujarat, there was no stipulation that if any interest is earned on such share money, the same would belong to the Government. He submitted that the assessee under identical circumstances had paid tax in the earlier year on interest income. He pointed out that in the present year also, the assessee had initially paid advance tax on such likelihood of accrual of the income. It was only later on that the assessee changed its stand.

14. Counsel relying on sections 41, 113 and 208 of the Companies Act, contended that under the Companies Act, there was no provision whereby a promoter can claim interest on a share money paid to the company. He submitted that any payment of such interest is expressly barred under s. 208 of the Companies Act.

15. Having thus heard the learned counsel for the parties, we may peruse the admitted facts more closely. The assessee company was promoted by the State

of Gujarat and the Gujarat Electricity Board to augment power generating capacity in the State of Gujarat. The Government of Gujarat sanctioned a sum of Rs. 1 crore in its resolution dated 11-12-1990 for the purpose of Government share capital contribution in the assessee company. Correspondingly, such amount was placed at the disposal of the assessee company under a communication dated 11-1-1992 in which the Government wrote to the assessee company that the Government has sanctioned such amount of Rs. 1 crore towards equity share capital. Such shares may be issued in the name of the Government of Gujarat. Share certificates when ready be sent to the State Bank of Saurashtra, Bhavnagar, for safe custody. Similar such resolution was passed on 25-3-1991 under which the Government sanctioned a further sum of Rs. 4 crores to be paid to the assessee corporation towards share capital contribution. Such amount was placed at the disposal of the assessee under communication dated 25-3-1991 requiring the assessee to issue share certificates in favour of the Government of Gujarat.

16. It is true that in such resolutions or the communications from the Government to the assessee company, there was no clear specification with respect to interest that may be earned in case such share money could not be utilized immediately for the purpose for which it was given. It is equally true that for whatever internal reasons, the assessee company could not allot the shares to the State Government for such total sum of Rs. 5 crores paid by the Government to the corporation. Such amount, therefore, remained in the hands of the assessee. Instead of allowing to remain idle, the assessee parked the same in short-term deposits with schedule banks and thereby, earned interest income of Rs. 53.92 crores (sic--lakh) in the previous year relevant to the assessment year 1992-93.

17. Vide letter dated 17-9-1992, Dy. Secretary of Government of Gujarat conveyed to the assessee company that the shares were to be issued in the name of the Government of Gujarat for which a total sum of Rs. 5 crores was transferred by the Government to the assessee, however, such shares have so far not been issued. The issue was discussed with respect to the position arising on account of non-appropriation of the funds contributed by the Government of Gujarat towards equity share capital. It was noted that this suggestion that the amount should bear interest payable by the Corporation was not found workable. However, it was considered fair by both the sides that the interest income being generated by the use of these funds by the corporation should belong to and be received on behalf of the Government of Gujarat. It was reiterated that the amount sanctioned should be utilized by the corporation towards equity capital. Pending such allotment of shares to the Government, whatever income is earned by way of interest by the corporation would belong to the Government of Gujarat.

18. From the above sequence of events, it can be seen that, though a total sum of Rs. 5 crores was placed by the Government of Gujarat at the disposal of the assessee company for allotment of shares, such sum was not utilized for the

purpose for which the same was transferred. As per the understanding between the assessee and the Government of Gujarat, pending allocation of shares, whatever interest was earned, should be paid over to the State of Gujarat. The suggestion that the corporation should pay interest on such amount to the State of Gujarat was not found workable. Instead, the Government staked its claim over the interest earned by the Government on such sum of money transferred by the Government to the corporation for allotment of shares.

19. To our mind, the assessee was justified in contending and claiming that such interest cannot be treated as income in the hands of the assessee and that the same, therefore, cannot be taxed accordingly. When the Government of Gujarat placed such funds at the disposal of the corporation, the specific stipulation was that the same should be utilized for the purpose of allotment of shares. If for whatever reason the assessee could not immediately allot the shares, the amount which remained with the corporation, must be held to have been held by the corporation in trust for and on behalf of the State of Gujarat. If during such period when the assessee was holding such amount in trust, any interest accrued by investment of such amount in short-term deposits, such interest also must belong to the Government and till it remained in the hands of the assessee, must be treated to have been held in trust.

