

IN THE INCOME TAX APPELLATE TRIBUNAL “K” BENCH, MUMBAI

**BEFORE SHRI PRASHANT MAHARISHI, AM AND
MS. KAVITHA RAJAGOPAL, JM**

ITA Nos. 2383 & 2384/Mum/2018
(Assessment Years: 2012-13 & 2013-14)

ACG Associated Capsules Pvt. Ltd. 1001, Dalamal House, 10 th Floor, Nariman Point, Mumbai -400 021	Vs.	DCIT Central Circle – 7(3) Room No. 655, 6 th Floor, Aayakar Bhavan, M. K. Road, Mumbai -400 020
PAN/GIR No. AAACA 4769 K		
(Assessee)	:	(Revenue)

&

ITA Nos. 3282 & 3283/Mum/2018
(Assessment Years: 2012-13 & 2013-14)

DCIT Central Circle – 7(3) Room No. 655, 6 th Floor, Aayakar Bhavan, M. K. Road, Mumbai -400 020	Vs.	ACG Associated Capsules Pvt. Ltd. 1001, Dalamal House, 10 th Floor, Nariman Point, Mumbai -400 021
PAN/GIR No. AAACA 4769 K		
(Revenue)	:	(Assessee)

Assessee by	:	Shri Ketan Ved/ Shri Abdulkadir Jawadwala
Revenue by	:	Shri Akhtar Hussain Ansari

Date of Hearing	:	07.09.2023
Date of Pronouncement	:	04.12.2023

ORDER

Per Kavitha Rajagopal, J M:

These are cross appeals filed by the assessee and the Revenue challenging the order of the learned Commissioner of Income Tax (Appeals) ('Id.CIT(A) for short), National Faceless Appeal Centre ('NFAC' for short) passed u/s.250 of the Income Tax Act, 1961 ('the Act'), pertaining to the Assessment Year ('A.Y.' for short) 2012-13 and 2013-14 respectively.

2. As the facts are identical in all the appeals, we hereby pass a consolidated order by taking ITA No. 2383/Mum/2018 as a lead case for the sake of convenience.

ITA No. 2383/Mum/2018

3. The brief facts are that the assessee is engaged in the manufacturing of empty hard gelatin capsules of various sizes and had filed its return of income dated 26.11.2012, declaring total income at Rs.130,94,30,870/-. The assessee's case was selected for scrutiny and notice u/s. 143(2) and 142(1) of the Act were duly issued and served upon the assessee. The source of income declared by the assessee is out of profit and gains of business and profession and income from capital gains.

4. During the assessment proceeding, the Id. Assessing Officer ('A.O.' for short) observed that the assessee has entered into the international transaction with its associated enterprises (AE for short) as per Form No. 3CEB. The Id. A.O. made a reference to the Id. Transfer Pricing Officer ('TPO' for short) vide letter dated 17.03.2015 u/s. 92CA(1) of the Act for determining the arm's length price ('ALP' for short) of the international transaction entered into by the assessee with its AE. The Id. TPO vide order dated 28.01.2016 passed u/s. 92CA(3) of the Act proposed the following TP adjustment, mentioned as below:

<i>Sr. No.</i>	<i>Nature of TP adjustment</i>	<i>Amount (Rs.)</i>
<i>1</i>	<i>Corporate guarantee fee</i>	<i>77,19,074</i>

5. The Id. A.O. then passed the assessment order dated 29.03.2016 u/s. 143(3) r.w.s. 144C(3) of the Act by determining the total income at Rs.133,09,20,341/- after making the various additions/disallowances along with the TP adjustment proposed by the Id. TPO. The assessee has entered into the following international transactions:

Sr. no.	Particulars	Amount (Rs.)	Method used	Amount (Rs.)	Method used
		<i>Current year</i>		<i>Preceding year</i>	
1	Export of empty hard gelatin capsules and cellulose capsules	98,53,48,463/-	TNM Method	76,72,60,795/-	TNM Method
2	Reimbursement of expenses paid	1,09,54,512/-	At Actuals	66,61,070/-	At actuals
3	Reimbursement of expenses received	75,37,378/-	At Actuals	15,22,821/-	At actual
4	Investments	4,86,42,080/-	NA	81,173/-	NA
5	Corporate Guarantee	40,73,40,000/-	NA	37,94,40,000/-	NA
6	Compensation for support services	35,39,443/-	TNM Method	33,26,296/-	TNM Method
7	Dividend	4,57,943/-	CUP Method	Nil	NA
8	Liquidation of WOS and investment in Equity and Preference share capital of ACG Lukapsd.o.o.	Euro 59,35,000/-	CUP Method	Nil	NA
9	Lending of Money	Nil	NA	29,05,598/-	NA
10	Commission on sales paid	NIL	NA	2,67,020/-	TNM Method

6. Aggrieved by the impugned order, the assessee was in appeal before the Id. CIT(A) challenging the various additions/disallowance made by the Id. A.O.

