

**IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH, BENGALURU**

**BEFORE SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER
and
SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER**

ITA No.692/Bang/2015
(Assessment year: 2011-12)

Income-tax Officer,
Ward 1(1)(3),
Bengaluru.

... Appellant

Vs.

Bank Note Paper Mill India Pvt. Ltd.
I floor, SR Complex, No.2, Tavarakere
Main Road, SG Paly, DRC Post,
Bengaluru-560029.
PAN:AAECB 3245M

... Respondent

AND

Cross Objn.No.177/Bang/2015
(In ITA No.692/Bang/2015)
(Assessment year: 2011-12)
(By the assessee)

Assessee by : Shri S.Parthasarathi, Advocate.
Revenue by : Smt.Swapna Das, JCIT(DR).

Date of hearing : 05/01/2017
Date of pronouncement : 17/03/2017

O R D E R

Per INTURI RAMA RAO, AM :

This is an appeal filed by the revenue directed against the order of the CIT(A)-I, Bengaluru, dated 03/02/2015 for the assessment year 2011-12. The cross objections are filed by the assessee-company.

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2. Briefly facts of the case are that the assessee is a company duly incorporated under the provisions of the Companies Act,1956. It is a joint venture company between Bharatiya Reserve Bank Note Mudran Pvt.Ltd., and M/s. Security Printing and Minting Corporation of India Ltd., It is engaged in the business of developing, designing, manufacturing and supplying of currency paper and bank note paper. During the previous year relevant to assessment year under consideration, it is in the process of setting up of plant for manufacture of paper. The assessee filed return of income for the assessment year 2011-12 on 29/09/2011 through e-filing. After processing the return of income, the case was selected for scrutiny by issuing notice u/s 143(2) Income-tax Act, 1961 ['the Act' for short] and the assessment was completed u/s 143(3) vide order dated 28/06/2013 by the ITO, Ward 11(1), Bengaluru, at total income of Rs.5,50,78,525/-. The disparity between returned income and assessed income is on account of making addition of interest earned by the respondent-assessee out of fixed deposits made with various banks out of share capital of Rs.200 crores. The assessee had reduced interest income so received from the pre-operative expenditure incurred by the company, whereas the Assessing Officer (AO) was of the opinion that in view of the judgment of the Hon'ble Supreme Court in the case of *Tuticorin Alkali Chemicals & Fertilizers Ltd. vs. CIT* (227 ITR 172), interest income is chargeable to tax under the head 'income from other

sources'. The AO also placed reliance on the decision of the Hon'ble Supreme Court in the case *CIT vs. Seshasayee Paper & Boards Ltd.* (156 ITR 542).

3. Being aggrieved by the above decision, an appeal was preferred before the CIT(A). Before the CIT(A), the assessee contended that the AO had no jurisdiction to convert the case to scrutiny assessment as the case of the assessee is outside the scrutiny guidelines. However, the CIT(A), while confirming that the case was selected for scrutiny under CASS, deleted the addition placing reliance on the decisions of the Hon'ble Supreme Court in the case of *CIT vs. Bokaro Steel Ltd.* (236 ITR 315)(SC) and *CIT vs. Karnal Co-operative Sugar Mills Ltd.* (243 ITR 2)(SC) and *CIT vs. Karnataka Power Corporation* (247 ITR 268)(SC). The relevant part of the CIT(A)'s order is extracted below:

7.2 Thus, the facts of the case would go to show that the amounts invested in bank deposits are not the surplus funds of the appellant company, rather it is the share capital meant for meeting the capital expenses and owing to the financial planning and depending on the requirement of funds at given intervals/time schedule, the funds were temporarily deposited in banks. Further, it is a fact that the Appellant company itself was formed in October 2010 and the RBI having made the capital available immediately and there being a time lag for utilizing the funds, the same were invested in bank deposits from November 2010 onwards. In making such depositss appellant has kept in mind its commitments from time to time and accordingly invested the same in fixed deposits of short term. Thus, in my considered opinion,

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the interest earned by the appellant is inextricably linked to its capital expenditure and therefore it is proper to reduce such income from the preoperative expenses rather than treating it as an item of revenue.

7.3 In the case of M/s Bokaro Steel Ltd. the Hon'ble Supreme Court has held as under;

" In case money is borrowed by a newly started company which is in the process of constructing and erecting its plant, the interest incurred before the commencement of production on such borrowed money can be capitalized and added to the cost of the fixed assets created as a result of such expenditure. By the same reasoning if the assessee receives any amounts which are inextricably linked with the process of setting up its plant and machinery, such receipts will go to reduce the cost of its assets. These are receipts of a capital nature and cannot be taxed as income".