20. Merely because the initial agreement between the parties did not make any provision with respect to treating such interest, in our opinion, would not be sufficient to change the nature and basic character of such income. In absence of specific stipulation to the contrary, such interest must be treated to be held by the assessee in trust for the Government. Further, on 17-9-1992, the Government of Gujarat and the assessee both after due deliberations, agreed that the best solution would be to transfer such interest income to the Government. The suggestion that the corporation should bear the interest liability and pay interest to the Government on such unutilized funds, was not found workable. Had such an opinion adopted, decision in case of Tuticorin Alkali Chemicals & Fertilizers Ltd. (supra) would have applied. Instead, the Government only insisted that the interest which the corporation earned on such sums of money, should be transferred to the Government. Thus, even if initially the agreement between the parties was silent on the treatment of the interest, subsequently by virtue of the further understanding and arrangement between the parties, sufficient clarity was given to the issue.

21. We do not find that the arrangement arrived at between the assessee and the Government was prohibited by any of the provisions of the Companies Act. Even if under the Companies Act, the assessee was under the obligation to issue share certificates within specified time, that would not in any manner imply that the assessee could not have paid the interest to the Government for non-utilization of the funds for the purpose for which it was made available, namely, for allotment of shares.

22. Reference to section 208 of the Companies Act is equally erroneous, section

208 of the Companies Act pertains to power of company to pay interest out of capital in certain cases. Sub-section (1) of section 208 provides, inter alia, that when 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 pay interest on so much of that share capital as is for the time being paid up, for the period and subject of the conditions and restrictions mentioned in sub-sections (2) to (7) of the said section. Sub-section (2) of section 208 in particular provides that no such payment shall be made unless it is authorized by the articles or by a special resolution. Sub-section (3) of section 208 provides that no such payment be made without the previous sanction of the Central Government.

23. In the present case, section 208 of the Companies Act has no application. The said section governs a situation where the company has already issued shares and the activity of the company cannot be made profitable for a lengthy period. In such circumstances, subject to restrictions provided under the said section, it would be open for the company to pay interest on such paid up share capital. In the present case, the question arises with respect to payment of interest on money received for allotment of shares, which shares could not be allotted on account of the company's internal reasons.

24. To our mind, situation in the present case was very similar to what arose before the Tribunal in the case of Gujarat Narmada Valley Fertilizers Co. Ltd. (supra). In the said case, the Government of Gujarat, as a promoter of the assessee company, had paid a sum of Rs. 6 crores as contribution towards the share capital. Such sum was invested by the assessee in short-term deposits earning interest thereon. Subsequently, pursuant to the directive issued by the Government, the assessee paid such interest earned by it to the Government. It was in this background that the Tribunal held that this was a case of diversion of income by overriding title. The Government was free to impose conditions regarding the payment of interest earned, until it gave permission for the issue of share capital, which was done later. The Tribunal held that the mere fact that the amount was shown in the balance sheet of the assessee was also not relevant. The interest earned could not, therefore, be considered to be the income of the assessee.

25. Reliance placed by the Tribunal in case of Tuticorin Alkali Chemicals & Fertilizers Ltd. (supra) was also misplaced. In the said decision, the assessee had earned interest out of investment made from the borrowed funds prior to the commencement of the business. It was in this background that the Apex Court held that such interest would be taxable and interest earned cannot be utilized to discharge liability for payment of interest. It was held that this was not a case of diversion of income by overriding title and that the deduction or set off against interest liability on the borrowed funds would not be permissible. The present case does not involve such facts. The assessee did not earn interest on funds borrowed for the purpose of its business. The prime question is whether the

interest income though received by the assessee from investment of the share capital money received from the Government which was deposited in fixed deposit, can be treated to be the income of the assessee or that of the Government. It is well-settled that every receipt by a person is not necessarily his income.

26. Mere fact that in the earlier year, the assessee had treated such income differently, or that in the year under consideration, initially had paid advance tax on such basis, to our mind, would not be conclusive of the nature of the income. What heeded to be ascertained was whether the assessee is legally correct in asserting that the income did not belong to the assessee, but that was of the Government of Gujarat, and that therefore, it cannot be taxed in the hands of the assessee. In our opinion, the assessee is perfectly justified in raising such a contention which was, to our mind, erroneously turned down by the Tribunal. In the result, the appeal is allowed. The judgment of the Tribunal dated 16-12-1999 is set aside to that extent. The question is answered in the negative, that is, in favour of the assessee and against the Revenue.