Supreme Court of India
M/S. Sahney Steel & Press Works ... vs Commissioner Of Income ... on 19 September, 1997
Author: Sen.
Bench: Suhas C. Sen, D. P. Wadhwa

PETITIONER:
M/S. SAHNEY STEEL & PRESS WORKS LTD. HYDERABAD

Vs.

RESPONDENT:
COMMISSIONER OF INCOME TAX.ANDHRA PRADESH-I , HYDERABAD

DATE OF JUDGMENT: 19/09/1997

BENCH:
SUHAS C. SEN, D. P. WADHWA

ACT:

HEADNOTE:

JUDGMENT:

WITH (C.A. Nos.10091/95, 5279/96, 2008/88,425/85 and 1664-65/97) J U D G M E N T SEN. J.

The question in this case is whether the subsidy received by the assessee-Company from the Andhra Pradesh Government is taxable as revenue receipt or not. It appears from the notification issued by the Andhra Pradesh Government that certain facilities and incentives were to be given to all the new industrial undertakings which commenced production on or after 1.1.1969 with investment capital (excluding working capital) not exceeding Rs.5 crores. The incentives were to be allowed for a period of five years from the date of commencement of production. Concession is also available for subsequent expansion of 50 per cent and above of existing capacities provided in each case, the expansion was located in a city or town or panchayat area other than that in which the existing unit is located. The incentives were:

> " (a) Refund of sales tax on raw materials, machinery and finished goods, levied by the State Government subject to a maximum of 10% of the equity capital paid up in the case of public limited companies and the actual capital in the case of others:
>
> (b) subsidy on power consumed for production to the extent of 10% in the case of medium and large scale industries. This concession will not apply to cases where

concessional tariffs are allowed by the Electricity Board.

(c) Exemption from payment of water rate on water drawn from sources not maintained at the cost of Government or any local body;

(d) Refund of water rate in respect of water drawn from a Government source or from a source maintained by any local body but returned purified to it;

(e) Liability on account of assessment of land revenue or taxes on land used for establishment of any industry shall be limited to the amount of such taxes payable immediately before the land is so used.

(f) The following additional incentives will be allowed to new industrial units set up in the ayacut areas of Nagarjunasagar, Pochampad and K.C.Canal in the Ramagundam Kothagudem areas in the following eight backward districts:

The salient features of the scheme formulated by the Andhra Pradesh Government was that the incentives were not available unless and until production had commenced. The availability of the incentives would be limited to a period of five years from the date of commencement of production. The incentives were to be given by way of refund of sales tax and also by subsidy on power consumed for production to the extent stated in the notification. Exemption were given also from payment of water rate. Refund was also provided for water rate in respect of water drawn from Government sources. There were certain additional incentives with which we are not concerned in this case.

The important point to note is that all the incentives are production incentives in the sense that the company will be entitled to these incentives only after it goes into production. The scheme was not to make any payment directly for setting up of the industries. It is only after the industries had been commenced that the incentives were to be given.

The second important thing to note is that there manner in which the incentives were given is of no consequence for determination of the question raised in this case. Incentives were given by way of refund of sales tax on raw material, machinery and finished goods. Similarly, Subsidy on " power consumed for production". In other words, if power is consumed for any other purpose like setting up the plant and machineries, the incentives will not be given. Refund of sales tax will also be in respect of taxes levied after commencement of production and upto a period of five years from the date of commencement of production. It is difficult to hold these subsidies as anything but operational subsidies. These subsidies were given to encourage setting up of industries in the State of Andhra Pradesh by making the business of production and sale of goods in the State more profitable.

Mr. Ganesh appearing on behalf of the assessee has contended that the incentives scheme was for setting up new industries undertakings in the State and also for the purpose of stimulating substantial expansion of the industries. The primary object was rapid industrialisation of the State.

The object was sought to be achieved by the various incentives. It was further contended that the subsidy given by the State was upto 10% of the capital investment in the undertakings. Since the subsidy was calculated on the basis of quantum of investment in capital such subsidy cannot be considered to have been received by the assessee on revenue account.

It was further contended by Mr. Ganesh that grant of subsidy was on the basis of refund of sales tax on raw materials, machineries, and finished goods already paid for by the assessee for a period of five years and was of a capital nature. The object for granting refund of sales tax was that the assessee could set up new business or expand substantially his existing business.