7. The Id. CIT(A) partly allowed the assessee's appeal vide order dated 01.02.2018.

8. Both the assessee as well as the Revenue are in appeal before us, challenging the order of the Id. CIT(A).

9. Ground nos. I and II of the assessee's appeal challenges the transfer pricing adjustment on corporate guarantee given by the assessee on behalf of its AEs. The facts of this ground are that the assessee company had given corporate guarantee aggregating to Euro 6 million equivalent to Rs.40,73,40,000/- on behalf of its AEs namely ACG Lukaps d.o.o, Croatia for availing various credit facilities from Zagrabacka Banka, Croatia and City Bank, NA. It is also observed that the assessee had not bench marked the said transaction for the reason that the same is not an international transaction and,

therefore, had not determined the ALP for the said transaction in its TP study report. The assessee had contended that it had given corporate guarantee to foreign bank which does not fall under the scope of international transaction and that the same would fall under the international transaction only when the foreign subsidiary defaults in repaying the said loan to the bank making the assessee liable for the said default. The assessee further contended that the same would not be “provision of service” and it was only to increase the value of the assessee’s investment in its subsidiaries and had not earned any income out of the said transaction. The assessee further to this stated that without prejudice, to consider the standard chartered bank as a comparable which had offered 0.7% for similar guarantee.

10. The Id. A.O./TPO held that the transaction of giving corporate guarantee on behalf of its AE comes under the purview of international transaction u/s. 92B read with Explanation (1)(c) which is inserted with retrospective effect from 01.04.2002 by Finance Act, 2012. The Id. A.O./TPO further held that the said transaction would have a greater impact on the income and the assets of the assessee in case where the AE defaults the payments to the banks. The Id. A.O/TPO relied on the decision of the co-ordinate bench in the case of *Everest Kanto Cylinders Ltd.*(in ITA No. 542/Mum/2012 vide order dated 23.11.2012) and *Nimbus Communication Ltd.* (in ITA No. 3664 & 2359/Mum/2010) and bench marked the transaction of corporate guarantee by applying cup method and by rejecting the internal cup applied by the assessee @ 0.7%. The Id. A.O/TPO stated that the bank rates for such guarantee varies from 0.7% to 3% where the lowest rate of commission is charged on entities having higher credit rating and highest commission is

charged on entities having less credit rating and thereby determined the guarantee commission @ 1.75% and worked out the ALP at Rs.77,19,074/-.

11. In an appeal filed by the assessee, the Id. CIT(A) upheld the said transaction to be an international transaction as per the amendment to section 92B(2) of the Act with retrospective effect from A.Ys. 2002-03 as per Finance Act, 2012. The Id. CIT(A) further held that the Id. A.O./TPO has determined the interest rate without considering the fact that the assessee has given guarantee for its own subsidiary and the Id. A.O./TPO has erred in determining the rate of loan of unsecured bonds which is not the assessee's case here. The Id. CIT(A) further held that the rate ranged from 1.75% to 2% where the AE could have borrowed funds at even 2% where the guarantee commission rate given have been 2.5%. The Id. CIT(A) determined the rate at 0.70% based on the assessee's reliance on the standard chartered bank rate to be reasonable for the impugned transaction.

12. Both the assessee as well as the Revenue are in appeal before us challenging the order of the Id. CIT(A).

13. The learned Authorised Representative ('Id. AR' for short) for the assessee contended that the transaction of giving corporate guarantee to its AE would not fall under the purview of the international transaction as there was no income element involved in the transaction and that the assessee was benefited since it was the assessee who was getting the benefit out of the said transaction, the AE were not charged by the assessee for providing guarantee. The Id. AR further contended that the assessee has not received any charges for giving such guarantee commission and even otherwise it was for

direct or indirect commercial interest of the assessee. The ld. AR relied on the decision of the Hon'ble Apex Court in the case of *SA Builders vs. CIT* (288 ITR 1). The ld. AR further contended that the assessee has not received any income out of the said transaction and the same would not be categorized as an international transaction.

14. The learned Departmental Representative ('ld.DR' for short), on the other hand, controverted the said fact and relied on the various decisions which has held the transaction of corporate guarantee on behalf of the AE to be an international transaction. The ld. DR further stated that the ld. CIT(A) has erred in determining the ALP @ 0.70% without taking into consideration the credibility of AEs and the risks involved in the said transaction when the AE defaults the repayment of the loan for which the assessee has given corporate guarantee to the banks. The ld. DR relied on the order of the ld. A.O./TPO.

