ITEM NO.33 COURT NO.10 SECTION XIV

S U P R E M E C O U R T O F I N D I A
RECORD OF PROCEEDINGS

Petition(s) for Special Leave to Appeal (C) No.30728-30732/2017

(Arising out of impugned final judgment and order dated 13-07-2017 in ITA Nos.315-316 of 2003 & 434/2005 relating to assessment years 1995-96 to 1999-2000 passed by the High Court Of Delhi At New Delhi)

M/S. BHUSHAN STEEL LTD. Petitioner(s)

VERSUS

COMMISSIONER OF INCOME TAX DELHI Respondent(s)
(With appln.(s) for exemption from filing O.T.)

Date : 20-11-2017 These petitions were called on for hearing today.

CORAM :
HON'BLE MR. JUSTICE ARUN MISHRA
HON'BLE MR. JUSTICE ROHINTON FALI NARIMAN

For Petitioner(s) Mr. Ajay Vohra,Sr.Adv.
Ms. Kavita Jha,AOR
Mr. Bhawan Dhoopar,Adv.

For Respondent(s)

UPON hearing the counsel the Court made the following
O R D E R

Issue notice.

In the meantime, the operation of the impugned judgment shall remain stayed.

(Sarita Purohit) (Jagdish Chander)
Court master Branch Officer

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

Reserved on: 14.03.2017
Pronounced on: 13.07.2017

\+ **ITA 315/2003**
\+ **ITA 316/2003**
\+ **ITA 317/2003**
\+ **ITA 349/2003**
\+ **ITA 434/2005**

COMMISSIONER OF INCOME TAX, DELHI ..... Appellant

Versus

M/S. BHUSHAN STEELS AND STRIPS LTD..... Respondent

Through: Sh. Rahul Chaudhary and Ms. Lakshmi Gurung, Advocates, for CIT, ITA Nos.315/2003, 316/2003, 317/2003 & 349/2003.
Sh. Zoheb Hossain, Advocate, for CIT in ITA 434/2005.
Sh. Ajay Vohra, Sr. Advocate with Ms. Kavita Jha, Sh. Bhuwan Dhoopar and Ms. Roopali Gupta, Advocates, for respondent.

\+ **ITA 681/2004**
\+ **ITA 708/2004**
\+ **ITA 755/2004**
\+ **ITA 725/2004**

COMMISSIONER OF INCOME TAX, DELHI ..... Appellant

Versus

M/S. VARDHMAN INDUSTRIES LTD. ..... Respondent

Through: Sh. Zoheb Hossain, Advocate, for CIT.

Sh. Ajay Vohra, Sr. Advocate with Ms. Kavita Jha, Sh. Bhuwan Dhoopar and Ms. Roopali Gupta, Advocates, for respondent.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE NAJMI WAZIRI

MR. JUSTICE S. RAVINDRA BHAT

%

1. The following common question arises in these batch of nine appeals arising from orders of the Income Tax Appellate Tribunal ("ITAT") hereafter:

> *"Whether the ITAT was correct in law in holding that the amount received by the assessee by way of exemption of sales tax payments was not a trading receipt but was a capital receipt, hence not liable to tax?"*

2. The main order- in the case of the assessee/respondent, Bhushan Steel, was made for AY 1995-96 and was followed in all succeeding assessment years; the same is the case with the appeals relating to the other assessee, M/s. Vardhman Industries Ltd. [hereafter "Vardhman"] – where the ITAT followed its decision in M/s. Bhushan Steels and Strips Ltd. [hereafter "Bhushan"] appeals. For the purpose of easy reference and convenience, the facts which are stated comprehensively in Bhushan's case (and which includes the relevant parts of the same industrial policy of the State of UP for 1990 as amended in 1991) are discussed from appeals arising out of the first order for AY 1995-96 (in Bhushan's case).

3. Bhushan was running the business of manufacture of cold rolled/galvanized steel strips and sheets etc. Its two units, namely, cold rolling, coal units and galvanized unit was located at Sahibabad (Distt. Ghaziabad – UP). The area was noticed as a "backward" area. The assessees Bhushan and Vardhman, claimed that in terms of Notification No.ST-2-7558/X- 1981-UP Act-XV/48-Order 85 dated 26.12.1983, the UP Government, in exercise of powers under Section 4-A of the *UP Sales Tax Act, 1948* read with Section 221 of *UP General Clauses Act, 1904* granted exemption from payment of the sales tax in respect of any goods manufactured in an industrial unit which is a new unit located in a specified backward area, and that such exemption was allowed for a period of six years. It was stated, by both assessees, that new units went into production on and w.e.f. 01.04.1990; the eligibility certificate in respect of these units effective from 07.03.1990 was issued by the Industries Department on 03.07.1992. In the batch of cases relating to the assessee Vardhman, the existing unit was expanded through a ghee manufacturing unit at Chhutmalpur, District Saharanpur, which commenced production on 20.09.1994. The assessees claimed that in terms of Notification No.STs.T.2-1093/11-7(42)/86-UP-Act-XV-48 Order-91 dated 27.07.1991 issued by the Government in exercise of powers under Section 4-A of *UP Sales Tax Act* read with Rule 25 of the *UP Sales Tax Rules*, certain exemption of sales-tax was granted to the industries set up in the specified backward area. Bhushan's galvanizing unit started production in January 1994, the eligibility certificate in respect of this unit was issued by the Industries Department effective from 19.01.1994. The exemption in terms of the notification dated

27.07.1991, in respect of the galvanizing unit was available up to a period of 8 years based in fixed capital investment.

