



**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION.**

INCOME TAX APPEAL NO.505 OF 2003

Bajaj Auto Limited

...Appellant

V/s.

Dy. Commissioner of Income Tax

...Respondent

**WITH
INCOME TAX APPEAL NO.156 OF 2003**

The Commissioner of Income Tax-3

...Appellant

V/s.

M/s. Reliance Industries Limited

...Respondent

Mr. P.J. Pardiwalla, Senior Advocate with Ms. Vasanti Patel for the Appellant in ITXA/505/2003.

Mr. Suresh Kumar for the Appellant in ITXA/156/2003 and for Respondent in ITXA/505/2003.

Mr. J.D. Mistri, Senior Advocate with Mr. Madhur Agarwal, Mr. Fenil Bhatt, Mr. P.C. Tripathi, Mr. Punit J. Shah, Mr. Ketan Dave and Mr. Pratik Shah i/b. M/s. A.S. Dayal and Associates for the Respondent in ITXA/156/2003.

CORAM: ALOK ARADHE, CJ. &

SANDEEP V. MARNE, J.

Judgment reserved on: 26 JUNE 2025.

Judgment pronounced on: 03 JULY 2025.

JUDGMENT (PER: SANDEEP V. MARNE, J.)

A. THE CHALLENGE

1. These Appeals, filed under Section 260A of the Income Tax Act, 1961, (**the Act**) raise a common question of law as to whether an incentive received in sales tax liability under a Scheme formulated by the State Government would be on capital account, exempt to taxation, or on revenue account, liable for taxation. The State Government had introduced schemes from time to time for encouraging setting up of industries in specified backward areas of the State, by providing sales tax incentives. In Income Tax Appeal No.156 of 2003 filed by the Revenue, the Income Tax Appellate Tribunal (**ITAT**) has treated the amount received towards such incentive to be capital receipt, exempt from taxation, whereas in Income Tax Appeal No.505 of 2003 filed by the Assessee, the amount forming part of similar incentive is treated as revenue receipt, liable for taxation.

2. Income Tax Appeal No.156 of 2003 is filed by the Revenue challenging judgment and order dated 25 July 2002 passed by the ITAT allowing the Appeal preferred by the Assessee-Reliance Industries Ltd. relating to Assessment Year 1985-86 and setting aside the assessment order by directing the Assessing Officer to treat the amount received under sales tax incentive scheme as capital receipt in the hands of the Assessee and to exclude the same from the title 'income chargeable to tax'.

3. Income Tax Appeal No.505 of 2003 is filed by the Assessee-Bajaj Auto Ltd. challenging the judgment and order dated 31 December 2002 passed by the ITAT partly dismissing its Appeal in respect of assessment year 1987-88 and upholding the order of Commissioner of Income Tax-Appeals (**CIT(A)**) to the extent of treatment of sales tax incentives as revenue receipt and not as capital receipt.

B. SUBSTANTIAL QUESTIONS OF LAW FORMULATED

4. Appeal No.156 of 2003 filed by the Revenue has been admitted by order dated 11 October 2004 on following substantial questions of law:

- (i) Whether on the facts and in the circumstances of the case the Tribunal was right in law in directing to capitalize the expenses incurred on account of foreign exchange fluctuation and interest thereon in respect of foreign currency loans availed by the assessee, although out of the total amount directed to be capitalized an amount of Rs.82,77,221/- represented interest accrued but no payment was made during the year?
- (ii) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding and allowing assessee's claim for deduction of entire amount of 'Traveling Expenses' on account of foreign travel by company executives accompanied by spouses, although there was no material on record to show that visit of the spouses was necessary in order to facilitated negotiation at top level with foreign corporation?
- (iii) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding allowing assessee's claim for deduction as in

respect of notional sales tax liability holding it as capital subsidy?

- (iv) Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the expenses incurred on the maintenance of guest house and depreciation will not be covered within the mischief of section 37(4) of the I.T. Act.

5. Income Tax Appeal No.505 of 2003 has been admitted on 19 October 2004 on following substantial questions of law:-

- (i) Whether on the facts and in the circumstances of the case and in law, the ITAT was justified in treating an amount of Rs.31,56,48,643/-, being the amount of sales-tax exempted from payment under the Scheme of incentives to the Government of Maharashtra for setting up a new industrial unit in the specified backward area at Waluj, Aurangabad as trading receipt, chargeable to tax under the provisions of the Income-tax Act?
- (ii) Alternatively, whether on the facts and in the circumstances of the case and in law, the ITAT was justified in not treating the notional sales-tax liability, determined as per the Sales-tax Assessment Order dated 20-2-1988 as liability under the Sales-tax Act, which is deemed to have been paid by the Appellant within the meaning of Section 43B of the Income-tax Act?

