

Marnite Polycast Ltd. Vs. Assistant Commissioner of

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Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Mar-16-1995

Reported in : (1995)53ITD345(Delhi)

Judge : V Gandhi, N Chopra

Appellant : Marnite Polycast Ltd.

Respondent : Assistant Commissioner of

Judgement :

1. This appeal by the assessee for the assessment year 1992-93 is directed against order of CIT(A) upholding interest income of Rs. 12,16,478 under the head "Income from other sources" against claim of the assessee to be assessed as business income and allow deduction of interest payable as expenditure.

2. In the original Memorandum of appeal, the assessee had raised a general ground that CIT(A) was not justified in dismissing appeal of the assessee against order of ACIT, Co. Circle 2(5), New Delhi.

Subsequently, vide letter dated November 10,1994 the assessee sought to raise a specific ground relating to assessability of interest income.

Shri C.S. Aggarwal, learned counsel for assessee submitted that no new ground was being raised but assessee was only trying to clarify the ground earlier raised before the Tribunal. This submission was opposed by learned departmental representative. He submitted that assessee was trying to raise a new plea relating

to business income and allowability of business expenditure. After considering submissions of both the parties, we permitted the assessee to argue on the ground clarified by it in its letter dated November 10, 1994. We proceed to consider the aforesaid ground.

3. The facts of the case, briefly stated, are that assessee-company was incorporated on May 31, 1990 to set up a plant for manufacture of cast polyester products like sanitary wares, etc. and other housing accessories. The assessee had a share capital of Rs. 20,52,920 up to last year ending 31-3-1991. The subscribed capital was increased to Rs. 1,33,50,210 up to the end of the previous year. The assessee also borrowed substantial amount from financial and other institutions. The assessee was still in the process of setting up its plant and on capital work in progress had spent Rs. 3,29,32,746 till the end of the accounting period. The surplus funds not required by the assessee were kept with the bank and other parties and on that assessee earned total interest of Rs. 12,16,453 besides miscellaneous income of Rs. 25.

Against above receipts, the assessee incurred total expenditure of Rs. 50,44,083. After adjusting receipt of Rs. 12,16,478 the balance expenditure of Rs. 38,27,605 was sought to be capitalised. The assessee thus disclosed 'nil' income in the return filed on 14-7-1992.

4. The Assessing Officer took up assessment and was of the view that interest income of Rs. 12,16,478 was taxable as income from other sources. After considering decisions of Hon'ble Delhi High Court in the cases of Snam Progetti S.P.A. v. Addl. CIT [1981] 132 ITR 70 and of CITv. State Trading Corporation of India Ltd. [1973] 92 ITR 292 and cases of Addl. CIT v. I.D.P.L. [1983] 141 ITR 134, CIT v. New Central Jute Mills Co. Ltd. [1979] 118 ITR 1005 (Cal.), Addl. CIT v. Madras Fertilisers Ltd. [1980] 122 ITR 139 (Mad.), CIT v. Cap Steel Ltd. [1986] 162 ITR 533 (Kar.), the learned Assessing Officer held that interest of Rs. 12,16,478 was to be taxed as income from other sources with following observations : Hence, the Delhi High Court's pronouncements that normally such interest income derived from placing of funds in banks on short or long term deposits, would be income from other sources. Snam Progetti's case, as

discussed earlier, was a little different from the normal cases and hence the distinction was made. In IDPL case, Delhi High Court has further stated that if surplus monies of the company are invested to earn interest, the interest would certainly be assessable as 'income from other sources'. With these remarks, Delhi High Court sought to establish that IDPL's case was different from the normal since the money received were related to the capital structure of the business. Here also assessee has in fact tried to befool the revenue by citing such examples and drawing a parallel with them. In fact, here the nation is a loser at two points - one at the time of obtaining the loan ostensibly for the purpose of constructing a factory - one can be sure that had the said financial institution known that the money loaned by them would be utilised to earn interest, the moneys would not have been disbursed to the assessee. On its own admission, the main aim behind such investment was 'to derive maximum benefits for its own self. The second point of attack is that the company, now having obtained the loans, invests its surplus monies (from whatever source for only case is also that it has not been clearly established that it was loaned money that was invested) to earn interest with the intention of benefiting itself and thereafter, tries to put forth the argument that such receipts should not be taxed. So the revenue loses all the way. Collection of revenue is obviously made to divert the money to more productive cases for development of the nation and in tune with the philosophy of a welfare State. Here our friend wants to deny the commoners this benefit and instead wants to reap the harvest for itself without sharing the 'booty' with the rest of the nation. No quasi-judicial authority should allow this misappropriation of scarce national funds considering that precious foreign exchange has also been expended.

