

Upcom Cables Ltd. Vs. Deputy Commissioner of

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Court : Income Tax Appellate Tribunal ITAT Allahabad

Decided On : Jan-24-1997

Reported in : (1997)63ITD404(All.)

Appellant : Upcom Cables Ltd.

Respondent : Deputy Commissioner of

Judgement :

1. These are two appeals by the assessee for the assessment years 1986-87 and 1987-88 which are being disposed of by a consolidated order, the issues involved being common.

2. Appellant before the Tribunal is a company which was incorporated on 19th July, 1983 with the object of setting up a plant for the manufacturing of jelly-filled telecommunication cables. During the year under consideration, the company was engaged in the process of setting up plant although admittedly no production actually commenced.

3. Appellant furnished a return of income on the 19th of January, 1987 declaring Nil income. The Assessing Officer treated this return as defective as the verification portion of the return was not filled up.

Vide a communication dated 28th September, 1987, the Assessing Officer informed about this defect to the assessee, contents of which with reference to page 1 of the paper-book read as under :- Subject : Assessment proceedings for

assessment year 1986-87 particulars regarding. In connection with the above, it is revealed that VERIFICATION portion of the return has not been duly filled in as prescribed, you are requested to rectify the defect within fifteen days from the receipt of this letter otherwise the return will not be treated as valid return under section 139 of the Income-tax Act, 1961.

Further you are also requested to furnish Articles and Memorandum of Association along with audited balance sheet, profit and loss account and details, etc., within the period as specified above.

4. The appellant, as a sequel to the aforesaid notice, filed a fresh return on the 19th of October, 1987, wherein once again income was declared by them Nil. This return was treated as 'non est' by the Assessing Officer on 31-3-1989 and a communication to this effect was sent to the assessee, copy of which is available at page 2 of the paper-book. The same reads as under :- Please refer to your return of income showing Nil income. Since as per your own submission dated 27-3-1989, the return was filed after 17-4-1986 it will be treated as non est as per provisions of section 139(10) of the Income-tax Act, 1961.

5. Subsequently, after a lapse of about 2 years' notice under section 147 of the Income-tax Act, 1961 was issued. The order-sheet entry dated 7-3-1991 as found in the assessment order on this aspect runs as under :- "In this case assessment proceedings were dropped under section 139(10) by the A.C., Company Circle, Lucknow on 31-3-1989.

The company had earned interest on surplus funds of Rs. 3,46,773 and miscellaneous receipts of Rs. 550. The A.C. had declared the return non est under section 139(10). In view of the case laws cited below income of Rs. 3,46,773 plus Rs. 550 has escaped assessment : 2. National Thermal Power v. ACIT 24 ITD 2 [ITAT Delhi Bench 'A' Special Bench] Therefore, action under section 147 is being taken. Notice under section 148 is issued." 6. The assessee challenged the initiation of action under section 147, took the stand that such action was not tenable in law as it came to be only due to change of opinion on a point of law; the provisions of section 147 before they were amended w.e.f. 1-4-1989 to apply. The Assessing Officer repelled both the contentions and took the view that his

predecessor had not recorded any finding on the issue that interest earned by the assessee during the pre-production period was exempt and that the amended provisions of section 147 would not apply as it was only a machinery section.

7. The assessee urged before the learned CIT (Appeals) that no action under section 147 could have been taken as all the facts including the one relating to the earning of interest were duly disclosed in the annual accounts filed along with the return which must have been taken into consideration by the Assessing Officer fully excepting the set off of the interest and miscellaneous income earned during the construction period against the cost of construction of the assets created. Further no new facts came to light which could have formed the basis for the reassessment sought to be made.

8. The learned CIT (Appeals) did not agree with the assessee took the view that the return having been treated as 'not est' meant that the same had never been furnished and in a situation where no return had been furnished and the Assessing Officer had reason to believe that income chargeable to tax had escaped assessment he would be justified in invoking the provisions of section 147. He held the applicability of the amended provisions of section 147, inter alia, by taking recourse to a Board Circular dated 31st October, 1989. On merits also, he did not agree with the assessee's stand substantially which aspect we would come little later.

