

Interest earned out of the share application money deposited in the bank due to the statutory requirement is inextricably linked with raising of share capital and thus adjustable towards share issue expenditure – Supreme Court

Background

Recently, the Supreme Court in the case of Shree Rama Multi Tech Ltd¹ (the taxpayer) held that interest income earned out of the share application money is allowed to be set off against the share issue expenditure since the taxpayer was statutorily required to keep the share application money in the bank till the allotment of shares was complete. The interest earned was inextricably linked with the requirement of the company to raise share capital and was thus adjustable towards the expenditure involved for the share issue.

The Supreme Court also held that the purpose of deposit of share application money received on share issue was not to earn additional income but to comply with the statutory requirement and interest accrued on such deposit is merely incidental.

Facts of the case

- The taxpayer is engaged in the manufacture of multilayer tubes and other specialty packaging and plastic products. During the year under consideration², the taxpayer had come out with the initial public issue and the amount of share application money received was deposited with the banks on which interest of INR 17.13 million was earned which was shown in the return of income originally filed as income from other sources.

- Even though initially the income from the interest was shown as income from other sources in the return of income, however, the taxpayer had raised an additional ground before the Tribunal to allow the set off of such interest against the share issue expenditure. The issue was examined by the Tribunal and was set aside for fresh adjudication by the Assessing Officer (AO).
- During the course of fresh proceedings, an opportunity was given to the taxpayer to file the details of interest on share application money. Subsequently, the taxpayer has provided the same. On verification of the same, it reveals that the taxpayer had earned the interest income on Fixed Deposit Receipts (FDRs) placed with the bank, however, the period for which such FDRs were placed and the specific period of the interest earned was not found to have been mentioned. The AO held that it is not possible to identify as to what portion of interest earned on FDRs was relating to the period prior to the allotment of shares or after the allotment of shares.
- Keeping in view the specific guidelines of the Tribunal in this regard and in the absence of specific working of interest for pre-allotment and post-allotment, the claim of the taxpayer was not allowed by the AO and added to the total income under the head income from the other sources as was declared in the original return of income filed by the taxpayer.
- The Commissioner of Income-tax (Appeals) affirmed the findings of the AO in not allowing set off of interest income from share application money.

¹ CIT v. Shree Rama Multi Tech Ltd (Civil Appeal 6391 of 2013) – Taxsutra.com

² The dispute in the present case relates to Assessment Years 1999-2000, 2000-01 and 2001-02

- The Tribunal and Gujarat High Court held the decision in favour of the taxpayer with respect to the deduction on account of interest income.

Supreme Court's decision

- In the present case, the taxpayer was statutorily required to keep share application money in the separate account till the allotment of shares was completed. Interest earned on such separately kept amount was to be adjusted towards expenditure for raising share capital. The Supreme Court observed that interest earned was inextricably linked with the requirement of the company to raise share capital and was thus adjustable towards the expenditure involved for the share issue.
- Though the tax department contended that part of the share application money would normally have to be returned to unsuccessful applicants, and therefore, the entire share application money would not ultimately be appropriated by the company, insofar as present case is concerned, the Supreme Court do not see how this factor would make any significant difference.
- Interest earned from share application money statutorily required to be kept in separate account was being adjusted towards the cost of raising share capital. In that view of the matter, the Supreme Court are of the opinion that the High Court was right in allowing such deduction.
- The Supreme Court in the case in Bokaro Steel Ltd.³ observed that the company was set up to produce steel. When the construction of the plant was yet not completed, the company earned interest on advances to the contractor, rent from quarters let out to employees of the contractor as well as other income such as hire charges on plant and machinery let out to the contractor, royalty on stones removed from its land. It was in this background that the Supreme Court held that the amounts were directly connected to and incidental to construction of the plant by the company, amounts were capital receipts and not income from any independent source. The said decision was followed in Karnal Cooperative Sugar Mills Ltd.⁴

- The common rationale that is followed in all these decisions is that if there is any surplus money which is lying idle and it has been deposited in the bank for the purpose of earning interest then it is liable to be taxed as income from other sources but if the income accrued is merely incidental and not the prime purpose of doing the act in question which resulted into accrual of some additional income then the income is not liable to be assessed and is eligible to be claimed as deduction.
- The issue of share relates to the capital structure of the company, and hence expenses incurred in connection with the issue of shares are to be capitalised because the purpose of such deposit is not to make some additional income but to comply with the statutory requirement, and interest accrued on such deposit is merely incidental.
- Accordingly, it has been held that the High Court was right in upholding the decision of the Tribunal that the interest income earned out of the share application money is liable to be set off against the share issue expenditure.

