

M/S Choudhary And Brothers vs Deputy Commissioner Of Income Tax on 31 August, 2018

Bench: Mohammad Rafiq, Goverdhan Bardhar

HIGH COURT OF JUDICATURE FOR RAJASTHAN
BENCH AT JAIPUR

D.B. Income Tax Appeal No. 355/2017

M/s Choudhary And Brothers, Village Ladana Phagi, Jaipur
Rajasthan.

----Appellant

Versus

Deputy Commissioner Of Income Tax, Circle Jaipur Raj.

----Respondent

Connected With D.B. Income Tax Appeal No. 356/2017 M/s Choudhary And Brothers, Village Ladana Phagi, Jaipur Rajasthan.

----Appellant Versus Deputy Commissioner Of Income Tax, Circle-7, Jaipur Rajasthan.

----Respondent For Appellant(s) : Dr. S.L. Jain & Shri Ashok Kumar Gupta For Respondent(s) : Shri Daksh Pareek on behalf of Shri Sameer Jain HON'BLE MR. JUSTICE MOHAMMAD RAFIQ HON'BLE MR. JUSTICE GOVERDHAN BARDHAR REPORTABLE Judgment 31/08/2018 (PER HON'BLE MOHAMMAD RAFIQ, J.) These two income tax appeals are directed against the common judgement dated 24.7.2017 passed by the Income Tax Appellate Tribunal, Jaipur Bench, Jaipur (for short- 'the ITAT') allowing the two appeals filed by the Revenue and dismissing the cross objections filed by the assessee.

(2 of 12) [ITA-355/2017] Appellant-assessee is a Civil Contractor. The case of the appellant was picked up for scrutiny and assessment order under Section 143(3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') was framed. The Assessing Officer while framing the assessment order rejected the books of account and estimated the profit and applied net profit @ 13%, thereby he made an addition of Rs.19,72,584. The Assessing Officer also made addition on account of income from interest on FDR and discounts received from suppliers of material, treating the same as income from other sources. The Assessing Officer computed the taxable income at Rs.56,78,516 against the income of Rs.7,08,390 declared by the assessee in respect of assessment year 2011-12. Aggrieved thereby, the assessee preferred appeal before the CIT(A), who partly allowed the same and estimated the net profit @ 11.5% and deleted the addition made on account of interest from FDR treating the same as business profit. The CIT(A) also deleted the addition made on account of various unverifiable payments. The Revenue aggrieved thereby preferred appeal before the ITAT. Similar orders were passed by the Assessing Officer in respect of assessment year 2012-13 by holding that interest income on FDR of the assessee as income from other sources. The CIT(A) reduced the G.P. rate under Section 145(3) from 13% to 11.75% and treated the income from

FDR and NSC as business income. The ITAT while partly allowing the appeal filed by the Revenue reduced the discount received by the assessee from various suppliers against the purchases made against the cost of raw material consumed in contract work and treated the income from FDR and NSC as income from other sources, but maintained the order passed by the CIT(A) on other aspects and (3 of 12) [ITA-355/2017] dismissed the cross objection filed by the assessee. This Court admitted the appeals filed by the assessee on 24.04.2018 on the following substantial question of law:

"Whether in facts and in the circumstances of the case, the learned Income Tax Appellate Tribunal was justified in holding the interest income from FDR & NSC as income from other sources by not considering the same as business income and part of total receipts?"

We have heard Dr. S.L. Jain, learned counsel for the appellant-assessee and Shri Daksh Pareek, learned counsel for the respondent-revenue.

Dr. S.L. Jain, learned counsel for the appellant-assessee has argued that the Tribunal has erred in law in computing the interest income from FDRs and NSCs as income from other sources, whereas the appellant is a Civil Contractor and is required to furnish the performance guarantee to the various works departments by way of FDRs and NSCs. The furnishing of FDRs and NSCs by the appellant to the Public Works Department is, therefore, incidental to his main business. It has got a nexus with the business and therefore the interest derived from FDRs and NSCs has to be treated as a business income. It is contended that the interest income earned on FDRs/NSCs is part of the business income as they were obtained for the purpose of business for giving bank guarantee to various departments. FDRs were made by utilising the bank overdraft limit on which interest was paid to the banks which forms a part of the business expenditure. Thus the interest income on such FDRs/NSCs, which was earned out of the funds placed with the bank by utilizing the bank overdraft limit has to be considered as business income and not 'income from other sources'.