4. As the units were located at Sahibabad (Dist. Ghaziabad and Saharanpur,) which was such a specified area, while filing the return of income, the grant of exemption given by the State Government through the said notifications with the object of promotion and development of industries was claimed by Vardhman. In Bhushan's case, it was not taken into consideration at the time of filing the original return, notwithstanding the fact that the subsidy allowed in the form of exemption was in the nature of a capital grant according to it. However, subsequently, Bhushan revised its return of income claiming that such amount of sales tax was in the nature of capital subsidy. Such amount was ₹7,27,71,570/-. During the course of assessment proceedings, the assessee also relied on decisions of the Andhra Pradesh High Court (in *Commissioner of Income Tax v Godavari Plywoods* 168 ITR 632); Bombay High Court (in *Commissioner of Income Tax v Elys Plastics* (1991)188 ITR 11) and the decision reported as *Commissioner of Income Tax v P.J. Chemicals* 210 ITR 830 (SC). However, the assessee's claim was not found accepted by the AO. In the order, the Assessing Officer (AO) made these observations:-

> *"(a) There is no doubt, that the amount of Rs.7,27,71,570/- represents the income of the assessee company. This issue had already been settled finally by several judgements of the Hon'ble Supreme Court of India (e.g. Chowringee Sales Bureau Pvt. Ltd. vs. CIT (SC) 87 ITR 542 and Sinclair Murray & Co. Pvt. Ltd. vs. CIT (SC) 97 ITR 615). The assessee's claim for deduction of this amount from its taxable income on the ground that Sales tax has been exempted by the State Govt. in the form of subsidy for installing industrial units in backward*

areas does not help if at all. Section 43-B opens with an overriding clause making it obligatory that any deduction of a sum "payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force", can be allowed such sum is actually paid by the assessee. The assessee has admittedly not paid the amount of sales tax collection to the State Govt.

(c) The assessee's assertion that it is entitled to claim deduction in view of subsidy by virtue of notifications issued by the State a Govt. does not help its case as, provisions of Sec.43-B are clear and non ambiguous as well as overriding in nature.

(d) The assessee's reference to several judgements of the High Courts and judgment of Supreme Court in the case of PJ Chemicals is not relevant as the issue before the courts was determination of "Actual Cost" of capital assets for the purpose of grant of depreciation and not the grant of deduction in respect of Sales-tax collections which had not been paid in accordance with the provisions of sec.43-B of the IT Act.

(e) No objection on the issue whether the assessee's industrial undertaking was set up in a backward area, notified by the Central Govt. for the purpose of benefit under provisions of Chapter VI-A of Income-tax is necessary at this state as the issue concerning assessee's claim is clearly covered by section 43-B of the Act."

5. On appeal, the CIT(A) allowed the assessee's claim. The CIT(A) held that the amount of sales tax collected as incentive for setting up industries in backward areas was not subject to tax as a trading receipt; but rather was to be towards establishment of the new unit and to buy machinery. He, consequently, deleted ₹7,27,71,570/- added by the AO. The revenue's appeal before the ITAT was dismissed.

6. The core of ITAT's reasoning is extracted below:

"We have, therefore, examined the notification of the Govt. in this regard. The notification dated 26.12.1985 starts that the word "whereas the State Govt. is of the opinion that it is necessary so to do so for promoting the development of industries in the state generally and in certain districts and parts of the districts in particular". The purpose behind such notification was the development of industries in the state. Notification dated 27.7.1951 also specified the same purpose. The exemption/reduction of sales tax was to be computed on the basis of capital investment of the assessees. In other words, the incentive was given to the assessees to establish industrial unit in the specified areas. The State Govts. come out with similar schemes for promoting the industries, the Government grants certain subsidies for the same. Instead of granting subsidies which was also relatable to the capital invested by the assessees or the investment in the fixed assets, the UP Govt. thought it fit not to give any amount by way of subsidy and then collect the same by way of sales-tax. The Government, therefore, quantifies the subsidies payable by it to various; industries in the specified areas and instead of giving such subsidy to them, the Govt. exempted the industries from paying the sales collected to the extent of qualified amount. It will not be out of place to mention that the amount of sales tax collected exceeding the computed amount, the assessee was liable to pay such excess sales tax so collected. In this connection, we feel it expedient to consider the decision of the Hon'ble Supreme Court in the case of Sawhney Steels & Press Works Ltd. reported in 228 ITR 253. The Hon'ble Supreme Court in this case decided that if the moneys are given to the assessees for assisting them in carrying out their business operations and the money was given only after and conditional upon commencement of the production, such subsidy must be treated as assistance for the purpose of trade. But in so far as the case before us is concerned, the subsidy is granted to appellant company by the State Govt. not for the purposes of carrying out its business in a more profitable manner but merely in consideration of setting up the production units in backward areas. The purpose of the Govt in granting subsidy is clear

