

A COMMISSIONER OF INCOME TAX, MADRAS
v.
PONNI SUGARS & CHEMICALS LTD.
(Civil Appeal No. 5694 of 2008 etc.)

SEPTEMBER 16, 2008

B [S.H. KAPADIA AND B. SUDERSHAN REDDY, JJ.]

Income Tax Act, 1961:

C *Subsidy receipt – Determination of nature – Whether includible in total income Held: Character of such receipt has to be determined applying the purpose test i.e. the purpose for which the subsidy is given – In the instant case, the object of the subsidy was capital in nature to utilize the same only for repayment of term loan undertaken by the assessee for setting up new units/expansion of existing business – Hence such receipt was not includible in total income.*

D *s. 80 P(2)(a)(i) – Exemption under – In respect of interest received from the members of co-operative Society – Held: In order to decide such question examination of Memorandum of Association, Articles of Association, the Return of Income, status of business etc., is required – In the present case, since Tribunal failed to examine the same, matter remitted to Tribunal for consideration of the question afresh.*

E *Area development funds – Collected by sugar mills – Whether trading receipt – Held: matter remitted to tribunal for consideration of the question afresh.*

The questions for consideration in the present appeals are:

G **(i) Whether the incentive subsidy received by the assessee is a capital receipt not includible in the total income?**

(ii) Whether the assessee was entitled to exemption u/s 80 P(2) (a) (i) of Income Tax Act, 1961 in respect of interest received from the members of the Society ? and

(iii) Whether the area development funds collected by sugar mills would be trading receipt ? A

Partly allowing the appeals filed by the Revenue, the Court

HELD: 1. 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. 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 the present case, 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. Such payment received by the assessee under the Scheme was not in the course of a trade but was of capital nature. [Paras 14, 16 and 17] [578 F & H] [579 AB, 580 C,D,E] B C D E

Sahney Steel and Press Works Ltd. and Ors. v. CIT (1997) 228 ITR 253 – relied on F

Seaham Harbour Dock Co. v. Crook (1931) 16 TC 333 – referred to

2. In order to earn exemption u/s 80 P(2), a co-operative society must prove that it had engaged itself in carrying on any of the several businesses referred to in sub-section (2). In that connection, it is important to note that under sub-section (2), in the context of co-operative society, Parliament has stipulated that the society must be G H

A engaged in carrying on the business of banking or providing credit facilities to its members. Therefore, in each case, the Tribunal was required to examine the Memorandum of Association, the Articles of Association, the Return of Income filed with the Department, the status of
 B business indicated in such Returns etc.. This exercise had not been undertaken at all. Therefore, the matters are remitted to the Tribunal for *de novo* consideration in accordance with law. [Paras 18 and 19] [581 B-D & E]

C 3. In view of the judgment of the Bombay High Court in *Chhatrapati Sahakari Sakhar Karkhana Ltd.* case, the matter is remitted to the Tribunal for *de novo* consideration of the question whether the area development funds collection by sugar mills would be trading receipt, in accordance with law and in accordance with the directions
 D given therein. [Paras 20 and 21] [581 F G]

CIT v. Chhatrapati Sahakari Sakhar Karkhana Ltd. (2000)
 245 ITR 498 – relied on

Case Law Reference

E	(1997) 228 ITR 253	Relied on	Para 14
	(1931) 16 TC 333	Referred to	Para 15
	2000) 245 ITR 498	Relied on	Para 21

F CIVILAPPELLATE JURISDICTION : Civil Appeal No. 5694 of 2008

From the final Judgment and Order dated 16.9.2002 of the High Court of Judicature at Madras in T.C. 492 of 1996

G P.V. Shetty, Harish Chandra, S. Ganesh, R.F. Nariman, P.H. Parekh, S.K. Bagaria, Rahul Kaushik, Sanjeev Bhardwaj, K. B. Sandeep, B.V. Balaram Das, Radha Rangaswamy, Shashi M. Kapila, Kush Chaturbedi, Vikas Mehta, E.R. Kumar, Arjun Garg, Shakun Sharma, Rukmini Bobde (for Parekh & Co.), K.K. Mani, C.K.R. Lenin Sekar, R.K. Pandey, C.N. Sree Kumar, Dushyant
 H Parashar, P.R. Nayak Pankaj Gupta, Aarohi Bhalla, Shekhar

COMMISSIONER OF INCOME TAX, MADRAS v. PONNI 573
SUGARS & CHEMICALS LTD.