Therefore, on the basis of all these judgments and obviously following Delhi High Court's options voiced through its various judgments discussed above, it is held that interest paid at Rs. 19.19 lakhs shall be allowed to be capitalised and the interest income earned at Rs. 12,16,478 shall be taxed as 'Income from other sources'. The amount of interest paid cannot be deducted Under Section 57 since it was not expended to earn this income. The assessee fails in the test prescribed by the Hon'ble Madras High Court on all counts and this deduction cannot be allowed from 'Income from other sources'. In any case, by logic any expenditure to

earn income cannot be greater than income itself, since interest paid at Rs. 19.19 lakhs exceeds the interest earned at Rs. 12.16 lakhs, it is quite clear that this interest was not paid to earn this income.

5. The assessee impugned the above assessment in appeal before CIT(A) but remained unsuccessful. The learned CIT(A) held that income under the head 'Other sources' has been correctly assessed Under Section 56 of the Income-tax Act. He dismissed the appeal. Hence this appeal.

Before us, learned counsel for assessee, Shri C.S. Aggarwal vehemently contended that assessee was in stage of construction and had deposited money in bank which could not be utilised for purposes of construction.

In these circumstances, whatever interest was received by the assessee, was liable to be adjusted against the interest paid by the assessee on borrowed funds. As interest paid was greater than interest earned, no assessable income accrued to the assessee. Excess of expenditure over receipt was liable to be capitalised. Shri Aggarwal vehemently challenged finding of lower authorities that subscribed/paid share capital was also deposited in the bank to earn interest income. In this connection, Shri Aggarwal drew our attention to the following summarised balance sheet of the assessee-company as on the end of the previous year (31-3-1992) with corresponding figures of last year : Liabilities (Rs.) Last year (Rs.) (Sources of funds) As on 31-3-1992 (as on 31-3-1991) A.1. Fixed assets 3,44,82,012 11,67,299 (work in progress (work in progress With reference to above figures, Shri Aggarwal pointed out that last year, total subscribed/paid capital was Rs. 20,52,920 which in the year increased to Rs. 1,33,50,210. As against above, investment in fixed assets increased from Rs. 4,05,379 (as on 31-3-1991) to Rs. 3,29,32,746 in the year under consideration. Thus, the above figure clearly showed that entire share capital received in the year under consideration plus borrowings were utilised in the fixed capital assets. Therefore, without evidence it could not be held that share capital was deposited in the bank to earn interest. Thus documentary evidence demonstratively showed that the finding of the Assessing Officer to the contrary was erroneous and unjustified.

6. Shri Aggarwal further argued that in the case of mixed funds, the option was with the assessee to appropriate fund and expenditure in a manner most favourable to the assessee. Shri Aggarwal drew our attention to the decision of Hon'ble Calcutta High Court in the case of Indian Explosives Ltd. v. CIT [1984] 147 ITR 392 wherein the Court has referred to the decision of the House of Lords in Edinburgh Life Insurance Co. v. Lord Advocate 5 TC 472. In the present case also, entire funds, i.e., share capital, borrowings, etc., were put in common account from where amounts were expended for different purposes.

The assessee, therefore, could rightfully contend and claim that entire share capital was utilised in making capital investments and that interest was earned on borrowed funds to reduce the cost of construction of plant.

7. In support of claim that expenditure were liable to be set off against receipt of interest, Shri Aggarwal placed strong reliance on decision of Hon'ble Andhra Pradesh High Court in the case of CIT v. Nagarjuna Steels Ltd. [1988] 171 ITR 663, wherein their Lordships held that interest received on funds borrowed for construction of plant but kept in short-term deposit were not assessable as income. Our attention was also drawn to decision of Hon'ble Patna High Court in the case of CIT v. Bokaro Steel Ltd. (No. 1) [1988] 170 ITR 522. Shri Aggarwal also drew our attention to decision of Hon'ble Calcutta High Court in the case of CIT v. Tirupati Woollen Mills Ltd. [1992] 193 ITR 252. Shri Aggarwal finally relied upon decision of Hon'ble Delhi High Court in the case of CIT v. Modi Rubber Ltd. [1994] 208 ITR 379 to support his submissions.