Before we examine these propositions advanced by Mr. Ganesh, we will examine the facts of the case a little more. The assessee maintains its accounts according to the Calender year. It was, therefore, entitled to the benefits of the benefits of the said G.O. in the year 1973, which means assessment year 1974-75. in the said accounting year, the assessee obtained refund of the following three item totalling Rs.14,665.70 in terms of G.O.Ms.No.455. The three items are:

(i) Refund of sales tax on purchase of machines during 1971-72	Rs. 5,839.93 5,839.93
(ii) Refund of sales tax on purchase of raw materials during the year 1971-72	390.79
(iii) Refund of Sales tax paid on sale of punished goods during the year 1971-72	8,423.98

The Income Tax Officer, while making the assessment for the year 1974-75, included the said amount in the assessable income of the assessee which was confirmed on appeal by the Commissioner of Income Tax (Appeals). On further appeal, however, the Tribunal upheld the assessee's contention and held that the amount of Rs.14,665.70, refunded to the assessee in terms of the said G.O. "did not represent refund of Sales tax" but was a development subsidy in the nature of a capital receipt. The Tribunal also held that the said amount cannot be deemed to be the income of the assessee under s.41(1) either. Thereupon the revenue asked for and obtained the reference of the following question:

> "Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was justified in holding that the amount of Rs.14,665 received by the assessee from the Government of Andhra Pradesh in the relevant accounting period was not liable, to be included in the total income assessable for the assessment year 1974-75".

The contention of Mr. Ganesh that the subsidies were of capital nature and were given for the purpose of stimulating 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 too provide the newly set up industries a helping hand for 5 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 28 T.C.262 in the following words:

> "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'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 1 of schedule d. It is sufficient to cite the decision of this House in the sugar beet case (Smart v. Lincolnshire Sugar Co., Ltd., 20 T.C. 643; 156 L.T. 215) an illustration.
>
> The second proposition constitutes an exception. If the undertaker is a rating authority and the subsidy is the proceeds is the proceeds of rates imposed by it or comes a fund belonging to the authority, the identify of the source with the recipient prevents any question of profits arising- see, for example, Lord Buckmaster's explanation in Forth conservancy Board V. Commissioner of Inland Revenue, (1931) A.C.540, at page 546 (16 T.C.103, at page 117) and compare what Lord Macmillan said in Municipal Mutual Insurance Ltd. V. Hills, 16 T.C. 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 to assessee to run the business more profitably.

In the judgement delivered by Viscount Simon with whom Lord Thankerton agreed two earlier decisions were relied on. The first of these two decision was the case of Seaham Harbour Dock Company V. Crook 16 T.c. 333. In this case the Harbour Dock Company had applied for and obtained grants from the Unemployment Grants Committee from funds appropriated by Parliament. These grants were paid as the work progressed and were equivalent to half the interest on approved expenditure met out of loans. The payment were made several times a year for some years. The Dock company had undertaken an extension of its docks. The extended dock was also for relieving unemployment problem. Because the work undertaken was extension of the dock and the main purpose was relief of unemployment , the House of Lords held that the financial assistance given to the company for extension of the dock cannot be regarded as receipt of the trade. Lord Atkin explained the position by saying that:

> "It is a receipt which is given for the express purpose which is named, and it has nothing to do with their trade in the sense in which you are considering the profits or

gains of the trade."

> Lord Buckmaster Observed as under: "Was this a trade receipt? and my answer is most unhesitatingly No. It appears to me that it was nothing wherever of the kind. It was a grant which was made by the Government department with the idea that by its use men might be kept in employment, and it was paid to and received by the Dock Company without any special allocation to any particular part of their [property , either capital or revenue, and was simple to enable them to carry out the work upon which they were engaged, with the idea that by so doing people might be employee."

Mr. Ganesh strongly relied on Seaham Harbour Company's case (supra) 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 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 House of Lords that it had nothing to do with the trading of the company.

In the case before us, payment 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.