15. We have heard the rival submissions and perused the materials available on record. It is evident that the issue of corporate guarantee commission by the assessee to its AEs was dealt with by the Tribunal in A.Y. 2008-09 in ITA No. 2750/Mum/2014 where the Tribunal has restricted the corporate guarantee commission @ 0.5% by relying on the decision of the Hon'ble Jurisdictional High Court in the case of *CIT vs. Everest Kento Cylinders* [2015] 378 ITR 57 (Bom). It is also pertinent to point out that the issue of the impugned transaction whether an international transaction falling within the meaning of section 92B of the Act has also been dealt with by the Tribunal holding the said transaction to be an international transaction. The ld. DR relied on the decision in the case of *Glenmark Pharmaceuticals Ltd.* (in ITA No. 5031/Mum/2012 vide order dated

13.11.2013) and stated that the Id. CIT(A) has failed to look into the credit rating of the AEs and has also failed to evaluate the risk factor involved by the assessee in providing the corporate guarantee on behalf of its AE. On considering the rival submissions it is observed that the corporate guarantee given by the assessee on behalf of its AE for availing loan facility is for the purpose of reducing the interest rate charged by the banks and while determining the ALP of the said transaction the same has to be considered on the perspective of the benefit received by the AE as per the interest saving approach by reason of the corporate guarantee given by the assessee and to compare the same as to what would be the interest rate charged by the bank for the loan availed by the AEs if the corporate guarantee is not given by the assessee for availing the said loan. It is observed that both the lower authorities have failed to look into this issue before determining the ALP of the said transaction. Reliance placed on the decision in the case of Hon'ble Jurisdictional High Court in the case of *Everest Kento Cylinders* (supra) cannot be the basis for holding the corporate guarantee commission to be 0.5% which was held to be an appropriate rate by the Hon'ble High Court in case of that assessee and for that particular year under consideration. It is evident that 0.5% cannot be a standard rate for charging corporate guarantee commission and the same has to be determined in each case and for each year based on the credit rating of AE, comparable loan transactions where guarantees are issued and non guaranteed loans by working out interest saving and then sharing it between transacting parties. We, therefore, direct the Id. A.O./TPO to determine the ALP on corporate guarantee commission on the basis of the interest saving approach of the said transaction. The assessee is also directed to bench mark the said transaction where it has already been held to be an international transaction and on the

basis of which the Id. A.O./TPO has to determine the ALP of the corporate guarantee commission as per the provisions of section 92CA of the Act which makes it compulsory to benchmark the international transactions every year. Exception may be if no significant difference between FAR or economic circumstances exists. We, therefore, remand this issue back to the Id. A.O. on the above observation. Hence, ground nos. I & II of the assessee's appeal are allowed for statistical purpose.

17. Ground no. III pertains to the disallowance u/s. 14A read with Rule 8D of the Rules amounting to Rs.53,72,465/-. The facts of this ground is that the assessee had earned exempt income as dividend amounting to Rs.2,48,02,871/- as share of profit from partnership firm and had made a *suo moto* disallowance of Rs.13,10,845/- u/s. 14A read with Rule 8D of the Rules. The Id. A.O. observed that the assessee has computed the disallowance without considering the investment in the group concerns on the pretext that the same are strategic investments where the assessee has invested in the capital of the firms in which the share of profit received by the assessee has been claimed as exempt u/s. 10(2A) of the Act. The Id. A.O. by relying on the decision of Special Bench of the Tribunal in the case of *Cheminvest Ltd. vs. ITO* [2009] 121 ITD 318 (Del) (SB) and the CBDT Circular No. 5/2014 dated 11.02.2014 held that even in case where the assessee has not earned exempt income, the expenditure related to the earning of such income has to be disallowed. The Id. A.O. also relied on the decision of the Tribunal in the case of *Asst. CIT vs. Nimbus Communications Ltd.* [2014] 30 ITR (T) 349 and the decision of Kolkata Tribunal in the case of *Coal India Ltd.* (in ITA No.1032 & 1238/Kol/2012 vide order dated 13.05.2015), wherein it was held that section 14A disallowance is applicable

even in case of investments made in subsidiary companies. The ld. A.O. computed the disallowance u/s. 14A read with Rule 8D at Rs.66,83,290/-.

18. The ld. CIT(A) in an appeal preferred by the assessee upheld the disallowance made by the ld. A.O.

19. The assessee has challenged the impugned disallowance before us.

20. The ld. AR for the assessee contended that the investments made in the subsidiary companies are strategic investments which should not be considered for computing the disallowance under Rule 8D(2)(iii) of the Rules. The ld. AR relied on a catena of a decision which are in favour of the assessee. The ld. AR further without prejudice contended that the disallowance u/s. 14A be restricted to *suo moto* disallowance made by the assessee and as per the provision of section 14A read with Rule 8D of the Rules.

21. The ld. DR, on the other hand controverted the said facts and stated that the exempt income earned by the assessee by way of dividend income as share of profit from partnership firm should be considered as those eligible for computing disallowance u/s. 14A read with Rule 8D of the Rules. The ld. DR further contended that the investment in the subsidiary companies should also be considered for the purpose of computing the disallowance u/s. 14A of the Act. The ld. DR relied on the decision of the Special Bench of the Tribunal in the case of *Cheminvest Ltd.* (supra). The ld. DR relied on the order of the lower authorities.