6. For the reasons discussed in the latter part of the judgment, Question Nos 1,2 and 4 in Appeal No. 156 of 2003 need no determination and therefore the only issue that survives for determination in both the Appeals is about treatment of sales tax incentive as capital receipt exempt from taxation or revenue receipt liable for taxation. Since both the Appeals essentially

involve same question of law, they are accordingly taken up for hearing and decision together.

C. FACTS IN APPEAL NO.156 OF 2003:

7. The Appeal arises out of Return of Income filed by the Assessee-Reliance Industries Ltd. for the assessment year 1985-86. The Assessee is engaged in the business of manufacturing synthetic fabrics from plain, crimped, twisted and worsted yarns. The Assessee used to operate manufacturing units at Sidhpur in Gujarat and set up a new manufacturing unit at Patalganga in Maharashtra in pursuance of the Scheme for encouraging industries in backward parts of the State. The Assessee received incentive in the form of sales tax waiver and was issued with the eligibility certificate under the Scheme. On 28 June 1985, Return of Income was filed by the Assessee for the assessment year 1985-86 treating the sales tax incentive as capital receipt. Notices under Sections 143(2) and 142 (1) of the Act were issued and served on the Assessee on 5 June 1987 alongwith questionnaire vide letter dated 27 May 1987. Thereafter additional questionnaires were also issued and served on the Assessee. While making the assessment order, the Assessing Officer disallowed certain claims of the Assessee relating to suppression of production, difference in exchange rate, notional sales-tax, foreign travelling expenses with spouses and guest house accommodation expenses. Being aggrieved by the Assessment Order dated 30 March 1988, the Assessee filed appeal before the CIT(A). The CIT(A) partly allowed the appeal

preferred by the Assessee by deleting the additions made under the head of 'suppression of production'. The claim towards difference in exchange rate was only partly allowed. The claim towards notional sales tax liability was rejected holding that the incentive should be treated as revenue receipt liable to income tax. The claim towards expenditure on foreign travel with spouse was partly allowed. The claim towards expenditure on guest house was also partly allowed.

8. Aggrieved by order dated 10 July 1989 passed by the CIT(A), cross appeals came to be filed before the ITAT by the Revenue and the Assessee. Both the appeals have been decided by the ITAT by common judgment and order dated 25 July 2002. The ITAT dismissed the appeal preferred by the Revenue and allowed the appeal filed by the Assessee by directing treatment of incentives received under sales tax scheme as capital receipt not liable to payment of income tax. The Revenue is aggrieved by judgment and order dated 25 July 2002 passed by the ITAT and has accordingly filed Income Tax Appeal No.156 of 2003.

D. FACTS IN INCOME TAX APPEAL NO. 505 OF 2003

9. The Assessee-Bajaj Auto is engaged in manufacture and sale of two wheelers, three wheelers and also in manufacture and sale of spare parts of vehicles sold by it. The Assessee filed its Return of Income for the assessment year 1987-88 declaring total income as Rs.45,26,94,700/-. The accounting year for the assessment year 1987-88 has ended on 30 June 1986. During the

previous year, the Assessee had started a new unit at Waluj, Aurangabad, which was notified as backward area. The Government of Maharashtra introduced the scheme on 4 May 1983 under which an option for sales tax exemption or deferral of sales tax for a period of five years was available. The Assessee obtained eligibility certificate for sales-tax exemption for a period of three years commencing from 1 February 1986. The sales-tax incentive under the said scheme amounted to Rs.3,56,43,643/- as determined by the assessment order dated 20 February 1988. During the process of assessment proceedings, Assessee claimed that the amount of sales tax incentives amounting to Rs.3,56,43,643/- should be regarded as capital receipt not liable to tax since the said incentive was received for promotion of industries in backward area. Since the Assessing Officer rejected the said claim of Assessee by order dated 31 January 1990 and treated the same as revenue receipt liable to tax and since the Assessing Officer also made certain additions in the income of the Assessee, it preferred appeal before the CIT(A) challenging the order of assessment.

