



T.C.A.No.285 of 2021

,IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 17.12.2025

CORAM :

THE HONOURABLE MR. MANINDRA MOHAN SHRIVASTAVA,
CHIEF JUSTICE
AND
THE HONOURABLE MR.JUSTICE G.ARUL MURUGAN

T.C.A.No.285 of 2021

The Dharmapuri District Co-operative
Milk Producers Union Ltd.,
Post Box No.13, Salem Main Road,
Krishnagiri - 635 001.

Appellant

Vs

The Deputy Commissioner of Income Tax,
Circle - 3, Salem.

Respondent

Prayer: Appeal filed under Section 260A of the Income Tax Act, 1961
against the order of the Income Tax Appellate Tribunal "C" Bench,
Chennai, dated 24.10.2018 in ITA No.621/Mds/2015.

For Appellant: Mr.T. Vasudevan

For Respondent: Mr.V.Mahalingam
Sr. Standing Counsel
and
Mr.P.E.R.Mangala Suvigaran
Jr. Standing Counsel



T.C.A.No.285 of 2021

JUDGMENT

(Order of the Court was made by the Hon'ble Chief Justice)

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Heard learned counsel for the parties.

2. This appeal was admitted on the following substantial questions of law:

"(i) Whether on the facts and in the circumstances of the case the Appellate Tribunal was justified in law in holding that the grant-in-aid/subsidy received from the Government under a rehabilitation scheme was a revenue?

(ii) Whether the conclusion of the Tribunal was perverse in law considering that the purposive test was misapplied and Apex Court decision in Ponni Sugars case was held to support the Revenue?

(iii) Whether the Tribunal was right in law in not considering that the purpose test was to be seen in the context of the subsidy granted was to keep the society operational in the interests of the milk growers and not profitability and hence the grant was a capital receipt?

(iv) Whether the Tribunal was right in law in not considering that the assessee as a primary co-operative society satisfies the parameters for



T.C.A.No.285 of 2021

deduction u/s.80P(2)(b) and thus ought to have granted the deduction?"

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3. The appellant is a co-operative society engaged in procurement of milk, manufacturing by-products and distribution of milk and related items and is a subsidiary to Aavin (*Apex Co-operative Society - engaged in distribution of milk*). The appellant procures milk in Dharmapuri and Krishnagiri Districts from 536 Primary Milk Co-operative Societies daily, which in turn, collect milk from individual members at village level. The milk collected is transported to Dharmapuri and Denkanikotta Milk Chilling Centres and Krishnagiri Feeder Balancing Dairy. The appellant pays for the procurement on the basis of quality of milk. As a part of the process, the appellant also implements milch animal schemes, society infrastructure schemes and gives veterinary health services to the growers free of cost. The appellant also supplies milch feeds at nominal rate to the growers at the village level. The appellant also provides training, education and awareness programme about clean milk production. The appellant procures milk from primary centres at village level and acts as a bridge between the growers and the marketing activity to reach the end consumer.



T.C.A.No.285 of 2021

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4. For the assessment year 2007-2008, the appellant filed its return of income admitting a loss of Rs.58,46,770/-. The assessment was completed under Section 143(3) of the Income Tax Act, 1961 (*the Act*). A sum of Rs.3,50,00,000/- received as grant in aid was treated as revenue receipt. Amongst other things, this addition was assailed by the appellant by filing an appeal before the Commissioner of Income (Appeals) and, thereafter, before the Income Tax Appellate Tribunal, though unsuccessfully. This has given rise to the instant appeal.

5. The first, second and third substantial questions of law are substantially the same.

6. The question which arises for consideration is whether the grant in aid/subsidy which was received by the appellant from the Government under rehabilitation scheme should be treated as revenue receipt in the hands of the assessee or as a capital receipt taking it out of the purview of the taxable income.

7. Before we take into consideration the details of the scheme



T.C.A.No.285 of 2021

under which the financial assistance was provided to the appellant and which the appellant claims in the nature of capital receipt, we consider it apposite to refer to the Supreme Court decision in the case of **Commissioner of Income Tax v. Ponni Sugars & Chemical Limited and others**¹, wherein the principles applicable in order to ascertain whether the receipt is in the nature of revenue receipt or capital receipt was enunciated.

8. In *Ponni Sugars & Chemical Limited* (supra), their Lordships in the Supreme Court examined the scheme applicable in that case under which the financial assistance was provided as below:

"(i) Benefit of the incentive subsidy was available only to new units and to substantially expanded units, not to supplement the trade receipts.

(ii) The minimum investment specified was Rs.4 crores for new units and Rs.2 crores for expansion units.

