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

\+ ITA 1077/2018

THE PR. COMMISSIONER OF INCOME TAX -4 ..... Appellant

Through: Mr. Kunal Sharma, SSC.

Versus

INDOCOUNT INDUSTRIES LTD ..... Respondent

Through: Mr. Om Prakash Mody, Mr. Avinash Mody, Mr. Ninad Dogra & Mr. Siddhant Sood, Advs.

CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE PURUSHAINDRA KUMAR KAURAV

<u>O R D E R</u>

% **04.04.2024**

<u>CM APPL 40122/2018 (28 days delay in filing)</u>

1. Bearing in the mind the disclosures made, the delay of 28 days in filing the appeal is condoned.

2. The application shall stand disposed of.

<u>ITA 1077/2018</u>

3. The **Principal Commissioner of Income Tax**[1] impugns the judgment dated 09 February 2018 by the Income Tax Appellate Tribunal [**"ITAT"**] and posits the following solitary question for our consideration:-

[1] PCIT

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> "2.1 Whether ld. ITAT is legally justified in holding sales tax subsidy granted by the State Government to meet manufacturing and other expenditure debited in profit and loss account is capital in nature?"

4. The question arises in the backdrop of various VAT refunds and interest subsidies obtained by the assessee company in the year in question and claiming it to be exempt, since according to it they were liable to be treated as capital receipts. The subsidies and refunds owe their genesis to an incentive scheme framed by the State of Maharashtra entitled **Package Scheme of Incentives**[2]. The historical background in which PSI came to be introduced in the State of Maharashtra has been noticed in some detail by the **Commissioner of Income Tax (Appeals)**[3]. We deem it appropriate therefore to extract the following from its decision:-

> "4.2 I have gone through various submissions made by the appellant and material produced before me. I have also perused various documents and government scheme relating the subsidy granted to the appellant and also considered the arguments of the AO while disallowing the appellant's claim and find that government of Maharashtra has been promoting various promotional scheme of incentives popularly known as package scheme of incentives (PSI) to disperse industries in remote and backward area categorizing them as A B C D D+ and other backward areas/Zones. Based on such demarcation the government gives subsidies which may vary from zone to zone. These schemes are effective and promoted since 1964 and have been extended from time to time. In the instant case the government of Maharashtra promoted scheme of incentive effective 2001 whose object as has been stated in preamble is reproduced as under:
>
> > "*In order to encourage the dispersal of industries to the less developed areas of the State, Government has been giving a Package of Incentives to new/Expansion Units set up in the developing region of the State since 1964 under a Scheme popularly known as the Package Scheme of Incentives.*"
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> The Package Scheme of Incentives, introduced in 1964, was amended from time to time. The last amended Scheme, commonly known as the 1993 Scheme was operative from the 1st October, 1993

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[2] PSI

[3] CIT(A)

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to 31st March, 2001. Government recognizes the need to address the emerging challenges in the phase of second generation economic reforms, the need for encouraging hi-tech and sunrise industries in the Information Technology and other fields to reap the strengths of the State in its developed areas, and the facilitate exports from the State. In the wake of the national consensus for abolishing the sales tax based incentives, the further rationalization of incentives, their scales and mode of release was under the consideration of the Government. New Scheme, viz. The Package Scheme of Incentives, 2001 (hereinafter referred to as the 2001 Scheme) for intensifying and accelerating the process of dispersal of industries to the less developed regions and promoting high-tech industry in developed areas of the State coupled with the object of generating mass employment opportunities.

Thus prima facie what is envisaged in the package scheme of incentive is development of backward area, modernization of industries and employment generation in such backward area on a uniform basis. Based on 2001 scheme the government has also promoted mega project scheme where capital requirement and employment generation is higher for which the government had come out with mega project scheme (PSI) 2001 vide Government Resolution, I.E. & L.D., dated 2/6/2005 based on the level of Fixed Capital Investment or employment generation. The State Government has also declared the Industrial, Investment and Infrastructure Policy-2006 so as to ensure sustained industrial growth, further improve the conducive investment climate in the State, provide a global competitive edge to the State's industry and promote employment and balanced regional development. The Policy envisages grant of a customized package of incentives to Mega Projects. While the Package Scheme of Incentives 2007 declared subsequently outlines the eligibility criteria and monitoring mechanism for administering the incentives, the issue of putting in place a mechanism for sanction and disbursement of Industrial Promotional Subsidy (IPS) as part of the customized packages to mega Projects under PSI 2001 and 2007 was under consideration of the Government.