7.4 The Supreme Court in the case of CIT Vs Karnal Co-Operative Sugar Mills Ltd.(2000) 243 ITR 2(SC), has held that where the assessee had deposited money to open a letter of credit for the purchase of the machinery required for setting up its plant, the interest earned from such deposit would be capital receipt since it is inextricably linked with the purchase of machinery. The relevant extract reads as under;

" In the present case, the assessee had deposited money to open a letter of credit for the purchase of the machinery required for setting up its plant in terms of the assessee's agreement with the supplier. It was on the money so deposited that some interest has been earned. This is therefore, not a case where any surplus share capital money which is lying idle has been deposited in the bank for the purpose of earning interest. The deposit of money in the present case is directly linked with the purchase of plant and machinery. Hence, any income earned on such deposit is incidental to the acquisition of assets for the setting up of the plant and machinery. In this view of the matter the ratio laid down by this Court in Tuticorin Alkali Chemicals & Fertilizers Ltd. v CIT (1997) 227 ITR 1721, will not be attracted. The more appropriate decision in the factual situation in the present case is in CIT v Bokaro Steel Ltd.(1999) 236 ITR 3152(SC). The appeal is dismissed. There will be no order as to costs".

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7.5 In the case of CIT Vs Karnataka Power Corporation (2001) 247 ITR 268(SC), the Supreme Court following its own decision in the case of Bokaro (Supra) held that interest receipts and hire charges from contractors are capital receipts which would go to reduce capital cost.

7.6 In the case of CIT vs VGR Foundation (2008) 292 ITR 132, Hon'ble Madras High Court has reviewed the available decisions on this issue and held that

'In the light of the Supreme Court decision in Tuticorin Alkali Chemicals & Fertilizers Ltd.(Supra), it is only in the event of interest earned from out of deposits made from borrowed funds that it would be in the nature of income. Share application monies do not fall into the category of borrowed funds and do not involve payment of interest. In effect share application monies etc., are gathered for being used in setting up of an industry, unit, purchase of assets, and so on. Till such time the money is required for deferment of various items, obviously the money has to be kept in deposit with a bank. Keeping the money in current account would not yield any interest income. It can therefore, be seen that it is during the course of construction that the monies are kept in deposits with the bank. In these circumstances, in the light of the Supreme Court decisions in the cases of Bokaro Steel Ltd.(Supra), Karnal Co-operative Sugar Mills Ltd.(Supra) and Karnataka Power Corporation (Supra), the claim of the assessee is reasonable and deserves to be accepted'.

8. Now, having regard to the facts brought on record that the bank deposits were made for a short period keeping in mind the commitments of the applicant company from time to time and not with an intention to earn the interest and such interest earned having been inextricably linked with its capital expenditure, I am of the considered opinion that the decision of the Hon'ble Supreme Court in the case of M/s Bokaro Steel Ltd (Supra) is applicable to the assessee case and

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not that of the Hon'ble Supreme Court decision in Tuticorin Alkali Chemicals & Fertilizers Ltd. v CIT (1997) 227 ITR 1721. Thus, the interest earned which is earmarked and kept as deposit with banks for capital expenditure has to go to reduce the cost of pre-operative expenses and does not constitute income in the hands of the appellant. Relief is allowed to appellant on this ground.

4. Being aggrieved, the revenue is in appeal in ITA No.692/Bang/2015. The revenue raised the following grounds of appeal:

1. The order of the CIT (A) is opposed to law and the facts and circumstances of the case.
2. The CIT (A) erred in allowing the claim of the assessee company by holding that the interest earned which was earmarked and kept as deposit with banks for capital expenditure has to go to reduce the cost of pre-operative expenses and does not constitute income in the hands of assessee following the decisions of the Hon'ble Supreme Court in the case of M/s Bokaro Steel Ltd without appreciating the fact that the interest earned on the deposit made by the assessee has no direct link with the construction activities/ activities of setting up of plant but it is independent source of income earned by the assessee by depositing its surplus funds in term deposits with the bank.
3. The CIT(A) ought to have appreciated that the case law relied upon by the AO in the case of M/s Tuticorin Alkali Chemicals and Fertilizers Ltd (1997) [227 ITR 172] is squarely applicable to the instant case wherein the Apex court has held that the interest income earned on surplus funds by the assessee before commencing the business is to be treated as income from other sources and taxed accordingly.
4. For these and such other grounds that may be urged at the time of hearing, it is humbly prayed that the order of the CIT(A) be reversed and that of the Assessing Officer be restored.
5. The appellant craves leave to add, to alter, to amend or delete any of the grounds that may be urged at the time of hearing of the appeal.

