

**IN THE INCOME TAX APPELLATE TRIBUNAL  
"B" BENCH : BANGALORE**

**BEFORE SHRI N. V. VASUDEVAN, VICE PRESIDENT AND  
SHRI JASON P. BOAZ, ACCOUNTANT MEMBER**

ITA No.1522/Bang/2017
Assessment Year : 2008-09

M/s. ONGC Mangalore Petrochemicals Ltd., Mangalore Special Economic Zone, Permude Village, Mangalore – 574 509. <b>PAN : AAFCM 0322 D</b>	Vs.	Assistant Commissioner of Income-Tax, Circle-1(1), Mangalore.
APPELLANT		RESPONDENT

Assessee by	:	Shri. B. R. Kamath, CA
Revenue by	:	Shri. R. N. Siddappaji, Addl.CIT

Date of hearing	:	10.01.2019
Date of Pronouncement	:	15.03.2019

**ORDER**

*Per Jason P Boaz, Accountant Member*

This appeal by the assessee is directed against the order of the CIT(A)-Mangalore, dated 26.04.2017 for Assessment Year 2008-09.

2. Briefly stated, the facts of the cases are as under:

2.1 The assessee company, promoted by ONGC, MRPL and others, for setting up an Aromatic Complex in Mangalore Special Economic Zone

(‘MSEZ’) to produce petrochemical products like paraxylene and benzene by using naphtha produced by MRPL. For Assessment Year 2008-09, the assessee filed its return of income on 19.09.2008 declaring total income of Rs.2,01,30,250/-. A revised return of income was filed on 09.02.2010 declaring NIL income. The case was selected for scrutiny for this Assessment Year and the assessment was concluded under section 143(3) of the Income Tax Act, 1961 (in short ‘the Act’) vide order dated 27.12.2010; wherein the assessee’s income was determined at Rs.2,01,30,250/-. This was on account of the Assessing Officer (AO) holding that the interest earned on funds deposited in Banks; out of equity contributions from promoters for construction of plant; till actual utilization for the project of setting up the Aromatic Plant in Mangalore SEZ; to be exigible to tax under the head “Income from Other Sources”. In doing so, the AO rejected the assessee’s claim that the interest earned should qualify for capitalization against capital work-in-progress being pre-operative expenditure incurred prior to the commencement of business. On appeal, the CIT(A) upheld the order of the AO that the said interest earned was exigible to tax as “Income from Other Sources” as the deposits were made out of surplus funds and dismissed the assessee’s appeal vide the impugned order dated 26.04.2017.

3.1 Aggrieved by the order of CIT(A), Mangalore dated 26.04.2017 for Assessment Year 2008-09, the assessee has preferred this appeal before the Tribunal in which it has raised the following grounds:-

- 1. The orders of the Authorities below insofar against the Appellant are against the law, weight of evidence and also against the facts and circumstance of the case.*
- 2. The learned C.I.T. (A) has grossly failed to appreciate the issues raised by the appellant as analysed by the Honorable Delhi High Court in Indian Oil Panipat Power Consortium Ltd. Vs ITO 315 ITR 255 (Delhi).*
- 3. The learned C.I.T. (A) has grossly failed to appreciate the distinction brought out by the Delhi High Court in 315 ITR 255.*
- 4. The learned C.I.T. (A) has grossly failed to distinguish the case of the appellant from the case of Tuticorin Alkali 227 ITR 172(SC).*
- 5. The learned C.I.T. (A) has grossly failed to appreciate that the capital contribution received by the Appellant are inextricably linked to settling up of the project by the appellant.*
- 6. Your appellant craves for Leave to add alter amend or delete all or any of these grounds of appeal.*
- 7. For these grounds and such other grounds as are advanced at the time of hearing, your appellant prays that the appeal be allowed.*

3.2 In support of the grounds raised (supra), the learned AR of the assessee was heard and has put forth the following written submissions which we extract hereunder:

1. *Your appellant is a company incorporated under the companies Act to set up an aromatic complex in Mangalore SEZ. Your appellant filed their return of income on 23-09-2008 declaring a total income of Rs.2,01,30,250/-. Subsequently, your appellant filed a revised return of income on 09-02-2010 declaring a Nil income. The original return was processed u/s.143(1) and then a rectification made u/s.154 was processed to grant credit for TDS. Then the case was selected for scrutiny by issue of notice u/s.143(2). After hearing the various submissions made by the appellant, the learned Assessing Officer completed the assessment rejecting the claim of the appellant that interest received on short term deposits with banks made out of advance towards share capital by the Promoters during the construction period is to be set of against the capital work in progress.*
2. *Being aggrieved by the said order, Your appellant assailed said assessment order before the learned Commissioner Income Tax (Appeals) Mangalore in ITA 76/MNG/CIT(A)/MNG 2010-11.*
3. *Before the learned CIT (A), it was submitted that the appellant company is promoted by ONGC Ltd. & MRPL for setting up an aromatic complex at MSEZ. The appellant received Rs.217.5 crores as advance against equity capital for the purpose of acquisition of land grading and development of site for industrial purposes, appointment and payment to project & Management consultants, placing orders for machineries, calling for tenders, payment to civil contractors and payments to machinery suppliers etc.*
4. *Land for the project admeasuring 442 acres has earmarked inside Mangalore SEZ. As the appellant company is in the construction phase and funds are infused as advance against equity from the promoters exclusively for the specific purpose of acquisition of land and development of infrastructure, the interest/earning on funds invested temporarily in Bank deposits etc., till actual utilization for the project purpose would qualify for capitalization (netting out) against the capital work in progress and preoperative expenses. The accounting has been done with books of accounts accordingly.*

5. *The appellant explained that the advance of the funds infused by the promoters and the investment of the idle funds in short term deposits with banks pending the disbursal are inextricably interwoven. It was further explained that these short term investment in Fixed Deposit were inextricably connected with the project implementation by the appellant company. The learned CIT (A), Mangalore rejected the appeal after hearing the appellant's submissions.*
6. *I earnestly submit that the funds were placed in fixed deposits for short periods so that liquidity is ensured and money would remain available as and when required for purchase of land, grading and development of land for industrial purposes, infrastructure development, payment to consultants, civil contractors and advance payments to machinery suppliers etc. and hence the interest so earned is inextricably linked to the setting up of the project.*
7. *I earnestly draw your attention to the decision of Delhi High Court in **Indian Oil Panipat Power Corporation Ltd. Vs ITO 315 ITR 255** and also the decision of Delhi High Court in **Principal C.I.T. Vs FACOR Ltd 380 ITR 0474 (Delhi)**.*
8. *I earnestly draw your attention to para 11 to 16 of the judgement reported in page 258-261 of ITR 315 which is reproduced here below:*

*"11. In our opinion, the Tribunal has misconstrued the the judgment of the Supreme Court in the case of **Tuticorin Alkali Chemicals (1997) 227 ITR 172** and that of **Bokaro Steel Ltd., (1999) 236 ITR 315**. The test which permeates through the judgment of the Supreme Court in **Tuticorin Alkali Chemicals (1997) 227 ITR 172** 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 taxable under the head "Income from other sources". On the other hand, the ratio of the Supreme Court judgement in **Bokaro Steel Ltd. (1999) 236 ITR 315** 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.*

*12. 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. v. CIT/Excess Profits Tax (1958) 34 ITR 368 (SC)** and **Narain Swadeshi Weaving Mills v. Commissioner of Excess Profits Tax (1954) 26 ITR 765 (SC)**. Once it is held that the assessed income is an income connected with business, which would be so in the present case, in view of the finding of fact by the Commissioner of Income-tax (Appeals) 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, inasmuch 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. v. CIT (1972) 83 ITR 700 (SC) and CIT v. Govinda Choudhury and Sons (1993) 203 ITR 881 (SC).*

*13. It is clear upon a perusal of the facts as found by the authorities below that the funds in the form of share capital were infused for a specific purpose of acquiring land and the development of infrastructure. Therefore, the interest earned on funds primarily brought for infusion in the business could not have been classified as income from other sources. Since the income was earned in a period prior to commencement of business it was in the nature of capital receipt and hence was required to be set off against pre-operative expenses. In the case of Tuticorin Alkali Chemicals (1997) 227 ITR 172 it was found by authorities that the funds available with the assessee in that case were "surplus" and, therefore, the Supreme Court held that the interest earned on surplus funds would have to be treated as "Income from other sources". On the other hand in Bokaro Steel Ltd. (1999) 236 ITR 315 (SC) 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 this 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 on money taken on loan for meeting the above expenses."*

*15. In our view, the situation in the instant case is quite similar except here instead of paying interest on funds brought in for specific purpose interest is earned on funds brought in by way of share capital for a specific purpose. Could it be said that in the former situation interest could have been capitalized and*