In line with the aforesaid government policy the appellant company decided to set up a plant at Plot No. T-3, Kagal Hatkanangale Five Star Industrial Area, MIDC, Tal. Hatkanangale, Dist. Kolhapur, to which approval was granted by the State Government vide letter no. HPC-1107/C.R.202/Ind-8 dated 13-07-2007, a copy whereof has been placed at page 75 and 76 of the APB (hereafter "the said mega project") and is kept on record. In relation to the said mega project, an "Eligibility Certificate" No. 42 dated 12-12-2007 has also been issued to the appellant company, a copy of which has been placed at page 77 to 84 of the APB and is kept on record. According to the said eligible certificate the Government of

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Maharashtra would give to the appellant company an "Industrial Promotion Subsidy" (IPS) equivalent to 100% of "eligible investments" made by it in the said mega project or the taxes paid by it to the State Government within a period of 7 years, whichever is lower. The eligibility certificate also certifies the quantum of eligibility worked out as per table given hereunder:

Sr.	Particular	Assets	Maximum Admissible fixed capital investment	Actual accepted investment made from 17.6.2005 to 31.08.2007
7	Capital cost in lacs	Land & site Development	275.00	258.53
		Building	2,688.00	2,688.00
		Plant & Machinery	11,823.00	11,823.00
		Others	3,762.00	3,762.00
		Contingency	1,452.00	00.00
		Total	20,000.00	18531.53

Perusal of the eligible amount worked out and accepted for subsidy is calculated on the basis of amount of capital investments made by the appellant company in capital assets and in the instant case the same is worked out at Rs. 18,531.53 lacs. True is the fact that the amount of subsidy is staggered for disbursal in seven years time (Maximum) but it is equally true that amount of subsidy is based only of capital investment and has nothing to do with future transactions/ sales or production. Thus on perusal of eligibility certificate it is not in dispute that the subsidy granted by the government is based on capital cost and that to before the commercial production has been started. Thus in my considered opinion the amount in question (subsidy) could not be linked to profit of the company or to the working capital requirement of the appellant company and hence the same is on capital account. This proposition is also supported by the Board Circular 142 dated 1st August, 1974 where it has been stated as under:

"The Board had occasion to consider whether the amount of subsidy received under 10% Central Outright Grant of Subsidy Scheme for industrial units to be set up in certain selected backward districts/ areas would constitute revenue receipt or capital receipt in the hands of the recipients for the

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purpose of income-tax.

I am directed to say that the payment of subsidy under the scheme is primarily given for helping the growth of industries and not for supplementing their profits. Under the scheme the quantum of subsidy is determined with reference to the fixed capital and not the profits. The working capital has been specifically excluded from the computation of fixed capital for this purpose. One of the conditions for the grant of the subsidy is that the undertaking must remain in production at least for a period of five years after it goes into production. Since the subsidy is intended to be a contribution towards capital outlay of the industrial unit the Board are advised that such subsidy can be regarded as being in the nature of capital receipt in the hands of the recipient."

On appreciation of circular 142 it is quite clear that where the subsidy is provided to help growth of industries and backward area and that when the subsidy is provided on the basis of fixed capital and not the profit the same should be regarded as capital receipt not eligible to tax."

5. As was noticed by the CIT(A), it was pursuant to the aforesaid Government policy that the respondent-assessee set up its plant in the District of Kolhapur in the State of Maharashtra. Pursuant to the approval granted by that State Government on 13 July 2007, it was also granted the Mega Project Eligibility Certificate on 12 December 2007. The CIT(A) in the tabular statement extracted hereinabove has also taken note of the investments which came to be made by the respondent-assessee during the period 17 June 2005 to 31 August 2007.

6. Addressing submissions in support of the appeal, Mr. Sharma submitted that the nature of subsidies were clearly liable to be treated as revenue receipts since they came to be disbursed during and after the establishment of the unit of the assessee.

7. We find ourselves unable to sustain the aforenoted submissions bearing in mind the following determinative principles which were enunciated by the Supreme Court in **Commissioner of Income Tax,**

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Madras vs. Ponni Sugars and Chemicals Limited[4]. We deem it apposite to extract the following passages from that decision:-

