Tax Insights

from India Tax & Regulatory Services

Subvention from parent company for making good losses is a capital receipt not chargeable to tax

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In brief

The Supreme Court (SC) recently held that subvention received by an Indian company from the parent company to make good the losses incurred by it, was in the nature of a capital receipt. The SC arrived at this conclusion on the ground that the subvention was a voluntary payment made by the parent company in Germany to protect the capital investment in the subsidiary company.

The SC further distinguished its earlier decisions in the case of Ponni Sugars[2] and Sahney Steel[3] on the grounds that in those cases, the subsidies were received as a grant-in-aid from public funds and not by way of a voluntary contribution from the parent company.

In detail

Facts

- The taxpayer[1] was engaged in the business of manufacture of electronic products and computer software. For the relevant assessment year, the taxpayer had filed its return of income declaring a loss.
- During the relevant assessment year, the taxpayer had received monies from its parent company which were not offered to tax by the taxpayer.
- During the course of the assessment proceedings, the taxpayer stated that the monies represented subvention payments by the parent company to make good the losses incurred by the taxpayer and as the taxpayer did not have sufficient working capital, the parent company infused further capital The taxpayer claimed these payments to be capital in nature.
- The tax officer rejected this stand of the taxpayer and treated such receipt as a revenue receipt taxable in the hands of the taxpayer.
- The Commissioner of Income-tax (Appeals) and the Income-tax Appellate Tribunal (Tribunal) agreed with the contention of the taxpayer and deleted the addition to the taxpayer's income.
- On further appeal by the Revenue authorities, the High Court (HC) reversed the order of the Tribunal and upheld the addition made by the tax officer.
- The ruling of the HC was on the principle laid down by the SC in the cases of Ponni Sugars[2] and Sahney Steel[3] which say that the purpose of the subsidy or subvention is relevant, and unless the subsidy is towards assistance for setting up or expanding of business or repayment of loan or creation of a new asset, it would be revenue in nature. The HC held that the subvention was to make good the losses and run the business more profitably, and hence the subvention was a revenue receipt taxable in the hands of the taxpayer.

[1] SPL (C) Nos. 6946/ 2014

[2] CIT *v.* Ponni Sugars and Chemicals Limited (2008) 9 SCC 337

[3] Sahney Steel & Press Works Ltd. *v.* CIT (1997) 7 SCC 764

Ruling of the Supreme Court

- The SC distinguished the present case from its earlier decisions in the cases of Ponni Sugars[2] and Sahney Steels[3] on the basis that in those decisions, the subsidy or assistance in question was from public funds (government subsidies) and not voluntary contributions from the parent company.
- Further, the SC held that the voluntary payments by the parent company to the taxpayer to make good its losses was with a view to protect its capital investment in the taxpayer.
- Accordingly, the SC upheld the contention of the taxpayer and reversed the decision of the HC.
- The SC also drew reference from and agreed with the decision of the Delhi HC in the case of Handicrafts and Handlooms Export Corporation of India[4] where, on similar facts, the Delhi HC had held that subsidy was a capital receipt, as the payment was to secure and protect the capital investment.

The takeaways

- The ruling of the SC supports the position that any assistance or subvention received from parent companies are capital receipts.
- The amendment to section 2(24)(xviii) relating to inclusion of subsidies and grants within the ambit of "income" may not be applicable unless the same are received from the Government or its agencies.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor.

[4] CIT *v.* Handicrafts and Handlooms Export Corporation of India (2014) 49 taxmann.com 488 (Delhi)

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