$~ R-47(Part-II-B)

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

\+ ITA 3/2001

% **Date of Decision**: 5th September, 2013

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr. Amol Sinha, Adv.

versus

M/S HANDICRAFTS AND HANDLOOMS EXPORT CORPN. OF INDIA LTD. ..... Respondent
Through: Mr. Kamal Mehta, Adv.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE SANJEEV SACHDEVA

SANJIV KHANNA, J.

Revenue by this appeal under Section 260A of the Income Tax Act, 1961 (Act, for short) which pertains to assessment year 1985-86 submits that grant of Rs. 25 lakhs received by respondent assessee, M/s Handicrafts and Handlooms Exports Corporation of India Ltd. from its holding company State Trading Corporation of India (STC, for short) constitutes revenue receipt and amount received should be taxed as income. By order dated 29th March, 2001, the appeal was admitted and the following substantial question of law was framed:-

> "Whether the tribunal was justified in holding that grant of Rs. 25 Lakhs received by assessee was not a revenue receipt."

2. The Income Tax Appellate Tribunal by impugned order dated 29th February, 2000 decided the issue in favour of the respondent in view of decision of the Delhi High Court in the respondent's case in earlier years reported as (1983) 140 ITR 532 (Del.) titled ***Handicrats and Handlooms Corporation Ltd. Vs. Commissioner of Income Tax, Delhi.***

3. The contention of the Revenue is that this decision in respondent's case stands impliedly overruled by decision of the Supreme Court in ***Sahney Steel and Press Works Ltd. Hyderabad. Vs. Commissioner of Income Tax*** (1997) 7 SCC 764.

4. The assessment order records that respondent is a Government company and operates as channelizing agency for sale of handicrafts and handlooms abroad. There is no discussion in the assessment order regarding addition of Rs.25 lakhs on account of grant received by respondent assessee. However, this additional ground of appeal was taken in the first appeal and the Commissioner of Income Tax (Appeals) admitted the said ground. He has recorded that this amount was received from the holding company and Income Tax Appellate Tribunal in its order in assessment year 1986-87

had held that the grant received was not taxable as revenue receipt. This grant was given to recoup losses incurred by the respondent corporation and was in the nature of capital contribution. As noticed above, this view has been upheld by the tribunal.

5. We have examined the judgment of the Supreme Court in ***Sahney Steels (supra)*** wherein the test has been expounded for determining whether subsidy received by an assessee is taxable as capital or revenue receipt. Subsidy received on revenue account is certainly taxable but subsidy received on capital account is not taxable as income. In the said decision, the Supreme Court has referred to salient features of various schemes formulated by Central/State Governments and the subsidy received thereunder, the purpose of the said subsidy and then determined whether or not it was taxable as revenue receipt. It has been held that payments made as incentives or subsidies by way of refund of sales tax, power and electricity consumed on production, water rate etc. should be treated as revenue receipts. Incentives and subsidy received in nature of production expenses after the production has started were not directly or indirectly for setting up of industries and hence revenue in character. Manner and mode of computation of subsidy was not determinative. Operational subsidies

would be revenue in nature and they amount to trading receipts. Refunds of sales tax, or on account of water rate, land revenue or electricity charges enables an assessee to run his business profitably. The Supreme Court approved the basic principle propounded in ***Pontypridd and Rhondda Joint Water Board vs. Ostine*** (1946) 14 ITR (Supp.) 45 which reads as under:-

> "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, are to be brought into account in arriving at the balance of profits or gains under Case I of Schedule D".

