



## **DEL HC: Where Interest Accrues On Temporarily Parked Project Funds With A Direct Nexus To Project Setup, It Partakes The Character Of A Non-Taxable Capital Receipt**

VNG Automotive P. Ltd. was incorporated in March 1992 with the object of manufacturing and exporting ecological brake-shoes for the automotive sector. In its early years, the company raised interest-free loans of Rs. 72.69 lakhs from its directors to meet pre-operative obligations that included a USD 2,50,000 technical know-how agreement with a Singapore-based company (CDB Holding Pte. Ltd.), purchase of industrial land, advances for plant and machinery, and import of raw materials. Since not all of these payments fell due simultaneously, the balance funds were temporarily parked in bank fixed deposits. The deposits earned interest of Rs. 1,23,151/- and Rs. 2,37,770/- in the Assessment Years ('AY' or 'AYs') 1993-94 and 1994-95 respectively. The company adjusted this interest against pre-operative expenditure and returned nil income for both years.

### **Issue Involved**

In 2001, the Assessing Officer re-opened the assessments u/s 148 of the Income Tax Act, 1961, relying on the Supreme Court's ruling in Tuticorin Alkali Chemicals & Fertilizers Ltd. v. CIT (1997) 227 ITR 172. The AO treated the bank deposits as surplus funds and brought the interest to tax as income from other sources. The CIT(A) allowed the assessee's appeal, holding that the deposits were directly linked to committed business obligations and the interest was incidental to the acquisition of assets. The ITAT reversed the order of the CIT(A), finding the facts closer to Tuticorin and holding the interest taxable.

### **Held**

In the appeal thereagainst the High Court ruled in favour of the assessee on the substantive issue. The Court drew a clear doctrinal distinction between two lines of Supreme Court authority. Under Tuticorin, interest on genuinely surplus funds independently invested to earn a return was taxable as income from other sources. Under Bokaro Steel Ltd. v. CIT (1999) 236 ITR 315, where income is inextricably linked to the setting-up of a project, it takes the character of a capital receipt and must be set off against project cost rather than taxed separately.

On the facts, the Court found that the deposited funds were not surplus at all. They were earmarked for imminent business obligations: instalment payments under the technical know-how agreement, purchase advances paid to multiple machinery suppliers, and land acquisition. The temporary parking of funds in fixed deposits was, in the Court's opinion, merely incidental and necessary for efficient financial management pending deployment. The nexus between the funds and the project being established, the interest was a capital receipt. The ITAT order was set aside, and the interest was directed to be capitalised and adjusted against pre-operative expenditure.

### **Citation**

VNG Automotive P. Ltd. v. ACIT | [TS-508-HC-2026(DEL)]

### **Our comments**

The principles in this regard are well-settled by the two Supreme Court decisions considered by the Court. It is for the assessee, to establish on facts, under which case law it falls. A direct nexus with capital expenditure/activity would help the tax payer to establish the income as tax-free required to be set off against corresponding capital cost.