# IN THE INCOME TAX APPELLATE TRIBUNAL
# SMC BENCH, PUNE

BEFORE SHRI R.S. SYAL, VICE PRESIDENT

आयकर अपील सं. /ITA No.792/PUN/2023

निर्धारण वर्ष / Assessment Year : 2010-11

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| Chaitanya Steelshape Private Limited,<br>G-95, MIDC, Jalgaon – 425 003<br>Maharashtra<br>PAN : AABCC4388B | Vs. | ITO,<br>Ward-1(2),<br>Jalgaon |
| Appellant | | Respondent |

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| Assessee by | Shri Bhushan R. Patil |
| Revenue by | Shri Ajay D. Kulkarni |
| Date of hearing | 27-07-2023 |
| Date of pronouncement | 28-07-2023 |

## आदेश / ORDER

PER R.S. SYAL, VP:

This appeal by the assessee emanates from the order dated 11-05-2023 passed by the CIT(A) in National Faceless Appeal Centre, Delhi u/s.250 of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2010-11.

2. The only point raised in this appeal is against the nominal addition of Rs.3,22,200/- made by the Assessing Officer (AO) treating the amount of subsidy as a revenue receipt.

3. The facts apropos the issue are that the assessee is a private limited company engaged in the business of manufacturing of Press parts, Engineering goods, Fabrication and Trading thereof. A return

was filed declaring total income of Rs.12,77,358/-. During the course of assessment proceedings, the AO observed that the assessee received a subsidy of Rs.3,22,200/- in the year under consideration, which was taken to "Reserve and Surplus" in the balance sheet. On being called upon to explain as to why the amount should not be charged to tax as a revenue receipt, the assessee submitted that it received Incentive under the Package Scheme for expansion of industry in the approved backward area. In support of its contention, the assessee also furnished a copy of the Agreement for disbursement of Special Capital incentive and Package Scheme of Incentive. The AO opined that the amount of subsidy was transferred by the assessee to 'Reserve and Surplus' account, which indicated that it was not utilised for incurring or setting up a new unit or for expansion of the existing one. Relying on the judgment in *Sahney Steel Works Ltd. Vs. CIT (1997) 228 ITR 253 (SC),* he held the amount chargeable to tax. The ld. CIT(A) did not provide any succour to the assessee, against which the extant appeal has been instituted.

4. Having heard both the sides and gone through the relevant material on record, it is seen that the assessee received subsidy of Rs.3,22,200/- in the year under consideration, which was transferred

to “Reserve and Surplus’ on the liability side of the balance sheet. The assessee explained to the AO that the subsidy was granted for making investment in Building and Plant and machinery. The AO did not accept the contention on the ground that the amount was standing on the liability side of the balance sheet. In my view, receipt of subsidy is one transaction and purchase of an asset another. Subsidy, if of the revenue nature, is taken to the credit side of the Profit and loss account; and if of the capital, then to the balance sheet. In the latter case, if subsidy is relatable to a particular asset, then it reduces the cost of the concerned asset and if not, it is taken to Reserve and surplus account on the liability side. On the other hand, transaction of purchase of the corresponding asset etc. continues independently. The mere fact that the assessee reflected the amount of subsidy in `Reserve and Surplus’ of its balance sheet is just an indicator that it was not a revenue receipt from the stand point of the assessee. Such a reflection *per se* is not determinative of the taxability or otherwise of the subsidy. The decisive test for determining whether subsidy is `revenue’ and hence taxable; or ‘capital’ and consequently not taxable during the year is to ascertain *purpose* and object and not how it is reflected in the accounts.

5. Adverting to the facts of the instant case, it is seen that the assessee proposed to expand its industry by investing Rs.2.54 lakh in Building and Rs.33.25 lakh in Plant and machinery, totalling to Rs.35.80 lakh, against which subsidy of Rs.8.055 lakh was sanctioned by means of Eligibility Certificate dated 18-10-2006 issued by the General Manager, District Industries Centre, Jalgaon. A copy of the Certificate has been placed on record. Para 2 of the Certificate states that: "On the basis of the information/details furnished by you, under the application form for Eligibility Certificate under the Package Scheme of Incentives, 2001....., the Gross Value of Fixed Capital Investment proposed to be made for the above indicated thereunder is found to be of the order of Rs.35.80 lacs." Para 6 of the Certificate states that: "The holder of Eligibility Certificate shall - (i) Complete all the Final Effective Steps as are listed under the 2001 Scheme by 31st March, 2007 and furnish the complete documentary evidence in respect thereof to the satisfaction of IMPLEMENTING AGENCY." On going through the relevant paras of the Eligibility Certificate, it clearly transpires that the incentive of Rs.8.055 lakh was sanctioned as a *quid pro quo* for the Gross Value of Fixed Capital Investment of Rs.35.80 lakh agreed to be made by the assessee. This fact is further corroborated from para 3

of the Eligibility Certificate stating that: "Accordingly subject to fulfilment of all the terms and conditions of the 2001 Scheme Procedure made thereunder of this Eligibility Certificate the following entitlements by way of incentive admissible under the scheme are provisionally worked out *on the basis of actual investment indicated by the unit for the project*". It is, therefore, amply manifest that the sanction of incentive of Rs.8.055 lakh, out of which incentive of Rs.3,22,200/- was actually received by the assessee during the year, was sanctioned for making Capital Investment in Building and Plant and Machinery to the tune of Rs.35.80 lakh. Now the moot question is whether such subsidy received by the assessee is a 'Capital' or 'Revenue' receipt?

