Sales tax subsidy without restriction on its use taxable as revenue receipts

July 19, 2017

In brief

In a recent decision[1], the Delhi High Court (HC) held that in the absence of any conditions stipulating the utilisation of subsidies towards capital or revenue expenditure, subsidy received by the taxpayer from the State Government would be taxable as revenue receipts.

In detail

Facts

- The taxpayer was an Indian company engaged in the business of manufacture of cold rolled/ galvanised steel strips and sheets etc.
- The taxpayer's two units were located in a notified backward area for the purpose of UP Sales Tax Act, 1948.
- In view of the applicable notification issued by the State Government, the taxpayer was granted exemption from the payment of sales tax in respect of its new unit located in the specified backward area. The same was claimed by the taxpayer in its revised return of income as a capital subsidy, not chargeable to tax.
- The Tax Officer disallowed the taxpayer's claim of deduction of the sales tax collected in view of section 43B of the Income-tax Act, 1961 (the Act), relying on the fact that the same was not actually paid to the State Government.
- The matter carried to the HC.

Issue before the HC

Whether the subsidy received by the taxpayer in the form of exemption from payment of sales tax collected from the customers is a revenue receipt or capital receipt?

Revenue's contention

- The principle laid down in the decision of Sahney Steel that the character of the subsidy in the hands of the recipient, whether capital or revenue, had to be determined with regard to the purpose for which the subsidy was given.

  By allowing the taxpayer to collect sales tax, without the corresponding obligation of passing it over to the Revenue, the State permitted augmentation of the taxpayer's income. No conditions were attached to the effect that any capital expenditure had to be incurred.
- There were specific parts to the subsidy scheme that dealt with capital subsidy, consisting of conditions to be complied with. Therefore, the other parts of the scheme, which conferred advantages by way of retention of sales tax collected, were in the nature of revenue receipts provided to the taxpayer for the economic viability of the unit set up in backward areas.
- The case of Ponni Sugars[2] was distinguishable, wherein the subsidy provided by the government had to be utilised for

[1] TS-276-HC-2017(Delhi)
[2] CIT *v.* Ponni Sugars & Chemicals Ltd. [2008] 306 ITR 392 (SC)

repayment of loans, unlike the present case, where the subsidy received by the taxpayer was nowhere conditioned to recoup the capital expenditure.

Taxpayer's contention

- The amendment brought by Finance Act 2015, under section 2(24) of the Act, in relation to taxability of assistance received by the taxpayer in form of subsidy etc. was prospective in nature. The facts of the instant case was to be adjudged in light of the judicial precedents available on the issue.
- In the case of Ponni Sugars[2], the eligible unit was entitled to incentive irrespective of whether the setting up of the unit or expansion of the unit was financed out of borrowed funds. Therefore, it was held that the amounts received were not by way of revenue subsidy but for augmenting the capital expenditure incurred.
- Relied upon the decision in case of Shree Balaji Alloys[3] wherein it was held that the excise duty refund received by the eligible unit was not liable to tax, as it was a capital receipt despite the absence of any provision in the scheme with regard to the use of fund.
- The very concept of grant of subsidy meant that the taxpayer was free to use it, either to augment its profit or to recoup its capital.

High Court's ruling

- The Delhi HC analysed the notification issued by the State Government and observed that the scheme launched by the State Government in 1991 was a supplemental scheme to the main scheme framed in 1990.
- The main scheme specifically provided for capital subsidy to set-up "Prestige Units". However, in the absence of similar specific conditions in the supplemental scheme, the subsidy received by the taxpayer under such a scheme could not be considered as a capital receipt.
- There were no conditions attached to the subsidy; therefore, it could not be said that capital expenditure would be recouped from such subsidy.
- The absence of any condition towards capital utilisation meant that the policy makers envisioned greater profitability as an incentive for investors to expand units, for rapid industrialisation of the state, and ensuring greater employment. Therefore, the subsidy was revenue in nature, and hence taxable under the Act.

The takeaways

- This ruling addresses the issue of taxability of subsidies in the form of exemption from payment of taxes collected from the customers and in the context where no conditions were attached to the grant of the subsidy. In light of the amendment brought by Finance Act, 2015, the assistance received from the government in the form of subsidy etc. has been included in the definition of income (except where such subsidy is taken into consideration for determination of actual cost). This ruling has further added to the litigation on taxability of subsidies in the form of exemption from the payment of sales tax collected from the customers, in relation to years prior to the amendment.

Let's talk

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

[3] CIT *v.* Shree Balaji Alloys [2016] 287 CTR 459 (SC)

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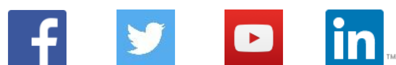

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