from the preamble portion of the two notifications under which the appellant company became entitled to exemption in respect of sales tax amount.

22. Though the subsidy/grant allowed by the Govt. appears to be in the nature of exemption/reduction in the amount of sales tax payable by the appellant company, actually, however, the sales tax amount is simply a measurement of the subsidy to be allowed by the State Govt. The subsidies are purely gratuitous in nature and cannot be considered to be an assistance provided to the appellant company for carrying on its business operation in a day to day manner. On the other hand as discussed earlier, the subsidy has been granted specially for the purpose of promotion and development of the industries in the backward areas of the state. In the case of Senai Ram Dungermal reported in 42 ITR 392 at 397, the Hon'ble Supreme Court held that it is the quality of the payment that is decessive of the character (if the payment and not the method of the payment or its measure that makes it fall within capital or revenue. Hon'ble Supreme Court in the case of PJ Chemicals Ltd. (supra) held that where the government subsidy is intended as an incentive to encourage entrepreneurs to move to backward areas and establish industries, the specified percentage of the fixed capital cost which is the basis for determining the sales being only a measure adopted under the scheme to quantity the financial aid was not a payment directly or indirectly to meet any operation of actual cost of such fixed assets. Hon'ble Calcutta High Court in the case of Balrampur Chini Mills Ltd. reported in 238 ITR 448, has considered similar issue. In this particular case, the government introduced an incentive scheme 1975 for the purpose of overcoming the problem of shortage of sugar. One of the incentive envisaged was increase in the free sale sugar quota. To avail the benefit of the Scheme that assessee took certain loans from the government financial institution for expansion of factory considerably by way of increasing per day crushing capacity. The Hon'ble Court held that though the subsidy was in the form of realization of certain additional sale proceeds and in that way looked like trading receipts actually,

however, it was of the nature of an incentive allowed by the state government for the purpose of expansion of capacity of the mill of the assessee and in that way the incentive expressed in terms of additional sale of sugar was of the nature of capital receipt. The ITAT Calcutta Bench in the case of Rasoi Limited (ITA No. 1080/Cal/98) and in the case of Pharma Impex Laboratory Pvt. Ltd. (ITA No.476/Cal/2000) and ITAT Bangalore Bench in the case of Hindustan Aeronautical Ltd., Bangalore (ITA No.763/Bang/98) have taken the same view even after considering the decision of Hon'ble Supreme Court in the case of Sawhney Steels & Press Works Ltd. (supra). In view of these facts, we have no hesitation in holding that the amount received by the assessee by way of exemption of sales tax payment, was not a trading receipt and, therefore, the CIT(A) has rightly held that the amount received by the assessee was capital receipt and not liable to tax up to the limits computed in accordance with the notification of the state government. While upholding the finding of the CIT(A), we dismiss the ground of appeal raised by the revenue.

23. In the result, the appeal directed by the revenue is dismissed."

Parties' contentions

7. The revenue in its appeal argues that the source of the funds and the manner it is collected from the public and also permitted to be retained by the assessee is immaterial for determination as to whether in the hands of the tax payer, it is a capital or revenue receipt. Acknowledging that this position is recognized and well established in law, learned counsel relied upon the decision in *Sahney Steel and Press Works Ltd. v. Commissioner of Income Tax:* 1997 (228) ITR 253(SC)

8. The counsel analyzed various provisions of the Uttar Pradesh (UP) subsidy scheme to say that the earlier scheme of 1982 was expanded in 1985

to promote industrial development in the State. Thereafter, in the year 1990, various elements of the existing scheme were subsumed and a new subsidy regime for industrial promotion was evolved. This envisioned various incentives to new units that were to be encouraged in certain parts of the State. It was pointed out by the revenue that the assessee's unit (in Bhushan Steel), came up in the Taj Trapezium zone which was entitled to be treated as a backward area and thus the enterprise setting up a new unit, could claim sales tax exemption for a certain number of years. Learned counsel pointed out that the scheme was further expanded in 1991 whereby existing units could take advantage by setting up of a new unit or expanding their operations by increasing capacity. The assessee in this case had sought advantage in terms of the expanded or enlarged provisions of the existing 1990 scheme. It is pointed out that as a consequence, both the provisions of the old scheme as amended in 1991 were to be looked into.