10. CIT(A) partly allowed the appeal but did not grant any relief to the Assessee in respect of its claim towards sales-tax incentive. The Assessee accordingly filed appeal before the ITAT challenging the order of CIT(A). The Revenue also filed cross appeal challenging the order of CIT(A) to the extent of deletion of some of the disallowances. By judgment and order dated 31 December 2002, the ITAT has partly allowed both the appeals. However, so far as the claim of the Assessee towards sales-tax

incentive is concerned, the ITAT directed the same to be treated as revenue receipt liable to payment of income tax and not capital receipt exempt from payment of income tax. Aggrieved by the order passed by the ITAT, the Assessee has filed Income Tax Appeal No.505 of 2003.

E. Submissions

11. Mr. Suresh Kumar, the learned counsel appearing for the Revenue, in support of Appeal No.156 of 2003 filed by the Revenue and for opposing Appeal No.505 of 2003 filed by the Assessee, has made following broad submissions:-

- (a) That the incentive paid under scheme formulated by the State Government in the form of exemption in payment of sales-tax needs to be treated as revenue receipt by the Assessee, liable to payment of income tax.
- (b) That the schemes introduced by the State Government envisaged grant of sales-tax incentive only on actual commencement of production.
- (c) That since provision for sales-tax incentive was conditional upon commencement of production, the incentive was necessarily for the activity of production taken up by the Assessee and the same cannot be treated as a capital receipt.
- (d) Any amount received by the Assessee for incentivising production would necessarily form part of revenue receipt and not a part of capital receipt. If the Assessee

was not to commence production, no incentive under the sales-tax scheme was payable making it abundantly clear that there was direct linkage between commencement of production and grant of incentive.

- (e) That the issue involved in the present Appeals is squarely covered by the judgment of the Apex Court in ***Sahney Steel & Press Works Ltd. Vs. Commissioner of Income-tax***¹, in which it is held that any incentive provided for production by the Assessee would necessarily form part of the revenue receipt.
- (f) There is no material on record to infer that the incentive under the scheme was provided for incurring of capital expenditure for establishment of the manufacturing units.
- (g) Sales-tax became liable for payment only on production and sale of the products and since the sale of products is incentivized, the incentive was making the business profitable rather than aiding the Assessee in setting up any industrial unit.
- (h) Incentivisation of sales-tax has resulted in the Assessee earning higher amount of profits and the amount of sales-tax collected from the customers is retained by the Assessee. That therefore the amount received under the sales-tax incentive scheme needs to be treated as revenue receipt.
- (i) That the Tribunal has passed contradictory orders by holding in the case of Bajaj Auto Limited that the sales-

¹ [1997] 228 ITR 253(SC)

tax incentive is revenue receipt while holding in the case of Reliance Industries Ltd. that the sales-tax incentive would form capital receipt.

- (j) Relying on judgment of Calcutta High Court in ***Commissioner of Income-tax Vs. Chhindwara Fuels***² it is contended that subsidy received in the form of refund of sales tax after commencement of production is liable to taxation by treating it as revenue receipt.
- (k) That the issue is also covered by judgment of the Apex Court in ***Commissioner of Income-tax Vs. P.J. Chemicals Ltd.***³ and ***Commissioner of Income-tax vs. Rajaram Maize Products***⁴

On above broad submissions, Mr. Suresh Kumar, would pray for allowing Income Tax Appeal No.156 of 2003 filed by Revenue and for dismissal of Income Tax Appeal No.505 of 2003 preferred by the Assessee.

12. Mr. Mistri, the learned senior advocate appearing for the Assessee-Reliance Industries for opposing Appeal No.156 of 2003 filed by the Revenue, would submit as under:-

- (a) The ITAT has rightly directed treatment of incentives received under the sales-tax scheme as capital receipt not liable to tax.

² [2001] 114 Taxman 707 (Calcutta)

³ [1994] 76 Taxman 611(SC)

⁴ [2001] 119 Taxman 492 (SC)

- (b) That the incentive in payment of sales-tax was provided in order to decongest industries in Mumbai, Thane and Pune belt and to encourage the industrialist to set up new industrial units in specified backward areas and that the incentive in payment of sales-tax was provided to the Assessee for having set up industry in specified area of Patalganga.
- (c) That the ITAT has rightly treated the incentive as a part of capital receipt not chargeable to tax by taking into consideration the purpose for which the incentive is granted.
- (d) That the decision of the Apex Court in ***Sahney Steel & Press Works Ltd.*** (supra) has been subsequently considered and explained in ***Commissioner of Income-tax, Madras Vs. Ponni Sugars & Chemicals Ltd.***⁵ which in turn had been followed and applied in ***Commissioner of Income Tax Vs. Shree Balaji Alloys***⁶, ***Commissioner of Income Tax-I, Kolhapur Vs. Chaphalkar Brothers Pune***⁷ and ***Dy. Commissioner of Income Tax Vs. M/s. Munjal Auto Industries Ltd.***⁸

⁵ [2008] 174 Taxman 87(SC)

⁶ [2017] 80 taxmann.com 239(SC)

⁷ [2018] 400 ITR 279 (SC)

⁸ Civil Appeal No.6226 of 2013, decided on 8 May 2018.