(4 of 12) [ITA-355/2017] Dr. S.L. Jain, learned counsel, further submitted that such argument of the assessee has been accepted by the Assessing Officer in the own case of assessee in respect of assessment years 2007-08 to continuously till 2010-11. The ITAT has erred in law in applying the judgement of this Court in the Commissioner of Income Tax vs. M/s. Bhawal Synthetics (India), Udaipur-(2017) 81 Taxmann.com 478 (Raj.), which is distinguishable on facts. Moreover, this court in M/s. Bhawal Synthetics (India) did not notice the judgement of the Supreme Court in Commissioner of Income Tax vs. Karnal Co-operative Sugar Mills Ltd.-(2001) 118 Taxman 489 (SC), which arose out of somewhat identical case and taken a contrary view. That was a case where the money in FDR was part of the amount that was kept to obtain letter of credit for purchase of machinery and, therefore, the interest earned thereon was held to be income from other sources. Learned counsel in support of his arguments has also relied on the judgement of Madhya Pradesh High Court in Bharat Oman Refineries Ltd. vs. Income-tax Officer, Bhopal-(2014) 52 Taxmann.com 347 (Madhya Pradesh), judgement of Gujarat High Court in Cedan Vinimay (P.) Ltd. vs. Assistant Commissioner of Income-tax-(2015) 54 Taxmann.com 425 (Gujarat) and judgement of Delhi High Court in Commissioner of Income-tax vs. Jaypee DSC Ventures Ltd.-(2012) 17 Taxmann.com 257

(Delhi).

Per contra, Shri Daksh Pareek, learned counsel for the respondent-revenue has submitted that since the interest income on the FDR is not part of contract receipt, the same is liable to be taxed under the head 'income from other source'. The Tribunal was perfectly justified in treating such interest income earned on FDR/NSC as income from other source. Learned counsel submitted (5 of 12) [ITA-355/2017] that this issue is squarely covered by judgement of this Court in M/s. Bhawal Synthetics (India), Udaipur, supra, in which assessee had income of interest through FDRs. Assessee claimed deduction or set off of his income from other sources against interest payable on the borrowed fund. The reason given was that the amount pertaining to FDR was not surplus amount but part of amount that was kept to obtain letter of credit for purchase of machinery. It was held by this Court that interest earned thereupon was nothing but income from other source and therefore the Commissioner of Income Tax rightly treated the same as taxable income. Learned counsel for the respondent has also relied on judgement of the Supreme Court in M/s. Tuticorin Alkali Chemicals and Fertilizers Ltd. vs. Commissioner of Income- tax-1997 (6) SCC 117.

We have given our anxious consideration to the rival submissions and perused the material on record.

This Court in M/s. Bhawal Synthetics (India), Udaipur, supra was dealing with a case where the case of the assessee was selected for scrutiny and the Assessing Officer considering the explanation given by the assessee arrived at the conclusion that since no expenditure or depreciation was claimed by the assessee, the addition sought to be made is set off and the returned income be treated as nil. The Commissioner of Income Tax, however, held that interest earned on FDRs amounting to Rs.9,31,572 had not been brought to tax and was wrongly set off. A show cause notice under Section 263 of the Act was thus issued. The Commissioner of Income Tax arrived at the conclusion that the order passed by the Assessing Officer was erroneous and, therefore, set aside the order of assessment with a direction that the same should be (6 of 12) [ITA-355/2017] passed afresh after making due and proper enquiry. The matter was taken to ITAT by the assessee, which set aside the order of Commissioner of Income Tax. This is how the matter reached the High Court in the appeal filed by the revenue. It was held by this Court that FDR was taken for obtaining letter of credit to purchase machinery but so far as interest earned thereon is concerned, that is nothing but income through other sources, as such, Commissioner of Income Tax rightly treated the same as taxable income.