9. Learned counsel for the revenue highlighted that the provisions of the scheme, especially the ones that confer advantages upon the assessee did not require it to utilize the funds collected and retained, which made the products economically viable during the formative years of the period that the subsidy was granted, compared to products that had suffered tax, and were not granted any benefit, through permitting the retention of amounts. Stressing on the fact that the absence of any such condition with respect to capital use meant that the scheme clearly granted flexibility to the unit that sought the benefit, it was stated that the purpose of the scheme in the present case was to promote industrialization and industrial production generally which included economic viability and profitability of the unit. In other words, by

allowing the unit to collect sales tax, but not have the corresponding obligation of passing it over to the revenue, the State permitted augmentation of the assessee's income. No strings were attached to the effect that equipment or any other capital expenditure had to be incurred.

10. Learned counsel relied upon the observations of the Supreme Court in *Sahney Steel (supra)* to state that payments in the nature of subsidy from public funds are made to the assessee to assist it in carrying on the business through the trade receipts. The counsel highlighted that the Supreme Court had ruled that the character of the subsidy in the hands of the recipient, whether capital or revenue, has to be determined having regard to the purpose for which the subsidy was given. Although the source is immaterial, the purpose should be examined; if the purpose was to help the assessee to set up its business or to complete the business, the moneys had to be treated as having received for capital purposes. Conversely, if moneys were given to the assessee for assisting it in carrying on business operations and if the money was given only after and conditional upon production, subsidies had to be treated as assistance for the purpose of the trade.

11. It was stated that there are two strong reasons for this Court to follow the rule in *Sahney Steel (supra)*. One is that, like the enunciation of the principle, the purpose for the grant of tax exemption was industrial production and industrial development generally; no strings were attached with respect to the expenditure and secondly, there were specific parts to the scheme that dealt with capital subsidy. It was submitted that the presence of specific provisions for capital subsidy which in turn contained conditions that were to be complied with and had a cap as to the capital subsidy limit

meant that the other parts which conferred advantages by way of retention of moneys collected, were by way of revenue receipts.

12. It was submitted that the judgment of the Supreme Court in *Commissioner of Income Tax v. Ponni Sugars & Chemicals* [2008] 306 ITR 392 (SC) in no way detracts from the rule recognized in *Sahney Steel (supra)*. Learned counsel points out that *Ponni Sugars (supra)* held that the test applicable is the character of the receipt in the hands of the assessee, which is determinable with respect to the purpose for which the subsidy is given. The point at which the subsidy is paid is not relevant. The source and the form of the subsidy are also immaterial. On the other hand, *Ponni Sugars (supra)* emphasized that the main eligibility condition and the scheme in that case was that the incentive had to be utilized for repayment of loans taken by the assessee to set up new units or for substantial expansion of existing units. The object of the subsidy, therefore, was to enable the assessee to recoup its capital expenditure. The Court clearly observed that if, on the other hand, the object of the subsidy scheme was to enable the assessee to run the business more profitably, then the receipts were on the revenue account.

13. It was submitted that in the present case the encouragement to enterprises through the incentive granted by the scheme was to set up a new business or expanding it in the backward area concerned. It no way conditioned the enterprise, to recoup the capital. The expansion of the unit meant that the expenditure had to be incurred by the assessee in this case. It was only thereafter that upon production and sale of goods that sales tax liability arose, which was suspended by the scheme (which permitted the

assessee to collect the amounts though not pass it on to the revenue). The form of the subsidy was collection as tax with permission of the State to retain the amount. The purpose of the subsidy, therefore, clearly was revenue augmentation to ensure greater profitability and economic viability in the particular backward area of Uttar Pradesh aimed at greater growth and higher levels of employment. Therefore, the impugned decision is clearly contrary to law.

14. It was argued on the assessee's behalf that its cold rolled unit went into production on 03.01.1990 and commenced sales from 07.03.1990. This unit was eligible for incentive in the form of sales tax exemption under the earlier notification of 29.01.1985 which had extended the existing Government Order of 30.09.1982. The incentive available to the newly established coal mill which was considered and classified as "Prestige" unit, involving fresh investment of over ₹ 2 crores under the Government Orders was in the form of sales tax exemption from the period of this exemption from the date of sale. The State of U.P. formulated the industrial policy of 1990. Reliance was placed upon the preamble to the policy which envisioned large scale industrialization of the State with special facilities and incentives for setting up industrial and manufacturing units in the State. It was submitted that the 1990 scheme was amended so as to expand its ambit to existing units if they expanded their capacity. The assessee then set up a new galvanizing unit by way of expansion of its existing business that went into production from January, 1994 and was eligible for incentive in the form of sales tax exemption. The incentive for this diversification or expansion

was in the form of sales tax exemption for 8 years limited to 100% of the fixed capital investment in the graded manner set out in the notification.