*in the latter situation it cannot be capitalized. To test the principle we could extend the example, that is, would our answer be any different had assessee passed on the interest to the respective shareholders. If not, then, in our view, the only conclusion possible is that interest earned in the present circumstances ought to be capitalized.*

*16. In view of the discussion above, in our opinion, the Tribunal misdirected itself in applying the decision of the Supreme Court in **Tuticorin Alkali Chemicals (1997) 227 ITR 172** in the facts of the present case. In our opinion, on account of the finding of fact returned by the Commissioner of Income-tax (Appeals) that the funds infused in the assessee by the joint venture partner were inextricably linked with the assessee and hence was held to be a capital receipt which permitted to be set off against pre-operative expenses.*

*14. There is another perspective from which the present issue can be examined. Under section 208 of the Companies Act, 1956, a company can pay interest on share capital which is issued for a specific purpose to defray expenses for construction of any work and which cannot be made profitable for a long period subject to certain restrictions contained in sub-section (2) to (7) of section 208. This section was specifically noted by the Supreme Court in **Challapalli Sugars Ltd. v. CIT (1975) 98 ITR 167**. The Supreme Court went on to observe at page 175 as follows:*

*"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 subsection (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 capitalizing 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 setting up of the plant, the interest earned by the assessee could not be treated as income from other sources. In the result we answer the question as framed in favour of the assessee and against the Revenue. These appeals are allowed and the impugned judgement is set aside.”*

9. *I earnestly submit that the Honourable Delhi High Court has rightfully distinguished the decision of Honourable S.C. in Tuticorin Alkali case 227 ITR 172 (SC) and has upheld the claim of the appellant assessee. It is apt to note that the decision of the Honourable Delhi High Court is squarely applicable to the case of the appellant before you. The learned CIT (A) has failed to note and appreciate the distinction made by the Honourable Delhi High Court.*
10. *The learned CIT(A) has failed to note and appreciate that Honourable Delhi High Court has followed the principle laid down by Honourable SC in **Bokaro Steel Plant case 236 ITR 315(SC)**. It may be noted that basing on the said principle, the Honourable Delhi High Court upheld the claim of the assessee that the interest earned on short term deposit with banks by the assessee out of capital contribution by the promoters pending investment in the implementation of the project.*
11. *I earnestly submit that my contentions are fortified by the under noted decisions:*
  - a) *CIT Vs Panem Coal Mines Ltd -ITA 639/2008 Delhi H.O*
  - b) *Electrosteel Steels Ltd. Vs DCIT -ITA No. 29 & 30 ITAT Kolkata 'C' Bench.*
  - c) *CIT Vs Sastn Power Ltd. -ITA No.10/2012 Delhi H.C.*
  - d) *CIT Vs Petronet LNG Ltd. -ITA 290 & 291/2011 - Delhi H.C.*
  - e) *NTPC SAIL Power Co (P) Ltd. Vs CIT - ITA No.1238/2011 Delhi HC*
  - f) *Bokaro Power Supply Co. Vs DCIT -ITA No. 3405 & 3692 ITAT Delhi 'A' Bench*
  - g) *ITO Vs NTPC Tamil Nadu Energy Co. Ltd. -ITA 4558 & 4559 ITAT Delhi 'E' Bench*

- h) ACIT Vs Aravali Power Co. (P) Ltd. -ITA 2953/Delhi/2012 ITAT Delhi 'A' Bench*
- i) Bank Note Paper Mill India Pvt. Ltd. Vs ITO Circle -1(1),(3) Bangalore - ITA No. 165 & 166/Bang/2018.*

*12. Therefore, I humbly pray that the claim of the appellant assessee be upheld and the appeal be allowed.*

The learned AR submits that in view of the above submissions, on facts and law, the assessee's claim be allowed, *inter alia*, in the light of the decisions of the Hon'ble Delhi High Court in the case of Indian Oil Panipat Power Corporation Ltd., Vs. ITO reported in 315 ITR 255, following the ratio of the decision of the Hon'ble Apex Court in the case of Bokaro Steel Ltd., 236 ITR 315, and is squarely applicable to the case on hand.

3.3 Per contra, the learned DR for Revenue supported the orders of the authorities below.

3.4.1 We have considered the rival submissions / contentions and carefully perused the material on record; including the judicial pronouncements cited. The issue for consideration before us is whether the interest received by the assessee on short term deposits kept temporarily with Bank out of advances towards share capital from promoters during the construction period i.e., for purchase of land, grading and development thereof for industrial purposes, development of infrastructure, payment to

consultants, civil contractors, advance payments to machinery suppliers, prior to the commencement of business, is to be capitalized and set off in capital work-in-progress as contended by the assessee OR is to be taxed as income under the head “Income from Other Sources” as held by the authorities below.