8. Shri Haldhar, learned Departmental Representative fully supported impugned orders of Revenue authorities. He argued that assessee before the lower authorities did not contend that interest received was business income. Therefore, the contention that deposit of funds with bank was part of business activity, should not be permitted to be raised at this stage. Shri Haldhar further contended that money-lending was never claimed to be its business by the assessee. Shri Haldhar submitted that interest income on share and other deposits was rightly taxed under the head 'Other sources'. As borrowings on which interest was paid was taken for construction of plant and other business purposes and not for

earning interest, the interest paid on borrowing could not be allowed to be adjusted against receipt. Shri Haldhar distinguished case of Modi Rubbers Ltd. (supra) on the ground that the assessee in that case claimed to be entitled to lend money as per Clause B-19 reproduced in report at page 392. Therefore, observations of Hon'ble Delhi High Court are to be considered with reference to above Clause B-19. Shri Haldhar further relied upon decision of Hon'ble Andhra Pradesh High Court in the case of CIT v. Andhra Farm Chemicals Corporation [1988] 171 ITR 660; Delhi High Court in the case of Indian Drugs & Pharmaceuticals Ltd. (supra) Bombay High Court in the case of CIT v. L & T McNeil Ltd. [1993] 202 ITR 662 and of Andhra Pradesh High Court in the case of Andhra Pradesh Carbides Ltd. v. CIT [1992] 198 ITR 386 (App.). Shri Haldhar also relied upon Special Bench decision of Tribunal in the case of National Thermal Power v. IAC [1988] 24 ITD 1 (Delhi). Shri Haldhar accordingly supported the impugned order.

9. We have given careful thought to the rival submissions of the parties. We have also considered case law cited before us. Before venturing to consider the legal controversy involved, we deem it necessary to resolve a minor dispute on facts. In the extract from assessment order quoted earlier, it is clear that the assessee was liable to pay interest of Rs. 19.19 lakhs to the financial institutions on loans initially taken for setting up of the factory. A part of above loans was not utilised in construction but was utilised in short-term deposits and therefrom interest of Rs. 12.16,478 was earned. There is no dispute on above. The Assessing Officer, however, held that interest was earned not only on borrowings but also on deposit of share capital.

This is disputed. In its letter dated 12-2-1993 reproduced at page 5 of the assessment order, after narrating relevant facts of deposit, the assessee claimed as under : From the above it will be seen that the money which were kept as fixed deposits have come out of borrowed money and borrowed money have been kept in such short-term deposits for facility of reducing the interest burden on the industrial undertaking.

The Income-tax Officer did not accept the above claim and held that interest was earned by assessee both on share capital and borrowed funds. The Assessing

Officer referred to the first Annual Report of the Company for the year 1991. According to the Assessing Officer, the assessee-company intended to derive maximum benefit and, therefore, had earned interest income. This finding of the Assessing Officer though confirmed on appeal by the CIT(A) was vehemently challenged before us.

From the balance sheet extracted in the earlier portion, it is clear that investment in fixed assets is more than the total share capital of the assessee-company. Therefore, without evidence, the plea of the assessee that entire available share capital was utilised in construction of factory, could not be rejected. The Assessing Officer brought no material on record to show that part of paid share capital was deposited in bank to earn interest and as such claim made to the contrary could not be accepted. It is not in dispute that the present is a case of mixed accounts and, therefore, assessee is entitled to argue that disbursement of funds must be taken in the manner most beneficial to the assessee as per decision of Hon'ble Calcutta High Court in the case of Indian Exclusives (supra). Therefore, in the circumstances of the case and on available material, we hold that interest of Rs. 12,16,478 was earned by the assessee not on share capital but on borrowings not utilised for construction but invested in short-term deposits.

10. The aforesaid finding would not advance the case of the assessee if the ratio of decisions in Cap Steel Ltd. 's case (supra), CIT v.Seshasayee Paper and Boards Limited [1985] 156 ITR 543 (Mad.); Madras Fertilisers Ltd.'s case (supra). New Central Jute Mills Co. Ltd.'s case (supra) and CIT v. United Wire Ropes Ltd. [1980] 121 ITR 762 (Bom.), etc. is applied.