9. Before us, Shri S.K. Garg, learned C.A. vehemently argued that in the First instance after a defect was pointed out by the Assessing Officer in relation to the return filed by the assessee on 19-1-1987 and such defect was removed, the same could not have been treated as 'non est'. In his submission, the return filed by him after removing the defect in pursuance of the letter dated 28th September, 1987 by the Assessing Officer was a valid return in law by invoking the provisions of section 139(10) of the Act.

10. Assailing the applicability of sub-section (10) of section 139 of the Act by the Assessing Officer, the learned counsel submitted that this provision was not applicable in the case of a company as there was no exemption limit and the income of a company was taxable from the first farthing. It was also contended by

him that as is evident from the reasons recorded by the Assessing Officer for initiating proceedings under section 147 reproduced hereinbefore, it was specifically stated that : "In this case assessment proceedings were dropped under section 139(10) by the A.C. Company Circle, Lucknow, on 31-3-1989." meant that the Assessing Officer had not treated the return to be a "return having not been filed at all" but a valid return and, therefore, on the last day of limitation as provided by section 153 of the Act, he dropped the assessment proceedings. The dropping of assessment proceedings amounted to the completion of assessment more so when in the case in hand as per the two returns referred to supra, income was shown as Nil. Thus, it was forcefully contended that it had to be presumed that the return was subjected to a careful and proper scrutiny and the issue of a notice exactly on the same material and nothing else only amounted to a change of opinion which was not permissible by law. That the relevant year being 1986-87 the term "regular assessment" as defined by section 2(40) of the Act included all variety of assessments made under section 143 unlike the changed situation which came into effect from 1-4-1989, as per which the term "regular assessment" meant only an assessment completed under sub-section (3) of section 143 of the Act. This was opposed by the learned D.R. who by placing reliance on the view taken by the learned CIT (Appeals) submitted that the action taken under section 147 was legally permissible.

11. We have considered the matter carefully. There is no gainsaying that the original return filed by the assessee on the 19th of January, 1987 was found to be defective for the sole reason that it did not contain verification. The Assessing Officer vide letter dated 28th September, 1987 enjoined upon the assessee to complete it with a specified period as also asked the assessee to furnish certain documents. It is nobody's case that there was any non-compliance on the part of the assessee which filed a fresh return after removing the defects pointed out on the 19th of October, 1987. The Assessing Officer admittedly did not take any action thereon and woke up from slumber only on the 31st of March, 1989, the last day of limitation as prescribed by section 153 of the Act informing the assessee that the same would be treated as non est in accordance with the provisions of section 139(10) of the Act.

12. Sub-section (10) of section 139 of the Act since omitted by the Finance (No. 2) Act, 1991 w.e.f. 1-4-1991 when live on the statute book read as under :- "(10) Notwithstanding anything contained in any other provision of this Act, a return of income which shows the total income below the maximum amount which is not chargeable to tax shall be deemed never to have been furnished;" The provision thereafter provides certain exceptions as to its non-applicability but there being no dispute that none such is applicable to the facts of the case, we are skipping them to avoid bulk to the order.

13. Patently in view of the fact that even farthings earned by a company is taxable no part of the income exempted, could it be said that a return showing Nil income would fall below the maximum amount which is not chargeable to tax. This provision was codified, inter alia, with a view to file returns where income shown was below taxable limit as it involved lot of avoidable work and perhaps discouraged people building up capital (as per the general belief). In this connection, reference may be made to Circular No. 493 dated 21st August, 1987 issued by the Board, copy available at page 3277, Chaturvedi & Pithisaria, Vol. 3, 1991 Edition, which states the object of the enactment of this provision as under :- "It is pertinent to note that the reason behind enactment of section 139(10) is to put an end to the defence, in challenging the initiation of proceedings under section 147, to the effect that pendency of even a return showing income below taxable limit bars the initiation of such proceedings." 14. In a case, therefore, if an assessee-company had filed a return showing income of even Re. 1 it could have been said that it did not Show its total income below the maximum amount which was not chargeable to tax but where the income shown is zero, taking a pragmatic view such return, in our opinion, would partake the character where income had been shown below taxable limit and, therefore, the provisions of section 139(10) applicable. Reference of a decision of the Jurisdictional High Court in the case of Ramlal Kishore Lal v. CIT [1972] 84 ITR 138 (All.) made by the learned counsel for the assessee is of no avail as it is entirely on a different issue relatable to section 263 of the Act.