15. Learned counsel took the Court through the decisions in *Sahney Steel (supra)* and *Ponni Sugars (supra)*, to say that neither is the point of time when the subsidy was paid relevant nor is the source or the form of the subsidy relevant but what is relevant is the assistance and its purpose. It is stated that the Finance Act of 2015 which came into force on 01.04.2016 amended Section 2(24) of the Income Tax Act and inserted Clause (xvi). It is stated that assistance in the form of subsidy or grant or cash incentive or duty drawback or waiver by Central or State Governments or any authority in cash or kind to the assessee other than subsidy or grant or reimbursement which is taken into account determining the actual cost of the asset, is deemed to be income. It was submitted that this amendment clarifies the intent of Parliament which is that the assistance received otherwise than towards capital augmentation or creation is deemed to be income. This amendment is prospective which means that the law is to be interpreted in the light of the judgments applicable, notably *Ponni Sugars (supra)* in the present case.

16. It is stated that in *Sahney Steel (supra)* and *Ponni Sugars (supra)* the issue decided was, what was the true purpose of the incentive or the subsidy. The end use of the funds was considered as an additional argument to decide the matter either way. In *Ponni Sugars (supra)*, the eligible unit which was the new sugar factory expanded its operations and the expanded unit was entitled to incentive irrespective of whether the setting up of the unit or expansion of the unit was financed out of borrowed funds. It was held by the

Court that the amounts received were not by way of revenue subsidy but for augmenting the capital expenditure incurred. Learned counsel also relies upon subsequent judgment of the Supreme Court in *Commissioner of Income Tax v. Shree Balaji Alloys* 2016 (287) CTR 459 (SC) which affirmed the decision of the Jammu & Kashmir High Court in *Shri Balaji Alloys vs. Commissioner, Income Tax* (2011) 333 ITR 335. It was stated that the *Ponni Sugars (supra)* principle was applied and the Court held that the excise duty refund received by the eligible unit, was not liable to tax as it was a capital receipt despite absence of any provision in the scheme with regard to the use of funds.

17. Learned counsel also relied upon the decision of a Division Bench of this Court in *Commissioner of Income Tax vs. Bougainvilla Multiplex Entertainment Centre Pvt. Ltd.* (2015) 373 ITR 14. There too, the Court held that subsidy given at the point of time after the commencement of production did not mean that the State ruled out capital utilization of the funds received. On the other hand, the very concept of grant of subsidy meant that the assessee was free to use it either to augment its profit or to recoup its capital. Therefore, the purpose test in this case had to be interpreted in the manner it was done in *Ponni Sugars (supra)* and it leaves no room for doubt that assistance in the form of tax rebate, which permitted amounts to be collected by the assessee was to assist it to set up the new unit and recoup the capital expenditure. The periodicity of the subsidy or its source and the form, i.e. collection and retention were immaterial as in the case of *Ponni Sugars (supra)* or even the other decisions cited in it.

Analysis and reasoning

18. Before considering the submissions of the parties, it would be necessary to extract the relevant parts of the supplementary notification dated 27.07.1991 issued by the State of UP, in the present case. The subsidy indicated, together with the preamble to the scheme, reads *inter alia* as follows:

> *"ST-II-1093/XI-7(42)-86-UP Act-XV/48-Order-91, dt. 27.07.1991*
> *(Gazette dt. 27.7.1991)*
>
> *WHEREAS the State Government is of the opinion that for promoting the development certain industries in the State, it is necessary to grant exemption from or reduction in rate of tax to new units and also to units which have undertaken expansion, diversification or modernization.*
>
> *NOW, THEREFORE, in exercise of the powers under section 4 – A of the Uttar Pradesh Sales Tax Act, 1948 (UP Act No. XV of 1948), hereinafter referred to as the Act the Governor is pleased to declare that*
>
> *1(A) In respect of any goods manufactured in a 'new unit, other than the units of the type mentioned in Annexure II established in the areas mentioned in Column 2 of Annexure I, the 'date of starting production' whereof falls or after first day of April, 1990 but not later than 31st day of March, 1995, no tax shall be payable, or, as the case may be, the tax shall be payable at the reduced rates, as specified in column 4 of Annexure I, by the manufacture thereof on the turnover of sales of such goods, for the period specified in column 3 of the said Annexure I, or till the maximum amount of tax relief by such exemption from or reduction in the rate of tax as specified in Column 5 of Annexure I is achieved, whichever is earlier. The period specified in Column 3 of the said Annexure shall be reckoned from the date of first sale, or the date following the expiration of six months from the date of starting production, whichever is earlier.*

(B) (1) In respect of any good manufactured in a unit other than the units of the type mentioned in Annexure II, which has undertaken expansion, diversification or modernization' on or after April 1, 1990 but not later than March 31, 1995, in the areas mentioned in Column 2 of Annexure I, not tax shall be payable or, as the case may be, the tax shall be payable at the reduced rates specified in Column 4 of Annexure I, by the manufacturer thereof for the period in Column 3 of the said Annexure I, or till the maximum amount of tax relief by such exemption from or reduction in rate of tax as specified in Column 5 of Annexure I is achieved, whichever is earlier, on the turnover of sales."

