

**Continental Float Glass Ltd. Vs. Assistant Commissioner of**

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**Court :** Income Tax Appellate Tribunal ITAT Delhi

**Decided On :** Jul-11-1994

**Reported in :** (1994)51ITD322(Delhi)

**Judge :** A Kalyanasundharam, B Saluja

**Appellant :** Continental Float Glass Ltd.

**Respondent :** Assistant Commissioner of

**Judgement :**

1. The assessee limited company in this appeal has raised the objection against the inclusion of interest earned on short term deposits with banks during the period of construction as its income, without allowing it any deduction for the interest that has been paid by it to the financial institutions.

2. Shri Ganesan, the learned counsel for the appellant company submitted that, the construction is still under way is undisputed. He contended that, one of the activities of the assessee is to construct its factory and all activities that are carried out during such construction period, are only to facilitate construction. He contended that, one of such activities carried out is the arrangement of its finances in such a way that would reduce the burden of interest on the company, which would result in the reduction of the capital cost. He accordingly contended that, the interest earning activity being closely related to the construction activity, it is only proper that, the interest is adjusted towards the capital cost. He submitted that, he is supported by the Delhi High Court in Snam Progetti (S.P.A.) v. Addl.

CIT [1981]132 ITR 70.

3. Shri Ganesan submitted that there are few decisions of the High Courts directly on the point which are against the assessee and in that context the alternative plea of setting off the interest paid to the financial institutions for that period during which the funds remained invested in short term deposits, may be considered. He contended that, the statement of funds for the financial years December 1987, December 1988 and December 1989 show that, in the first year, the share capital as had been raised was fully invested in the capital assets. The finances having been raised from the second year only, it shows that the short term deposits are taken from out of the borrowed funds. He contended that, in the absence of any other finances being available and there being direct co-relation with the borrowed funds, to the extent of its utilisation in getting short term deposits, for the period of such deposits, the proportionate interest paid on borrowed funds to the extent of the amount invested should be allowed to be reduced from the interest earned on short term deposits.

4. The learned counsel submitted that he derives support for his submission from the decision of the Supreme Court in Seth R. Dalmia v. CIT [1977] 110 ITR 644. He contended that, in the said case the assessee claimed interest paid to bank for delayed payment of the consideration for purchase of shares from it as a deduction from out of the dividend income and it was held as allowable. He submitted that, in this case the assessee had agreed to pay the consideration for the shares within the stipulated date, failing which he was liable to pay interest for delayed payment of consideration. Though, the interest paid had no direct link with the earning of the dividend, but, since, it was remotely connected, it was held as allowable. He pleaded that, the loan from the financial institution was primarily for investment in capital assets, but, during the intervening period the surplus funds available with it, were prudently invested with a view to generate some income on that term deposits, with the ultimate objective of reducing the total cost burden, the interest on loan in accordance with the like manner as decided by the Supreme Court in Seth R. Dalmia's case (supra).

5. He further submitted that the abovesaid decision of the Supreme Court was under Section 12(2) of the Income-tax Act, 1922, which is similar to the provision contained in Section 57(iii) of the Income-tax Act, 1961. He referred to the Supreme Court decision in *Indian Aluminium Co. Ltd. v. CIT* [1972] 84 ITR 735, where wealth-tax paid was allowed to be deducted as an expense from its business income. He referred to the provisions in Sections 36(1)(iii) and 43(1) read with Explanation No. 8.

6. Shri Suman Gupta, the learned departmental representative in his written submission had stated that, the provisions of Section 12(2) of the Income-tax Act, 1922 and Section 57(iii) of the Income-tax Act, 1961 are not similar, because the words used are very different and hence, the decision of the Supreme Court in *Seth R. Dalmia* is inapplicable. He had also contended that, the borrowal was for investment in capital asset and not for the purpose of earning of interest and therefore, the interest paid could not be held to be an expenditure incurred for the earning of the interest. He supported his contention by referring to the decisions in *CIT v. Sir Homi M. Mehta* [1943] 11 ITR 142 (Bom.) and *CIT v. Jagmohandas J. Kapadia* [1966] 61 ITR 663 (Bom.). He referred to the Gujarat High Court decision in *CIT v. Kasturbhai Lalbhai* [1968] 70 ITR 267 and submitted that, without any nexus between the borrowal and the investment, interest on borrowal could not be deducted from the income on investment. He referred to the decision of the Madras High Court in *Addl. CIT v. Madras Fertilizers Ltd.* [1980] 122 ITR 139 and contended that, borrowal being on capital accounts the interest paid on such borrowal could not be deducted from the interest earned. He also relied on the decision of the Supreme Court in *Smt. Padmavati Jaikrishna v. Addl. CIT* [1987] 166 ITR 176.