- (e) That purpose for which the incentive is granted is the key and the form in which the incentive is released is irrelevant.
- (f) That the Delhi High Court has considered the very same scheme in the case of ***Commissioner of Income Tax-IV V/s. M/s. Indo Rama Textiles Ltd.***⁹ and has concluded that the amount of subsidy received by the Assessee under the scheme is for the purpose of setting up a new unit and therefore should be treated as capital receipt not chargeable to tax.

13. Mr. Pardiwalla, the learned senior advocate appearing for the Assessee-Bajaj Auto in support of Appeal No.505 of 2003 has canvassed following broad submissions:-

- a) That the incentive under the sales tax scheme introduced by the State Government has been received by the Assessee for setting up of industry in the backward area;
- b) That the incentive is not towards production activity undertaken by the Assessee.
- c) That instead of paying cash amount towards the subsidy, the scheme envisaged adjustment of the incentive amount in the sales tax payable on commencement of production.

⁹ 158 taxmann.com 685

- d) That what needs to be applied is the 'purpose test' as held by the Apex Court in ***Sahney Steel & Press Works Ltd.***(supra).
- e) That the purpose of grant of incentive was not to enable the Assessee to earn higher profits but the purpose was to incentivise the Assessee for setting up the industry in notified backward area.
- f) That the Tribunal has failed to appreciate the real nature and purpose of incentive scheme and has erroneously mixed up the concept of adjustment of incentive after commencement of production with the purpose for which the incentive is granted.
- g) That the scheme itself made it abundantly clear that the incentive was towards the expenditure incurred in setting up of the industry. He would also rely upon judgment of the Apex Court in ***Chaphalkar Brothers*** (supra) in support of his contention that once the subsidy is granted to industrialize the State, the form in which the subsidy is paid becomes irrelevant and therefore the grant of subsidy after commencement of production would make no difference.

On above broad submissions Mr. Pardiwalla would pray for allowing the appeal No.505 of 2003.

F. REASONS AND ANALYSIS

18. Before proceeding further with the main and the only issue involved in these appeals, it would be necessary to quickly deal with the three other questions of law formulated in Appeal No.156 of 2003 filed by the Revenue in the case of Reliance Industries Ltd. As observed above, total four questions of law are framed while admitting the appeal. It is common ground that Question No.1 is squarely covered by the Apex Court judgment in ***Commissioner of Income-tax Delhi vs. Woodward Governor India (P) Ltd.***¹⁰, in which it is held that loss suffered by an Assessee on account of foreign exchange difference as on the date of balance sheet would constitute an item of expenditure under Section 37 (1) of the Income Tax Act, 1961. Since the question of law No. 1 is already covered by the Hon'ble Apex Court judgment, it is not necessary to deliberate on the said issue. Question No.1 therefore needs to be answered against the Revenue.

19. So far as Question No.2 is concerned, the same involves minuscule amount of Rs.48,288/- incurred towards foreign tour expenses of executives accompanied by their spouses. It appears that out of claimed expenditure of Rs.48,288/-, CIT(A) has already allowed amount of Rs.32,192/-. Considering the amount involved in respect of Question No.2 we are not inclined to

¹⁰ [2009] 312 ITR 254 (SC)

interfere in the order passed by the ITAT. Question No.2 is also answered against the Revenue.

20. So far as Question No.4 in Appeal No.156 of 2003 is concerned, both parties are *ad idem* that same does not really arise in the present appeal. The ITAT has categorically held that Section 37(4) of the Act has been attracted and it is not held that maintenance and depreciation will not be covered within Section 37(4) of the Act. Therefore, Question No.4 does not arise for consideration in the appeal and the same is erroneously framed. Question No. 4 therefore need not be answered.

21. This is how only Question No.3 relating to amount of sales tax incentive as capital receipt or revenue receipt remains to be answered in Income Tax Appeal No.156 of 2003 filed by Revenue. The two questions of law framed while admitting the Assessee's Income Tax Appeal No. 505 of 2003 also relate to the same issue of treatment of sales tax incentive as capital or revenue receipt.