ANNEXURE – I

S. No.	*Location of Unit*	*Total period of exemption* *Reduction in the rate of tax*	*Rate of tax applicable (denoted as percentage of the rate of tax normally applicable under the Act to the goods concerned)* *Year in Case of ib case of Units with other a fixed units* *Capital investment* *Exceeding 50 Crores*	*Monitory limit upto which exemption from or reduction in the rate of tax is admissible*
1	*2*	*3*	*4*	*5*

		A	B	C	
(iii)	*The Taj Trapezium Area*				
1.	*The district of Agra (excluding Taj Trapezium Area)* *Aligarh (excluding Taj Trapezium area)* *Allahabad (excluding the area in south of Rivers Jamuna & Confluent Ganga but including the area included under Nagar Mahapalika, Allahabad)* *Bareilly, Bijore, Firozabad (Taj Trapezium Area)* *Ghaziabad, Gorakhpur, Haridwar, Kanpur (Nagar), Lakhmpur-Kheri, Lucknow, Maharajganj, Meerut, Mirzapur, Muzzaffarnagar, Saharanpur, Sonbhadra and*	*Eight years*	*1st year* *2nd year* *3rd year* *4th year* *5th year* *6th year* *7th year* *8th year*	*NIL* *NIL* *NIL* *NIL* *NIL* *NIL* *NIL* *NIL*	*NIL* *NIL* *10%* *30%* *40%* *60%* *70%* *90%*	*125% of the fixed capital investment in the case of small scale unit and 100% of the fixed capital investment in case of other unit*

	Varanasi			

19. In the arguments on behalf of the revenue, it was acknowledged that the assessee was entitled to retain the amounts collected from customers towards sales tax, to the extent that 100% of the outlay of capital expenditure was attained, for a given number of years. At the same time, the scheme is supplemental to the existing scheme framed in 1990; the revenue relied on the following parts of that scheme, which too applied, according to its submission:

> *"STATE CAPITAL SUBSIDY SCHEME*
>
> *A. No capital subsidy shall be due to the unit having fixed capital investment of more than Rs.5 crore.*
>
> *B. The aforeasaid units shall also be eligible for facilities under the scheme on 25% or more expansion/modernization with this restriction that the amount of entire grant received under the scheme shall not be more than the maximum admissible amount mentioned in para No. 5."*
>
> *[Page 61 - 6(A) & 6(B)]*
>
> *"6 (A) :Special capital subsidy for the prestige units:-*
>
> *Any district, where any industry of fixed capital investment of 25 crore is not already established, the first industrial unit to be established from the capital investment of Rs.25 crore or more, within the period of 1.4.90 to 31.3.95, shall be treated as "Prestige" Unit and the special state capital subsidy worth Rs.15 lakh shall be granted to this unit. If prestige unit incentive to the ancillary units for the supply of requirement of more than 30% of its own purchased parts and components, then the further additional special capital subsidy of Rs.15 lakh shall be available to it. This scheme shall be*

applied with effect from 1.4.90 and the facility of subsidy shall not be admissible in the district under the scheme, where any unit of the capital investment of Rs.25 crore has already been established prior to 1.4.90.

6 (B) :Special State Capital Subsidy to the Tehsil Level Pioneer Units.

In any Tehsil, within the period of 1.4.90 to 31.3.95, the first industrial unit to be established from the fixed capital investment of Rs.5 crore or more, shall be treated as Tehsil Level Pioneer Unit. The special state capital subsidy of Rs.10 lakh shall be granted to the Pioneer Unit.

If pioneer unit encourage to the ancillary units for the supply of requirement of 30% of its own purchased parts and components, then the further additional special capital subsidy of Rs.10 lakh shall be available to it. This scheme shall be applied with effect from 1.4.90 and the facility of raw material shall not be admissible in the district under the scheme, where any unit of the capital investment of Rs.5 crore has already been established prior to 1.4.90."