22. We have heard the rival submissions and perused the materials available on record. It is observed that the assessee has earned dividend income amounting to

Rs.2,48,02,871/- as share of profit from the partnership firm and the assessee has made a *suo moto* disallowance of Rs.13,10,825/-. The lower authorities have relied on the decision of the co-ordinate bench in the case of *Nimbus Communication Ltd.* (supra) and the Kolkata Tribunal decision in the case of *Coal India Ltd.* (supra) wherein it was held that even in case of investment made in the subsidiary companies disallowance u/s. 14A is attracted. The contention of the assessee that these are strategic investment made in sister concerns for which it should not be included in computing the average value of the investments for the purpose of Rules 8D(2)(iii) of the Rules, does not hold merit as per the proposition laid down by the Hon'ble Apex Court in the case of *Maxopp Investment Ltd. vs. CIT* (in Civil Appeal Nos. 104-109 of 2015 vide order dated 12.02.2018). It is also pertinent to point out that as per the decision of the Special Bench of Ahmedabad Tribunal in the case of *Shri Vishnu Anant Mahajan vs. ACIT* (in ITA No. 3002/Ahd/2009) which held that the investments made in the partnership firms are also to be considered for computing the disallowance under Rule 8D of the Rules. We are not in agreement with the view of the Revenue in relying on the decision of ITAT in the case of *Cheminvest Ltd.* (supra) as the same has been reversed by the Hon'ble Delhi High Court.

23. On the above observation, we deem it fit to direct the Id. A.O. to restrict the disallowance to the extent of investment which has yielded in earning of the exempt income and not those investments where the assessee has not earned any exempt income for the purpose of computing the disallowance u/s. 14A read with Rule 8D. For this, we place reliance on the decision of the Special Bench of ITAT Delhi in the case of *ACIT vs. Vireet Investments Pvt. Ltd.* 165 ITD 27 (Trib-Del). We, therefore, remand this issue back

to the file of the Id. A.O. for recomputing the disallowance u/s. 14A read with Rule 8D to the extent of the investments made by the assessee which has resulted in earning of the exempt income. Hence, ground no. III raised by the assessee is partly allowed.

24. Ground no. IV being general in nature requires no separate adjudication.

25. In the result the appeal filed by the assessee is allowed for statistical purpose.

ITA Nos. 3282/Mum/2018 (A.Y. 2012-13)

26. This is the cross appeal filed by the Revenue challenging the order of the Id.

CIT(A) on the following grounds:

1 *"Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) justified in allowing the additional depreciation of Rs. 83,97,933/- to the assessee for the F.Y. 2011-12 despite the fact that the explicit provision for the deduction for the balance 50% of the amount has been introduced in the I T Act vide third proviso to subsection (l) of section 32 with effect from 01.04.2016. prospectively and not retrospectively.*

2 *"The Ld. CIT(A) erred in reducing rate of corporate guarantee commission chargeable from 1.75% to 0.7%, merely holding the transaction as fair and reasonable, without appreciating the fact that the Act specifically discusses each and every method including the Other Method to compute the ALP, and ALP cannot be determined considering a transaction to be fair and reasonable?"*

3 *"The Ld. CITA) erred in reducing rates of corporate guarantee commission chargeable from 1.75% to 0.7% based on a quotation produced by the assessee from Standard Chartered Bank ignoring the material differences between the two namely (i) that it pertained to a different financial year and (ii) was issued not to the AE but to the assessee, and there would be substantial difference in the rates of commission charged/chargeable to the assessee and the AE due to their differential credit ratings?"*

27. During the appellate proceeding, the Id. AR for the assessee stated that this appeal would be covered under the low tax effect as per the CBDT Circular No. 17 of 2019 dated 08.08.2019.

28. The Id. DR had nothing to controvert the same.

29. We have heard the rival submissions and perused the materials available on record. As this appeal filed by the Revenue would be covered under the low tax effect vide CBDT Circular No. 17 of 2019 dated 08.08.2019, we deem it fit to dismiss the said appeal with the liberty given to the Revenue to restore the appeal if in case the same would fall under the Exception to the said Circular.

30. In the result, this appeal filed by the Revenue is dismissed.

ITA No. 2384/Mum/2018 (A.Y. 2013-14)

31. This appeal has been filed by the assessee challenging the order of the Id. CIT(A) on various grounds.

32. Ground nos. I & II are on corporate guarantee commission and is identical to ground nos. I & II of ITA No. 2383/Mum/2018 and the observation given in the said appeal applies mutatis mutandis to this ground of appeal also.

33. Ground no. III pertains to the disallowance made u/s. 14A which on identical facts has been decided in ground no. III of ITA No. 2383/Mum/2018 and the observation given in the said appeal applies mutatis mutandis to this ground of appeal also.

34. Ground no. IV pertains to the interest income on temporary deposits. The Id. A.O. observed that the assessee has availed external commercial borrowings (ECB) and temporary surplus of such borrowings were deposited in bank fixed deposit out of which