Raj Sharma, Sujata Kurdukar, S.U.K. Sagar, Bina Madhavan, A
Manish, Ashima Chalia (for M/s. Lawyers Knit & Co.) and Manik
Karanjawala for the appearing parties.

The Judgment of the Court was delivered by

S. H. KAPADIA, J. 1. Leave granted. B

2. In the above batch of civil appeals, based on the argu-
ments addressed before us, we are mainly concerned with the
following two questions, namely:

(i) Whether the incentive subsidy received by the C
assessee is a capital receipt not includible in the
total income?

(ii) Whether the assessee was entitled to exemption D
under Section 80 P(2)(a)(i) of the Income Tax Act,
1961 in respect of interest received from the
members of the society?

3. At the outset, it may be noted that this batch of civil ap-
peals covers four incentive subsidy Schemes of 1980, 1987,
1988 and 1993. All the four schemes are almost identical. They E
are different in matter of details. However, in 1980 and 1987
Schemes there is an additional benefit by way of rebate in re-
spect of payment of excise duty which is not there in the re-
maining two Schemes of 1988 and 1993.

4. With the above preface, we refer to the facts in the case F
of Salem Cooperative Sugar Mills Ltd (civil appeal arising out
of SLP (C) No. 12355/06).

5. That matter concerns the 1980 Scheme. The dispute
pertains to Assessment Year 1986-87. In this matter both the G
above questions arises for determination. The incentives con-
ferred under that Scheme were twofold. First, in the nature of a
higher free sale sugar quota and second, in allowing the manu-
facturer to collect excise duty on the sale price of the free sale
sugar in excess of the normal quota, but pay to the Government
only the excise duty payable on the price of levy sugar. In that H

A connection, we quote clause 7 of the Scheme, which reads as under:

B “The beneficiaries of the incentive scheme shall ensure that the surplus funds generated through sale of the incentive sugar are utilized for the repayment of term loans, if any, outstanding from the Central Financial institutions. The sugar factories should submit utilization certificates annually from Chartered/Cost Accountant, holding certificate of practice. Utilisation certificate in respect of each sugar season during the incentive period should be furnished on or before the 31st December of the succeeding year. Failure to submit utilization certificate within the stipulated time may result not only in the termination of release of incentive free sale quota, but also in the recovery of the incentive free sale releases already made, by resorting to adjustment from the free sale releases of future years.”

E 6. At this stage, we may again note that the 1980 and 1987 Schemes are similar to each other. In the case of Salem Cooperative Sugar Mills Ltd. we are concerned with the Scheme of 1980.

F 7. On the first question, namely, whether the incentive subsidy received by the assessee is a capital receipt, Shri P.V. Shetty, learned senior counsel appearing on behalf of the Department (appellant) submitted that the additional revenue generated by higher free sale sugar quota cannot be considered to be a capital receipt in the hands of the assessee (respondent herein) as held by the High Court. He further contended that similarly retention of the collective excise duty on the sale price of free sale sugar in excess of the normal quota and paying to the Government only the excise duty payable on the price of levy sugar resulted in revenue generation in the hands of the assessee which contention of the Department has been erroneously rejected by the High Court. According to the learned counsel, under the Scheme, there were two distinct concepts,

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namely, the concept of accrual of income in the hands of the assessee and the concept of application of additional funds generated thereunder. According to the learned counsel, application of additional funds is neither material nor relevant for deciding the character of the incentive subsidy. In this connection, learned counsel placed reliance on the judgment of this Court in the case of *Sahney Steel and Press Works Ltd. and Ors. v. CIT* reported in (1997) 228 ITR 253.