5. The learned DR vehemently contended that the CIT(A) ought not to have deleted the addition, inasmuch as, there was no direct nexus of borrowed funds being used for earning interest

income. It is the contention of the learned Standing Counsel that the decision of the Hon'ble Supreme Court in the case of *Tuticorin Alkali Chemicals & Fertilizers Ltd.*(supra) is squarely applicable to the facts of the case.

6. On the other hand, learned counsel for the assessee placed reliance on the order of the CIT(A).

7. We heard rival submissions and perused material on record. The short issue that comes up for consideration in the present appeal is whether interest income earned by the assessee during the construction period on bank deposits made out of share application money received by it, is taxable as 'income from other sources' or it should go to reduce capital cost of the plant which is being set up by the assessee-company. Undisputedly, facts are that the said interest income was earned by the assessee-company on bank deposits made out of share capital received by it from the Reserve Bank of India. The share capital was received by the respondent-assessee-company to meet capital expenditure for setting up of assessee's factory. As the funds were not immediately required, the respondent-assessee made deposits with bank on which assessee earned interest. This interest income was treated as abatement of capital cost of the project/factory by the assessee-company in the books of account, whereas the AO was of the opinion that the same should be treated as revenue receipt and brought to tax placing reliance on

the decision of the Hon'ble Supreme Court in the case of *Tuticorin Alkali Chemicals & Fertilizers Ltd.* (supra). The decision of the Hon'ble Supreme Court in the case of *Tuticorin Alkali Chemicals & Fertilizers Ltd.* (supra) was distinguished by the Hon'ble Supreme Court in the case of *Bokaro Steel Ltd.* ((236 ITR 315)(SC) wherein it was held that the ratio of the decision of the Hon'ble Supreme Court in the case of *Tuticorin Alkali Chemicals & Fertilizers Ltd.* (supra) is not applicable where interest receipt is directly connected with or incidental to working of construction of the assessee's plant. The decision of the Hon'ble Supreme Court in the case of *Bokaro Steel Ltd.* (supra) was followed subsequently in the case of *CIT vs. Karnal Co-operative Sugar Mills Ltd.* (243 ITR 2). An identical issue had come up for consideration before the Hon'ble Jurisdictional High Court in the case of *CITA vs. Karnataka State Agricultural Produce Processing and Export Corporation Ltd.*(377 ITR 496). In that case the State Government Corporation earned interest on deposits temporarily kept out of grants received from the State Government was taxable or not? The facts are that the State Government Corporation earned interest during the construction period on the fixed deposits temporarily made out of State Government grants. The issue before the Hon'ble High Court was whether such interest income was taxable or should go to reduce the capital cost of the project. The Hon'ble High Court, after considering the decisions of the Hon'ble Supreme Court in the case of *Bongaigaon*

Refinery Petrochemicals Ltd. v. CIT (251 ITR 329)(SC), Bokara Steel Ltd. (supra), and Tuticorin Alkali Chemicals & Fertilizers Ltd. (supra) and its own decision in the case of *CIT v. Karnataka Power Corporation, (247 ITR 268)* and *CIT vs. Karnataka Urban Infrastructure and Development and Finance Corporation (284 ITR 582)* held that such interest income would go to reduce the capital cost of the project, is on the capital account and should not be brought to tax. The relevant portion of the judgment is as under:

“9. After hearing the rival contentions and perusing the material on record, we have noticed that the assessee-company is a Government owned company. In order to facilitate infrastructure facilities in various parts of the State of Karnataka, for increasing the export of horticultural produce, a sum of Rs. 10.00 crores was granted to the assessee. Before the utilisation of this grant amount, it was temporarily kept in fixed deposits and the interest was earned on the said amount. The assessee has placed certain additional evidence before the Tribunal to establish that the Government of Karnataka had specifically directed that interest earned on fixed deposits of grants pending utilisation should be treated as additional grant of the scheme and not to be treated as "income of the company". No liberty was provided to the company to make use of that the interest earned on the said amount kept in fixed deposits. Though the assessee-company is engaged in trading in agricultural produce, it has no power to make use of the said grant made by the Government of Karnataka other than for a particular scheme *i.e.*, the said amount cannot be diverted for any other purpose other than for which it was sanctioned as per the Government Order dated 23.1.2007. Thus, the emphasis made by the revenue that the assessee-company being engaged in trading activities cannot be considered as a nodal agency of the State Government and the interest earned on the grants by the assessee-company has to be treated as income is not acceptable in view of the specific directions issued by the State Government regarding the utilization of the amount granted and on the interest accrued thereon.