15. If, thus, the Assessing Officer was justified in treating the return filed by the assessee as 'non est 'the legislative language of section 139(10) itself meant as if

such return had never been furnished. Referring to the case law relied on by the learned counsel for the assessee in the case of *Sirigeri Kanakappa Shetty & Sons v. Dy.*

CIT [1992] 198 ITR 711 (Kar.), it may again be stated that there the issue was different as the return filed by the assessee on 31-7-1987 for the assessment year 1986-87 disclosing loss without claiming the benefit of carry-forward on the strength of a circular issued by the CBDT, the Karnataka High Court held that such a return was bound to be considered holding that directive to this effect coming through the circular was binding on the income-tax authorities on the principle that CBDT's Circulars were binding on them. We will now take up the objection of the assessee about the applicability of the amended provisions of section 147 of the Act.

16. Section 147 before substituted by Direct Tax Laws (Amendment) Act, 1987 w.e.f. 1-4-1989 reads as under :- (a) the Assessing Officer has reason to believe that, by reason of the omission or failure on the part of an assessee to make a return under section 139 for any assessment year to the Assessing Officer or to disclose fully and truly all material facts necessary for his assessment for that year, income chargeable to tax has escaped assessment for that year, or (b) notwithstanding that there has been no omission or failure as mentioned in clause (a) on the part of the assessee, the Assessing Officer has in consequence of information in his possession reason to believe that income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153, assess or reassess such income or recompute the loss or the depreciation allowance, as the case may be, for the assessment year concerned (hereinafter in sections 148 to 153 referred to as the relevant assessment year)." 17. After amendment, the provisions were tightened and a legal condition required was that the Assessing Officer should have reason to believe that any income chargeable to tax had escaped assessment, etc.

The view taken by the learned CIT (Appeals) is that since it is a machinery section, the provisions that existed at the time of the issue of notice should be applied. In this connection, a reference may also be made to a Board Circular No. 549 dated

31st October, 1989 available at page 3535 of Chaturvedi & Pithisaria at para 7.13 reads as under :-" "7.13 Amendments to have retrospective effect. - These amendments come into force with effect from the 1st day of April, 1989.

However, it may be clarified that since the provisions of sections 147 to 152 lay down procedural law, these have retrospective effect, unless the amending statute provides otherwise. Therefore, the amendments made to these sections by the Amending Acts, 1987 and 1989, discussed in the preceding paragraphs, which came into force with effect from 1-4-1989, will be retrospective in the sense that these will apply to all matters which were pending on 1-4-1989 and had not become closed or dead on this date." That the provisions are relatable to the procedure and the amending statute not providing anything to the contrary, we too are in agreement with the view taken during first appeal that it would be the new law which would be applicable to the facts of the case as it came into effect from 1st of April, 1989 and notice was issued to the assessee on the 7th of March, 1991 (referred to page 3 of the paper-book).

18. In the result, both the preliminary objections taken by the assessee fail and we affirm the view that the proceedings initiated by the Assessing Officer under section 147 were legally valid.

19. Coming to the merits of the matter, as is seen, the Id. CIT (Appeals) sustained the addition of an amount of Rs. 3,46,773 representing the interest received by the assessee on surplus funds.

