* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No.950/2008**

% Reserved On: MAY 20, 2011
Judgment Delivered On**:** JULY 11, 2011

THE COMMISSIONER OF INCOME TAX-II NEW DELHI .... **APPELLANT**

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel for the Revenue.

Versus

MADHYA BHARAT ENERGY CORPN. LTD. .... **RESPONDENT**

Through: Ms. Devashish Bharuka, Advocate for the Assessee.

CORAM:
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MR. JUSTICE M.L. MEHTA

1.	Whether reporters of Local papers be allowed to see the judgment?	Yes
2.	To be referred to the reporter or not?	Yes
3.	Whether the judgment should be reported in the Digest?	Yes

M.L. MEHTA, J.

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1. This is an appeal under Section 260A of the Income Tax Act (hereinafter referred to as 'the Act' for short) against order dated 21st September 2007 of the Income Tax Appellate Tribunal ('the

Tribunal' for short). This appeal was admitted on the following substantial questions of law:

> *"(a) Whether the ITAT was correct in law in holding that the reassessment order was invalidly made for assessment years 1999-2000 and 2000-2001 as no notice under Section 143(2) was issued?*
>
> *(b) Whether the ITAT was correct in law in holding that the interest income on FDRs is not to be treated as income from other sources and is required to be reduced from pre-production expenses?"*

2. Though the impugned order is related to Assessment Years (henceforth 'AY' for short) 1999-2000 to 2003-2004, but the challenge is in respect to the order relating to AY 1999-2000 and 2000-2001. The facts leading to filing of the present appeal, being relevant need to be narrated.

3. The assessee company entered into an agreement with AGIO Countertrade PTE Ltd., Singapore (hereinafter to be referred to as 'the investing company) and Madhya Pradesh State Electricity Board (hereinafter to be referred to as 'MPSEB'). The Assessee company was established to set up a power plant in Madhya Pradesh. It participated in a bid which was called by MPSEB. As per the requirement of the bid process, a security deposit of ₹11.65 crore was to be deposited with MPSEB on or before 17th August 1998. The assessee company requested the investing company to remit the requisite amount, but, the same could only be received on 18.08.1998, and due to delay in remittance, the

assessee could not deposit the security amount with MPSEB on or before the stipulated date of 17th August 1998 and consequently the bid of the assessee was rejected. As per the arbitration agreement, the assessee raised claims against the investing company for the loss caused due to disqualification by MPSEB. This claim of the assessee was resisted by the investing company. The amount of ₹6.00 crore submitted by the assessee to MPSEB on 18.08.1998 was returned back by MPSEB due to delay of one day and the balance amount of ₹5.65 crore which was deposited by the assessee on 17.08.1998 was also returned back by MPSEB vide their letter dated 11.09.1998. The assessee company filed a writ against MPSEB in the High Court of Jabalpur, Madhya Pradesh. In the meantime, on 15.09.1998, the assessee company and the investing company referred the matter to the sole arbitrator for resolution of their dispute. The claim of the investing company before the arbitrator was that a sum of ₹6.77 crore was remitted by it to enable the assessee to make security deposit with MPSEB to obtain the bid for setting up of a power plant. The said bid was rejected, but the assessee was holding the said money even though the purpose for which the amount was remitted had failed. The investing company pleaded that it apprehended that during the proceedings of arbitration, the assessee may appropriate these funds for the purposes other

than repayment of amounts to the investing company, and if the funds are diverted by the assessee, the right of the investing company in the remittances would be adversely affected. On the other hand, it was pleaded by the assessee that since the investing company is not a resident of India, it will be difficult for the assessee to obtain remittance again. In case the investing company is allowed to take the funds out of India, then all the legal proceedings now initiated by the assessee against the MPSEB will be jeopardized and the assessee will not be able to make the payment of security deposit in time. It was also pleaded by the assessee that it being a statutory body is required to incur various expenses to comply with the statutory requirements, but its own capital is too inadequate to meet these expenses and the promoters have also not contributed, after the failure of the bid with MPSEB. On 25.09.1998, the arbitrator passed the following directions:

> *"On the due consideration of the submissions by the claimant and respondent, I find that the claims of the parties are justified in their own right. I fully agree with the claimant that if the respondent is permitted to take away the remittance sum of ₹6.77 crores out of India then its claim raised under the present proceedings shall be frustrated. Further the claimant is still pursuing legal proceeding shall be frustrated. Further the claimant is still pursuing legal proceeding shall be frustrated. Further the claimant is still pursuing legal proceedings to obtain rights to set up power plant in Madhya Pradesh and for which it might be necessary to take payment of security*

deposit. If the respondent's plea for retransfer of funds is allowed then claimant's bid to obtain these rights through judicial proceedings may also stand defeated. In these circumstance the respondent's plea for retransfer of funds is not acceptable at this stage of the proceedings.

