

“Purpose” is the conclusive test for determining nature of subsidy for income tax purposes

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In brief

In a recent Supreme Court (SC) decision¹ it was upheld that government subsidy was capital in nature if it was granted to promote construction in capital intensive industries (multiplex theatres, in the instant case). The SC reiterated the principles laid down in earlier SC decisions that the purpose of the subsidy and not the form in which it was granted.

In detail

Facts

- The Government of Maharashtra (GoM) noticed that the average occupancy in cinema theatres had reduced considerably, and the new concept of multiplex theatres had emerged. Further, these complexes were highly capital intensive and with long gestation period required government support and incentive in entertainment duty.
- Thus, the GoM introduced a subsidy scheme to boost investment in multiplex theatre complexes. The scheme was brought by amending the Bombay Entertainment Duty Act, 1923, as follows:
 - For the first three years entertainment duty was exempted
 - For next two years applicable entertainment duty upto 25% was levied
- The taxpayer was granted the aforesaid subsidy by way of exemption from payment of entertainment duty. Such duty was collected from its customers, as a charge on the gross value of tickets sold.
- The Bombay High Court (HC) ruled in favour of the taxpayer, and thus appeal was filed by the tax department before the SC.

Issue before the SC

Whether the subsidy received by the taxpayer was in the nature of capital or revenue?

Revenue’s contention

The subsidy came into play after multiplexes started functioning and contributed

towards day-to-day running expenses by waiver of entertainment duty on the tickets issued. Thus, the subsidy was a revenue receipt.

Taxpayer’s contentions

- The purpose of the subsidy was the test for finding the nature of the scheme, and not mode of computation or the form in which it was passed to the taxpayer.
- The statement of object for introducing the scheme by the GoM clearly stated that the grant of subsidy was to promote the construction of new cinema houses. Thus, the subsidy was capital in nature.

Supreme Court’s decision

- The SC analysed and placed reliance on its earlier judgments in the case of *Sahney Steel*² and *Ponni Sugars*³.

¹ Civil Appeals Nos. 6513-6514 of 2012

² *Sahney Steel and Press Works Limited v. CIT* [1997] 228 ITR 253 (SC)

³ *CIT v. Ponni Sugars & Chemicals Limited* [2008] 174 306 ITR 392Taxman 87 (SC)

- The SC observed that in the case of Sahney Steel², the nature of subsidy was held to be revenue, as the purpose for which the subsidy was granted, was to provide a helping hand to enable the industry to be viable and competent. Thus, the purpose of subsidy was applied as the test for determining its nature.
- Further, the SC observed that in the case of Ponni Sugars³, the nature of subsidy was held to be capital, as the objective was to promote newly setup or substantially expanded units. Further, the source of subsidy, point of time when paid and form of subsidy was held to be immaterial.
- Relying on the principles laid down by SC in its aforesaid decisions, in the instant case,

the SC applying the “purpose test”, observed that the objective of waiver of entertainment tax duty was to encourage investment and boost construction of multiplex theatres.

- The fact that the subsidy was available post construction and on actual sale of tickets were held to be irrelevant. Hence the subsidy received was held to be capital in nature.

The takeaways

- This SC judgment reinforces the principle laid in its earlier judgments that the “purpose test” is the determinative factor for the nature of any subsidy, incentive, etc., irrespective of the form in which it is granted.

- However, it is pertinent to note that the Finance Act, 2015 [relevant for financial year (FY) 2016-17 onwards] has amended the definition of income to bring parity with the provisions of Income Computation and Disclosure Standards⁴. The new definition includes any assistance in the form of subsidy/ grant/ cash, etc., received from the government as income for the purposes of the Act, if not reduced from the cost of assets⁵.
- Thus, the aforesaid decision would be relevant for subsidies granted for FY 2015-16 and before.

Let's talk

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

⁴ ICDS VIII – Government Grants

⁵ As per Explanation 10 to Section 43(1) of the Income-tax Act

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