8. Shri Ganesh, learned senior counsel appearing on behalf of the assessee submitted that the benefits were conferred on the assessee under the 1980 and 1987 Schemes, namely, additional price by reason of enhancement of free sale sugar quota, which resulted in the benefit of additional price, which price had to be utilized only for repayment of loans taken by the assessee to establish a new unit or for expanding the existing unit. The said Schemes were not meant for a running unit. The second benefit, according to the learned counsel, lay in the rebate of excise duty under which the assessee was required to pay excise duty on the manufacture of additional quota of free sale sugar. According to the learned counsel, in judging the character of the incentive, the "purpose test" is applicable. In other words, according to the learned counsel, the character of the receipt in the hands of the assessee had to be determined with respect to the purpose for which the subsidy was given and that the point of time at which it is paid or its source or its form was irrelevant. In this connection, learned counsel also places reliance on the same judgment of this Court in the case of *Sahney Steel and Press Works Ltd.* (supra).

9. The key question which arises for determination is: what is the character of the incentive subsidy under the said Schemes?

10. At the outset, it may be stated that during the relevant year in question, on account of economic factors, namely, high cost, the new sugar factories could not come up as it was not economically viable. Due to high cost, the financial institutions

A did not come forward to advance loans to the entrepreneurs of
new sugar factories. Secondly, the tempo of establishing new
sugar factories received a serious set back, therefore, the Gov-
ernment appointed a Committee known as Sampat Commit-
tee to examine the question relating to economic viability of
B new sugar factories. One of the terms of reference suggested
was to work out various incentives for making new sugar facto-
ries economically viable units. The increase of the cost of the
project during the relevant years was on account of the increase
in the cost of Plant and Machinery. The said Committee gave
C its Report in which the Committee recommended that the eco-
nomic viability of a factory would mean that the unit should not
break even after meeting the working expenses, interest on
borrowings, depreciation on Plant and Machinery, but it should
also be able to declare a reasonable dividend on the equity
D capital. According to the Committee, the factory should be able
to generate sufficient funds to repay the instalments of the term
loans. Under Para 21.0 the said Committee stated that five
possible incentives for making a sugar plant economically vi-
able unit could be provided for, namely, capital subsidy, allow-
E ing a larger percentage of free sale sugar, high levy sugar price,
allowing rebate on excise duty and remission of purchase tax.
In this case, we are concerned with allowability of a larger per-
centage of free sale sugar and rebate on excise duty. Follow-
ing the said Report of the Sampat Committee, the above
Schemes came to be formulated.

F 11. We have examined in this case the 1980 and 1987
Schemes. Essentially all the four schemes are similar except in
the matter of details. Four factors exist in the said Schemes,
which are as follows:

- G (i) Benefit of the incentive subsidy was available only to
new units and to substantially expanded units, not to
supplement the trade receipts.
- (ii) The minimum investment specified was Rs. 4 crores
H for new units and Rs. 2 crores for expansion units.

- (iii) Increase in the free sale sugar quota depended upon increase in the production capacity. In other words, the extent of the increase of free sale sugar quota depended upon the increase in the production capacity. A
- (iv) The benefit of the scheme had to be utilized only for repayment of term loans. B

12. One important aspect may also be noted that in the case of Salem Cooperative Sugar Mills Ltd. we are concerned with Notification dated 15.11.1980. It indicates the above factors of the Scheme. The important point to be noted is that Government of India, financial institutions as well as the sugar industries are parties to the scheme in the sense that but for the scheme the financial institutions would not have given term loans to set up new units/expansion of the existing units. C

13. The main controversy arises in these cases because of the reason that the incentives were given through the mechanism of price differential and the duty differential. According to the Department, price and costs are essential items that are basic to the profit making process and that any price related mechanism would normally be presumed to be revenue in nature. In other words, according to the Department, since incentives were given through price and duty differentials, the character of the impugned incentive in this case was revenue and not capital in nature. On the other hand, according to the assessee, what was relevant to decide the character of the incentive is the purpose test and not the mechanism of payment. D E F

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 G H

- A 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
- B 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
- C 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
- D 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
- E 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
- F 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
- G 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
- H aspect there is no dispute. If the object of the subsidy scheme

was to enable the assessee to run the business more profitably than 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.

