IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL NO. 316 of 2012
With
TAX APPEAL NO. 317 of 2012
TO
TAX APPEAL NO. 318 of 2012

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COMMISSIONER OF INCOME TAX....Appellant(s)
Versus
BIRLA VXL LTD....Opponent(s)

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Appearance:
MR PRANAV G DESAI, ADVOCATE for the Appellant(s) No. 1

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CORAM: HONOURABLE MR.JUSTICE AKIL KURESHI
and
HONOURABLE MS JUSTICE SONIA GOKANI
12th February 2013

ORAL ORDER *(PER : HONOURABLE MR.JUSTICE AKIL KURESHI)*

These Tax Appeals filed by the Revenue arise out of the common background. We may notice facts as arising in Tax Appeal No. 316 of 2012.

For the Assessment Year 1991-92, Revenue challenged the judgment and order of the Income Tax Appellate Tribunal dated 4th November 2011. Following question has been presented for our consideration :-

> "Whether in the circumstances and the facts of the case and in law, the Appellate Tribunal has erred in holding that the Sales Tax exemption of Rs. 30940235/= granted

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to the assessee company by the State Government was in the nature of 'Capital Receipt' not chargeable to tax ?"

The respondent-assessee had received incentives under the scheme framed by the Government of Gujarat under resolution dated 2nd January 1991 in the form of Sales Tax Waiver/Deferment scheme. For the A.Y 1991-92, the assessee had received sales tax exemption of Rs. 3,09,40,235/=. Similar sales tax exemptions of varying amounts were received for the subsequent assessment years ie., AY 1992-93 and 1993-94 also. Such incentives, according to the assessee, were in the nature of capital receipts. The Assessing Officer, however, did not accept such contention and held that the same was revenue in nature. The assessee carried the matter in appeal. CIT [A] by his order dated 28th March 2011, reversed the view of the Assessing Officer. He held that the purpose of incentives was clearly for promoting capital investment and thereby to achieve industrial development and therefore, incentive was in the nature of capital receipt. He relied on the decision of the Apex Court in case of ***CIT v. Ponni Sugars & Chemicals Limited***, reported in 306 ITR 392.

Revenue carried the matter in appeal before the Tribunal. The Tribunal, dismissed the Revenue's appeal by judgment dated 4th November 2011. The Tribunal relied on the decision in case of ***Ajanta Manufacturing Limited v. CIT*** [ITA No. 793/RJT/2010]. The Revenue is thereupon before us in the present

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Tax Appeals.

Learned counsel for the Revenue pointed out that the decision of the Tribunal in case of *Ajanta Manufacturing Limited* [Supra] is under challenge before this Court in Tax Appeal No. 358 of 2012 which has been admitted. However, from the *impugned* judgment of the Tribunal, in the present cases, we noticed that the decision in case of *Ajanta Manufacturing Limited* [Supra] was rendered in the background of a different incentive scheme altogether. It emerges that in Ajanta Manufacturing Limited's case the Tribunal was concerned with the Sales Tax Incentive Scheme of the State Government made available to the Kutch region industries in wake of devasting earthquake hitting that region in the year 2001. Since in every case, decision whether incentive is in the nature of capital or revenue receipt must depend on the terms of the scheme involved. Mere fact that the High Court has admitted Revenue's appeal in case of *Ajanta Manufacturing Limited* need not detain us in deciding these appeals.

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In case of ***Sahney Steel and Press Works Limited & Ors. vs. Commissioner of Income Tax***, reported in 228 ITR 253, the Apex Court observed that to determine the character of subsidy in the hands of the recipient, whether revenue or capital, it would have to be determined having regard to the purpose for which the subsidy is given. The source of fund is

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quite immaterial. If the payment is in the nature of subsidy to assist the assessee in carrying on its trade or business, it a trade receipt. However, if the purpose is to help assessee to set-up its business or complete the project, the monies must be treated as having been received for capital purposes.