At the same time, however, I find that with the fears expressed by the respondent regarding diversion of funds by the claimant cannot be said to be misplaced. I, therefore, direct the claimant out of the remittance received from the respondent amounting to ₹6.77 crore shall make fixed deposits for sum of ₹6.77 crore with any of the scheduled bank or banks and the FDR's shall be kept in the safe custody.

I, further, accept the claimants submission that in order to meet the day today business expenses and to meet the costs, charges and expenses of pursuing and defending, the court proceedings, the funds would have to be arranged. I, therefore, direct that interest earned on the FD's made shall be sued and or appropriated for meeting the day today costs or for running of the organization of the claimant and to meet legal costs, charges and expenses. However, it is expressly provided that in case the respondent's claims are upheld then the claimant may have to pay interest/ finance charges or appropriate compensation to the respondent for use of funds which now stands locked up in making the FD."

4. After the aforesaid order the arbitrator adjourned the matter to 07.12.1998, but the investing company filed a suit before this Court before 07.12.1998. In view of this, the arbitrator adjourned the proceedings *sine die* on 09.12.1998. This Court on a petition filed by the assessee for release of various bank accounts passed the under-mentioned order:

> *"By this application, the defendant No. 1 seeks a direction to the defendant No.6 Corporation Bank to allow the defendant No. 1 to operate its all other bank accounts except the seven fixed receipts bearing No.981830 to 981836. Learned counsel for the defendant No. 6 does not wish to oppose the application. Accordingly, the application is allowed and the Corporation Bank is directed to allow the defendant No.1 to operate its all other bank accounts including the fixed deposit receipts etc. except the aforesaid seven fixed deposit receipts bearing No. 981830 to 981836."*

5. It is in this manner that 07 Fixed Deposits of ₹1.00 crore each were maintained by the assessee. It may be noted here that in the mean time for making assessment for the AY 2001-2002, the interest income earned by the assessee from FDRs and bank deposit were treated as "Income from Other Sources" and was allowed to be adjusted against the pre-operative expenses and therefore, reassessment proceedings were initiated in respect of AY 1999-2000 & AY 2000-2001. Undisputedly, the assessee was at the stage of pre-commencement of its business when the amounts as mentioned above came to be invested in the FDs. For the AY 1999-2000, the assessee earned interest amounting to Rs.93,81,222/- out of which it had received interest of Rs.48,65,812/- from MPSEB on security deposit of Rs.5.22 crore. The balance amount of interest of Rs.45,15,408/- was earned by the assessee on FDs of Rs.7.00 crore.

6. The assessee filed Return of Income (ITR) on 28.12.1999 under Section 143(1) of the Act. Subsequently, the AO noted that the assessee had adjusted interest income of Rs.93,81,222/- against the pre-operative expenses. The AO being of the view that the interest income in pre-production stage was to be taxed as "Income from Other Sources" in view of the decision of the Supreme Court in the case of ***Tuticorn Alkali Chemicals & Fertilizer,*** 227 ITR 172 and ***CIT Vs. Cormondal Cement Ltd.,*** 234 ITR 412, he formed reason to believe that interest income of Rs.93,81,222/- has escaped assessment. He also noted that on the same facts the interest income for the AY 2001-2002 was also charged to tax as "Income from Other Sources". The AO, therefore, issued a notice under Section 148 of the Act on 21.03.2003. In response to this notice, the assessee filed its return of income declaring Nil income on 25.04.2003. The AO issued a notice under Section 142(1) of the Act and also a questionnaire to the assessee, but the same remained un-replied. Another notice along with questionnaire was issued on 21.01.2004, in response to which the AR of the assessee attended the proceedings on 30.01.2004 and asked for reasons for issue of notice under Section 148 of the Act. He was given a copy of the reasons recorded on 06.02.2004, 03.03.2004 and 15.03.2004 and he also filed the requisite details. It was

thereafter that the AO passed an order of re-assessment on 23.03.2004. The AO had noted that the company was setting up a power plant in Madhya Pradesh and commercial operation had not started, but interest of Rs.45,15,408/- received on FDs was adjusted against the pre-operative expenses. While passing the order on 23.03.2004, the AO rejected the claims of the assessee that the money remained in the fixed deposits as per the order of this Court which restrained it from encashment from FDRs till further order and that the money was for setting up a power project and thus the interest received during the pendency of the matter before this Court was to be adjusted against the power project. In this regard the AO noted that vide order dated 09.12.1998, this Court allowed the assessee to operate all its bank accounts except 07 FDRs which were already in existence prior to the filing of the suit in this Court by the investing company on 01.12.1998. On 02.12.1998 this Court issued restraint of all assets and bank accounts against the assessee. However, on 09.12.1998, the said restraint order was modified and the same remained restricted to FDRs of Rs.7.00 crore. The operative part of the order passed by this Court on 09.12.1998 has already been reproduced above in para No.4. We note that Rs.10.00 crore was invested by the assessee in FDRs on 28.09.1998 after MPSEB returned the security money and thus

the investment in FDRs is in no way linked with the power project. The AO also observed that these funds were surplus with the assessee at that stage and its business activities had not yet commenced and thus investment in FDRs was neither connected with nor was it incidental to setting up of a power project.