22. Therefore, the only common issue that needs to be decided in these two Appeals is about treatment of the sales tax incentive paid to the Assesseees under the State Government Scheme either as capital receipt or revenue receipt. The issue is essentially linked to the exact character of the incentive subsidy offered by the State Government, decision of which would be the determinative factor for deciding whether the incentive subsidy is provided to enable the Assessee to set up a new unit or to run

the business more profitable. In the former case, the receipt of the subsidy would be on capital account whereas in the latter case, receipt of such subsidy would be on revenue account. Thus, the object or purpose for which the subsidy incentive is given would determine the nature of receipt in the hand of the Assessees.

F. 1 PRECEDENTS GOVERNING THE ISSUE

23. Before proceeding ahead with examination of the schemes under which the subsidy is provided to the Assessees, it would be necessary to take a stock of few judgments dealing with the issue of treatment of the subsidy as capital receipt or revenue receipt. The leading judgment on the issue is in the case of ***Sahney Steel & Press Works Ltd.*** (supra), in which the issue before the Apex Court was whether the subsidy received by the Assessee-Company from Andhra Pradesh Government was taxable as a revenue receipt. Under the Notification issued by the Andhra Pradesh Government, certain facilities and incentives were to be given to all industrial undertakings, which commenced production on or after 1 January 1969 with investment capital not exceeding Rs.5 crores. The incentives were to be allowed for a period of five years from the date of commencement of production. The concession was also available for subsequent expansion of 50% and above of existing capacities provided in each case, provided that the expansion was located in the city or town or panchayat area other than the one in which the existing unit was located. The incentives comprised of refund

of sales tax on raw material, machinery and finished goods; subsidy on power consumed for production; exemption from payment of water rate, etc. The Apex Court has decided the issue of treatment of the subsidy received under the said scheme by holding as under :-

19. 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 plants 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. case* [16 TC 333] , the monies must be treated as to have been received for 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.

(emphasis and underlining added)

24. The Apex Court thus held in ***Sahney Steel & Press Works Ltd.*** that if the Assessee was given refund of sales tax on purchase of machinery as well as raw material to enable it to acquire new plant and machinery for further expansion of its manufacturing capacity in the backward area, the entire subsidy must be held to be capital receipt. It further held that 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 the commencement of such production, such subsidy must be treated as assistance for the purpose of trade.

25. The judgment of the Apex Court in ***Sahney Steel & Press Works Ltd.*** is relied upon by the Revenue in support of contention that in every case where assistance is given subject to the condition of commencement of production, the subsidy must be treated as assistance for the purpose of trade and needs to be necessarily treated as revenue receipt. On the other hand, it is contended on behalf of the Assesseees that the Apex Court has clearly drawn a distinction in cases where the subsidy is given for setting up an industrial unit and subsidy given for assistance in carrying out the business operation.

26. The judgment of the Apex Court in ***Sahney Steel & Press Works Ltd.*** (supra) has been further explained in the judgment in ***CIT, Madras vs. Ponni Sugars and Chemicals Ltd.*** (supra). In case before the Apex Court, the Assessee had received subsidy under the Incentive Subsidy Scheme, 1980. The incentive was in the nature of higher free sale sugar quota and allowing the manufacturer to collect the excise duty on sale price of free sale sugar in excess of normal quota but to pay to the Government excise duty payable on price of levy sugar. Under the scheme, the Assessee was under obligation to utilize the subsidy only for repayment of term loans undertaken by it for setting up a units/expansion of existing business. In these circumstances, the Assessee claimed that the incentive received by it was a capital receipt, whereas according to the Revenue, since incentives were given through price and duty differentials,

the character of the incentive was that of revenue receipt. In the light of the above factual position, the Apex Court formulated two questions in paragraph 2 of the judgment as under:-

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

(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 under Section 80-P(2)(a)(i) of the Income Tax Act, 1961 in respect of interest received from the members of the society?

27. The Apex Court thereafter formulated the exact key question in paragraph 9 of the judgment as under :-

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

28. The Apex Court thereafter referred to the judgment in ***Sahney Steel & Press Works Ltd.*** (supra) and held in paragraphs 13, 14, 15, 16 and 17 as under:

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.

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 *Sahney Steel and Press Works Ltd.* [(1997) 7 SCC 764 : (1997) 228 ITR 253] 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 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 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 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 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 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 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 in 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 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.