(iii) Increase in the free sale sugar quota depended upon increase in the production capacity. In other words, the extent of the increase of free sale sugar quota depended upon the increase in the production capacity.

(iv) The benefit of the scheme had to be utilized only for repayment of term loans."

¹(2008) 9 SCC 337



T.C.A.No.285 of 2021

WEB COPY

9. The Supreme Court took note of the nature of controversy by observing that the incentives were given through the mechanism of price differential and the duty differential. According to the department therein, price and costs are essential items that are basic to the profit making process and any price related mechanism would normally be presumed to be revenue in nature. Further, the assessee's case was that what was relevant to decide the character of the incentive is the purpose test and not the mechanism of payment.

10. In the aforesaid factual premise and the issue raised for consideration, the Supreme Court proceeded to examine the legal position as below:

"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



T.C.A.No.285 of 2021

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.

14. The importance of the judgment of this Court



T.C.A.No.285 of 2021

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 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



T.C.A.No.285 of 2021

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.



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T.C.A.No.285 of 2021

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.

16. One more aspect needs to be mentioned. In Sahney Steel and Press Works Ltd. [(1997) 7 SCC 764 : (1997) 228 ITR 253] this Court found that the assessee was free to use the money in its business entirely as it liked. It was not obliged to spend the money for a particular purpose. In Seaham Harbour Dock Co. [(1931) 16 TC 333] the assessee was obliged to spend the money for extension of its docks. This aspect is very important. In the present case also, receipt of the subsidy was capital in nature as the assessee was obliged to utilise the subsidy only for repayment of term loans undertaken by the assessee for setting up new units/expansion of existing business.

17. Applying the above tests to the facts of the present case and keeping in mind the object behind the payment of the incentive subsidy we are satisfied that such payment received by the assessee under the Scheme was



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T.C.A.No.285 of 2021

not in the course of a trade but was of capital nature. Accordingly, the first question is answered in favour of the assessee and against the Department."

11. The Supreme Court in the aforesaid decision clearly enunciates the principle that 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.

12. Keeping in mind the aforesaid principle, we shall now examine as to what was the purpose of extending the financial assistance to the appellant in the present case.

13. The letter dated 28.09.2005 of the Ministry of Agriculture, Department of Animal Husbandry, Dairying and Fisheries, Government of India, shows that the financial assistance was part of Central Sector Plan Scheme, titled as "*Assistance to Cooperatives*" on 50:50 sharing basis between Government of India and the State Government concerned during 10th Plan period – Administrative approval for rehabilitation proposal in respect of Dharmapuri Milk Union in Tamil



T.C.A.No.285 of 2021

Nadu. The contents of the said letter, being relevant, are reproduced below:

"I am directed to refer to NDDB's letter No.FPS:AC:GOI:24748 dated 17.3.2005 submitting therewith the proposal for rehabilitation of Dharmapuri Milk Union under the Central Sector Plan Scheme 'Assistance to Cooperatives' on 50:50 sharing basis between Govt. of India & concerned State Govt. in the State of Tamil Nadu and to convey the administrative approval of Government of India for implementation of the Scheme for the Dharmapuri Milk Union in Tamil Nadu.

2. The total rehabilitation cost for Dharmapuri Milk Union is Rs.970.99 lakhs out of which Government of India's share and that of Govt of Tamil Nadu's share is Rs.485.495 lakhs each. The year-wise pattern of Central assistance is as under:

<i>Year</i>	<i>By GOI</i>
<i>2005-06</i>	<i>175.00</i>
<i>2006-07</i>	<i>175.00</i>
<i>2007-08</i>	<i>100.00</i>
<i>2008-09</i>	<i>35.495</i>
<i>Total</i>	<i>485.495</i>

3. The Government of India's share will be released depending upon availability of budgetary provision.

4. This administrative approval is subject to following



T.C.A.No.285 of 2021

conditions:-

(i) As laid down in the Administrative Approval for continuation of Central Sector Scheme 'Assistance to Cooperative' during the year 2005-06 issued vide this Ministry's letter No.20-10/02-DP dated 10.5.2005 and subsequent modification vide letter No.20-8/2003-DP dated 30.8.2005.

(ii) Milk Union should first clear up their liabilities, in the order of DCS, other Milk Unions and employers respectively.

(iii) Repayment to NDDB/State Federation/State Govt. will commence only after milk union starts making net profit.

(iv) The release of the grant in subsequent year would be subject to the performance/achievement as per fixed targets of the project.

5. The Govt. of India's share shall be routed through NDDB. The NDDB shall ensure that this amount will be released to the concerned Milk Producers' Cooperative Union only after the State Govt/Milk Union has abide by the condition laid down in para 4 above.