20. Predictably, the rival positions of parties are that according to the revenue, the amounts retained were not towards capital subsidy, but were revenue or trade subsidies, to ensure greater profitability. The assessee naturally, takes the opposite position: it succeeded before the tribunal, which ruled that the amount was towards capital subsidy. The question is which of these two positions is correct in law, according to the authorities? Like other issues, whether a particular item of expenditure or receipt falls within the capital or revenue stream, determines its treatment for tax liability. *Sahney Steel (supra)* discussed this rather extensively. The Supreme Court held:

"The contention of Mr. Ganesh that the subsidies were of capital nature and were given for the purpose of stimulating the setting up and expansion of industries in the State cannot be

upheld, because of the subsidy scheme itself. No financial assistance was granted to the assessee for setting up of the industry. It is only when the assessee had set up its industry and commenced production that various incentives were given for the limited period of five years. It appears that the endeavour of the State was to provide the newly set up industries a helping hand for five years to enable them to be viable and competitive. Sales tax refund and the relief on account of water rate, land revenue as well as electricity charges were all intended to enable the assessee to run the business more profitably. The basic principle to be applied for determination as to whether a subsidy payment is in the nature of capital or revenue, has been stated by Viscount Simon in Ostime v. Pontypridd and Rhondda Joint Water Board [1946] 14 ITR (Suppl.) 45, 47; [1946] 28 TC 261 (HL) in the following words (page 278):

"The first proposition is that, subject to the exception hereafter mentioned, payments in the nature of a subsidy from public funds made to an undertaker to assist in carrying on the undertaker's trade or business are trading receipts, that is, are to be brought into account in arriving at the balance of profits or gains under Case I of Schedule D. It is sufficient to cite the decision of this House in the sugar beet case (Smart v. Lincolnshire Sugar Co. Ltd. [1937] 20 TC 643; 156 LT 25] as an illustration.

The second proposition constitutes an exception. If the undertaker is a rating authority and the subsidy is the proceeds of rates imposed by it or comes from the fund belonging to the authority, the identity of the source with the recipient prevents any question of profits arising-see, for example, Lord Buckmaster's explanation in Forth Conservancy Board v. IRC [1931] AC 540, at page 546 (16 TC 103, at page 117) and compare what Lord Macmillan said in Municipal Mutual Insurance Ltd. v. Hills [1932] 16 TC 430, at page 448."

In the instant case, the first proposition of Viscount Simon clearly applies. The amount paid to the assessee in the instant case is in the nature of subsidy from public funds. The

funds were made available to the assessee to assist it in carrying on its trade or business. In our view, having regard to the scheme of the notification, there can be little doubt that the object of various assistances under the subsidy scheme was to enable the assessee to run the business more profitably.

Mr. Ganesh strongly relied on Seaham Harbour Dock Co.'s case [1931] 16 TC 333 (HL) which does not come to the assistance of his contention in any way. In that case application for assistance was made even before the work of expansion of dock commenced. The money was for extension of the docks of the company. The extension would have enabled some persons to be kept in employment who would otherwise have lost their jobs. Money was given in several instalments as the work of extension of the dock continued. Money was given for the express purpose which was named. It was found by the House of Lords that it had nothing to do with the trading of the company.

In the case before us, payments were made only after the industries have been set up. Payments are not being made for the purpose of setting up of the industries. But the package of incentives were given to the industries to run more profitably for a period of five years from the date of the commencement of production. In other words, a helping hand was being provided to the industries during the early days to enable them to come to a competitive level with other established industries.

********** **********

In the case before us, the payments were made to assist the new industries at the commencement of business to carry on their business. The payments were nothing but supplementary trade receipts. It is true that the assessee could not use this money for distribution as dividend to its shareholders. But the assessee was free to use the money in its business entirely as it liked and was not obliged to spend the money for a particular purpose like extension of docks as in the Seaham Harbour Dock Co.'s case [1931] 16 TC 333 (HL).

************* *************

That precisely is the question raised in this case. By no stretch of imagination can the subsidies whether by way of refund of sales tax or relief of electricity charges or water charges be treated as an aid to the setting up of the industry of the assessee. As we have seen earlier, the payments were to be made only if and when the assessee commenced its production. The said payments were made for a period of five years calculated from the date of commencement of production in the assessee's factory. The subsidies are operational subsidies and not capital subsidies.

*********** ****************

In the case before us, the subsidies have not been granted for production of or bringing into existence any new asset. The subsidies were granted year after year only after setting up of the new industry and commencement of production. Such a subsidy could only be treated as assistance given for the purpose of carrying on of the business of the assessee. Applying the test of Viscount Simon in the case of Ostime [1946] 14 ITR (Suppl) 45 (HL), it must be held that these subsidies are of revenue character and will have to be taxed accordingly."

21. *Ponni Sugars (supra)* was the authority relied on by the assessee. In *Ponni Sugars (supra),* the court observed about the decision in *Sahney Steel (supra)* as follows:

"The importance of the judgment of this court in Sahney Steel case 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 utilized 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 or the mechanism through which the subsidy is given are irrelevant.

One more aspect needs to be mentioned. In Sahney Steel and Press Works Ltd. 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 the case of Seaham Harbour Dock Co. 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 utilize the subsidy only for repayment of term loans undertaken by the assessee for setting up new units/expansion of existing business.

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 not in the course of a trade but was of capital nature."