15. In the decision of the House of Lords in *Seaham Harbour Dock Co. v. Crook* [(1931) 16 TC 333] 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. 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 the House of Lords shows that the source of payment or the form in 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.* [(1997) 7 SCC 764 : (1997) 228 ITR 253] 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 *Seaham Harbour Dock Co.* [(1931) 16 TC 333] the 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 utilise 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.

(emphasis and underlining added)

29. Thus in *CIT vs. Ponni Sugars & Chemicals Ltd.* (supra), the Apex Court has explained the ratio of the judgment in *Sahney Steel & Press Works Ltd.* (supra) by holding that the judgment lays down the basic test to be applied in judging the character of subsidy and holding that the real test is character of the receipt in the hands of the Assessee which has to be determined with respect to the 'purpose' for which the subsidy is given. The Apex Court thereafter held that one has to apply the "*purpose test*" and the point at which the subsidy is paid becomes irrelevant and the source is also immaterial. It is also held that the form of subsidy is also immaterial. It is held that 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 Assessee to set up a new unit or

expand the existing unit, then the receipt of subsidy was on capital account. Thus, the object for which the subsidy is given determines the nature of receipt in the hands of the Assessee. Most importantly, the Apex Court held that the form or the mechanism through which the subsidy is paid is irrelevant. Applying the above test, the Apex Court held that the payment received by the Assessee therein under the scheme was not in the course of a trade, but was of capital nature.

30. Another vital judgment on the issue which discusses the judgments in *Sahney Steel & Press Works Ltd.* as well as *CIT vs. Ponni Sugars & Chemicals Ltd.*, is the judgment in *CIT vs. Chaphalkar Brothers* (supra). In case before the Apex Court, the Government of Maharashtra provided for exemption from payment of entertainment duty in Multiplex Theatre Complexes which were newly set up, for a period of three years and thereafter scheme envisaged payment of entertainment duty at 25% for subsequent years. The object of introducing the scheme was to arrest the falling average occupancy in cinema theatres and also to encourage setting up of new cinema theatres. The assessment order held that the scheme was to support ongoing activities of multiplex and not for its construction and therefore treated the assistance under the scheme as revenue receipt. The ITAT however reversed the finding of the Assessing Officer holding that the scheme was meant to promote construction of new multiplex cinema halls and an incentive for construction purpose. After High Court upheld the order of ITAT,

the revenue filed appeal before the Apex Court. The Apex Court held as under:

What is important from the ratio of this judgment in *Ponni Sugars case* is the fact that *Sahney Steel* was followed and the test laid down was the “purpose test”. It was specifically held that the point of time at which the subsidy is paid is not relevant; the source of the subsidy is immaterial; the form of subsidy is equally immaterial.

Applying the aforesaid test contained in both *Sahney Steel* as well as *Ponni Sugars*, we are of the view that the object, as stated in the Statement of Objects and Reasons, of the amendment ordinance was that since the average occupancy in cinema theatres has fallen considerably and hardly any new theatres have been started in the recent past, the concept of a complete family entertainment centre, more popularly known as multiplex theatre complex, has emerged. These complexes offer various entertainment facilities for the entire family as a whole. It was noticed that these complexes are highly capital intensive and their gestation period is quite long and therefore, they need government support in the form of incentives qua entertainment duty. It was also added that the Government with a view to commemorate the birth centenary of late Shri V. Shantaram decided to grant concession in entertainment duty to multiplex theatre complexes to promote construction of new cinema houses in the State. The aforesaid object is clear and unequivocal. **The object of the grant of the subsidy was in order that persons come forward to construct multiplex theatre complexes, the idea being that exemption from entertainment duty for a period of three years and partial remission for a period of two years should go towards helping the industry to set up such highly capital intensive entertainment centres.** This being the case, it is difficult to accept Mr Narasimha's argument that it is only the immediate object and not the larger object which must be kept in mind in that the subsidy scheme kicks in only post construction, that is when cinema tickets are actually sold. We hasten to add that the object of the scheme is only one—there is no larger or immediate object. **That the object is carried out in a particular manner is irrelevant, as has been held in both *Ponni Sugars* and *Sahney Steel*.**

Mr Ganesh, learned Senior Counsel, also sought to rely upon a judgment of the Jammu and Kashmir High Court in *Shree Balaji Alloys v. CIT* [*Shree Balaji Alloys v. CIT*, 2011 SCC OnLine J&K 269 : (2011) 333 ITR 335] . While considering the scheme of refund of excise duty and interest subsidy in that case, it was held that the scheme was capital in nature, despite the fact that the incentives were not available unless and until commercial production had

started, and that the incentives in the form of excise duty or interest subsidy were not given to the assessee expressly for the purpose of purchasing capital assets or for the purpose of purchasing machinery.