7. The rival contentions have been very carefully considered. The plea of the assessee that the interest earned during construction is not income, in our view needs to be rejected because, it has no connection whatsoever with the construction activity. The decision of Patna High Court in *CIT v. Bokaro Steel Ltd.* No. 1 [1988] 170 ITR 522 is misplaced because in that case the assessee during the construction of its factory had allowed advances to the contractor, provided quarters to the employees of the contractor, which were all incidental to the

construction activity and therefore, the interest from advances to contractors and the rent from quarters from the employees of the contractors was held as not in the nature of income. The decision of the Delhi High Court in Snam Progetti (S.P.A.)'s case (supra) is of no assistance because in that case the issue was whether the interest earned on deposits is business income or not and it was held that, arrangement of its finance is an activity related to the business and hence, the interest on deposits is income from business. The views of the Karnataka High Court in CIT v. Cap. Steel Ltd. [1986] 162 ITR 533, the two decisions of the Madras High Court in Madras Fertilisers Ltd. 's case (supra) and CIT v. Seshasayee Paper and Boards Ltd. [1985] 156 ITR 542 are identical to the effect that, the interest on short term deposits during the period of construction is assessable as income from other sources and in the absence of any contrary decision, we respectfully following these decisions, reject the claim of the appellant and hold that, interest earned on short term deposits during the period of construction is taxable as income from other sources.

8. On the alternative submission, the counsel has referred to the fund's statement for the three years 1987 to 1990. This is reproduced below for appreciation of the contention of the appellant company :

Particulars	1987	1989	1990
(in Rs. (in Rs. (in Rs.			
Share capital	1074	1689	1876
Bridge Loan from IFCI	-	1500	1500
Application Expenses on construction	1017	1874	2733
Short term Deposits with Banks	-	1300	881
Balance with Banks	55	__	9.

Shri Ganesan had contended that, since the capital had been fully utilised in the construction in the first year itself, the loan from IFCI only could be managed to be placed in short term deposits and therefore, the nexus between borrowal and deposit had been established.

His related contention was that, the interest claimed as deduction is of that proportion of the loan that stood invested in the short term deposits. The above table shows that, the contention of the learned counsel is factually correct for the entire share capital received in the first year stood invested in the capital assets and therefore, unavailable for making short term deposits. The above table also confirms the contention of the learned counsel that the borrowed funds were utilised in making the short term deposits.

10. The decisions of the Karnataka High Court and the Madras High Court were on the point of whether the interest that is to be capitalised should be net of interest paid and the interest earned on short term deposits, for which the answer provided was that, the interest that is related to the capital cost has to be grossed up and the interest earned is taxable as revenue income. It could be said that the alternative contention of the assessee is answered by the above decisions indirectly.

11. In the case of Seth R. Dalmia (supra), the assessee had agreed to buy certain shares and to pay the consideration before a stipulated date, failing which he was to bear interest for the period of delay in making payment of the consideration, during which period, the bank was to receive the dividend, bonus shares on behalf of the assessee. The question that was considered was whether from the dividend income the assessee could be allowed interest paid to bank for the period of delay in the making payment of the consideration amount. Their Lordships observed at page 653 of the report as under.

Summarising, therefore, the facts of the present case, the position which emerges is as follows : 1. that a genuine and bona fide contract had been entered into between the assessee and the bank for transfer of large number of shares to the assessee ; 2. that the assessee in pursuance of this agreement had raised a loan of Rs. 44,14,990 from the bank in order to acquire the shares and had paid interest of Rs. 2,04,744 for this purpose; and 3. as a result of the aforesaid acquisition, under Clause (3) of the agreement the dividends, rights, bonuses, etc., held by the bank were held for the benefit of the assessee after they were declared.

It is obvious that if the assessee would not have paid the interest on the loan raised by him he would not have been able to get the dividend income.

In these circumstances, therefore, there was a direct nexus between the expenditure of Rs. 2,04,744 incurred by the assessee as interest and the earning of the dividend income. The assessee has clearly established that the expenditure aforesaid was incurred solely and wholly for the purpose of earning the bonuses and dividend income. As the shares were not stock-in-trade of the appellant it

could not be said that the interest paid by the assessee to the bank was an expenditure of a capital nature, nor was there any material to show that the expenditure incurred by the assessee amounted to his personal expenses. In these circumstances, we are satisfied that the case of the appellant in paying the interest amounting to Rs. 2,04,744 falls clearly within Section 12(2) of the Act and the conditions of the aforesaid provision being fulfilled, the assessee was in law entitled to deduction of the amount of Rs. 2,04,744 under Section 12(2) of the Act. We are therefore, of the opinion that High Court and Tribunal were wrong in taking the view that the income-tax authorities rightly disallowed the amount of Rs. 2,04,744 as claimed by the assessee. We are clearly of the opinion that this amount was a permissible deduction under Section 12(2) of the Act and should have been allowed by the income-tax authorities. In these circumstances, therefore, we hold on question No.(1) that both the Tribunal and the High Court should have held that the assessee's claim for deduction of interest amounting to Rs. 2,04,744 was wrongly rejected by the income-tax authorities.