The second case is Lincolnshire Sugar Company Ltd. V. Smart, 20 T.C. 643. In that case it was found that Lincolnshire Sugar Company Ltd. carried on the business of manufacturing sugar from home grown beet. The Company was paid various sums under British Sugar industry (Assistance) Act, 1931 out of monies provided by parliament. The question was whether these monies were to be taken into account as trade receipts or not. The object of the grant was that in the year 1981, in view of heavy fall in prices sugar, sugar industries were in difficulty. The Government decised to give financial assistance to certain industries in respect of sugar manufactured by them from home-grown beet during the relevant period. Lord Macmillan held that:

> "What to my mind is decisive that these payments were made to the Company in order that the money might be used in their business." He furthered observed that :
>
> "I think that they were supplementary trade receipts bestowed upon the company by the Government and proper to be taken into computation in arriving at the palace of the company's profits and gains for the year in which they were received."

In the case before us, the payments were made to assist the new industries at the new industries at the commencement of business to carry on their business. The payment were nothing but supplementary trade receipts. It is true that the assesses could not use this money for distribution as

dividend to its shareholders. But the assesses 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 Company's cases.

There is a Canadian case St. John Dry Dock & Ship Building Co. Ltd. v. Minister of National Revenue, A D.L.R., which has close similarly to the case of Seaham Harpour Dock Company's Case (supra). In that case, it was held that where subsidies were given under statutory authority, the statutory purpose for which they are authorised is relevant and may even be decisive in determining whether it is taxable income in the hands of the recipient. In that case, it was pointed out after discussing the Seaham harbor Dock Company's Case (supra) as well as that of Lincolnshire Sugar Company's case (supra) that subsidy given by the Canadian Government to encourage construction of dry docks was "an aid to the construction of dry dock and not an operational subsidy".

This 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 can be treated as an aid to setting up of the industry of the assesses. As we have seen earlier, the payments were to be made only if and when asssessee 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 Mr. Ganesh's further argument was that the three types of refunds contemplated in the scheme, the refund of sales tax on purchase of machinery must be treated as capital. The payment for the purchase of machineries must be of capital nature and the entire payment of sales tax must have been treated as capital expenditure of the Company. If any refund of sales tax paid on purchase of capital goods is made the refund will partake of the character which it had originally borne. Such refunds cannot in any circumstances be treated as trade receipts or supplementary trade receipts. This argument overlooks the basic principle laid down in the cases discussed above. It is not the source from which the amount is paid to the assesses which is determinative of the question whether the subsidy payments are of revenue or capital nature. The first proposition stated by Viscount Simon in Ostime's Case (supra) is that if payment in the nature of subsidy from public funds are made to the assessee to assist him in carrying on his trade or business, they are trade receipts. The sales tax upon collection forms part of the public funds of the State. If any subsidy is given, the character of the subsidy in the hands of the recipient-whether revenue or capital- will have to be determined by having regard to the purpose for which the subsidy is given. If it is given by way of assistance to the assessee in carrying on of his trade or business, it has to be treated as trading receipt. The source of the fund is quite immaterial.

For example, if the scheme was that the assessee will be given refund of sales tax on purchase of machinery as well as on raw materials to enable the assessee to acquire new plants and machinery for further expansion of its manufacturing capacity in a backward area, the entire subsidy must be held to be a capital receipts in the hands of the assessee. It will not be open to the Revenue to contended that the refund of sales tax paid on raw materials or finished products must be treated as revenue receipts in the hand of the assessee. In both the cases , the Government is paying out of public funds to the assessee for definite purpose. If the purpose is to help the assessee to set up its business or complete a project as in Seaham Harbour Dock Company's Case(supra), the monies

must be treated as to have been received for capital purpose. But if monies are given to the assessee for assisting him in carrying out the business operation and the money is given only after and conditional upon commencement of production, such subsidies must be treated as assistance for the purpose of the trade.

In Seaham Harbour Dock Company's case (supra) which appears to be sheet-anchor of the argument of Mr. Ganesh, the Company in contemplation of an expansion of its dock 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 payment was equivalent to half the interest for two years (not exceeding average rate of 5-1/2 per cent per annum) on approved expenditure made out of loans. Even though the payment was equivalent to half the interest amount payable on the loan which might have been a revenue expenditure the House of Lords had no difficulty in holding that the money received by the company was not in course of trade but was of capital nature.