After setting out both the Supreme Court judgments referred to hereinabove, the High Court found that the concessions were issued in order to achieve the twin objects of acceleration of industrial development in the State of Jammu and Kashmir and generation of employment in the said State. Thus considered, it was obvious that the incentives would have to be held capital and not revenue. Mr Ganesh, learned Senior Counsel, pointed out that by an order dated 19-4-2016 [*CIT v. Shree Balaji Alloys*, (2018) 13 SCC 373], this Court stated that the issue raised in those appeals was covered, inter alia, by the judgment in *Ponni Sugars*, and the appeals were, therefore, dismissed.

We have no hesitation in holding that the finding of the Jammu and Kashmir High Court on the facts of the incentive subsidy contained in that case is absolutely correct. **In that once the object of the subsidy was to industrialise the State and to generate employment in the State, the fact that the subsidy took a particular form and the fact that it was granted only after commencement of production would make no difference.**

(emphasis and underlining added)

31. Thus, in *CIT vs. Chaphalkar Brothers* (supra), the Apex Court held that the scheme was to promote construction of new multiplexes and that therefore though the incentive was to be provided only after actual sale of cinema tickets, the said mechanism made no difference as the purpose still remained the same viz. promotion of construction of new multiplexes. The Apex Court thus held that mere form in which the incentive under the scheme is to be ultimately paid becomes irrelevant once the objective of the scheme is to industrialize the State.

F.2 PRINCIPLES DEDUCIBLE

32. After considering the ratio of judgments in ***Sahney Steel & Press Works Ltd., CIT vs. Ponni Sugars & Chemicals Ltd.*** and ***CIT vs. Chaphalkar Brothers*** following principles are deducible:

- (i) While determining the nature of receipt under a particular incentive subsidy scheme, what needs to be applied is “purpose test” i.e. to determine the purpose for which the incentive is offered;
- (ii) If the incentive is offered for the purpose of setting up of new industrial unit or for expansion of existing unit, the receipt of incentive would be on account of capital. On the other hand, if the incentive is given for enabling the Assessee to run business more profitably, then the receipt would be on revenue account;
- (iii) Since purpose of incentive scheme is the determinative factor, the form or mechanism through which the incentive is actually provided becomes irrelevant;
- (iv) Even if actual payment/grant of the incentive is linked to production or sale activity after completion of construction of the industrial unit, the receipt of incentive would still be on capital account so long as purpose of grant of incentive is to promote industrialization.

33. Having broadly discussed the conclusions deducible from various judgments of the Apex Court it is now time to consider

the nature of schemes involved in the present appeals and to apply above principles to the facts of the present case for examining whether the incentive received by the Assessees is on capital account or on revenue account?

F. 3 APPLICABLE SCHEME IN RELIANCE INDUSTRIES

34. The Government of Maharashtra, Industries, Energy and Labour Department issued Government Resolution dated 5 January 1980 revising the package of scheme of incentives for dispersal of industries. In order to achieve the target of dispersal of industries out of Mumbai-Thane-Pune belt, the Government had started giving a package of incentives comprising of refund of sales tax, relief in electricity charges, octroi etc. to the industrial units coming up in developing areas of the scheme since 1964. The Government decided to revise and integrate various schemes and to make them more broadbased and effective so as to speed up pace of industrialisation in the developing regions of the State. Accordingly, a Modified Package Scheme of Incentives-1979 was introduced, which was to remain in operation till 31 March 1983. For the purpose of implementation of the scheme, the areas of the State of Maharashtra were classified into Groups A, B, C and D, depending on the extent of industrial development, Group D representing the areas where least development had occurred. The industrial units were categorized as existing units, new units, pioneer units and resource-based units. The implementing agency for the scheme was State Industrial and Investment

Corporation of Maharashtra Ltd. (SIICOM), who was empowered to issue Certificate of Eligibility, under the Scheme. The application for eligibility could be filed by the industrial unit only after it had taken the initial effective steps. The major incentives introduced by 1979 Scheme included sales tax incentive in Part I and Part II. The incentive in Part I was by way of exemption from payment of sales tax, whereas incentive in Part II was in the form of interest free unsecured loan repayable after 12 years. The incentive in Part I was available only to a new area, which could include a new pioneer unit. The period of eligibility was differently fixed under Part I scheme for small, medium and large scale units.