The claim of the assessee has been that this receipt was liable to be set off against the sum of Rs. 4,02,209 being interest paid by them during the same (construction) period. The main reliance by the assessee is on a decision of the Allahabad Benches of the Tribunal in the case of Indo-Gulf Fertilisers Chemicals Corpn. Ltd. [IT Appeal No.2306 (All.) 1990 dated 26-6-1992] copy available at pages 8 to 26 of the assessee's paper-book. Besides this, reliance was also placed by the learned counsel for the assessee on a Supreme Court decision in the case of Keshavji Ravji & Co. v. CIT [1990] 183 ITR 1/49 Taxman 87 and a decision of the Bombay High Court in the case of CIT v. Maharashtra Electros melt Ltd. [1995] 214 ITR 489.

20. Learned D.R., on the other hand, relied on the view taken by the learned CIT (Appeals) and placed reliance on a decision of the Patna High Court in the case of CIT v. Bihar Alloy Steels Ltd. [1994] 206 ITR 350/76 Taxman 571.

22. To recapitulate the facts, it may be stated that the assessee-company though incorporated on 19-7-1983, its business did not commence during any part of the accounting period relevant to the assessment year 1986-87. Assessee earned the disputed amount as interest from surplus funds kept in banks. The Assessing Officer treated it as 'income from other sources'. The assessee's plea is that this interest received should be set off against interest expenses incurred by them during this period as also opined by the Institute of Chartered Accountants in its publication entitled "Study of Expenditure during construction period" referred to by the Assessing Officer.

However, the Assessing Officer taking the aid of a decision of the Karnataka High Court in the case of CIT v. Cap Steel Ltd. [1986] 162 ITR 533/29 Taxman 125 discarded the assessee's plea and assessed the assessee accordingly, which view has been confirmed during first appeal.

23. There being no dispute to the facts of the case, we will now deal with the law relied on by both the sides. Insofar as the ratio in the case of Keshavji Ravji & Co. (supra) is concerned, the Apex Court was dealing with a situation where interest was paid by a firm to partner and also by a partner to the firm on the funds of the partnership withdrawn by him. Their Lordships held that the former interest had to be excluded from interest paid to partner before disallowing it. In saying so, it was observed that in determining the intention of Legislature it is not as if equitable construction had to be excluded where strict literal construction did not lead to result intended. We would only say that this view is not a direct authority on the subject.

Coming then to the decision of the Bombay High Court referred to supra, it appears necessary to give, facts of the case : During the accounting period relevant to the assessment year 1977-78, the assessee-company engaged in the erection of a smelter (incorporated for doing business as a manufacturer of ferro-manganese), commercial production not started incurred expenses amounting to

Rs. 83,32,473. It realised a sum of Rs. 3,14,356 as interest on short-term deposits not immediately required by them. As the same time, they paid a sum of Rs. 58,51,505 as interest on funds borrowed by it for the purpose of its business. The amount of interest earned was deducted by the assessee with adjustment of certain other items and the balance capitalised. The ITO, inter alia, took the view that interest receipt of Rs. 3,14,356 was exigible to tax under the head 'Income from other sources'. The Ld. CIT (Appeals) directed the ITO not to assess such item but accepted an adjustment made by the assessee. This view was upheld by the Tribunal.

"Held (i) that the whole arrangement of obtaining the finance and its temporary utilisation formed one composite transaction and, as such, the interest received by the assessee on account of temporary utilisation of the loans could not be considered in isolation. The assessee did not derive any income by temporary utilisation of the loans and since no income was derived by the assessee, the question of assessing the sum of Rs. 3,14,366 in the hands of the assessee as 'income from other sources' did not arise (see pp. 493H, 494C) : " 25. It is in the wake of this decision in particular that the learned counsel for the assessee strenuously contended that the issue before us was covered whole hog in their favour.

26. We would now deal with the ratio of Patna High Court in the case of Bihar Alloys Steel Ltd. (supra). Their the assessee had offered shares for public subscription which were over-subscribed. The amount of over-subscription was deposited by them with banks on short-term deposits and the interest received by the assessee was adjusted against expenditure on "capital work in progress". Further the assessee was paying interest on loans obtained for purpose of construction. On these facts, it was held that the short-term deposits were not incidental to construction of plant and building and the interest earned by the assessee thereon constituted income from other sources.