6. The total rehabilitation period for this Milk Union would be seven years beginning from 2005-06.

7. The progress in respect of physical and financial targets of the project under this scheme will be



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T.C.A.No.285 of 2021

monitored periodically as per O.M.No.20-15/2001-DP dated 6th July 2001 and subsequent OM of even number Dated 6th May 2005 of this Ministry.

8.This sanction is issued with the concurrent of Integrated Finance Division of this Department vide Dy.No.2163/FA/2005 dated 26.9.2005.

9. Receipt of this letter may please be acknowledged."

14. The text and tenor of the said letter leaves no manner of doubt that the financial assistance which was provided to the appellant was towards rehabilitation. One of the important conditions was that the milk union should first clear up their liabilities in the order of DCS, other milk unions and employers, respectively. On similar lines, as sanctioned by the Government of India, the Tamil Nadu Cooperative Milk Producers' Federation Limited (*Federation*) also passed an order on 14.03.2007. The conditions, on which the Federation has provided financial assistance as part of its share towards rehabilitation, are reproduced below:

"1) Deposit the amount in a separate bank account and shall not be used for any other purpose than the purposes mentioned therein.

2) Union should first clear up their liabilities in the



T.C.A.No.285 of 2021

order of DCS, other milk unions and employers respectively.

3) Repayment to NDDB/State Federation/State Government will commence only after milk union starts making net profit.

4) The release of the grant in subsequent year would be subject to the performance/achievement as per fixed targets of the project.

5) The total rehabilitation period for Dharmapuri milk union would be seven years beginning from 2005-2006.

6) The union should maintain proper accounts of the expenditure incurred and also submit the statement of audited accounts to the Govt. of India and State Government within the prescribed period.

7) The audited records of all assets (permanent and semi-permanent) acquired wholly or substantially out the grant should be available for scrutiny of audit.

8) Monthly and quarterly progress reports to be submitted to Govt. of India and State Govt. through TCMPF."

The conditions incorporated therein were similar to that contained in the sanction order of the Government of India which clearly show that the appellant was first required to clear up their liabilities in the order of DCS, other milk unions and employers.



T.C.A.No.285 of 2021

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15. Thus, it is clear that the object and purpose of grant of financial assistance and consequent receipt in the hands of the appellant was to pull it out of the financial crunch, as a part of rehabilitation. The funds were to be first utilised for clearing its loan liabilities.

16. The submission of learned counsel for the revenue that the other conditions incorporated in the letter of the Government of India and the order of the Federation indicate that the purpose of extension of financial assistance was performance related, on a closer scrutiny, is liable to be rejected. The check on performance level was only to ensure whether the financial assistance, which has been granted for rehabilitation, is being properly used or not.

17. In any case, even if we accept the submission of learned counsel for the revenue that the purpose of grant of financial assistance was also to scale up performance, in such a case, the dominant purpose shall be decisive factor for considering the nature of receipt. Quite obviously, the dominant purpose of providing financial assistance was towards rehabilitation of the loss making



T.C.A.No.285 of 2021

society/assessee and the funds were to be utilised for the purpose of clearing all loans and liabilities, which the assessee was unable to clear because of the financial stringency.

18. Therefore, in our firm view, the receipt in the hands of the appellant was capital receipt and cannot be treated as revenue receipt, in view of the principle enunciated by the Supreme Court and applying the purpose test.

19. Accordingly, the first, second and third substantial questions of law are answered in favour of the appellant and against the revenue.

20. The fourth substantial question of law would not arise for consideration for the reason that at no point of time it was raised before the Assessing Officer or the CIT(A). According to learned counsel for the appellant, there was no occasion to raise the same. However, in view of the decision which has now been rendered by this Court on the first substantial question of law, the fourth substantial question of law has become purely academic.



T.C.A.No.285 of 2021

21. The appeal is allowed in the manner and to the extent indicated above. There shall be no order as to costs.

(MANINDRA MOHAN SHRIVASTAVA, CJ) (G.ARUL MURUGAN,J)
17.12.2025

Index : Yes
Neutral Citation : Yes
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To:

- 1.The Assistant Registrar
Income Tax Appellate Tribunal
"C" Bench, Chennai.
- 2.The The Commissioner of Income Tax (Appeals).
Salem.
- 3.The Deputy Commissioner of Income Tax,
Circle-3, Salem.



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T.C.A.No.285 of 2021

THE HON'BLE CHIEF JUSTICE
AND
G.ARUL MURUGAN,J.

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T.C.A.No.285 of 2021

17.12.2025