7. It is also gathered from the impugned order that the AR of the assessee informed the Tribunal that vide order dated 20.02.2002 this Court passed a decree in the aforesaid suit vide which assessee was permitted encashment of 07 FDRs and these FDRs were actually encashed on 08.07.2002 and the amounts were repatriated to the investing company on 11.07.2002.

8. The AO accordingly assessed the interest income of Rs.45,15,408/- earned from FDs under the head “Income from Other Sources”. Before the CIT(A) additional ground was taken by the assessee challenging the validity of the assessment alleging that no notice under Section 143(2) of the Act was served upon the assessee before the reassessment. The CIT(A) maintained the order of the AO on merits and also rejected the additional plea of invalidity of the assessment on account of non issuance of notice under Section 143(2) of the Act. Against this order of the CIT(A), the assessee preferred an appeal before the Tribunal which came to be allowed by the impugned order.

9. We have heard Mr. Sanjeev Sabharwal, Sr. Standing Counsel for the Revenue and Mr. Devashish Bharuka, learned counsel for the Assessee.

10. The reopening of the assessment under Section 148 of the Act has been challenged on two grounds. Firstly, it is alleged that the assessment could not be reopened under Section 148 of the Act as the assessee had given detailed note with the original return as to why interest income was not to be taxed, but was to be adjusted against the project cost, and so it cannot be reopened merely on account of change of opinion. Secondly, reassessment has been alleged to be a nullity in the absence of issue of notice under Section 143(2) of the Act to the assessee. The submission that issue of notice under Section 148 of the Act represented change of opinion has not been dealt with by the Tribunal. However, the CITA has rightly recorded that the change of opinion is only possible if there was application of mind in the first assessment, but in this case there was no assessment and the intimation under Section 143 (1) (a) of the Act was neither an assessment nor it involved application of mind. This Court in the case of ***Mahanagar Telephone Nigam Ltd. Vs. Chairman, Central Board of Direct Taxes And Another*** has in regard to an argument similar to the assessee's argument held that "Therefore, there being no assessment under

Section 143 (1) (a) of the Act, the question of change of opinion, as contended, does not arise." With regard to this ground of challenge, it may be stated that admittedly the assessee filed original return of income on 28th December, 1999 and the same was processed under Section 143 (1) (a) of the Act. It was only during the proceeding of AY 2001-2002, that the AO noticed that the interest income of Rs.93,81,222/- has escaped assessment and he also noticed that on the same facts, the interest income for the AY 2001-2002 was charged to tax as "Income from Other Sources". He accordingly issued notice under Section 148 of the Act. It is settled law that the intimation with regard to assessment made under Section 143 (1) (a) of the Act is not an assessment. A reference in this regard can also be made to the decision in ***Mahanagar Telephone Nigam Ltd.*** (supra).

11. As per explanation 2(b) to Section 147 of the Act, where a return income is furnished, but no assessment has been made and it is noticed by the AO that an assessee had understated the income, it will be deemed to be a case where income chargeable to tax had escaped assessment. In the case of ***Ranchi Club Vs. CIT***, 214 ITR 643 (Patna) it was held in a case where only intimation was sent, notice under Section 148 of the Act could be issued in terms of Explanation 2 (b) to Section 147 of the Act. The case of ***Mahanagar Telephone Nigam Ltd.*** (supra) confirmed that "So

long as the ingredients of section 147 are fulfilled, the Assessing Officer is free to initiate to proceed under Section 147 and failure to take steps under section 143(3) will not render the Assessing Officer powerless to initiate reassessment proceedings even when intimation under Section 143(1) had been issued."

12. It is noted that the impugned assessment is in response to notice under Section 148 of the Act and the Act does not specifically provide that the assessment made under Section 147 of the Act will be after issue of the notice under Section 143(2) of the Act. In fact, AO has the basic jurisdiction to assess the income in terms of Section 147 and Section 148 of the Act where he has reason to believe that the income has escaped assessment. On the submissions of non issuance of notice under Section 143(2) of the Act, we are of the view that the findings of the Tribunal in this regard are not as per the scheme of the provisions of Section 147 and 148 of the Act.

13. Though no specific notice was required under Section 143(2) of the Act, as noted above, the questionnaires dated 11.11.2003 and 21.01.2004 provided the assessee specific opportunity to support his return by seeking documentary evidence and details in regard to the following query:

> *"As per return, interest of Rs.93,81,222/- was received by you during the year, which is adjusted*

against pre operative expenses. The interest income should be charged."