27. Insofar as the assessee is concerned strong reliance was also placed on a decision of 'B' Bench of the Allahabad Tribunal in the case of Indo-Gulf Fertilisers Chemicals Corporation Ltd., (supra). In that case, the assessee a Public Limited

Company had commenced the installation of gas based fertilizer plant at Jagdishpur. During the year under consideration, the plant was under construction and admittedly, no business activity had commenced. The Assessing Officer noted during the course of assessment that the assessee had shown in their balance sheet interest income exceeding Rs. 8,00,000 apart from certain miscellaneous receipts. The assessee claimed that these amounts did not constitute their income but went towards reducing the cost of capitalisation in the hands of the company. The interest in question had come to the assessee as the amounts received by way of loan from IDBI, etc., could not be fully utilised. In support of their case, reliance was placed by the assessee on a decision of the Andhra Pradesh High Court in the case of CIT v. Nagarjuna Steel Ltd. [1988] 171 ITR 663/38 Taxman 229 and CIT v. Bokaro Steel Ltd. (No. 1) [1988] 170 ITR 522 (Pat.). After a careful consideration of all the facts and circumstances of the case and also taking into consideration the objection by the department, the Tribunal decided the issue in favour of the assessee holding that the interest received by them on short-term deposits which were available out of borrowed funds went to reduce the liability of interest which they were liable to pay and which was to be accounted for while capitalising the cost of the plant.

Incidentally, the Id. CIT (Appeals) before whom the ratio of this decision was pressed has found the facts to be distinguishable.

According to him, one of the factors taken into consideration by the Tribunal in Indo-Gulf Fertilizers Chemicals Corpn. Ltd.'s case (supra) was a letter dated 13-12-1988 from the IDBI (the lending agency in that case) which specifically stipulated that the cash accruals (like interest earned on deposits, etc.) would be taken into consideration for means of finance before making final disbursement for the project, and such receipts would come towards reduction of the incidental or bank loans. According to the Id. CIT (Appeals), there was no such condition/stipulation or binding clause from the lending institution in the present case. On the other hand, the loan agreement with IFCI in the case in hand permitted that assessee to make call deposits with bank with the prior approval of the lender, i.e., IFCI. Learned counsel for the assessee assailing this view submitted that in their case also it was specifically laid down by the IFCI that loan

will be disbursed subject to the borrower complying with the conditions laid down by the lenders and one such condition stipulated that the drawals from the loan would be kept in a special bank account to be approved by the bankers. In this respect, reference was made to clause 2.6 of the loan agreement filed before us, which reads as under : The loans will be disbursed to the Borrower in one or more instalment(s) as may be decided by the lenders subject to the Borrower complying with the provisions of this Agreement and the disbursement procedure stipulated by the lenders and the financing of the expenditure incurred in the project being in consonance with the details mentioned in Schedule II hereto. All payments to be made by the lenders to the borrower shall be by Cheque(s)/authorisation(s) and the collection/remittance charges, if any, in respect thereof will have to be borne by the borrower and the interest on the loans will begin to accrue in favour of the lenders as from the date of the cheque(s)/authorisation(s)." Further Article 6 containing "Covenants and Terms to apply during the currency of this agreement" clause (d) with the heading drawals from the loans to be kept and a special bank account reads as under :- (i) Keep the drawals from the loans in special account in the name of the borrower with a Scheduled Bank to be approved by the lenders the payment from which account shall be subject to verification by an officer of the lenders or any other person duly authorised in this behalf by the lenders. The borrower shall also obtain and furnish to the lenders a letter (in a form approved by the lenders) from the said Bank foregoing its right of set-off or lien on such account." The learned counsel for the assessee with reference to the aforesaid stipulations urged that the drawals made by the assessee from out of the amount of loans sanctioned by the Financial Institution, namely, IDBI had necessarily to be kept in a bank account to be approved by the lenders and in the backdrop of these stipulations interest amount by the bank on certain unutilised portion of the loan could not be treated in isolation with the interest paid by the assessee on this very fund which got credited in the said bank account.