Such decision in case of *Sahney Steel & Press Works Limited* [*Supra*] came up for consideration before the Supreme Court in case of *Ponni Sugars & Chemicals Limited* [*Supra*] wherein, the Apex Court observed as under :-

> 14. In our view, the controversy in hand can be resolved if we apply the test laid down in the judgment of this Court in the case of Sahney Steel and Press Works Ltd. (supra). In that case, on behalf of the assessee, it was contended that the subsidy given was up to 10% of the capital investment calculated on the basis of the quantum of investment in capital and, therefore, receipt of such subsidy was on capital account and not on revenue account. It was also urged in that case that subsidy granted on the basis of refund of sales tax on raw materials, machinery and finished goods were also of capital nature as the object of granting refund of sales tax was that the assessee could set up new business or expand his existing business. The contention of the assessee in that case was dismissed by the Tribunal and, therefore, the assessee had come to this Court by way of a special leave petition. It was held by this Court on the facts of that case and on the basis of

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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. 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

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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. In our view, the controversy in hand can be resolved if we apply the test laid down in the judgment of this Court in the case of Sahney Steel and Press Works Ltd. (supra). In that case, on behalf of the assessee, it was contended that the subsidy given was up to 10% of the capital investment calculated on the basis of the quantum of investment in capital and, therefore, receipt of such subsidy was on capital account and not on revenue account. It was also urged in that case that subsidy granted on the basis of refund of sales tax on raw materials, machinery and finished goods were also of capital nature as the object of granting refund of sales tax was that the assessee could set up new business or expand his existing business. The contention of the assessee in that case was dismissed by the Tribunal and, therefore, the assessee had come to this Court by way of a special leave petition. It was held by this Court on the facts of that case and on the basis of the analyses of the Scheme therein that the subsidy given was on revenue account because it was given by way of assistance in carrying on of trade or business. On the facts of that case, it was held that the subsidy given was to meet recurring expenses. It was not for acquiring

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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. 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

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> 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."

We may apply the above ratio to the cases on hand. We may take note of the incentive scheme in question. The same was named, "Incentive for modernization by Existing Industrial Units : 1990-95". It was announced by the Government as a part of new industrial policy, to accelerate the industrial development, to disperse industries to under-developed areas as well as to provide additional employment. Preamble to the resolution dated 2nd January 1991 under which the scheme was framed records that it was represented to the State Government that on account of rapid changes in technology and need to upgrade technology in industries, it is necessary to encourage modernization and evolve a scheme for incentives towards modernization. With these purposes in mind, the said scheme was framed. Term, "*modernisation*" was defined in clause 2{i} as under :-

> "***Modernisation***" means adoption of a new and upgraded process by an existing industrial unit under the same management which leads to savings in energy or reduction in pollution and improvement in production capacity by installation of new machinery,

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balancing equipment etc; as may be required. If the existing industrial unit merely replaces plant and machinery it will not be considered modernization, eligible for incentives under this scheme."

Conditions for seeking benefit of the scheme were as under :-

"New Investment in Modernization which fulfills the following criteria will be treated as modernization eligible for incentives under this scheme :-

[a] The existing industrial unit would make new investment towards modernization to the extent of not less than 25% of the original book value of the plant and machinery for which incentives are claimed.

[b] Such new investment should not be less than Rs. 5 Crores.

[c] Such new investment towards modernization must be accompanied by and result into 25% or more increase in the licenced capacity as it existed prior to modernization.

[d] The benefit of incentives towards modernization will be restricted to the new investment towards additional 50% increase in the licenced capacity thereby aggregating the licenced capacity upto 150%.

[e] Modernization in respect of new plant and machinery which is not a replacement and modernization in respect of plant and machinery which is depreciated upto 80% or more of the original book (gross) value will be eligible for incentive under this scheme."

Eligibility criteria for investment provided *inter alia* that the new plant and machinery and imported second hand machinery and installation expenditure capitalized under the head of "Plant & Machinery" would qualify

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for the incentive alongwith technical knowhow, fees or drawing fees, diesel generating sets, equipments for non-conventional sources of energy, as installed in the process of modernization and equipments required for purification or desalination of water or for pollution control measures for the existing industrial units.