3.4.2 The facts of the matter, as emerge from an appraisal of the record, is that the assessee company is promoted by ONGC Ltd., MRPL and others for setting up of an aromatic plant at MSEZ; for which 442 acres has been earmarked. For this purpose, the assessee received Rs.217.50 Crores as advance against equity capital for the purpose of acquisition of land, grading and development of site for industrial purposes, appointment and payment to Project Management Consultant, placing orders for machineries, calling for tenders, payments to civil contractors, machinery suppliers, etc. Since the assessee company is in the construction phase of this project, and funds are infused as advances against equity share capital from the promoters, the assessee has temporarily invested the funds available in short term bank deposits etc., till actual utilization for the project. Therefore, according to the assessee, the interest so earned on these short-term deposits would qualify for capitalization against capital work-in-progress and pre-operative expenses; as these funds / deposits /

investments and interest thereon are inextricably linked to the setting up / implementation of the project at MSEZ.

3.4.3 In the light of the facts and circumstances of the case, as discussed above, we find that the decision of the Hon'ble Delhi High Court in the case of Indian Oil Panipat Power Consortium Ltd., Vs. ITO reported in (2009) 315 ITR 255 (Del) is squarely applicable factually to the case on hand and supports the case of the assessee. In the aforesaid case, the Hon'ble Court held that where the interest on money received on share capital is temporarily placed in fixed deposits awaiting acquisition of land and development of infrastructure, then the interest earned on funds, primarily brought in for infusion in business, cannot be classified as "Income from Other Sources". Since the interest income was earned in a period prior to commencement of business, the claim that such interest is a capital receipt, in the nature of capital receipt and was required to be set off against pre-operative expenses incurred prior to the commencement of the assessee's business is to be accepted.

3.4.4 In a subsequent judgment, the Hon'ble Delhi High Court in its decision in the case of NTPC SAIL Power Company Pvt. Ltd., Vs. CIT (ITA 1238/2011 dated 17.07.2012), at para 9 of its order, observed that the reasoning rendered in the decision in the case of Indian Oil Panipat Power

Consortium Ltd., Vs. ITO (supra), is in line with Bokaro Steel Ltd., (226 ITR 315) of the Hon'ble Apex Court and that the Hon'ble Court in the cases of CIT Vs. Karnataka Power Corporation (247 ITR 268) (SC), and Bongaigon Refinery and Petrochemical Co. Ltd., (251 ITR 329) (SC) held that such receipts are not income. In view of the facts and circumstances of the case on hand and the aforesaid decision of the Hon'ble Delhi High Court in the case of Indian Oil Panipat Power Consortium Ltd., Vs. ITO (supra) and the other decisions referred to by us (supra), we are unable to sustain the view taken by the learned CIT(A) by placing reliance on the decision in the case of Tuticorin Alkalis Chemicals and Fertilizers Ltd., (227 ITR 172) (SC). Respectfully following, *inter alia*, the decision of the Hon'ble Delhi High Court in the case of Indian Oil Panipat Power Consortium Ltd., (supra), we hold that the interest income of Rs.2,01,30,250/-; being the amount invested temporarily in short term deposits out of advance towards equity share capital by promoters are capital receipts and go to reduce the project cost of setting up the aromatic complex at MSEZ with which it is inextricably linked. We, therefore, reverse the findings rendered by the authorities below that the aforesaid interest of Rs.2,01,30,250/- is exigible to tax under the head "Income from

Other Sources". Consequently, the grounds raised by the assessee on this issue are allowed.

4. In the result, the assessee's appeal for Assessment Year 2008-09 is allowed.

*Pronounced in the open court on 15<sup>th</sup> March, 2019.*

Sd/-  
**(N. V. VASUDEVAN)**  
**VICE PRESIDENT**

Sd/-  
**(JASON P. BOAZ)**  
**Accountant Member**

Bangalore.

Dated: 15<sup>th</sup> March, 2019.

/NS/\*

Copy to:

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|-------------------------|---------------|
| 1. Appellants           | 2. Respondent |
| 3. CIT                  | 4. CIT(A)     |
| 5. DR, ITAT, Bangalore. | 6. Guard file |

By order

Assistant Registrar,  
ITAT, Bangalore.