We shall now see how our Courts have dealt with the problem.

This Court in V.S.S.V. Meenakshi Achi & Anr. Vs. Commissioner of Income Tax, Madras, 60 ITR 253 followed the same principle and relied upon and approved of an English decision in the case of Higgs V. Wrightson.(1944) 26 T.C.

73. There a dairy farmer had received grant in respect of the ploughing and bringing into a state of cleanliness and fertility land previously under grass for seven years or more. Macnaghtenn, j. held that since the amount of the grant depends on the area ploughed, the grant was towards the expenditure of ploughing and therefore, a revenue receipts in the hands of the assessee. It was observed in Meenaksi Achi's case (supra) by subha Rao, j. (as His Lordship then was):

> "So too, in the instant case, the payments to the planters were made against the expenditure incurred for maintaining the rubber plantations.
>
> Having regard to the aforesaid facts, we must hold that the amounts from the fund earmarked for the appellants on the basis of the rubber produced by them were paid against the expenditure incurred by them for maintaining the rubber plantation and producing the rubber."

A full bench of the Kerala High Court examined the question of subsidy received for replanting rubber trees in the case of Commissioner of Income Tax V. Ruby Rubber Works Ltd. 178 ITR 181. it dealt with a scheme of subsidy framed by the Rubber Board in 1976 for replanting rubber planting. The subsidy was not given for budding immature unselected plants but was not given for budding immature unselected plants but was restricted to replanting only of old and uneconomic trees. The subsidy was not for the purpose of upkeep or maintenance of immature rubber trees. On these facts, the Full Bench came to the conclusion that the object of the Scheme was replanting and the subsidy was being paid for planting high yielding variety of rubber plants which the Rubber Board and the Government thought was necessary for the Development of the rubber industry. What was sought

was to be achieved was a public purpose of vital public interest.

The full Bench pointed out that the economic assistance offered by the Board was under stringent conditions for implementing a scheme designed to achieve development of rubber plantation industry on efficient and economic lines. After an exhaustive revue of the case law and the subsidy scheme, the full Bench observed.

> "We are tempted to say that the subsidy received by the assessee is used to acquire an asset by replanting high-yield variety of rubber trees. The difference is, as said by Bowen L.J., the expenditure in the acquisition of the concern will be capital expenditure and the expenditure in carrying on the concern is revenue expenditure. This makes the vital difference between the cases reported in Karimtharuvi Tea Estates Ltd. V. State of Kerala (1963) 48 ITR (SC) 83 and Travancore Rubber and Tea Co. Ltd. V. Commr. Of Agrl. I.T. (1961), 41 ITR 751 (SC)."

So far as the scheme is concerned, the full Bench further observed:

> "The subsidy scheme makes it very clear, that the amount of subsidy has to be spent 'for the acquisition of an asset' by replanting rubber plants of high- yielding varieties."

It will be seen from this decision that the Full Bench relied upon the decision of the House of Lords in Seaham Harbour Dock Company's Case (supra) and pointed out that a beneficial scheme had been evolved for replanting of the trees and as a result of replanting, the assesses acquired an asset which was of capital nature. It was further pointed out in that judgement that the scheme was definitely only for one purpose, viz., replanting. It was not for the purpose of unkeeping and maintaining nature of immature rubber plants. This was the vital factor on the basis of which the full Bench of the Kerala's High Court came to the conclusion that the subsidy given for replanting of old rubber trees cannot be included as a revenue receipt of the rubber company.

Our attention was drawn to the case of Sadichha Chitra . V. Commissioner of Income Tax, 189 ITR 774. In that case, was noted that in a given case subsidy may be granted with the object of supplementing trade receipts and profits of the recipient. In another case, the scheme of subsidy may have been formulated by the authority to assist the assessee in acquiring a capital asset or for the growth of the industry generally in public interest without any objective of supplementing trade receipts or recoupment of revenue expenditure already incurred by the assessee.