14. On merits, the submissions of learned counsel for the assessee was that the interest received on FDs was incidental to acquisition of assets. In other words his submission was that the interest received was inextricably linked with the process of setting up of plant and machinery and as such receipts are to go to reduce the cost of assets and the nature of capital and cannot be taxed as income. He submitted that the money which was deposited in the shape of FDs was not lying idle or surplus and was not deposited for the purpose of earning interest. The learned counsel appearing for the assessee replied upon the case of ***Tuticorn Alkali Chemicals & Fertilizer*** (supra).

15. As per the finding of fact as was recorded by the AO, the assessee received share application money of about Rs.18.37 crore from co-promoters including approximately Rs.7.00 crore from the investing company. There is nothing on record to suggest that money received from the investing company was directly invested in FD. In fact, the assessee was regularly incurring expenses in pre-operative expenses account, fixed assets, as well as giving loans and advances out of funds received by it. This court only restrained the assessee on

09.12.1998 from enacting Rs.7.00 crore FDR, whereas share application money had been received in August'98. Therefore, till the passing of the order by this Court on 09.12.1998, all surplus funds lying with the assessee were invested in the FDs. It was after the return of Rs.6.00 crore on 19.08.98 and Rs.5.65 crore on 11.09.1998 by MPSEB due to delay in deposit of security money, that the assessee got issued ten FDs of Rs.1.00 crore each on 28.09.1998. This was in fact investment made by the assessee to earn interest from the surplus amount lying with it till the resolution of the issues with the investing company and MPSEB. When the MPSEB had already rejected the bid, the assessee seemed to be fighting a lost battle. The investment in FDs in such circumstances could not be said to be anyway linked with the power project. At that stage the funds were lying surplus with the assessee and its business activities had not yet commenced. Thus, the investment in FD cannot be said to be connected with or incidental to setting up a power project.

16. In the case of ***Tuticorn Alkali Chemicals & Fertilizer*** (supra), the assessee company was incorporated on 03.12.1971 for the purpose of manufacturing heavy chemicals such as ammonium chloride and soda ash. The trial production of the factories of the company commenced on 30.06.1982. For the purpose of setting up of the factories, the company had taken term loans from

various banks and financial institutions. That part of the borrowed funds which was not immediately required by the company was kept invested in short-term deposits with banks. Such investments were specifically permitted by the memorandum and articles of association of the said company. For accounting year ending on 30.06.1981 i.e. AY 1982-83, the company received total amount of interest of Rs.2,92,440/-. The company disclosed the said amount of Rs.2,92,440/- as income from other sources. It also disclosed business loss of Rs.3,21,801/-, after setting off the interest income, it was claimed by the company the benefit of carry forward of net loss of Rs.29,360/-. Later on revised return was filed showing business loss of Rs.3,21,801/-. It was claimed that as per accepted accounting practice, interest and finance charges along with pre-production expenses had to be capitalized and thus interest income of Rs.2,92,440/- should go to reduce the pre-production expenses (including interest and finance charges) which would ultimately be capitalized. The claim of the assessee was rejected by the AO and CIT(A). In this case it was found that the company had surplus funds in its hands and invested the same for the purpose of earning interest. Therefore, it was held that the interest earned was clearly of revenue nature and the same had to be taxed accordingly.

17. Now coming back to the facts of this case, it is seen that the assessee had retained money received from the investing company without any purpose as the bid of the assessee had already been rejected by the MPSEB. Though the assessee was contesting rejection of bid in the High Court, the amount was kept deposited in the shape of FDs only to earn interest till such time the issues with MPSEB and investing company were resolved. The interest earned on these investments cannot be related to setting up of business. In the case of ***CIT vs. Monarch Tools (Pvt. Ltd.),*** 260 ITR 258 (Madras), the interest earned by making FDs with banks was not in any way linked to the business that the assessee was carrying on and, therefore, the interest income was held to be 'income from other sources' and not 'business income'.

18. In the given circumstances, the act of the assessee of making FDs and earning interest thereon could not be said to be for the only definite purpose and project of setting up of a unit. Since the bid had already been rejected, the investment could not be said to be for the setting up of the said unit. It was a case of depositing unutilized and surplus money by the assessee to earn interest and therefore, the interest earned by the assessee being revenue in nature is liable to be assessed as "income from other sources".

19. In view of these discussions, we come to the conclusion that the interest earned by the assessee on FDs is assessable as 'income from other sources' and any set off of the same cannot be given to the assessee as pre-operative expenses.

20. In view of above discussion, we answer both the questions in negative and in favour of the revenue and against the assessee. The appeal is accordingly allowed.

M.L.MEHTA
(JUDGE)

A.K. SIKRI
(JUDGE)

JULY 11, 2011
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