Ineligible investment included land, building, civil construction/ working capital, good-will fees, etc. Annexure-A to the Scheme specified the category-wise eligible talukas for the incentives under the scheme. Annexure-B to the scheme provided the rate of incentives in the following manner :-

Rate of incentives of Sales Tax Exemption/Deferment for Modernization
Annexure to GRIMED No. INC/1090/1023(9)-I dated 2 January 1991

Category of Area	Quantum S.T. Exemption/Deferment	Time Limit
I.	75% of the fixed capital investment	For a period of 8 years from the date of commencement of commercial production.
II.	60% of the fixed capital investment	For a period of 6 years from the date of commencement of commercial production.
II.	50% of the fixed capital investment	For a period of 5 year from the date of commencement of commercial production

Note :

1. If a unit reaches admissible amount stated in the col.2 above before the expiry of the time limit mentioned in col.3 above, it will not be eligible for incentives thereafter.
2. In respect of Sales Tax Deferment, the amount so deferred will be recovered in six annual installments beginning from the next financial year to the year in which unit reaches the maximum limit of incentive

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granted to the unit under the Scheme of after the inquiry.

3. Units claiming the incentive under this Scheme will not be eligible for sales tax incentives under any other Scheme.

From the above provisions contained in the said Scheme, it can be immediately noticed that the scheme was framed as a part of Government's initiative to encourage modernization of existing industries in under-developed areas. The main purpose of the scheme was to accelerate the industrial development and to disperse industries to under-developed areas as well as to provide additional employment. The Government responded positively to the representations that on account of rapid changes in technology, there was constant need for upgradation of technology in industries. It was, therefore, necessary to encourage modernization. As part of such a scheme, incentives were given to industries existing in under-developed areas to undertake modernization. The scheme thus was primarily concerned with the modernization of the existing industries. It was not a scheme either for development of new industries in specified areas, or for mere expansion of the existing production capacities of the industries. Thus, the main purpose of the resolution was to modernize industries, which ordinarily would come at a considerable cost, particularly when such industries were located in under-developed areas. It can be imagined that the industries will find it difficult without Government's incentive to undertake large-scale modernization with

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the use of modern technology. It was for this purpose that the said scheme was framed giving benefit of the Sales Tax Waiver/Deferment, at the option of the industry concerned. Such benefit had to be computed in terms of the percentage of the fixed capital investment. Benefits were to last for specified periods and upto exhausting maximum limit computed in terms of the percentage of the fixed capital investment.

It can thus be straightaway seen that the benefit, though computed in terms of the Sales Tax liability in the hands of the recipient, the same was not mean to give any benefit on day-to-day functioning of the business, or for making the industry more profitable. The principle aim of the scheme was to cover the capital outlay already made by the assessee in undertaking special modernization of its existing industry.

In a recent decision dated 28th January 2013 in Tax Appeal No. 450 of 2012 and connected appeals, we had an occasion to examine the nature of incentives received by the assessee from the State Government in the form of entertaining tax waiver for setting up multiplexes. In such context, we had in wake of the revenue's contention that the receipt was revenue in nature, held and observed as under :

> " From the provisions of the said scheme, it clearly emerges that the subsidy though computed in terms of sales tax deferment or waiver, in essence it was meant for

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capital outlay expended by the assessee for set up of the unit in case of a new industrial unit and for expansion and diversification of an existing unit. As noted, such subsidy was available only to a new industrial unit or a unit undertaking expansion or diversification. Fixed capital investment has been defined as to include various investments in land under use, new construction, plant and machinery etc. The entitlement was related to percentage of fixed capital investment.

It is undoubtedly true that such subsidy was computed in terms of sales tax deferment and necessarily therefore, would accrue to an industry only once the commercial production commences. However, this by itself would not be either a sole or concluding factor. In case of Sahney Steel and Press Works Ltd. and others v. Commissioner of Income-tax reported in 228 ITR 253, the Apex Court held and observed that the character of the subsidy in the hands of the recipient whether revenue or capital will have to be determined, having regard to the purpose for which the subsidy is given. The source of fund is quite immaterial. If the purpose is to help the assessee to set up its business or complete a project the monies must be treated as having been received for capital purposes. But, if monies are given to the assessee for assisting him in carrying out the business operations and given after the satisfaction of the conditions of commencement

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of production, such subsidy must be treated as assistance for the purpose of the trade."

In the result, we do not find that the Tribunal has committed any error. No question of law, therefore, arises. Tax Appeals are therefore dismissed.

(AKIL KURESHI, J.)

(Ms. SONIA GOKANI, J.)

*Prakash**

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