In that case, the Government of Maharashtra sanctioned a subsidy scheme for grant of financial assistance to Marathi film producers to promote production of better Marathi films and help Marathi colour films in preference to black and white films. It will be seen from the facts noted in the judgement of the Bombay High Court that any producer of Marathi films could apply to the Collector of Bombay (Entertainment Duty Department) for grant of a certificate of eligibility for getting the grant. The Collector after holding necessary enquiry in respect of various matters referred in the scheme would recommended that the desease of the amount to the applicant. One of

the pre-conditions of the grant was that the applicant must prepare adequate plants for production of new film and also fulfil financial and technical requirement for production of the film. Financial assistance was to be given in four equal instalments in the following manner. The first instalment was to be released after completion of one third of the proposed footage of the film, the second instalment on the completion of the entire film ready for censors and the financial instalment had to be released immediately after the new film had crossed the hurdle of censorship and actual release. It was noted in the judgement:

> "The said subsidy was released to the assessee so as to assist the assessee to acquire a new capital asset so as to meet part of the cost of the new film in public."

On the basis of that vital distinction, the Court held that the ratio of the judgement of this court in Meenakshi Achi's case was not applicable in the facts of the case before it.

In the case of Commissioner of Income Tax v. Udaya Picture (p) Ltd., 225 ITR 394, subsidy was granted by the State Government for producing new regional films. It was held that the entitlement to the subsidy sprang from the business carried on by the assessee and the amount was received during the course of conduct of the business. What was received by the assessee was not capital receipt but a subsidy.

The facts of this case have not been clearly stated in the judgement. But it appears that subsidy was granted after making of the film. The Bombay judgement in the case of Sadichha Chitra (supra). Proceeded on the footing that subsidies were granted as and when the film was being completed which resulted in creation of a capital asset. A similar vies was taken by the Andhra Pradesh High Court in the case of Commissioner of Income Tax V. Chitra Kalpa, 177 ITR 540 where it was held that subsidy was for making a film and was to be treated ad a capital receipt because the film taken by the Bombay and Kerala Courts appears to be correct and accords with the principle laid down in Seaham Harbour Dock Company's Case (supra) that assistance given by the Government for completion of a project must be of capital nature.

In the case before us, 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. It must be held that these subsidies are of revenue character and will have to be taxed accordingly.

A Division Bench of the Calcutta High Court in the case of Kesoram Industries and Cotton Mills Ltd. v. Commissioner of Income Tax, 191 ITR 518 also examined a scheme of refund of sales tax framed by Andhra Pradesh Government to assist newly set up industries. There the assessee had set up a cement plant. The Calcutta High Court held that receipt of the incentives from the State Government was incidental to carrying on the business of the assessee . Such subsidies were received year after year by refund of sales tax. The benefit was received in course of carrying on the assessee's business. it was a benefit incidental to its business. The subsidy was not intended to be

contribution towards capital outlay of the industry. Therefore, it was held that the subsidy received by the assessee in that case could not be regarded as anything but a revenue receipt.

The Madhya Pradesh High Court in the case of Commissioner of Income Tax v. Dusad Industries, 162 ITR 734, dealt with a case where Government had framed a scheme for granting sales tax subsidies to industries set up in backward areas. The High Court was of the view that the object of the scheme was not to supplement the profits made by industries. In that view of the matter, the High Court held that the subsidies five under the said scheme by the Government to newly set up industries were capital receipts in the hands of the industries and could not be taxed as revenue receipts. In that case, 75 per cent of the sales tax paid in a year for a period of five years from the day of starting of production was to be given back by the Government to the industry concerned. The High Court was of the view that obviously the subsidy was given by way of addition to the profits of the assessee as was clear from the facts and circumstances of the case. The Madhya Pradesh High Court, however, failed to notice the significant fact that under the scheme framed by the Government, no subsidy was given until the time production was actually commenced. Mere setting up of the industry did not qualify an industrialist for getting any subsidy. The subsidy was given as help not for the setting up of the industry which was already commenced production. The view taken by the Madhya Pradesh High Court is erroneous.

In view of the aforesaid, it is not necessary to discussed the point relating to applicability of section (41) of the Income Tax Act, 1961 in this case.

The appeal fails and is dismissed . There will be no order as to costs.

C.A.NOS. 10091/95, 5279/96, 2008/88, 425/85 In view of our above decision, these appeals also stand dismissed with no order as to costs.

C.A.NOS. 1664-65/97 These appeals by the Revenue are allowed with no order as to costs.