6. When subsidy is received from a public fund and these are to assist the assessee to carry on or business, the object of subsidy is apparent i.e. to enable the assessee to run business more profitably, become more competitive etc. These are operational subsidies and not capital subsidies. The source from which the amount is paid is not determinative, as in such cases the subsidy is paid from public fund but the character of the subsidy in the hands of recipient determines whether the subsidy is revenue or capital in nature. It has accordingly been observed:

> "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, though attractive at first blush, does not bear close scrutiny. 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 assessee, 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 [1946] 14 ITR (Suppl.) 45 (HL) is that if payments 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.
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> 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 plant and machinery for further expansion of its manufacturing capacity in a backward area, the entire subsidy must be held to be a capital receipt in the hands of the assessee. It will not be open to the Revenue to contend that the refund of sales tax paid on raw materials or finished products must be treated as revenue receipt in the hands of the assessee. In both the cases, the Government is paying out of public funds to the assessee for a definite purpose. If the purpose is to help the assessee to set up its business or complete a project as in *Seaham Harbour Dock Co.'s* case [1931] 16 TC 333 (HL), the monies must be treated as having been received for a 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."

7. Reference was made to the full bench decision of Kerala High Court in ***CIT vs. Ruby Rubber Works Ltd.*** [1989] 178 ITR 181 where subsidy was

received for acquisition of an asset by replanting rubber plants of high yield varieties and it was held that the subsidy was capital in nature as it was not for maintenance of mature and immature rubber trees. Similarly, subsidy received for producing new original films was held to be capital receipt as they were for creating or acquiring of a new asset.

8. In a subsequent decision, ***CIT vs. Ponni Sugars and Chemicals***, [2008] 9 SCC 337 Supreme Court has lucidly explained the performance test in the following words:

> "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 is this case is that the incentive must be utilised for repayment of loans taken by the assessee to set up new units or for substantial expansion of existing units. On this aspect there is no dispute. If the object of the Subsidy Scheme was to enable the assessee to run the business more profitable 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".

9. It was observed that the purpose for payment of subsidy was made relevant criteria. It was further observed that in the case of ***Sahney Steel and Press Works Ltd. (Supra)*** the money received could be utilised in any manner by the assessee and the assessee was not obliged to spend the money for a particular purpose.

10. In ***Ponni Sugars and Chemicals Ltd. (Supra)*** subsidy had been received under the schemes stipulating four requirements:-

> "(i) Benefit of the incentive subsidy was available onto new units and to substantially expanded units, not to supplement the trade receipts.
>
> (ii) The minimum investment specified was Rs.4 Crores for new units and Rs.2 crores for expansion units.
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> (iii) Increase in the free sale sugar quota depended upon increase in the production capacity. In other works, the extent of the increase of free sale sugar quota depended upon the increase in the production capacity.
>
> (iv) The benefit of the Scheme had to be utilised only for repayment of term loans."

11. The payment of subsidiary under the scheme was held to be capital in nature and not made during the course of trade.

12. The findings recorded by the Delhi High Court in their earlier decision in the case of the respondent/assessee reported in [1983] 140 ITR 532 is the grant given by the holding company was of capital nature and not revenue or contributing to the trading income of the respondent.

13. In the present case, Rs.25 lakhs was not paid by a third party or by a public authority but by the holding company. It was not on account of any trade or a commercial transaction between the subsidiary and holding company. The holding company was a shareholder and the shares partake and were in nature of capital. Share subscription money received in the hands of the respondent assessee was a capital receipt. The intention and purpose behind the said payment was to secure and protect the capital investment made by STC Ltd. in the respondent. The payment of grant by STC and receipt thereof by the respondent was not during the course of trade or performance of trade, thus, could be categorised or classified as a gift or a capital grant and did not partake character of a trading receipts. Trading receipts reach a trader in his capacity as such and are made to assist him to carry on the trade. In ***Handicrafts and Handlooms Corpn. Ltd.vs. CIT, Delhi (supra)***, the Division Bench noticing the difference between Government grant and the payment by made STC, has observed as under:

> "There is, in our opinion, a basic difference between grants made by a Government or from public funds generally to assesses in a particular line of business or trade, with a view to help them in the trade or to supplement their general revenues or trading receipts and not earmarked for any specific or particular purpose and a case of a private party agreeing to make good the losses incurred by an assessee on account of a mutual relationship that subsists between them. The former are treated as trading receipts because they reach the trader in his capacity as such and are made in order to

assist him in the carrying on of the trade. The amounts with which we are concerned are different. They are not grants received from an outsider or the Government on such general grounds. As found by the Tribunal, these are specific amounts paid by the STC to the assessee in order to enable the assessee, which was its subsidiary and was incurring losses year after year, to recoup those losses and to enable it to meet its liabilities. These amounts, we are of opinion, cannot form part of the trading receipts of the assessed. As stated in our order for the earlier year, the position will be clear if we consider the case of a father agreeing to recoup the losses incurred by sons in his business. The amounts given by the father will be only in the nature of gifts or voluntary payments motivated by affection or personal relationship and not stemming from any business considerations. The position is similar here."

In an earlier part of decision the High Court had held:

"Before dealing with the objections raised by the assessee we may mention that even for the assessment year 1970-71, the assessee-company had received a sum of Rs. 2,04,640 from the STC. This was the balance amount which had been received by the assessee towards the reimbursement of its losses in earlier years. As already pointed out, a portion of the losses had been recouped by the amounts given in earlier years and the sum of Rs. 2,04,640 was given with a view to enable the assessee to write off all the losses of the earlier years. So far as this item is concerned both the AAC and the Tribunal deleted it and the correctness of their findings is the subject-matter of ITR No. 196/77, which is pending before this court. We are not here concerned with it. So far as the sum of Rs.11,70,000 is concerned, however, the AAC rejected the plea of the assessee but the Tribunal accepted it and it is the correctness of the conclusion of the Tribunal that is challenged before us.

We have heard learned counsel on both sides in regard to this matter and we agree with the conclusion of the Tribunal that the sum of Rs. 11,70,000 stands on no different footing from the amounts received from the STC in earlier years. We have pointed out that what happened in earlier years was that the assessee, having incurred certain losses in its export business, approached the STC for assistance to enable it to meet its liabilities consequent on such losses and

> the STC agreed to do so by reimbursing the losses incurred by the assessee. There was, therefore, even in those years an agreement on the part of the STC to recoup the losses made by the assessee. The circumstance, therefore, that in the present year, there was an agreement during the previous year by which the STC agreed to give financial assistance to the assessee will not, therefore, make any difference in principle. We are also of opinion that the other distinguishing feature pointed out by the Department does not also make a difference. As pointed out by the Tribunal the nature and purpose of the payments by the STC to the assessee is the same in earlier years as well as this years. In all the years the STC has only provided monies to the assessee-corporation with the object of enabling it to offset the losses which it had incurred in the course of its business. The fact that the contribution which the STC was prepared to make to enable the assessee to do this was measured in terms of a percentage of its export earnings and was not a flat or round sum of money as in the prior years does not, it seems to us, make any difference. In all the years it is only a case of a cent. per cent. holding company coming to the rescue of its subsidiary which has incurred losses and enabling it to recoup those losses and continue to carry on the business in spite of such losses. In the circumstances, what we have said in our earlier judgment in ITR Nos. 17 and 94/74 (Addl. CIT v. Handicrafts & Handloom Export Corpn. [1982] 133 ITR 590) will equally apply in regard to the assistance received by the assessed from the STC during the current year."

14. The aforesaid findings recorded by the High Court in the earlier decision i.e. (1983) 140 ITR 532 merit acceptance, even when we apply the purpose test applied in the case of **Sahney Steel & Press Works Ltd. (supra)** as explained in ***Ponni Sugar and Chemicals Ltd. (Supra)***. It cannot be said that the earlier decision of the Delhi High Court has been overturned or overruled by the Supreme Court in the two decisions

mentioned above.

15. Accordingly, we answer the question of law against the appellant Revenue and in favour of the respondent assessee.

16. The appeal is disposed of without any order as to costs.

(SANJIV KHANNA)
JUDGE

(SANJEEV SACHDEVA)
JUDGE

SEPTEMBER 05, 2013
cl/kkb