6. The law on the point is trite by virtue of the judgment of the Hon'ble Supreme Court in *Sahney Steel Works Ltd. (supra)* which has laid down the criterion for determining if the subsidy is a Capital or a Revenue receipt. The relevant test is to see the '*purpose'* or object of the subsidy. If the purpose is to enable the carrying on the business operations more profitably by means of some assistance against certain expenses incurred or taxes paid, then it should be treated as 'Revenue' receipt. In the case of *Sahney Steel (supra)*, the assessee received subsidy by way of reduction of Sales Tax on

purchase of machinery after commencement of the production. The Hon'ble Supreme Court held that the subsidy given after commencement of production to enable the assessee to run the business more profitably was '*operational subsidy*' and hence a 'Revenue' receipt. It, therefore, follows that when the Government comes forward to help the existing businesses *de hors* the setting up or expansion of new industrial units, it becomes a 'Revenue' receipt chargeable to tax. *Au contraire,* if the subsidy does not satisfy the above conditions, or, in other words, the purpose of the subsidy is not to subsidize the expenses incurred or taxes paid, but to encourage the industrial growth, then it assumes the character of 'Capital' receipt. To simply put, if the subsidy is received for setting up of a new industry or expansion, then it ceases to be '*operational subsidy*' and becomes a 'Capital' receipt. The crux of the matter is that one needs to ascertain the '*purpose'* for which the subsidy was granted and not the timing or the manner of quantification. If the '*purpose*' of the subsidy is to accelerate the industrial growth by setting up new units or the expansion of the existing units, then it becomes a 'Capital' receipt. The manner of disbursement of subsidy, that is, whether by means of cash paid or bank loans on soft terms or reduction in expenses or taxes etc. is absolutely alien to the question of

determination of the nature of subsidy as a 'Capital' or a 'Revenue' receipt. It is quite possible that a scheme of the Government makes an assessee eligible for subsidy on setting up or expansion of industry in a particular backward area and such subsidy is granted after the commencement of production in the shape of reduction in Sales Tax or Electricity bill etc. In such circumstances, even though, the subsidy is in the nature of reduction in Sales Tax or Electricity bills etc. after the commencement of production, still it will be a capital receipt, because '*purpose*' of the subsidy is to set up a new units or expansion of the existing units. Thus, it is evident that one needs to examine the purpose of subsidy and not the manner of its quantification or disbursement. If subsidy is in the nature of a 'Revenue' receipt as is the case of *Sahney Steel Works Ltd. (supra)*, it becomes 'Revenue' receipt chargeable to tax. If, however, the subsidy assumes the character of a 'Capital' receipt, then other provisions of the Act get triggered. In holding the subsidy a revenue receipt, the Hon'ble Apex Court in *Sahney Steel (supra)* found that : `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 5 years to enable them to be viable and competitive.' It is in this backdrop of the facts that the subsidy was held to be chargeable to tax as a revenue receipt. The Hon'ble Summit Court also added a word of caution by remarking in para 8 that : `If *the purpose is to help the assessee to set up its business or complete a project*, as in Saeham Harbour Dock Co.'s case (supra), *the monies must be treated as to have been received for capital purpose*.' Justifying the taxability of subsidy as a revenue receipt in that case, the Hon'ble Supreme Court observed in para 13 that : `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.' The nitty gritty of the above discussion is that if subsidy is given to an already operational unit and there is no link between the setting up of the industry and the grant of subsidy in the form of reduction in expenses incurred or taxes paid etc., then it becomes revenue subsidy; but where it is given for setting up of industry or expanding existing industry, such subsidy becomes a capital receipt.

7. At this juncture, it would be pertinent to consider the judgment of Hon'ble Supreme Court in *CIT Vs. P.J. Chemicals Ltd. (1994) 210 ITR 830 (SC)* in which the assessee was granted Central Subsidy which was admittedly of the 'Capital' nature. The Hon'ble Supreme Court held that the amount of subsidy was not for the specific purpose of a portion of the cost of the asset, though quantified as a percentage of such cost and hence it did not partook of the character of a payment intended either directly or indirectly to meet the 'actual cost'. Resultantly, the capital subsidy was held to be not deductible from the cost of assets in terms of section 43(1) of the Act. The Finance (No.2) Act, 1998 inserted Explanation 10 to section 43(1) w.e.f. 01-04-1999 to the effect that where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Govt. or a State Govt. etc. in the form of a subsidy or grant, then so much of the cost as is relatable to such subsidy or grant etc. shall not be included in the actual cost of an asset to the assessee. Proviso to the Explanation further provides that where such subsidy or grant etc. is of such a nature that it cannot be directly related to the asset acquired, then, so much of the amount which bears to the total subsidy the same proportion as such asset bears to all the assets in respect of which the subsidy is so received, shall not be included in