the assessee has earned an interest of Rs.7,55,68,354/- and in that Rs.6,17,98,074/- was netted off against the interest expenses which was capitalized. The ld. A.O. had shown that the assessee caused the assessee for taxing the said interest income as income from other source u/s. 56 of the Act. The assessee contended that the external commercial borrowings were to be used only for the purpose of building of factory and plant and machinery as per the agreement and the same has to be capitalised and the interest out of the said borrowed fund should also be capitalized as per the provision to section 36(1)(iii) of the Act from the date of borrowal till the date on which the asset was put to use. The assessee further contended that it was paying interest on the said funds which were deposited and had also offered Rs.1,37,70,280/- out of the total interest to the tax which was credited in the profit and loss account as "Note 21 – other income". The assessee has netted off the balance interest cost which is capitalized to the cost of the project. The assessee relied on the decision of *Indian Oil Panipat Power Consortium Ltd. vs. ITO* [2009] 20 DTR 107 (Del) and the decision of the tribunal in the case of *Whistling Woods International Ltd. vs. ITO* (in ITA No. I.T.A.NOs.4662/Mum/2007 & 1394/Mum/2008 vide order dated 18.06.2010), wherein it was held that if income from temporary investments would be taxed as income from other sources u/s. 56, then the interest on such deposits should be allowed as deduction u/s. 57 of the Act. The ld. A.O. not satisfied with the assessee's contention held that the assessee has failed to prove the nexus of the borrowed funds to the temporary funds which had earned interest income and even otherwise if it was from the loans availed for purchasing of plant and machinery for SEZ unit, which has not commenced operation and is a distinct unit, the interest ought to be taxed as income from other sources, as the same is revenue in nature. The ld. A.O. relied on the decision of the

Hon'ble Apex Court in the case of *Tuticorin Alkali Chemicals and Fertilizers Ltd. vs. CIT* 141 CTR 387 (SC), which has held that interest out of the short term investment of funds borrowed for setting up of factory has to be assessed as income from other sources until the commencement of the business. The Id. A.O. added the interest income u/s. 56 of the Act and the corresponding adjustment is made as work-in-progress under fixed assets.

35. The assessee was in appeal before the first appellate authority challenging the impugned addition made by the Id. A.O. and the Id. CIT(A) by relying on the decision of the co-ordinate bench of the Tribunal in the case of *M/s. Z Square Shopping Mall Pvt. Vs. DIT* [2016] 65 Taxmann.com 139 (LKW Tribunal) and various other decisions upheld the addition made by the Id. A.O. on the interest income u/s. 56 of the Act.

36. The assessee is in appeal before us, challenging the order of the Id. CIT(A).

37. The learned Authorised Representative ('Id. AR' for short) for the assessee contended that the assessee had availed ECB for setting up for new plant as SEZ unit at Pitampur, Madhya Pradesh which has not commenced its operation during the year under consideration and that the borrowed fund has been temporarily parked in the bank fixed deposit for which the assessee has also paid interest on the said loan amount. The Id. AR relied on the decision of the Delhi High Court in the case of *Indian Oil Panipat Power Consortium Ltd.* (supra) and *Tuticorin Alkali Chemicals and Fertilizers Ltd.* (supra) wherein it was held that the interest income out of the borrowed funds deposited in the bank for the purpose of setting up of business or for specific purpose of acquiring land and development of infrastructure for the assessee's business has to be capitalized and the

same if is to be treated as revenue receipt then the corresponding expenditure is to be allowed u/s. 57 of the Act.

38. The Id. DR on the other hand controverted the said facts and relied on the decision of the Hon'ble Apex Court in the case of *Tuticorin Alkali Chemicals and Fertilizers Ltd.* (supra) which held that interest earned out of the fixed deposits from the surplus borrowed funds, the interest earned out of it should be taxed under the head income from other sources. The Id. DR further contended that the assessee has failed to prove that the funds parked in the fixed deposits are 'inextricably linked' to the set up of the plant and, therefore, the lower authorities have added the same u/s. 56 of the Act as revenue receipt. The Id. DR relied on the order of the lower authorities.

39. We have heard the rival submissions and perused the materials available on record. It is observed that the assessee has availed external commercial borrowings from banks for the purpose of setting up of a new plant and had temporarily parked the surplus of such borrowing in the bank's fixed deposits out of which the assessee has earned interest income of Rs.7,55,68,354/- and had offered Rs.1,37,70,280/- to tax after netting off the interest expenses amounting to Rs.6,17,98,074/- which was capitalized by the assessee. The Revenue's contention is that the same is revenue receipt and not a capital receipt which has to be taxed u/s. 56 of the Act. The Revenue placed strong reliance on the decision of the Hon'ble Apex Court in the case of *Tuticorin Alkali Chemicals and Fertilizers Ltd.* (supra) and the assessee has relied on the decision of Delhi High Court in the case of *Indian Oil Panipat Power Consortium Ltd.* (supra) and *Pr. CIT vs. Triumph Realty (P) Ltd.* [2023] 148 taxmann.com 196 (Del) along with other decisions. The moot

question here would be whether the interest earned out of the surplus borrowed fund in the fixed deposit would be a capital receipt or revenue receipt. The Hon'ble Delhi High Court in the case of *Indian Oil Panipat Power Consortium Ltd.* (supra) has dealt with the Hon'ble Apex Court decision in the case of *Tuticorin Alkali Chemicals and Fertilizers Ltd.* (supra) and has also relied on the decision of the Hon'ble Apex Court in the case of *CIT vs. Bokaro Steels Ltd.* [1999] 236 ITR 315 (SC) where if the assessee was able to prove that the funds are inextricably linked to the set up of the plant then the same would be capitalized as preoperative expenses. The assessee draws support from the said decision which has held that the interest income out of the temporary funds has to be capitalized and not to be taxed under the head 'income from other sources'. In the present case in hand, we do not find any observation by the lower authorities as to how the borrowed fund and the surplus amount parked in the fixed deposits are not 'inextricably linked' to the setting up of the new unit by the assessee. In the absence of such observation and by placing reliance on the decision cited by the assessee we hold that the interest income out of the fixed deposits which is made from the ECB has to be capitalized as capital receipt and not revenue receipt. The relevant extract of the decision of the Hon'ble High Court in the case of *Indian Oil Panipat Power Consortium Ltd.* (supra) is cited hereunder for ease of reference:

4. It is important to note that the Tribunal without holding that the finding of fact of the CIT(A), that the interest earned was „inextricably linked“ with the setting up of the power plant reversed the decision of the CIT(A) by making a bald observation that the "deposit of share capital has no or very remote connection with setting up of plant and machinery". The Tribunal further observed that it was an independent income earned in a similar fashion as was the case in *Tuticorin Alkali Chemicals* (supra).

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 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 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 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* (*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 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.

6. 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 Section (2) to (7) of Section 208. This section was specifically noted by the Supreme Court in *Challapalli*

Sugars Ltd vs 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 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 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 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 any plant. The reason indeed would be stronger in case such interest is paid on money taken on loan for meeting the above expenses."

6.1 *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 later 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.*

7. *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 (supra) in the facts of the present case. In our opinion on account of the finding of fact returned by the CIT(A) that the funds infused in the assessee by the joint venture partner were inextricably linked with the 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 judgment is set aside.*

40. On the above observation, we are inclined to allow ground no.IV raised by the assessee.

41. Ground no. V pertains to the disallowance on expenditure incurred for foreign travelling of Director's relative. The ld. AR submitted that this ground of appeal raised by the assessee is not pressed and, therefore, ground no. V raised by the assessee is dismissed.

42. In the result, the appeal filed by the assessee in ITA No. 2384/Mum/2018 is partly allowed.

ITA No. 3283/Mum/2018 (A.Y. 2013-14)

43. This appeal has been filed by the Revenue challenging the order of the Id. CIT(A) in allowing the additional deposit of Rs.1,26,46,017/- despite the fact that the explicit provision for deduction of the balance 50% of amount has been introduced in Income Tax Act vide third proviso to sub section (1) of section 32 which is w.e.f 01.04.2016 is to be applied prospectively and not retrospectively and challenging the adjustment made towards corporate guarantee commission by the Id. CIT(A) restricting the same to 0.7% as against the adjustment made by the Id. A.O./TPO @ 2.58%.

44. The ground no. 1 is on the claim of additional deposit u/s. 32(1)(ii) of the act. It is observed that the assessee has claimed balance additional deposits of Rs.1,26,46,017/- on the new plant and machinery put to use for less than 180 days during the previous year, i.e., A.Y. 2012-13 by relying on the decision of the co-ordinate bench in the case of *DCIT vs. Cosmo Films Ltd.* (24 Taxman 189). The assessee has also relied on the decision of the Hon'ble Karnataka High Court in the case of *M/s. Rittal India Pvt. Ltd. vs. ACIT* (2016-TIOL-180-HC-KAR-IT).

45. The Id. A.O. held that the additional deposits is admissible only in case of new machinery or plant (other than ships and aircrafts) which is acquired and installed after 31.03.2005 and the assessee should have been engaged in the business of manufacturing or production of any article or not. The assessee in the present case is engaged in the manufacturing of empty hard gelatin capsules of various sizes and had claimed 50% of the additional depreciation for plant and machinery which was purchased and put to use for less than 180 days during the financial year 2011-12. The Id. A.O. held that the

additional depreciation is to be restricted as per the second proviso to section 32(1)(ii) of the Act which restricts the claim of additional depreciation to ½ the amount otherwise allowable and in the absence of the explicit provision, the balance 50% of the additional depreciation would lapse. The Id. A.O. relied on the decision of the co-ordinate bench of the Tribunal in the case of *DCIT vs. Brakes India Ltd.* (in ITA No. 1069/Mds/2010). The Id. A.O. further held that the explicit provision applies 50% of the said claim was introduced by Finance Act, 2015 which is w.e.f. 01.01.2016 vide third proviso to sub section (1) of section 32 and since the said provision is applicable prospectively, the assessee's claim of additional depreciation was disallowed by the Id. A.O. The Id. CIT(A), on the other hand, allowed the additional claim of depreciation by relying on the decision of Hon'ble Karnataka High Court in the case of *M/s. Rittal India Pvt. Ltd.* 380 ITR 423 (Kar).

