Interest earned on FD out of money granted by Govt. for metro project isn't taxable

Summary – The Kolkata ITAT in a recent case of Kolkata Metro Rail Corpn. Ltd., (the Assessee) held that where money given by Government to assessee-joint venture company of Central and State Government for implementation of construction work of metro railway was kept in fixed deposit with a bank before utilisation, interest income earned could not be taxed as income from other sources in hands of assessee

Facts

- The assessee-company was engaged in the construction work for metro rail under metro project in the capacity of joint venture with Government of India and Government of West Bengal. The assessee had received money both from State Government and Central Government for execution of construction work for metro project. The assessee had parked money so received in bank during unutilised period and earned interest on same. The assessee stated that interest accrued out of investment made in the banks from the said borrowed loan, were to be treated as capital receipts and, accordingly, accounted same in the accounts of the company. The Assessing Officer rejected the contention of the assessee and held that the interest so received from bank deposits should be taken as 'income from other sources'.
- On appeal, the Commissioner (Appeals) observed that it was found to be an admitted fact that the impugned interest income was earned on short-term deposits with scheduled banks, and the investments were derived from Central and the State Government funds for infrastructure project *i.e.*, development of metro corridor project undertaken by the assessee. The Commissioner (Appeals) noted that the assessee had treated the impugned amount as capital receipts in its audited accounts, as amount received during pre-operative period. It was clear from documents on record that as per book results of the assessee the interest income was accrued during the pre-operative period.
- On appeal to the Tribunal:

Held

- The assessee, is a Government company in the form of joint venture of Government of India and Government of West Bengal with equal equity participation for the execution of East-West metro corridor project at Kolkata by creating a rapid transit system surrounding the city. The required fund has been provided from time to time by Government of India and Government of West Bengal in the form of equity and subordinate debt/loans. The total funds received by the assessee from the respective Governments was put in the bank accounts and utilized as and when required. Interest on fund parked with banks in the form of short term deposits resulted in some additional funds in the form of interest which could be utilized exclusively for the purpose of construction of the project. The interest income earned on such short term deposits during construction period was fully utilized for the construction of the project and resulted in reduction of project costs. The assessee does not have any other source of income, as such, treatment of interest income is accounted for as capital receipt and adjusted with pre-operative expenditure during the construction period, so that, the net off expenditure is carried over to balance sheet under the head capital-work-in progress.

- The Commissioner (Appeals) has rightly dealt with the issue and reversed the findings of the Assessing Officer who had treated the interest earned as 'income from other sources'. The test is whether the activity which is taken up for setting up of the business and the funds which are garnered are inextricably connected to the setting up of the plant. The clue is perhaps available in section 3 which states that for newly set up business the previous year shall be the period beginning with the date of setting up of the business. Therefore, as per the provision of section 4 which is the charging section, income which arises to an assessee from the date of setting of the business but prior to commencement is chargeable to tax depending on whether it is of a revenue nature or capital receipt. The income of a newly set up business, post the date of its setting up can be taxed if it is of a revenue nature under any of the heads provided under section 14 in chapter IV. For an income to be classified as income under the head 'profits and gains of business or profession' it would have to be an activity which is in some manner or form connected with business. The word 'business' is of wide import which would also include all such activities which coalesce into setting up of the business. Once it is held that the assessee's income is an income connected with business, which would be so in the present case, in view of the finding of fact by the Commissioner (Appeals) that the monies which were inducted into the joint venture company by the joint venture partners were primarily infused to purchase land and to develop infrastructure then it cannot be held that the income derived by parking the funds temporarily with bank, will result in the character of the funds being changed, inasmuch as the interest earned from the bank would have a huge difference than that of business and be brought to tax under the head 'income from other sources'. It is well-settled that an income received by the assessee can be taxed under the head 'income from other sources' only if it does not fall under any other head of income as provided in section 14. The head 'income from other sources' is a residuary head of income. Since the income was earned in a period prior to commencement of business it was in the nature of capital receipt and hence was required to be set off against pre-operative expenses.
- The very purpose of constitution of the assessee was to act as a Special Purpose Vehicle (SPV) created by the Government of India and Government. of West Bengal in the form of joint venture with equal equity participation for implementation of rapid transport infrastructure in Kolkata. Both the Central and the State Governments are to provide requisite finances for implementation of the said project. The funds from the Central and State Governments flow directly to the assessee-company as equity and subordinate debt/loans. The objective is to create and maintain a fund for the development of infrastructural assets on a continuing basis and, therefore, the assessee is a SPV formed by the Government of India and Government of West Bengal as per the guidelines; there is

no profit motive as the entire fund entrusted and the interest accrued therefrom on deposits in bank though in the name of the assessee has to be applied only for the purpose of welfare of the State as provided in the guidelines. Therefore, considering the factual position discussed above, the assessee has rightly set off the interest income against the pre-operative expenses in its books of account and therefore the order passed by the Commissioner (Appeals) is confirmed.