the actual cost of the asset to the assessee. It is palpable that Explanation 10 to section 43(1) has the effect of neutralizing the decision of *P.J. Chemicals (supra)* by making it clear that where a portion of cost of an asset acquired by the assessee has been met directly or indirectly by means of some subsidy, then it should be reduced from the cost of asset whether or not it is directly relatable to the asset acquired. Ergo, it is manifest that the Explanation covers all the cases of receipt of grant towards cost of an asset acquired provided it is for meeting the cost or a portion of the cost of the asset. There can be other scenarios where the subsidy is otherwise of a capital nature but is not given to meet the cost of assets as such, thereby not magnetizing the mandate of Explanation 10 to section 43(1) of the Act. The '*purpose*' test as laid down in *Sahney Steel Works Ltd. (supra)* would come into play thereby not permitting to treat the amount of subsidy as a 'Revenue' receipt. Such subsidy of capital nature would spare the rod of taxation. In order to plug such a loophole, the Finance Act, 2015 has amended the definition of `income' u/s.2(24) by inserting clause (xviii) w.e.f. 01-04-2016 providing that the subsidy or grant etc. given in cash or kind by the Government or any authority etc. would be `income' except where,

*inter alia,* such subsidy has been taken into account for determining the actual cost as per Explanation 10 to section 43(1) of the Act.

8. On an overview of the '*purpose*' test laid down in *Sahney Steel Works Ltd. (supra);* Explanation 10 to section 43(1); and section 2(24)(xviii), the position which now emerges is that if the '*purpose*' of the subsidy is to extend a helping hand by the Government etc. towards the expenses incurred or taxes paid etc. to a continuing business, unlinked with its setting up or expansion, it would be of the 'revenue' nature and chargeable to tax. Where the subsidy is granted otherwise than for the above, such as, for setting up a new industry or expansion of an existing industry, then it would be chargeable to tax as `income' in terms of section 2(24)(xviii), provided it is not given directly or indirectly to meet the cost of an asset acquired by the assessee. If the subsidy is so given for meeting the cost of an asset, then it would be reduced from the cost of an asset u/s.43(1) of the Act and would not be separately chargeable to tax as income. The crux of the matter is that the hitherto Capital subsidy would now either be reduced from the cost of asset in terms of Explanation 10 to section 43(1) or would be directly chargeable to tax as `income' u/s 2(24)(xviii) of the Act. However, it is pertinent to note that clause (xviii) to section 2(24) has been inserted by the Finance Act, 2015

w.e.f. 01-04-2016 which is prospective in nature and cannot apply to earlier assessment years.

9. Turning to the facts of the instant case, it is found that the amount of subsidy received by the assessee is towards the investment made in expansion of its industrial unit under the Package Incentive Scheme 2001. Applying the '*purpose*' test, it would be characterised as a 'Capital' receipt. Further, it is not the case of the AO that Explanation 10 to section 43(1) is attracted. Thus, section 2(24)(xviii) would be attracted, in principle, but would not apply as the assessment year under consideration is prior to the insertion of the proviso. It is, therefore, held that the authorities below were not justified in treating the amount of subsidy as a 'Revenue' receipt chargeable to tax.

10. In the result, the appeal is allowed.

Order pronounced in the Open Court on 28th July, 2023.

Sd/-
**(R.S.SYAL)**
**VICE PRESIDENT**

पुणे Pune; दिनांक Dated : 28th July, 2023
सतीश

**<u>आदेश की प्रतिलिपि  ग्रेषित/Copy of the Order is forwarded to</u>:**

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent
3. The Pr.CIT concerned
4. DR, ITAT, 'SMC' Bench, Pune
5. गार्ड फाईल / Guard file.

**आदेशानुसार**/ BY ORDER,

**// True Copy //**

Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune

| | | Date | |
|---|---|---|---|
| 1. | Draft dictated on | 27-07-2023 | Sr.PS |
| 2. | Draft placed before author | 28-07-2023 | Sr.PS |
| 3. | Draft proposed & placed before the second member | | JM |
| 4. | Draft discussed/approved by Second Member. | | JM |
| 5. | Approved Draft comes to the Sr.PS/PS | | Sr.PS |
| 6. | Kept for pronouncement on | | Sr.PS |
| 7. | Date of uploading order | | Sr.PS |
| 8. | File sent to the Bench Clerk | | Sr.PS |
| 9. | Date on which file goes to the Head Clerk | | |
| 10. | Date on which file goes to the A.R. | | |
| 11. | Date of dispatch of Order. | | |

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