10. The Tribunal relied on the Judgment of this Court in the case of *Karnataka Urban Infrastructure Development Finance Corpn.'s case (KUIDC) (supra)* wherein it is held that:

"The material on record shows that the very purpose of constitution of the assessee was to act as a nodal agency for implementation of mega-city scheme worked out by the Planning Commission. Both the Central and the State Governments are expected to provide requisite finances for implementation of the said project. The funds from the Central and State Governments will flow directly to the specialised institutions/nodal agencies as grant and the nodal agency will constitute a revolving fund with the help of Central and State shares out of which finance could be provided to various agencies such as water, sewerage boards, municipal corporations, etc. The objective is to create and maintain a fund for the development of infrastructural assets on a continuing basis and, therefore, the assessee is a nodal agency formed/created by the Government of Karnataka as per the guidelines; there is no profit motive as the entire fund entrusted and the interest accrued therefrom on deposits in bank though in the name of the assessee has to be applied only for the purpose of welfare of the nation/States as provided in the guidelines; the whole Of the fund belongs to the State Exchequer and the assessee has to channelise them to the objects of centrally sponsored scheme of infrastructure development for mega-city of Bangalore. Funds of one wing of the Government is distributed to the other wing of the Government for public purpose as per the guidelines issued. The monies so received, till it is utilised, is parked in a bank. The finding recorded by the Tribunal clearly shows that the entire money in question is received for implementation of the scheme which is for a public purpose and the said scheme is implemented as per the guidelines of the Central Government and, therefore, the assessee is only acting as a nodal agency of Central Government for implementation of these projects. It is not the case of the Revenue that the assessee was carrying on any business or activities of its own while implementing the scheme in question. The unutilised money, during which the project could not be fully implemented, is deposited in a bank to earn interest. That interest earned is also again utilised for the implementation of the mega-city scheme which is also permitted under the scheme. Therefore, in computing the total income of the assessee for any previous year the

interest accrued on bank deposits cannot be treated as an income of the assessee as the interest is earned out of the money given by the Government of India for the purpose of implementation of mega-city scheme. Therefore, we do not find any error in the conclusion reached by the Tribunal that there was no income earned by way of interest by the assessee and setting aside the order of AO which is affirmed by the first appellate authority. The finding given by the Tribunal is purely a question of fact. We do not find any substantial question of law involved in this appeal and therefore, this appeal is liable to be dismissed at the stage of admission itself."

11. In *Tuticorin Alkali Chemicals & Fertilizers Ltd.'s* case (*supra*), the Apex Court has held that:

"There is another aspect of this matter. The company, in this case, is at liberty to use the interest income as it likes. It is under no obligation to utilise this interest income to reduce its liability to pay interest to its creditors. It can re-invest the interest income in land or share, it can purchase securities, it can buy house property, it can also set up another line of business, it may even pay dividends out of this income to its shareholders".

12. In the case of *Karnataka Power Corpn. (supra)*, the Apex Court following the Judgment of *Bokaro Steel Ltd's* case (*supra*) has held that "interest receipts and hire charges from contractors are in the nature of capital receipts".

13. In the case of *Bongaigaon Refinery & Petrochemicals Ltd., v. CIT [2001] 251 ITR 329/119 Taxman 488* the Apex Court considering the decision in *Tuticorin Alkali Chemicals Ltd.'s* case (*supra*) and *Bokaro Steel Ltd.'s* case (*supra*) has held that in *Tuticorin Alkali Chemicals & Fertilizers Ltd.'s* case, the question related was with the interest earned by the Company during its formative period by investments while in *Bokaro Steel Ltd.'s* case (*supra*), it is so confined and did not apply where the receipts were directly connected with or were incidental to the work of construction of the assessee's plant. Accordingly, applying the law enunciated in *Bokaro Steel Limited* case allowed the appeal.