22. The object of providing subsidy by way of permission to not deposit amounts collected (as sales tax liability)- which meant that the customer or servicer user concerned had to pay sales tax, but at the same time, the collector (i.e. the assessee) could retain the amount so collected, undoubtedly was to achieve the larger goal of industrialization. The achievement of a

quantitative limit (of 125% of capital expenditure in the case of small scale units and 100% in the case of other units) meant that the subsidy could no longer be claimed.

23. The revenue in this case stresses upon the lack of any conditionality that the amounts were to be spent towards capital expenditure and that the assessee had the flexibility of just increasing profitability, to say that the subsidy here was revenue, and not capital. It also harps on the fact that the quantitative limit indicated, i.e. amount (to be retained could be equal to 100% of capital expenditure) was only a reference point; the policy makers did not, therefore, have to actually deal with figures or create a slab or graded subsidy. This, according to the revenue, meant that the amounts retained could be spent for any purpose, not necessarily capital. It was lastly submitted that the subsidy operated only after expansion, i.e. after the capital expenditure was incurred and capacity expanded.

24. Both parties have used different passages from *Sahnay Steel (supra)* and *Ponni Sugars (supra).* In the former, the court was persuaded to hold that the amounts were revenue subsidies and "operational", not capital, because *"the payments were to be made only if and when the assessee commenced its production. The said payments were made for a period of five years calculated from the date of commencement of production in the assessee's factory."* The added feature was that the assessee was free to use the amounts for any purpose. In *Ponni Sugars (supra),* the following was highlighted specifically:

> *"In Sahney Steel and Press Works Ltd. 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 the case of Seaham Harbour Dock Co. 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 utilize the subsidy only for repayment of term loans undertaken by the assessee for setting up new units/expansion of existing business."*

25. In the present case, the provisions of the original scheme (i.e. the original policy of 1990) and its subsidy scheme are relevant; they have quite correctly been relied upon by the revenue. Paras 6 (A) and 6(B) of that scheme specifically provided for capital subsidy to set up prestige units; the amounts indicated (Rupees fifteen lakhs) were to be towards capital expenditure. Now, if that was the scheme under which the assessees set-up their units, undoubtedly it contained specific provisions that enabled capital subsidies. Whether the assessees were entitled to it, or not, is not relevant. The assessees are now concerned with the sales tax amounts they were permitted to retain, under the amended scheme (dated 27.07.1991) which allowed the facility of such retention, after the unit (established and which could possibly claim benefit under the first scheme) was *already set up.* This subsidy scheme had no strings attached. It merely stated that the collection could be retained to the extent of 100% of capital expenditure. Whilst it might be tempting to read the linkage with capital expenditure as not only applying to the limit, but also implying an underlying intention that the capital expenditure would thereby be recouped, the absence of any such condition should restrain the court from so concluding.

26. How a state frames its policy to achieve its objectives and attain larger developmental goals depends upon the experience, vision and genius of its

representatives. Therefore, to say that the indication of the limit of subsidy as the capital expended, means that it replenished the capital expenditure and therefore, the subsidy is capital, would not be justified. The specific provision for capital subsidy in the main scheme and the lack of such a subsidy in the supplementary scheme (of 1991) meant that the recipient, i.e. the assessee had the flexibility of using it for any purpose. Unlike in *Ponni Sugars (supra)*, the absence of any condition towards capital utilization meant that the policy makers envisioned greater profitability as an incentive for investors to expand units, for rapid industrialization of the state, ensuring greater employment. Clearly, the subsidy was revenue in nature.

27. In view of the above discussion, the common question of law, is answered in favour of the revenue and against the assessees, in both cases.

28. In the Bhushan Steel batch of appeals, another question of law, i.e. whether the assessee was entitled to claim depreciation under Section 32 of the Income Tax Act, despite not owning the property or not being the owner and being a lessee during the years under consideration, arises for consideration.

29. During the course of hearing, this court was informed that this question is now covered against the revenue/appellant, in the assessee's favour, in this court's order for AY 1994-95 in ITA 314/2003 (*Commissioner of Income Tax v Bhushan Steels and Strips*, decided on 1st December, 2016). In that decision, this court held that the judgments of the Supreme Court in *Mysore Minerals Ltd v Commissioner Income Tax* 1999 (239) ITR 75 (SC) and *Commissioner Income Tax v Poddar Cement Ltd* 1997 (226) ITR 625 (SC) are conclusive that a lessee can claim depreciation.

Therefore, the second question of law, arising in the Bhushan Steel batch of appeals, is decided in the assessee's favour and against the revenue.

30. As a result, the revenue's appeals are partly allowed, in view of the findings about taxability of the subsidy amounts as revenue receipts. There shall be no order as to costs.

S. RAVINDRA BHAT
(JUDGE)

NAJMI WAZIRI
(JUDGE)

JULY 13, 2017