The decision of Special Bench of Tribunal in the case of National Thermal Power (supra) is also not in favour of the assessee. In all the above-mentioned cases, it has been held that interest paid on borrowed capital on short-term deposits is not to be deducted from the interest paid on borrowings taken for construction of building or erection of plant. Gross amount of interest earned before the commencement of business is to be taxed. As noted by the Special Bench, the Hon'ble Karnataka High Court in the case of Cap Steel Ltd. (supra) decided the issue after considering the decision of Hon'ble Supreme Court in the case of

Challapalli Sugars Ltd. v. CIT [1975] 98 ITR 167. and the recommendation of Research Committee of Institute of Accountants of India.

11. However, after the decision of the Special Bench given on October 20, 1987, the law on the subject further developed. This would be clear from the following decisions : In the case of Nagarjuna Steel Ltd. (supra), their Lordships of Andhra Pradesh High Court, again considered the recommendations of Institute of Chartered Accountants of India and decision of Supreme Court in the case of Challapalli Sugars Ltd. (supra), on the question whether the bank interest received during the stage of construction of the factory on account of depositing a part of the borrowed money in the bank should be treated as "Income from other sources" or whether it should go towards reducing the actual cost of the assets. The Court put seal of approval on Accountancy Principles stated by the Institute of Chartered Accountants. The Court observed as under : On the facts found in this case, we are of the opinion that the reasoning adopted by the Tribunal is the correct one and is a realistic assessment of the situation. The company was incorporated for setting up a plant and to manufacture certain products and to deal in them. During the relevant accounting year, it was in the course of setting up the plant. For that purpose, it had borrowed certain amounts upon which it was paying interest. All the amount borrowed was not needed at once. A portion of the said amount was kept in deposit, until needed. Those deposits earned some interest.

Would it be realistic to say that that is income from other sources or would it be more appropriate to adopt the approach indicated by the Institute of Chartered Accountants of India in their 'A Study on Expenditure during construction period', relied upon by the Tribunal. . . .

In our opinion, the course indicated by the Institute of Chartered Accountants of India is the proper one to be adopted in such circumstances. . . .

In the case of CIT v. Derco Cooling Coils Ltd. [1992] 198ITR 375, the Andhra Pradesh High Court after examining the decision in the case of Nagarjuna Steels Ltd. (supra) held that there was no warrant in law to extend principles of decision in Nagarjuna Steels Ltd. 's case (supra) to a case of interest earned from a different source, viz.. share money. The Court in this connection referred to para

17.11 of the booklet of Institute of Chartered Accountants where summary of conclusions was recorded by the Institute. The Court further held as under : 17.11. During the construction period, a project may earn income from miscellaneous sources - for example, share transfer fees, interest income, income from hire of equipment or assets and income from sale of products manufactured during the period of test runs and experimental production. It is recommended that such income should be set off against the related items of expenditure so that only the net amount of the expenditure is capitalised or treated as deferred revenue expenditure, as the case may be. In either case, consideration may have to be given to the question of providing for the income-tax liability on such income (paragraph 8.4).

Prima facie, the term 'related items of expenditure' is suggestive of a nexus between the two transactions giving rise to receipt and expenditure but not a broad nexus based upon capital or revenue character of the receipt and expenditure. At any rate, in view of the apparent ambiguity, it is not possible to lay undue emphasis on the passages quoted above which, as already stated, furnished the main basis for the argument of the assessee's counsel.

Section 56 of the Income-tax Act, 1961, enjoins that income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head 'Income from other sources', if it is not chargeable to income-tax under any of the heads specified in Section 14, items A to E. We will assume that an item of receipt that could be set off against or deducted from an item of expenditure which ought to be capitalised for accounting purposes shall not be treated as income in the ordinary sense of the term. Even then, to fall within the ambit of this principle, the receipt in question must be capable of being legitimately set off against a particular expenditure. The very idea of set off connotes that there is a nexus or correlation between the items of receipt and the item of expenditure. In our view, it is not permissible to set off an item of receipts from out of an item of expenditure unrelated to the former or incurred in a different connection. That is why the nexus theory has been applied in several cases for the purpose of determining the character of receipts during pre-production period. In the very decision of this Court in Nagarjuna Steels' case [1988] 171 ITR 663, this Court did

apply the principle of nexus for reaching the conclusion it did, though it has not been stated in so many terms in the judgment. While distinguishing the decisions in *CJT v. United Wire Ropes Ltd.* [1980] 121 ITR 762 (Bom.) and *Addl. CIT v. Madras Fertilisers Ltd.* [1980] 122 ITR 139 (Mad.), this Court adverted to the finding recorded in those cases to the effect that there was no connection or nexus between the two transactions of payment of interest and receipt of interest and held that it remained as a distinguishing factor. We are of the view that the theory of transposing an item of receipt - which is prima facie income - into capitalisation account by resorting to an omnibus set off, cannot be countenanced. As already observed, the set off must be in respect of a related item of expenditure.

