



## Tax alert: Interest earned on fixed deposit receipts taxable as business income

27 July 2023

The Amritsar Bench of the Income-tax Appellate Tribunal has rendered its decision that interest earned by the taxpayer on fixed deposit receipts (FDRs) kept with the bank as margin money for obtaining letter of credit in relation to foreign transaction, is taxable as business income.

### In a nutshell



The interest earned on fixed deposits had immediate nexus with the business of the taxpayer i.e., import of edible oil and its resale. It was not a case of surplus and idle funds of the taxpayer having been invested or parked in FDRs of long or short term maturity.



The investment in fixed deposit of the taxpayer were duly utilised for formation of FLCs in relation to the foreign transaction. Further, in export and import, the investments are utilised in short term investments and there is no fixed time of investment related to generation of interest out of the said investment.



Separately, based on facts, it was held that high sea sale of goods by the taxpayer was not speculative in nature since, the entire transaction went through by proper delivery of the goods during purchase and the documents were provided for evidence of delivery of goods related to high sea sale.



Scroll down to read the detailed alert

## Background:

- The taxpayer<sup>1</sup> is a company engaged in the business of trading crude palm oil (import of oil and its resale). For import of oil, the taxpayer necessarily needs to open Foreign Letters of Credit (FLCs) and for that fixed deposit receipts (FDRs) have to be necessarily pledged as margin with the bank, which also holds a lien on the same.
- During the Financial Year (FY) 2012-13, corresponding to Assessment Year (AY) 2013-14, the taxpayer earned interest on FDRs kept with the bank as margin money for obtaining FLCs required for the import of oil. The taxpayer treated the interest earned on FDRs as business income and adjusted the same with loss of “high sea sale” of imported goods.
- During the course of audit proceedings, under section 143(3) read with section 263 [relating to revision of orders prejudicial to Revenue] of the Income-tax Act, 1961 (ITA), the Assessing Officer (AO), amongst others, treated the interest as income from other sources.
- Aggrieved, the taxpayer filed an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)] who rejected the observations of the AO and treated the income earned on FDRs as business income.
- Aggrieved by the CIT(A)'s order, the Revenue filed an appeal before the Amritsar Bench of the Income-tax Appellate Tribunal (ITAT).

## Decision of the ITAT:

The ITAT noted /observed the following:

- The CIT(A) while allowing the taxpayer's appeal had observed the following:
  - The taxpayer's business of import of oil and its resale was not in doubt. For import of oil, the taxpayer was required to open FLCs and for that, FDRs were mandatorily required to be pledged as margin with the bank, which held a lien on the same. Such FDRs also earned interest which came to the credit of the business of the taxpayer.
  - The interest earned on fixed deposits had immediate nexus with the business of the taxpayer i.e., import of edible oil and its resale. It was not a case of surplus and idle funds of the taxpayer having been invested or parked in FDRs of long or short term maturity.
  - An earlier ruling<sup>2</sup> of the Supreme Court (SC) was often used<sup>2</sup> by the AOs to tax interest as 'Income from Other Sources'. However, the said decision dealt with interest earned on short-term investment of funds borrowed for setting up of factory during construction of factory i.e., before commencement of business. It was held that such interest had to be assessed as 'Income from Other Sources' and that it could not be said that interest income was not taxable on the ground that it would go to reduce interest on borrowed amount which would be capitalised.

Subsequent to the aforesaid ruling of the SC, the issue of taxation of interest on short-term investment was decided<sup>3</sup> differently on the theory of nexus with the business. The issue had also come up for consideration before the Delhi High Court (HC) in an earlier ruling<sup>4</sup> where the issue for consideration was whether interest earned on FDRs should be taken into consideration while computing the benefit under section 80HHC [relating to deduction in respect of profits retained for export business] of the ITA and

---

<sup>1</sup> DCIT vs. G. G. Continental Traders (P.) Ltd. [2023] 151 taxmann.com 384 (Amritsar - Trib.)

<sup>2</sup> Tuticorin Alkali Chemicals & Fertilisers Ltd. v. CIT [1997] 227 ITR 172 (SC)

<sup>3</sup> CIT v. Karnal Co-operative Sugar Mills Ltd. [2001] 118Taxman489 (SC) and CIT v. Bokaro Steel Ltd. [1999] 236 ITR 315 (SC)

<sup>4</sup> CIT v. Shahi Export House [2010] 195 taxman 163 (Delhi HC)

netting of the interest should be allowed by deducting the same from the interest paid by the taxpayer on certain guarantees made by it from banks.

- The decisions of HCs<sup>5</sup> relied on by the Revenue were factually not similar with the taxpayer's issues. Reliance had to be drawn to an earlier ruling<sup>6</sup> where interest was taken as expense and not as 'Income from Other Sources', and the following was upheld:

"If the interest received is found to have a nexus with the business, still it remains to be excluded from the profits of the business by virtue of Explanation (baa)(1), but the claim is that the quantum of such interest income to be excluded must be determined in accordance with the computation provisions relating to business by allowing expenditure by way of interest which bears a nexus with the interest receipt. The computation provisions included section 37(1) under which any expenditure incurred or laid wholly and exclusively for the purpose of the business is to be allowed as a deduction. Therefore, any expenditure incurred which has a connection or nexus with interest receipt has to be allowed as a deduction and only the balance can be excluded from the business profits."

- The investment in fixed deposit of the taxpayer were duly utilised for formation of FLCs in relation to the foreign transaction. Further, in export and import, the investments are utilised in short term investments and there is no fixed time of investment related to generation of interest out of the said investment. Reliance was also placed on an earlier ruling<sup>7</sup> of the Amritsar Bench of the ITAT in this regard.

In view of the above, the ITAT confirmed the order of CIT(A) treating interest earned on FDRs as business income.

#### **Comments:**

Characterisation of interest income as business income or income from other sources has been a subject matter of litigation.

This ruling, based on the facts of the case, has held that interest income earned on FDRs pledged as margin with the bank for obtaining FLCs, is taxable as business income and not as income from other sources.

Separately, it may be pertinent to note this ruling has also, based on facts, held that high sea sale of goods by the taxpayer was not speculative in nature since, the entire transaction went through by proper delivery of the goods during purchase and the documents were provided for evidence of delivery of goods related to high sea sale.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.

---

<sup>5</sup> Mantola Co-operative Thrift & Credit Society Ltd. vs. CIT [2014] 50 taxmann.com 278 (Delhi HC) and CIT vs. Bhawal Synthetics (India) Udaipur [2017] 81 taxmann.com 478 (Rajasthan HC)

<sup>6</sup> CIT v. Shahi Export House [2010] 195 taxman 163 (Delhi HC)

<sup>7</sup> Dy. CIT v. G.H. Crop. Science (P.) Ltd. [IT Appeal Nos. 56 and 84 (Asr.) of 2020, dated 23-2-2023] (Amritsar ITAT)



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) for a more detailed description of DTTL and its member firms.

This material and the information contained herein prepared by Deloitte Touche Tohmatsu India LLP (DTTI LLP) is intended to provide general information on a particular subject or subjects and is not an exhaustive treatment of such subject(s). This material contains information sourced from third party sites (external sites).

DTTI LLP is not responsible for any loss whatsoever caused due to reliance placed on information sourced from such external sites. None of DTTI LLP, Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the “Deloitte Network”) is, by means of this material, rendering professional advice or services. This information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser.

No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this material.

©2023 Deloitte Touche Tohmatsu India LLP. Member of Deloitte Touche Tohmatsu Limited