14. In the light of the judgments referred to above, we have examined the case on hand. It is clear that the assessee has received the grant of Rs 10.00 crores from the Government of Karnataka for a particular project *i.e.*, for improvement of infrastructure and to promote export of horticultural produce. Before the said grant was utilized for the specific purpose it was parked in fixed deposits and the interest was earned and

by the subsequent additional evidence produced by the assessee before the Tribunal, it is further made clear that the State Government has categorically specified that any interest earned on those grants originally granted has to be considered as an additional grant and not an income of the assessee-Company.

15. As explained by the Apex Court, in *Bongaigaon Refinery & Petrochemicals Ltd.'s case*, (*supra*), in *Tuticorin's case*, the investment in deposits was made by the Company during its formative period by investments and in *Bokaro Steels Ltd.'s case* (*supra*) the inextricable link between the interest earned and the set up of the plant was established. Thus, in the present case we are of the view that this is not an investment made subsequent to the setting up of the project but this is the unutilized income parked in fixed deposits for a temporary period and inextricable link for the interest earned on the grants and the original grant made by the State Government to set up a project is established as in *Bokaro Steel case*. ”

Respectfully following the ratios of the decisions laid down in the above cases, we hold that even in the present case also, interest earned should only go to reduce the capital cost of the project to be set up by the respondent company and it should not be brought to tax, as the interest is earned on capital account. The appeal of the revenue is dismissed.

8. The assessee has filed cross objections. The assessee raised the following grounds of cross objections:

1. **The Order {to the extent it is against the Respondent} of the Learned Commissioner (Appeals) is not justified in law and on facts and circumstances of the case.**
2. **As regards jurisdiction of the Learned Assessing Officer in selecting Respondent's case for scrutiny assessment under Section 143 of the Act:**

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- (1) The Learned Commissioner (Appeals) is not justified in upholding action of the Learned Assessing Officer in selecting Respondent's case for scrutiny assessment under Section 143 of the IT Act even though the case of the Respondent does not fall under any of criteria specified under Instruction F.No. 225/93/2009/ITA.II dated 08.09.2010.
- (2) The Learned Commissioner (Appeals) is not justified in upholding action of the Learned Assessing Officer in selecting Respondent's case for scrutiny assessment under Section 143 of the IT Act on the ground that reasons for cases selected under CASS are not to be disclosed and prior approval in such cases is not required as the Assessing Officer has no role in selection of such cases. He has failed to appreciate that the case of the Appellant is not selected through CASS, but manually by the Assessing Officer and hence, conditions specified under paragraph (g) to instructions have to be fulfilled.
- (3) The Learned Commissioner (Appeals) is not justified in stating that residual parameters provided under the scrutiny norms for the impugned assessment year are the general parameters and not the only conditions for selecting a case for scrutiny.
 - (4) The Learned Commissioner (Appeals) has failed to appreciate that scrutiny norms are issued by the CBDT with the sole object of ensuring that the tax payer is not unduly harassed by the tax department, therefore, the conditions provided therein have to be scrupulously fulfilled.
 - (5) The Learned Commissioner (Appeals) has failed to appreciate that instruction/ guideline issued by the CBDT for selecting cases for scrutiny assessment is binding on the Learned Assessing Officer and violation of the same renders entire assessment *void ab initio* and *bad in law*.

For the above reasons and for such other reasons which may be allowed by the Honourable Members to be urged at the time of hearing, it is prayed that the aforesaid cross-objections be allowed.

9. The grievance of the assessee is that case of the assessee-company does not fall within the guidelines given for scrutiny assessment for the year under consideration. The CIT(A) has clearly held that the case of the assessee-company falls within the CASS. The respondent-assessee had not brought any evidence on record controverting the factual findings of CIT(A). Since we had already adjudicated on the merits of addition in favour of the assessee-company, this issue becomes academic and infructuous and therefore, dismissed as such.

10. In the result, cross objections of the assessee are dismissed.

Order pronounced in the open court on 17th March 2017

Sd/-
(ASHA VIJAYARAGHAVAN)
JUDICIAL MEMBER

sd/-
(INTURI RAMA RAO)
ACCOUNTANT MEMBER

Place : Bangalore
D a t e d : 17/03/2017

srinivasulu, sps

Copy to :

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- 4 CIT
- 5 DR, ITAT, Bangalore.
- 6 Guard file

By order

Assistant Registrar
Income-tax Appellate Tribunal
Bangalore