Our comments

The issue with respect to tax treatment of interest earned out of the share application money deposited with a bank due to a statutory requirement, has been a matter of debate before the Courts.

The Supreme Court in the case of Tuticorin Alkali Chemicals & Fertilizers Ltd.⁵ held that if funds have been borrowed for setting up of a plant and if the funds are 'surplus' and by virtue of that circumstance they are invested in fixed deposits, the income earned in the form of interest will be taxable under the head 'income from other sources'. On the other hand, the Supreme Court in the case of Bokaro Steel Ltd. held that if income is earned, whether by way of interest or in any other manner on funds which are otherwise 'inextricably linked' to the setting up of the plant, such income is required to be capitalised to be set off against pre-operative expenditure.

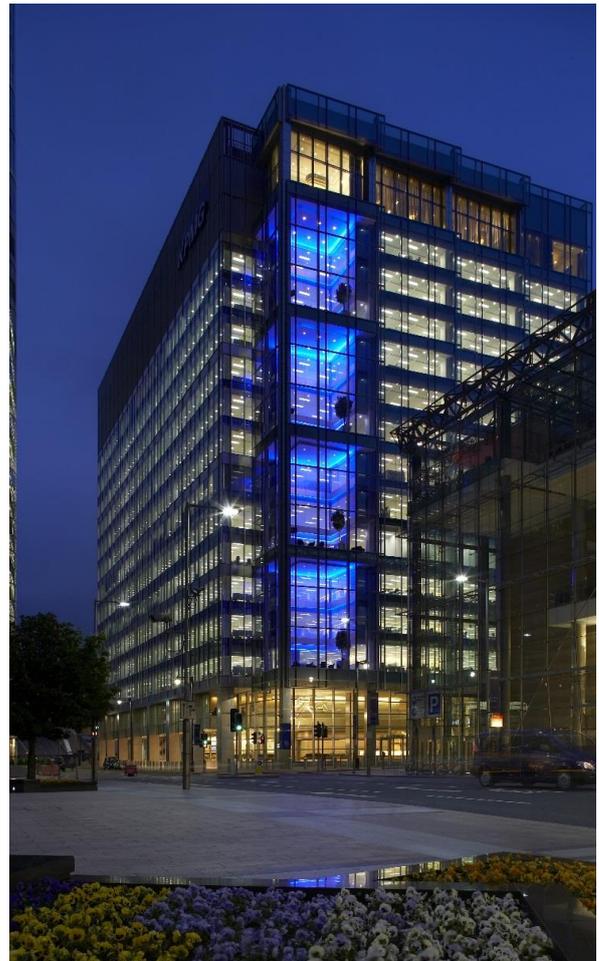
³ CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315 (SC)

⁴ CIT v. Karnal Cooperative Sugar Mills Ltd. [2000] 243 ITR 2 (SC)

⁵ Tuticorin Alkali Chemicals & Fertilizers Ltd. v. CIT [1997] 227 ITR 172 (SC)

The Delhi High Court in the case of Indian Oil Panipat Power Consortium Ltd.⁶ held that funds infused by joint venture partners in the consortium were inextricably linked with setting up of a power plant and interest earned by the taxpayer by parking said funds temporarily with the bank cannot be treated as income from other sources. Since income was earned in a period prior to the commencement of business, it was in nature of capital receipt and, hence, was required to be set off against pre-operative expenditure.

In the present case, the Supreme Court followed the decision of Bokaro Steel Ltd. and observed that any surplus money which is lying idle and deposited in the bank for the purpose of earning interest is liable to be taxed as income from other sources. However, if the income accrued is merely incidental and not the prime purpose of doing the act in question which resulted into accrual of some additional income, then the income is not liable to be assessed and is eligible to be claimed as a deduction. Therefore, the interest income earned out of the share application money is liable to be set off against the share issue expenditure since the taxpayer was statutorily required to keep the share application money in the bank till the allotment of shares was complete.



⁶ Indian Oil Panipat Power Consortium Ltd. v. ITO [2009] 181 Taxman 249 (Del)

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