> "**13.** In our view, the controversy in hand can be resolved if we apply the test laid down in the judgment of this Court in Sahney Steel and Press Works Ltd. [(1997) 7 SCC 764 : (1997) 228 ITR 253] In that case, on behalf of the assessee, it was contended that the subsidy given was up to 10% of the capital investment calculated on the basis of the quantum of investment in capital and, therefore, receipt of such subsidy was on capital account and not on revenue account. It was also urged in that case that subsidy granted on the basis of refund of sales tax on raw materials, machinery and finished goods were also of capital nature as the object of granting refund of sales tax was that the assessee could set up new business or expand his existing business. The contention of the assessee in that case was dismissed by the Tribunal and, therefore, the assessee had come to this Court by way of a special leave petition. It was held by this Court on the facts of that case and on the basis of the analyses of the Scheme therein that the subsidy given was on revenue account because it was given by way of assistance in carrying on of trade or business. On the facts of that case, it was held that the subsidy given was to meet recurring expenses. It was not for acquiring the capital asset. It was not to meet part of the cost. It was not granted for production of or bringing into existence any new asset. The subsidies in that case were granted year after year only after setting up of the new industry and only after commencement of production and, therefore, such a subsidy could only be treated as assistance given for the purpose of carrying on the business of the assessee. Consequently, the contentions raised on behalf of the assessee on the facts of that case stood rejected and it was held that the subsidy received by Sahney Steel could not be regarded as anything but a revenue receipt. Accordingly, the matter was decided against the assessee.
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> **14.** The importance of the judgment of this Court in Sahney Steel case [(1997) 7 SCC 764 : (1997) 228 ITR 253] lies in the fact that it has discussed and analysed the entire case law and it has laid down the basic test to be applied in judging the character of a subsidy. That test is that the character of the receipt in the hands of the assessee has to be determined with respect to the purpose for which the subsidy is given. In other words, in such cases, one has to apply the purpose test. The point of time at which the subsidy is paid is not relevant. The source is immaterial. The form of subsidy is immaterial. The main eligibility condition in the Scheme with which we are concerned in this case is that the incentive must be utilised for repayment of loans taken by the assessee to set up new units or for

[4] (2008) 9 SCC 337

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substantial expansion of existing units. On this aspect there is no dispute. If the object of the Subsidy Scheme was to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the assistance under the Subsidy Scheme was to enable the assessee to set up a new unit or to expand the existing unit then the receipt of the subsidy was on capital account. Therefore, it is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. The form of the mechanism through which the subsidy is given is irrelevant.

15. In the decision of the House of Lords in Seaham Harbour Dock Co. v. Crook [(1931) 16 TC 333] Harbour Dock Co. had applied for grants from the Unemployment Grants Committee from funds appropriated by Parliament. The said grants were paid as the work progressed; the payments were made several times for some years. Dock Co. had undertaken the work of extension of its docks. The extended dock was for relieving the unemployment. The main purpose was relief from unemployment. Therefore, the House of Lords held that the financial assistance given to the Company for dock extension cannot be regarded as a trade receipt. It was found by the House of Lords that the assistance had nothing to do with the trading of the Company because the work undertaken was dock extension. According to the House of Lords, the assistance in the form of a grant was made by the Government with the object that by its use men might be kept in employment and, therefore, its receipt was capital in nature. The importance of the judgment lies in the fact that the Company had applied for financial assistance to the Unemployment Grants Committee. The Committee gave financial assistance from time to time as the work progressed and the payments were equivalent to half the interest for two years on approved expenditure met out of loans. Even though the payment was equivalent to half the interest amount payable on the loan (interest subsidy) still the House of Lords held that money received by the Company was not in the course of trade but was of capital nature. The judgment of the House of Lords shows that the source of payment or the form in which the subsidy is paid or the mechanism through which it is paid is immaterial and that what is relevant is the purpose for payment of assistance. Ordinarily such payments would have been on revenue account but since the purpose of the payment was to curtail/obliterate unemployment and since the purpose was dock extension, the House of Lords held that the payment made was of capital nature."

8. As is manifest from the principles which came to be elucidated in *Ponni Sugars*, the question posed for our consideration is liable to

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be answered bearing in mind the "purpose test" as formulated. The Supreme Court pertinently observed that it is the purpose for which subsidy is given which would be critical and of vital import. It had further observed that the form of subsidy is wholly immaterial.

9. As we read the judgment of the Supreme Court we find that it proceeded to hold that if the object of the assistance extended in the shape of subsidy or otherwise be intended to enable the assessee to set up a new unit or expand an existing unit, the receipt would be on the capital account. If the object of the subsidy scheme, however, were to be restricted to facilitating the assessee to run the business more profitably then the receipt would be on the revenue account.

10. From the undisputed facts which have come to be noticed by the CIT(A), we find that the receipt of incentives and subsidies was directly connected to the establishment of a new industrial unit in a backward area.

11. Viewed in that light, it is evident that the conclusions recorded by the CIT(A) as affirmed by the ITAT, namely, that the receipt of the subsidy was on the capital account, merits no interference.

12. The appeal raises no substantial question of law. The appeal consequently fails and shall stand dismissed.

YASHWANT VARMA, J.

PURUSHAINDRA KUMAR KAURAV, J.

APRIL 04, 2024

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