This Court in the aforesaid judgement has relied on the judgement of the Supreme Court in Tuticorin Alkali Chemicals & Fertilizers, supra in which case it was held that the interest earned on short-term investment of funds borrowed for setting up of factory during construction of factory before commencement of business has to be assessed as income from other sources and it cannot be said that interest income is not taxable on the ground that it would go to reduce interest on borrowed amount which would be capitalized. The Supreme Court in para 14 of the report in Tuticorin Alkali Chemicals and Fertilizers Ltd., supra has held that "if the capital of a company is fruitfully utilised instead of keeping it idle the income thus generated will be of revenue nature and not accretion of capital. Whether the company raised the capital by issue of shares or debentures or by borrowing will not make any difference to this principle. If borrowed capital is used for the

purpose of earning income that income will have to be taxed in accordance with law. Income is something which flows from the property. Something received in place of the property will be capital receipt. The amount of interest received by the company flows from its investments and is its income and is (7 of 12) [ITA-355/2017] clearly taxable even though the interest amount is earned by utilising borrowed capital." Then in para 22, the Supreme Court noted that "the company had surplus funds in its hands. In order to earn income out of the surplus funds, it invested the amount for the purpose of earning interest. The interest thus earned is clearly of revenue nature and will have to be taxed accordingly."

This Court in M/s. Bhawal Synthetics, supra where the amount in the FDR was kept for obtaining letter of credit for purchase of machinery has indeed not noticed the judgment of the Supreme Court in Karnal Cooperative Sugar Mills Ltd, supra. In that also, money in FDR was part of the amount that was kept to obtain later of credit for purchase of machinery. Facts were thus identical. The judgement of the Supreme Court in Karnal Cooperative Sugar Mills Ltd., supra thus provides guidance on the point of law involved in this case. It was held therein that income earned would fall in the category of income from other sources, but may come in the category of income earned from business. The Supreme Court in the aforesaid case has considered the judgement in Tuticorn Alkali Chemicals and Fertilizers Ltd., supra and held thus:

"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 and Fertilizers Limited v. CIT- (1997) 227 ITR 172 , will not be attracted. The more appropriate decision in the factual situation in the present (8 of 12) [ITA-355/2017] case is in CIT v. Bokaro Steel Ltd.-(1999) 236 ITR 315 (SC). The appeal is dismissed. There will be no order as to costs."

The Delhi High Court in Jaypee DSC Ventures Ltd., supra was dealing with a case where the assessee filed its return of income for the relevant assessment year declaring nil income. It had furnished performance guarantee in favour of National Highway Authority of India to get the contract awarded in its favour and to procure the said guarantee, it had kept the amount in a fixed deposit in the bank. The amount of interest income from fixed deposits was set off against the project expenses. The case of the assessee was that the furnishing of bank guarantee had a direct nexus with the carrying on of the project and, therefore, the said set off deserves to be allowed. The Assessing Officer held that interest received by the company on the bank deposit was taxable as income under the head 'income from other sources'. According to the Assessing Officer, project expenses did not have even remote proximity with the earning of interest and thus the same could not be allowed to be set off against the interest income. On second appeal, the ITAT allowed the

assessee's claim. The revenue approached the High Court. The High Court on consideration of the number of precedents including the Tuticorin Alkali Chemicals & Fertilizers, supra dismissed the appeal holding thus:-

"21. Keeping in view the aforesaid pronouncements in the field, the present controversy is to be adjudged. As is noticeable from the stipulations in the agreement, the performance guarantee by way of bank guarantee was required for faithful performance of its obligations. The non-submission of the guarantee would have entailed in termination of the agreement and NHAI would have been at liberty to appropriate bid security. That apart, the (9 of 12) [ITA-355/2017] release of such performance security depended upon certain conditions. Thus, it is clearly evincible that the bank guarantee was furnished as a condition precedent to entering the contract and further it was to be kept alive to fulfill the obligations. Quite apart from the above, the release of the same was dependent on the satisfaction of certain conditions. Thus, the present case is not one where the assessee had made the deposit of surplus money lying idle with it in order to earn interest; on the contrary, the amount of interest was earned from fixed deposits which was kept in the bank for furnishing the bank guarantee. It had an inextricable nexus with securing the contract. Therefore, we are disposed to think that the factual matrix is covered by the decisions rendered in Bokaro Steel Ltd. (supra), Karnal Co-operative Sugar Mills Ltd. (supra) and Koshika Telecom Ltd. (supra) and, accordingly, we hold that the view expressed by the tribunal cannot be found fault with."