In the instant case, the amount of expenditure out of which the interest amount is sought to be deducted relates to term loans used for construction and setting up of the plant. The receipt in question arises out of share capital money deposited with the bank which may or may not be utilised or meant to be utilised for the purpose of setting up of the plant. This again emphasises that the interest received may not stand on the same footing as the interest incurred during the pre-production period so that one could be set off against the other.

It is clear from the aforesaid decision that on consideration of recommendations of the Institute of Chartered Accountants, a distinction was drawn between receipt of interest from share capital and from un-utilised borrowings taken for purposes of construction. The interest payable on borrowings could be deducted from interest earned on un-utilised borrowings but not from Interest earned on share capital. The same view has been taken by Hon'ble Delhi High Court in the case of *Modi Rubbers Ltd.* (.supra). We would refer to the said decision in more detail hereinafter.

It is thus clear that after the decision of Special Bench their Lordships of Andhra Pradesh High Court had deducted interest paid on borrowings taken for construction of factory out of interest earned on such borrowings not utilised for purposes of construction and deposited with bank in short-term deposit. The recommendation of Institute of Chartered Accountants of India, not approved by Hon'ble Karnataka High Court, has been specifically approved by the Hon'ble

Andhra Pradesh High Court. For allowing deduction of expenditure, the Courts laid down that nexus between receipt and expenditure is to be seen. Only expenditure related to the income earned could be deducted and net amount of expenditure capitalised. The aforesaid distinction and principle are different from the case law considered and applied by the Special Bench of the Tribunal. It is thus clear that two reasonable views of the matter in dispute are possible. In such a situation, a view favourable to the assessee is required to be adopted. Therefore, we hold that where interest is paid on borrowings utilised for making short-term deposit the same is to be deducted from interest earned by the assessee and only the balance is to be capitalised. The aforesaid view is also the view of jurisdictional High Court as is clear from the latest decision in the case of Modi Rubber Ltd. (supra). We may say with utmost respect that the view taken by Hon'ble Andhra Pradesh High Court is more appealing. Under Section 57(iii) of the Act, any expenditure (not being capital expenditure) laid out or expended wholly and exclusively for purposes of making or earning income from other sources is to be allowed as deduction. The interest on loan is not being allowed as deduction as it is held not to be expended wholly and exclusively for purposes of making or earning income. It was taken for purposes of construction of building and not for purposes of deposit in the bank. It is true that original or initial purpose of taking loan was the setting up of factory. But for various reasons, loan could not be utilised for above purpose and was utilised in short-term deposits to earn interest. Thus deposit in bank, etc., is the source which has generated income taxable under the head "Other sources". If for taxation of receipt, the changed purpose or utilisation is being considered, the revenue cannot go to original purpose for allowing expenditure. Under Section 56 of the Act, what is brought to charge is "income" from other sources. Thus "income" and the "source" thereof are only to be considered. It is the case of the revenue that short-term deposit for earning interest was not part of business of setting up the factory. It was an independent source of income. This changed or replaced purpose or source is being taken into account. For determining income from this source, the receipt generated by the source and expenditure laid out or expended wholly or necessarily for making or earning such receipt must be taken into account. Thus when interest bearing loans are utilised for earning or making income all conditions of Section 57(iii) are

satisfied.

There is direct nexus or connection between expenditure and income.

Under Section 56 of the Income-tax Act, what is to be taxed is "income" and not gross receipt. The income cannot be determined without deducting expenditure from the receipt. Thus considered, it is appropriate to hold that interest paid on borrowings utilised for short-term deposit, is to be deducted from interest receipt from such deposit.