28. On a careful consideration of these facts, we are of the view that the ratio of Bombay High Court decision in the case of Maharashtra Electromelt Ltd. (supra) squarely applies to the facts of the case and there are no distinguishing features in the case of the Indo-Gulf Fertilisers Chemicals Corporation Ltd., decided by the Tribunal and the present case. Similarly, the ratio of Nagarjuna Steels Ltd. of the

Andhra Pradesh High Court referred to by the Tribunal in the case of Indo-Gulf Fertilisers Chemicals Corpn. Ltd. (supra) also supports the assessee's case. In this case, the High Court held as under :- "Where the object of the assessee is to do business and in the course of set off the balance, since all borrowed money is not required at once, it keeps such surplus funds in short-term deposits, the interest earned on such short-term deposits should be set off against interest paid by the assessee on the loans obtained by it and the balance of the interest amount should be kept alive.

Interest received on such short-term deposits is not assessable as revenue receipts." Reliance placed on the ratio of Bihar Alloys Steels Ltd.'s case (supra) decided by the Patna High Court does not help the department as much as the decision in favour of the assessee, as in Bihar Alloys Steels' case, the interest had been earned by the assessee from the over-subscription and had sought to be adjusted against expenditure incurred on "capital work-in-progress". In the case in hand, the interest was earned by the assessee on the very amounts which they took on loan and which could not be utilised immediately and it necessarily had to be kept in a bank as per the stipulations referred to supra.

29. We are, therefore, of the view that the assessee by his prudent manner of running business only tried to reduce the liability of the cost and by no stretch of imagination, it could be said that they made any earning 'from other sources'. The pith and substance from whatever angle the issue was examined of the matter is that the interest paid by the assessee was clearly liable to be set off against such receipts; in this case the whole of the receipts getting absolved by the corresponding debits leaving nothing to be taxed. In saying so, we may also refer here to the law expounded by the Apex Court in the case of Keshavji Ravji & Co. (supra), wherein it was held that where mutuality was implicit in a transaction the principle of set off should be invoked. On the facts and in the circumstances of the case, there is no doubt that mutuality is writ large in the two transactions, namely, payment of interest by the assessee and the receipt of interest both at the stage of pre-manufacturing and outgoing and the incoming flowing from the same head. In the result, we are of the view that the assessee has to succeed on this issue. Order accordingly.

30. The next dispute is about the charging of interest under-sections 139(8), 215/217 of the Act. However, in view of our categorical finding in favour of the assessee on the substantive issue holding that the whole of the interest received by the assessee was liable to be set off against the interest paid by the assessee, the latter amount being much higher, there is no question of any interest either under section 139(8) or 217 of the Act, to which the assessee could be made liable.

There is no need to answer this issue, the same being consequential and rendered academic on the facts and in the circumstances of the case.

32. Common issues are involved as in the earlier year's appeal excepting that the return for the assessment year 1987-88 filed by the assessee was regular return and accepted by the department under section 143(1) on 9-3-1990. Proceedings under section 147 for this year were issued by notice dated 18-4-1991. The learned Dy. Commissioner of Income-tax (Assessment), Special Range-I, Lucknow, subjected the following amounts to tax :-(a) Interest earned 13,38,120(b) Miscellaneous receipts 2 ----- 33. Following her earlier order, the learned CIT(Appeals) subjected the interest amount of Rs. 13,38,120 to tax, excluded the amount of Rs. 2 from the assessee's income. There being no distinguishing feature in the facts of these two years our decision rendered for the assessment year 1986-87 shall mutatis mutandis apply to this year and the interest receipt would similarly remain liable to be set off against interest paid by the assessee during the corresponding period.

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