
(1984) 03 BOM CK 0012

In the Bombay High Court

Case No : I. T. APPEAL NO. 712 (DELHI) OF 1983

INSPECTING ASSISTANT COMMISSIONER

APPELLANT

Vs

CHANDPUR SUGAR CO.

RESPONDENT

Date of Decision : 31-03-1984

Acts Referred:

Income Tax Act, 1961 — Section 57(iii)

Citation : (1986) 17 ITD 795

Hon'ble Judges : Rajendra, A.M.

Bench : Division Bench

Judgement

Per Shri Rajendra, Accountant Member - The revenue is aggrieved against the order of the Commissioner (Appeals) holding that the interest of Rs. 2,64,279 received by the assessee-company was not assessable.

2. The assessee-company was setting up a sugar mill during the accounting year under consideration ending 31-3-1978. It had borrowed funds from Industrial Finance Corpn., Indian Overseas Bank, U.P. State Sugar Corpn., etc., on which during the relevant accounting year it paid interest of Rs. 9,13,380. The part of the fund so received was deposited in short-term deposits with the banks on which the assessee earned interest of Rs. 2,64,279. The assessee claimed that the said interest receipts should be set off against the interest payments made by the assessee and, therefore, no interest income was assessable in the hands of the assessee-company. The ITO, however, rejected this contention holding that the interest of Rs. 2,64,279 earned by the assessee was assessable under the head Income from other sources and only the expenditure laid out or expended wholly or exclusively for the purposes of making or earning such interest income was allowable as deduction against the interest income. He then analysed the sources of bank deposits and observed that (a) no deduction was allowable in respect of the capital contribution collected by the assessee and deposited with the bank. (b) Out of the loans from U.P. State Sugar Corpn. and Industrial Finance Corpn. the ITO noted that only part of the said loans was deposited with

the bank as the loans were taken for the purposes of establishing the sugar factory and not for making the deposits with the banks. The ITO relied on Commissioner of Income Tax (Central) Vs. New Central Jute Mills Co. Ltd., where it was held that the purpose of the loan was not to utilise the amount for earning interest from bank and, therefore, the expenditure by way of payment of interest on the loans taken by the assessee was not incurred solely and wholly for earning interest by making deposits with the bank and, therefore, was not allowable as revenue expenditure. The ITO, accordingly, assessed the interest receipt of Rs. 2,64,279 as assessee-company income from undisclosed sources.

3. The Commissioner (Appeals) deleted the addition holding that only net amount of interest payable against loans taken for installation of plant and machinery was includible in the total cost of construction and as the assessee had paid interest on the borrowed funds a part of which had been deposited with the bank, only the net result in the interest account should be seen. The Commissioner (Appeals) distinguished the Tribunals decision in the assessee's case for the assessment year 1977-78 which was the first year of the construction period and when no loans from financial institutions had been obtained and interest was earned on the shares subscription money.

4. The department is in appeal before us. The learned departmental representative relied on the Tribunals order in the assessee's case for the assessment year 1977-78 as also on ADDITIONAL COMMISSIONER OF Income Tax, MADRAS-I Vs. MADRAS FERTILISERS LTD., , Commissioner of Income Tax, Bombay City-II Vs. United Wire Ropes Ltd., and New Central Jute Mills Co. Ltd.s case (supra).

5. The learned counsel for the assessee relied on the decisions of the Tribunals, Special Bench namely, Arasan Aluminium Industries (P.) Ltd. v. First ITO [1982] 1 ITD 10 (Mad.) , (1983) 3 ITD 796 and Addl. Commissioner of Income Tax, New Delhi Vs. Indian Drugs and Pharmaceuticals Ltd., and Addl. CIT v. Rewari Electric Supply & General Industries [1983] 32 CTR (Dehli) 338.

5.1. We have considered the submissions of both the parties. We hold that the interest income of Rs. 2,64,279 is assessable in the hands of the assessee-company. Decisions relied on by the revenue fully support our findings - Madras Fertilisers Ltd.s case (supra) dealt with a similar case where the assessee had borrowed funds were deposited in bank on which interest was earned and the Madras High Court held that the interest earned was assessable but the interest paid on the borrowings was not an allowable deduction. Similar view was taken by the Bombay High Court in United Wire Ropes Ltd.s case (supra) where it was held that the loans raised by the assessee and kept as bank deposit due to restriction on remittance and interest earned thereon was not connected with the interest paid on foreign exchange loan and, therefore, the interest paid could not be set off against the interest receipt.

6. The Calcutta High Court in New Central Jute Mills Co. Ltd.s case (supra) held

that the interest earned on loan obtained on interest from the Government for erection of chemical plant could not be set off against the interest paid on the loan raised from the Government and that while the interest paid was to be utilised and added to the cost of plant, the interest earned was assessable and the purpose of loan raised was not to utilise the amount for earning interest from bank and, therefore, interest payment was not for earning interest from bank and could not be allowed as revenue expenditure.

7. The Bombay High Court in *Smt. Zubedabai v. CIT* 1983 Tax LR 1518 held that for claiming deduction u/s 57(iii) of the Income Tax Act, 1961 (the Act) nexus between the expenditure and income has to exist.

8. The Madhya Pradesh High Court in *MADHYA PRADESH STATE INDUSTRIES CORPORATION LTD. Vs. COMMISSIONER OF Income Tax, M.P.*, held that the interest earned on deposit of share money with the bank was assessable under the head Income from other sources.

9. The Delhi High Court in *Indian Drugs & Pharmaceuticals Ltd.s* case (supra) held that the receipts from the sale of tender forms and supply of water and electricity to contractor engaged in construction and on account of sale of trees, grass, stones were not receipts from an independent source unrelated to the business but were inextricable linked with the process of setting up the business and were directly related to the capital structure of business and were, therefore, of capita nature. However, at para 138 in line 8 they observed, "it is from this point of view that these receipts are distinguishable from interest on deposits or surplus money. Interest was realised by utilisation of surplus money and the utilisation created a separate independent source".

10. Thus, the High Courts are unanimous that the interest earned on surplus money created an independent source and was assessable and the interest paid on borrowed money was not an allowable deduction.

11. It is true that the two decisions of the Tribunal Special Bench in *Arasan Aluminium Industries (P.) Ltd.s* case (supra) and *Nagarjuna Steel Ltd.s* case (supra) are in favour of the assessee but in view of the unanimous decisions of the High Courts, we are unable to follow the said decisions of the Special Bench. We have already noted that in the assessment year 1977-78, the Tribunal had taken the same view as we are taking now.

12. Under these circumstances, we accept the revenues appeal and vacate the order of the Commissioner (Appeals) and restore that of the ITO. The assessee's cross-objection supports the Commissioner (Appeals)'s action. The assessee did not press before us the other grounds taken in the cross-objection regarding non-disposal of some grounds of appeal before the Commissioner (Appeals).

13. In the result, the revenues appeal is allowed and the assessee's cross-objection is dismissed.