15. In the decision of House of Lords in the case of *Seaham Harbour Dock Co. v. Crook* (1931) 16 TC 333 the Harbour Dock Co. had applied for grants from the Unemployment Grants Committee from funds appropriated by Parliament. The said grants were paid as the work progressed the payments were made several times for some years. The Dock Co. had undertaken the work of extension of its docks. The extended dock was for relieving the unemployment. The main purpose was relief from unemployment. Therefore, the House of Lords held that the financial assistance given to the company for dock extension cannot be regarded as a trade receipt. It was found by the House of Lords that the assistance had nothing to do with the trading of the company because the work undertaken was dock extension. According to the House of Lords, the assistance in the form of a grant was made by the Government with the object that by its use men might be kept in employment and, therefore, its receipt was capital in nature. The importance of the judgment lies in the fact that the company 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 payments were equivalent to half the interest for two years on approved expenditure met out of loans. Even though the payment was equivalent to half the interest amount payable on the loan (interest subsidy) still the House of Lords held that money received by the company was not in the course of trade but was of capital nature. The judgment of House of Lords shows that the source of payment or the form in

A which the subsidy is paid or the mechanism through which it is paid is immaterial and that what is relevant is the purpose for payment of assistance. Ordinarily such payments would have been on revenue account but since the purpose of the payment was to curtail/obliterate unemployment and since the purpose was dock extension, the House of Lords held that the payment made was of capital nature.

16. One more aspect needs to be mentioned. In *Sahney Steel and Press Works Ltd.* (supra) 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.* (supra) 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.

17. 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. Accordingly the first question is answered in favour of the assessee and against the Department.

18. Coming to the second question, namely, whether the assessee was entitled to exemption under Section 80 P(2)(a)(i) of the Income Tax Act, 1961 ("1961 Act") in respect of interest received from the members of the society, we find that none of the authorities below, including the High Court, have examined the Memorandum of Association filed by Salem Co-operative Sugar Mills Ltd., Madurantakam Co-operative Sugar Mills Ltd., Ambur Co-operative Sugar Mills Ltd., Dharampuri District Co-operative Sugar Mills Ltd., Vellore Co-operative Sugar Mills Ltd., Attur Agricultural Producers Co-operative Society Ltd. and Modern Engineers Construction Co-operative Society Ltd.. Under

COMMISSIONER OF INCOME TAX, MADRAS v. PONNI 581
SUGARS & CHEMICALS LTD. [S. H. KAPADIA, J.]

Section 80 P(1) deduction in respect of income of co-operative societies is provided for. Under Section 80 P(1), where the gross total income of a co-operative society includes any income referred to in sub-section (2) then the sums specified in sub-section (2) shall be deducted from the gross total income to arrive at the total income of the assessee-society. In order to earn exemption under Section 80 P(2) a co-operative society must prove that it had engaged itself in carrying on any of the several businesses referred to in sub-section (2). In that connection, it is important to note that under sub-section (2), in the context of co-operative society, Parliament has stipulated that the society must be engaged in carrying on the business of banking or providing credit facilities to its members. Therefore, in each case, the Tribunal was required to examine the Memorandum of Association, the Articles of Association, the Return of Income filed with the Department, the status of business indicated in such Returns etc.. This exercise had not been undertaken at all.

19. For the aforesaid reasons, we set aside the impugned judgments of the High Court and remit the matters to the Tribunal for de novo consideration in accordance with law. All the contentions on both sides are expressly kept open.

20. In addition to the above two questions, one more question arises for consideration in the civil appeal arising out of SLP (C) No. 573/07 [CIT, Salem v. Dharampuri District Co-operative Sugar Mills Ltd.] filed by the Department is: whether the area development funds collection by sugar mills would be trading receipt?

21. In view of the judgment of the Bombay High Court in *CIT v. Chhatrapati Sahakari Sakhar Karkhana Ltd.* reported in (2000) 245 ITR 498 the matter is remitted to the Tribunal for de novo consideration in accordance with law and in accordance with the directions given therein.

22. Accordingly, the appeals filed by the Department are partly allowed with no order as to costs.

K.K.T.

Appeals partly allowed.