46. The Revenue is in appeal before us, challenging the order of the Id. CIT(A).

47. We have heard the rival submissions and perused the materials available on record. As this issue has been squarely covered by the decision of the Hon'ble Jurisdictional High Court in the case of *CIT vs. Rashtriya Chemicals and Fertilizers Ltd.* (in ITA No. 1861 of 2017 vide order dated 26.10.2021), wherein it was held that the 3rd proviso to clause (ii) of sub section (1) of section 32 of the Act being clarificatory in nature would apply to previous years also. The relevant extract of the said decision is cited hereunder for ease of ready reference:

5. *The judgment of Karnataka High Court in Rittal India (supra) has been considered by this Court in an unreported order in Pr. Commissioner of Income Tax-14 vs. M/s. Godrej Industries Ltd. 2 and this Court has followed the view expressed by the Karnataka High Court. This Court in Godrej Industries Ltd. (supra) has also relied upon the judgment of Madras High*

Court in Commissioner of Income Tax vs. T. P. Textiles Pvt. Limited, 3 wherein Madras High Court has considered the additional proviso which was inserted to Section 32(1) (iia) of the Act and has also concurred with the view of the Madras High Court that said newly added third proviso to clause (ii) of subsection 1 of Section 32 of the Act being clarificatory in nature would apply to case covering past period also. Paragraph 5 to 10 of Godrej (supra) reads as under:

"5 Having heard Counsel for the Revenue and for the Assessee, we notice that the Assessee's claim of additional depreciation arises out of clause (iia) of subsection 1 of Section 32 of the Act. Clause (ii) of sub-section 1 of Section 32 of the Act recognizes the depreciation on block of assets. Clause (iia) grants additional depreciation in case of acquisition and installation of new machinery or plant by an Assessee after 31st March, 2005, the Assessee being engaged in business of manufacture or production of an article or things.

6 We may also notice that the second proviso to clause (ii) of sub-section 1 of Section 32 of the Act, would restrict Assessee's claim of depreciation to 50% in case, the assets are acquired by the Assessee during the previous year and put to use for the purposes of business or profession for a period less than 180 days in the said previous year.

7 In the context of such statutory provisions, the Revenue has raised the question – whether when 50% of the additional depreciation is claimed by the Assessee in a particular Assessment Year, since the acquisition and putting in to use of the assets in the previous Year was for less than 180 days, the Assessee can claim the remaining depreciation in the subsequent Assessment Year. Such a question came up for consideration before the Division Bench of Karnataka High Court in Commissioner of Income Tax and Another v/s. Rittal India Pvt. Ltd., reported in 380 ITR 423. The Court, after referring to the statutory provisions, held and observed in para 8 as under:-

"8:- The aforesaid two conditions, i.e., the undertaking acquiring new plant and machinery should be a new industrial undertaking, or that it should be claimed in one year, have been done away by substituting clause (iia) with effect from April 1, 2006. The grant of additional depreciation, under the aforesaid provision, is for the benefit of the assessee and with the purpose of encouraging industrialization, by either setting up a new industrial unit or by expanding the existing unit by purchase of new plant and machinery, and putting it to use for the purposes of business. The proviso to clause (ii) of the said section makes it clear that only 50 per cent of the 20 per cent would be allowable, if the new plant and machinery so acquired is out to use for less than 180 days in a financial year. However, it nowhere restricts that the balance 10 per cent would not be allowed to be claimed by the assessee in the next assessment year.

The language used in clause (iia) of the said section clearly provides that "a further sum equal to 20 per cent of the actual cost of such machinery or plant shall be allowed as deduction under clause (ii)". The word "shall" used in the said clause is very significant. The benefit which is to be granted is 20 per cent additional depreciation. By virtue of the proviso referred to above, only 10 per cent can be claimed in one year, if plant and machinery is put to use for less than 180 days in the said financial year. This would necessarily mean that the balance 10 per cent additional deduction can be availed of in the subsequent assessment year, otherwise the very purpose of insertion of clause (iia) would be defeated because it provides for 20 per cent deduction which shall be allowed.

It has been consistently held by this Court, as well as the apex court, that the beneficial legislation, as in the present case, should be given liberal

interpretation so as to benefit the assessee. In this case, the intention of the legislation is absolutely clear, that the assessee shall be allowed certain additional benefit, which was restricted by the proviso to only half of the same being granted in one assessment year, if certain condition was not fulfilled. But, that, in our considered view, would not restrain the assessee from claiming the balance of the benefit in the subsequent assessment year. The Tribunal, in our view, has rightly held, that additional depreciation allowed under Section 32(1) (iia) of the Act is a one-time benefit to encourage industrialization, and the provisions related to it have to be construed reasonably, liberally and purposively, to make the provision meaningful while granting the additional allowance. We are in full agreement with such observations made by the Tribunal.

In view of the aforesaid, we do not find that any interference is called for with the order of the Tribunal, or that any question of law arises in this appeal for determination by this court.”

After the said judgment of the Karnataka High Court in Rittal India Pvt. Ltd., (supra), legislation has also amended the statutory provisions by adding the third proviso to clause (ii) of sub-section 1 of Section 32 of the Act, which reads as under:-

“ Provided also that where an asset referred to in clause (iia) or the first proviso to clause (iia), as the case may be, is acquired by the assessee during the previous year and is put to use for the purposes of business for a period of less than one hundred and eighty days in that previous year, and the deduction under this sub-section in respect of such asset is restricted to fifty per cent of the amount calculated at the percentage prescribed for an asset under clause (iia) for that previous year, then, the deduction for the balance fifty per cent of the amount calculated at the percentage prescribed for such asset under clause (iia) shall be allowed under this sub-section in the immediately succeeding previous year in respect of such asset.”