12. The learned Assessing Officer has held that decisions of Hon'ble Delhi High Court are against the assessee. In this connection, she has referred first to the case of Snam Progetti (SPA) (.supra). In that case, the assessee, an Italian Company, carrying on business as Engineers and Contractors in the field of Petroleum and Petro Chemical Plants, placed excess business funds in short-term deposit with the bank and earned interest income. The assessee suffered business loss and wanted the same to be carried forward and set off against interest income. The Assessing Officer rejected the claim that interest income be treated as business income. The assessee carried the matter in writ before the Hon'ble Delhi High Court and relied upon certain decisions of Supreme Court. The Hon'ble Delhi High Court accepted the claim of the assessee with the following observations : In the present case, the assessee claimed that it has funds which it derived from business and which are used only in business and for no other purpose. If they are spare funds, then they are deposited in banks and, hence, it is clear that this income is also business income. To repeat what was said earlier, the company has not come from Italy to make bank deposits in India but has come to carry on business. If at any time it has spare funds it prefers not to keep the same idle but makes deposits in banks which give some income.

This also is, therefore, business income and for the purpose of set off has not to be treated as separate from business income.

The case cannot be held to be against assessee. Next case referred to by the Assessing Officer in the assessment order is that of State Trading Corporation of India Ltd. 's case (supra). In that case, the assessee, a Government company, had

received grant-in-aid to enable the company to meet expenditure in connection with its administration. The assessee admittedly had not started its business. The Court held that above grant could not be treated as taxable income before the company had commenced the business. The decision is not very material.

The next case considered is that of Indian Drugs & Pharmaceuticals Ltd. 's case (supra). There, the assessee during the course of setting up of its factory and before the production had commenced, realised Rs. 40,540 by supply of tender forms to contractors for erection of plant and machinery. The assessee further realised Rs. 28,241 from sale of grass, etc. and Rs. 17,818 by sale of stones and boulders consequent upon clearance of land for construction of factory. For supplying water and electricity to contractors, assessee realised Rs. 76,201. The Income-tax Officer took 10% of Rs. 76,201 as profit and other receipts as income from other sources. On further appeal, Tribunal held that all the receipts resulted in reducing cost of setting up of capital structure of business and were referable to the source, 'business, profession or vocation'. These were of capital nature. On a further reference, the Hon'ble High Court of Delhi held as under : Held, affirming the decision of the Tribunal, that the receipts were from sources which were not independent but which were inextricably linked with the process of setting up the business. The tender forms were supplied by the assessee to the contractors not in order to earn income nor was the sale of tender forms a source of income as understood commonly. The activity was a part and parcel of the constructional activities of the assessee. Similarly, the water and electricity were supplied to the contractors not with a view to charging them or making a profit, for, a surplus on an estimated basis had been treated as income in this respect. Here again, the source was not independent of, but was closely connected and interlinked with, the process of setting up the factory. Since the business had not been fully set up, the receipts were capital in nature. Therefore, the receipts did not constitute income liable to tax.

As is clear from the above referred to decision, we do not find anything against the assessee. In a case recently decided, the Hon'ble Delhi High Court dealt with question of taxability of interest earned on share capital which was sought to be adjusted against other expenditure incurred by the assessee during the course of

setting up of factory. The Court negated the claim made by the assessee. However, the broad distinction between interest earned on share deposit and that earned on surplus borrowed funds taken for construction but utilised for earning interest was appreciated by the Hon'ble Court. After review of all relevant law, the Hon'ble Court observed as under : Thus, we find there is a chain of authorities of the High Courts holding the view that share money received by the assessee-company, if not immediately required and placed by the assessee in fixed deposit receipts with banks to earn interest, would be income under the head 'Income from other sources'. In the present case as well, the assessee was in the process of setting up its factory and had not come into business and the share capital which was its own money was invested by it in fixed deposits in the banks to earn income.

The interest income so earned was not related to the activity of the assessee of construction of its factory as such. The interest was also not earned on borrowed capital by the assessee and could not be charged to capital as part of the cost of construction of the factory. The principle laid down by the Supreme Court in *Challapalli Sugars Ltd.'s case* (1975] 98 ITR 167, would not, therefore, be applicable.

It is thus clear that interest earned on borrowed capital by the assessee is to be given different treatment from interest earned on share capital. The latter is to be taxed as 'Income from other sources' while the former is to be adjusted against the interest paid on borrowed capital and only the balance is to be capitalised. For the aforesaid reasons, we direct the Assessing Officer to adjust receipt from short-term deposits against interest payable by assessee and excess of interest payable should be capitalised.

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