12. The Supreme Court in T.S. Krishna v. CIT [1973] 87 ITR 429 on which reliance had been placed by the departmental representative was considering allowability of wealth-tax payments as a deduction from dividend on shares, which shares were liable to wealth-tax. Since there was no link between the earning of the dividend and the liability on wealth-tax, they rejected the claim of the assessee. This case only emphasises the point that, there must be direct nexus between the earning of the income and the incurring of the expense and a mere remote connection is insufficient.

13. We shall reproduce Section 12(2) of the Income-tax Act, 1922 and Section 57(iii) of the Income-tax Act, 1961, to appreciate the difference if any, in the language of the sections as pleaded by the departmental representative :Such income, profits and gains The income chargeable under the shall be computed after making head "Income from other sources" allowance for any expenditure (not shall be computed after making being in the nature of capital the following deductions, namely:-expenditure) incurred solely for (iii) any other expenditure (not the purpose of making or earning being in the nature of capital such income, profits and gains expenditure) laid out. or expended provided that no allowance

shall wholly and exclusively for thebe made on account of- purpose of making or earning(a) any personal expenses of the such income.

14. The reading of the above two sections shows that the provisions are identical in intention as well. The differences in words in Section 57(iii) of the Act: are, laid out and expended wholly and exclusively as against the only words incurred solely. The plain reading of the present Section 57(iii) of the Act indicates that, expenditures that are allowable under this section must fall into the following categories. Firstly, the expenditure incurred must not be capital in nature. Secondly, the expenses must be incurred wholly and exclusively for earning or deriving the income.

15. In the present case, the assessee had shown that the investments in short term deposits have been from out of the amount borrowed. The claim of the assessee is that, during the intervening period, the borrowed funds being available to it, which it has used to earn some interest income, having come from the borrowed funds, the interest paid for those intervening periods must be held to have been incurred wholly and exclusively for earning of the interest income. The intention of the section in our view is that, the amount borrowed must not be towards capital expenditure unrelated to the income that could be earned from the capital asset(sic). In our view any other interpretation for the terms used in the section any other expenditure (not being in the nature of capital expenditure)' is not possible. The Supreme Court in SethR. Dalmia (supra) had considered the fact the assessee had purchased the shares from a bank with the condition that any delay in the payment of consideration would involve interest and during the period of non-payment of the consideration, the bank would be holding the dividend, bonus shares as a trustee for the assessee, upheld the claim of deduction of interest paid for delayed payment of consideration because, it was directly linked to the acquisition of the shares, the income from which was taxable under the head 'Income from other sources'. This decision in our view, fully supports our above view that, borrowal must be for investment on only those assets, the income from which is liable to be taxed under Section 56 of the Act.

The continuing requirement of the section is that, the expenditure must be wholly and exclusively incurred for making or earning of income, which in our view suggests that, the expenditure must have direct nexus or connection with the earning or deriving of the income. This section in our view is not concerned with mere using of the funds that are borrowed, but, that the borrowal must be for investment on those assets, income from which are liable to be taxed under Section 56 of the Act, under the head 'Income from other sources'. When the borrowal is for a different purpose and the terms of borrowal provide for payment of interest from the moment of giving of advance, the arrangement by the assessee unilaterally during the intervening period before its utilisation for construction purpose, does not in any way change the original nature of borrowal and its purpose. Since, the borrowal was towards construction and not for making of investment in such assets and for the purpose of making or earning of income, the incidental derivation of income during the intervening period, though may have been possible because of the effective management of funds, it does not entitle the claim of deduction of interest on such borrowed funds during the intervening period.

Further, with reference to the interest paid on borrowed funds till the time the business is set up and commences, Explanation 8 to Section 43(2) of the Act suggests that it needs to be capitalised as part of the cost of the capital asset, for arriving at the actual cost of the asset, for purposes of allowing of depreciation on those assets. This also fortifies our conclusion that the term not being in the nature of capital expenditure used in Section 57(iii), refers to the making of expenditure only on those assets the income from which is taxable under Section 56 of the Act.

We may observe that, the argument advanced by the assessee for the claim of deduction of interest did appeal to us as a reasonable proposition, because of the nexus shown between the borrowed funds and its utilisation. However, the reading of the section indicated that, it is not sufficient to show the connection between borrowed amount and its utilisation but, that the borrowal must be for making investment on such assets with a view to earn income, so that the interest paid could be classified as expenditure incurred wholly and exclusively for the purpose of earning of income.

We accordingly are of the opinion that the claim of the appellant company that the interest on borrowed funds for the period and to the extent they are utilised in making of short-term deposits (sic) is not a tenable proposition because, the borrowal was not for the purpose of investment on short term deposits but, for the purpose of construction and therefore is rejected. The appeal is dismissed.

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