8 The third proviso, thus, now recognizes the right of an Assessee to claim the remaining 50% depreciation in subsequent year in a case where machinery and plant being acquired and put to use for less than 180 days in the previous year, the depreciation was restricted to 50%. Such a situation as in the present case, was considered by the Division Bench of the Madras High Court in Commissioner of Income Tax v/s. Shri T. P. Textiles Pvt. Ltd., 394 ITR 483, the Court referred to the judgment of the Karnataka High Court in Rittal India Pvt. Ltd., (supra) as well as the addition of third proviso to clause (ii) of subsection 1 of Section 32 of the Act and observed as under:

“10.1: The plain language of section 32(1)(iia) read along with relevant proviso would have us come to the conclusion that, there is no limitation in the assessee claiming the balance 10 per cent of additional depreciation in the succeeding assessment year.

10.2:- As a matter of fact, with effect from April 1, 2016, the ambiguity, if any, in this regard, in the mind of the Assessing Officer, stands removed by virtue of the Legislature, incorporating in the Statute, the necessary clarificatory amendment.

10.3

11: We may only indicate that during the course of the arguments, our attention was drawn to the “Memorandum explaining the provisions in Finance Bill, 2015” whereby, the aforementioned amendment was brought about.

11.1: The relevant part of the memorandum is extracted hereafter:

“.... To remove the discrimination in the matter of allowing additional depreciation on plant or machinery used for less than 180 days and used for 180 days or more, it is proposed to provide that the balance 50 per cent of the additional depreciation on new plant or machinery acquired and used for less than 180 days which has not been allowed in the year of acquisition and installation of such plant or machinery, shall be allowed in the immediately succeeding previous year. This amendment will take effect from 1 st April, 2016 and will, accordingly, apply in relation to the assessment year 2016-17 and subsequent assessment years.”

11.2:- A perusal of the extract of the memorandum relied upon would show that the legislature recognized the fact that the manner in which the Revenue chose to interpret the provision, as it stood prior to its amendment would lead to discrimination, in respect of plant and machinery, which was used for less than 180 days, as against that, which was used for 180 days or more itxa-511- 2016

11.3:- In our opinion, as indicated above, the amendment is clarificatory in nature and not prospective, as is sought to be contended by the Revenue. The memorandum cannot be read in the manner, in which, the Revenue has sought to read it, which is, that the amendment brought in would apply only prospectively.

11.4:- We are, clearly, of the view that the memorandum, which is sought to be relied upon by the Revenue, only clarifies as to how the unamended provision had to be read all along.

11.5:- In any event, in so far as the court is concerned, it has to go by the plain language of the unamended provision, and then, come to a conclusion in the matter. As alluded to above, our view, is that, upon a plain reading of the unamended provision, it could not be said that the assessee could not claim balance depreciation in the assessment year, which follows the assessment year, in which, the machinery had been bought and used, albeit, for less than 180 days.”

9 It could be thus, to seen that the Karnataka High Court in Rittal India Pvt., Ltd.,(supra) even without the aid of the statutory amendment held that remaining 50% unclaimed depreciation would be available to the Assessee in the succeeding Assessment Year. Now the legislation has amended the provision by adding a proviso which, specifically recognizes the said right. The Madras High Court in Shri T. P. Textiles Pvt. Ltd., (supra) ruled that such proviso being clarificatory in nature, would apply to pending cases, covering past period also.

10 We have no reason to take view different from two High Courts, examining the situation at considerable length. In the result, no question of law arises.”

6. We have no reason to take a different view from the view expressed by our own High Court. In our view, ITAT has not committed any perversity or applied incorrect principles to the given facts and when the facts and circumstances are properly analysed and correct test is applied to decide the issue at hand, then, we do not think that question as pressed raised any substantial question of law.

48. By respectfully following the above said decision, we hold that the assessee is entitled to the additional depreciation claimed u/s. 32(1)(ii) of the Act and, therefore, find

no infirmity in the order of the ld. CIT(A). Ground no. 1 raised by the Revenue is dismissed.

49. Ground nos. 2 & 3 pertains to the corporate guarantee on commission. As this issue has been decided by us in ground nos. I & II of ITA No.2383/Mum/2018. The observation in that applies mutatis mutandis to this ground also.

50. In the result, the appeal filed by the Revenue is allowed for statistical purpose.

Order pronounced in the open court on 04.12.2023.

Sd/-

(Prashant Maharishi)
Accountant Member

Mumbai; Dated : 04.12.2023
Roshani, Sr. PS

Sd/-

(Kavitha Rajagopal)
Judicial Member

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent
3. CIT - concerned
4. DR, ITAT, Mumbai
5. Guard File

BY ORDER,

(Dy./Asstt. Registrar)
ITAT, Mumbai