Another judgment on the similar facts is of Madhya Pradesh High Court in Bharat Oman Refineries Ltd., supra. That was a case in which assessee-company filed nil return and along with the return, statement of income and expenditure was filed. In this statement, income from interest on account of short-term deposit with the bank was indicated. The Assessing Officer made assessment and treated the said sum as income from 'other sources'. The assessee challenged the said assessment pointing out that interest income could not be added under the head 'income from other sources'. On appeal, both the Commissioner (Appeals) and the Tribunal upheld the order of Assessing Officer. The High Court however held that the appellant has not earned interest on the money lying idle with him for running industry. On the contrary by virtue of terms and conditions of the contract (10 of 12) [ITA-355/2017] petitioner was to submit a performance guarantee and for that purpose, he had to deposit certain funds with the Bank as margin money and it is on this margin money the interest was earned in the light of the nature of deposit made and the source from which the interest was received.

We may in this connection also refer to the judgement of the Karnataka High Court in CIT vs. Chinna Nachimuthu Constructions-(2008) 297 ITR 70 (Karn). That was a case somewhat similar on facts where the assessee being a contractor, in order to secure a contract work was required to offer a bank guarantee to the contractee. There also the assessee had shown the interest accrued on the fixed deposit as business income but the Assessing Officer treated the interest as "Income from other sources". The Karnataka High Court noticed that the investment of amount in fixed deposits by the assessee was only to provide a bank guarantee to the contractee in order to acquire the

contract work. It was held that the interest income could not be treated as income from other sources and had to be treated as business income only. Karnataka High Court in that case relied upon judgement of the Supreme Court in the Supreme Court in CIT vs. Govinda Choudhary and Sons-(1993) 203 ITR 881.

The aforesaid judgement of the Karnataka High Court was followed by Patna High Court in Shyam Bihari vs. Commissioner of Income Tax & Anr.-(2012) 345 ITR 283. That was also a case where the assessee was a civil contractor and his business income was from the contract work obtained from Government departments. The assessee objected before the Tribunal that the inclusion of interest income being assessed as "income from other sources" on the ground that the income was from money (11 of 12) [ITA-355/2017] deposited in FDRs and NSCs, which was required to be furnished by way of security for securing the contract work and, therefore, it should have been treated as income from business and not from other sources. The Patna High Court relying on the judgement of Karnataka High Court held that the Tribunal as well as the subordinate Revenue authorities erred in holding that interest accrued on security deposits to the extent used for the purpose of securing the contract work would also be assessable as income from other sources.

In the present case also, on the facts of the present case, we find that appellant being a civil contractor was required to provide a performance guarantee to the various works departments for obtaining contracts of civil construction. He to keep such performance guarantee alive by way of utilizing the bank overdraft limit against which he had to furnish FDRs/NSC for execution of the contracts. His failure to submit the performance guarantee or inability to keep them alive would have resulted in termination of the contract awarded to him and in that event, the concerned departments/employer could encash the security. Release of such performance guarantee is dependent on fulfillment of certain conditions. It is not that the appellant had invested surplus money lying idle with him only in FDRs/NSCs with a view to earning interest. Obtaining of FDRs/NSCs and furnishing of the same against the performance guarantee by the appellant, therefore, had an inextricable nexus with his business of securing civil contracts and integral to his working as civil contractor. The income of interest earned from the interest such FDRs/NSCs by the appellant therefore, in our considered view, cannot be treated (12 of 12) [ITA-355/2017] as income from other sources and would rather be an income earned from business.

In view of above discussion, the question of law extracted above is answered in the terms that "in the facts and circumstances of the case, the interest income from FDRs and NSCs of the petitioner has to be treated as income from business and not income from other sources as the income is part of the total receipts and not from other sources."

In the result, the appeals are allowed. The judgement of the ITAT dated 24.7.2017 is set aside and that of the CIT(A) in regard to interest earned on FDRs and NSCs dated 18.3.2016 is restored and the matter is remitted back to the Assessing Officer for passing fresh order of assessment in accordance with law keeping view the question answered by this Court.

Office to place a copy of this judgment in connected matter.

(GOVERDHAN BARDHAR) , J

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