35. Reliance Textiles Industries Ltd. made an application on 16 December 1980 stating that it did not have any industrial unit in Maharashtra and that it was proposing to set up a new unit at Patalganga Industrial Area for manufacture of polyester filament yarn. It represented that it had spent Rs.1.40 crores on acquisition of land and its total investment towards fixed assets for the project was in the range of Rs.1.50 crores. The expected date of commencement of production was indicated as 31 March 1983. The aggregate cost of the project was estimated at Rs. 66.21 crores. The implementing agency (SIICOM) issued Letter of Intent to the Assessee on 27 January 1981 showing willingness to issue eligibility certificate under Part I of the 1979 Scheme. SIICOM issued Eligibility Certificate dated 6 June 1983 to the Assessee under Part-I of the 1979 Scheme for a period of

five years from 8 June 1983 to 7 June 1988. The capital cost of the project was indicated in the Certificate at Rs.73.80 crores and the entitlement for exemption under the scheme was worked out at Rs.59.04 crores at the rate of 80% of the Gross Value of Fixed Capital Investment. SIICOM imposed various conditions including employment of personnel from Scheduled Castes and Scheduled Tribes and local candidates. Later, SIICOM issued amended certificate on 14 September 1984 increasing the amount of exemption entitlement to Rs.79.6 crores being 80% of enhanced capital cost of the project at Rs.99.08 crores.

36. Towards implementation of the 1979 Scheme, the State Government adjusted the amount of incentive/subsidy payable against the sales tax liability incurred by the Assessee after commencement of production. Thus, instead of the State Government actually paying the subsidy/incentive to the industrial unit, the scheme envisaged adjustment of the Government's liability to pay the incentive against industrial unit's liability to pay sales tax on manufactured products in the newly set up industrial unit.

F. 4. APPLICABLE SCHEME IN BAJAJ AUTO LIMITED.

37. Case of Assessee-Bajaj Auto Limited is governed by the 1983 Scheme introduced vide Government Resolution dated 4 May 1983, which again was introduced for decongesting the industrial belt of Mumbai-Thane-Pune and to attract

industrialisation towards underdeveloped and backward areas of the State. The 1983 Scheme was almost similar to the 1979 Scheme. The Assessee set up a new industrial unit at MIDC, Industrial Area, Waluj, District Aurangabad for manufacture of Scooters with capacity of three lakh per annum and involving fixed capital investment of Rs.156.88 crores. SIICOM issued Eligibility Certificate dated 1 February 1986 holding the Assessee eligible for 90% of gross value of fixed capital investment. Thus, the eligibility of the Assessee for application of incentive scheme was determined on the basis of gross value of fixed capital investment made for setting up of the new industrial unit.

F. 5 APPLICATION OF PRINCIPLES TO THE INCENTIVE GRANTED UNDER THE SCHEMES

38. The 1979 Scheme applicable in the case of the Assessee-Reliance Industries Ltd. and 1983 Scheme applicable in the case of Assessee-Bajaj Auto Limited were almost similar. Both the schemes were introduced to promote industrialisation in backward areas in Maharashtra State with a view to decongest the industrial belt of Mumbai-Thane-Pune. The Schemes were aimed that promoting setting up of new industries in other areas of the State. An entity setting up a new industrial unit in developing areas were provided incentive in the form of sales tax subsidy under both the schemes. The eligibility of an industrial unit was determined based on the value of fixed capital investment made for setting up of the concerned unit. However

instead of actual payment of incentive by the Government to the Assessees, the scheme provided for adjustment of amount of such incentive against the liability of the Assessee to pay the sales tax to the Government after commencement of the production.

39. In our view therefore, the incentives/subsidy granted by the State Government under both the 1979 as well as 1983 Schemes were for the purpose of setting up of new industrial units. The incentive/subsidy was not granted for the purpose of enabling the Assessees to run the business more profitably. After applying the “*purpose test*” it is clear that the incentive provided to the Assessee under both the Schemes was for promoting setting up of new industrial units in developing areas of the State. The incentive was aimed at promoting industrialization in the State.

40. As held by the Apex Court in ***CIT vs. Ponni Sugars & Chemicals Ltd.***, (supra), the form or the mechanism through which the subsidy is given is irrelevant. Similarly, it is held by the Apex Court in ***CIT vs. Chaphalkar Brothers*** (supra) that the factum of subsidy taking a particular form and granted only after commencement of production, would make no difference. Therefore, the mere fact that the amount of subsidy payable under the scheme was adjusted against the liability of the Assessees to pay sales tax to the Government after commencement of production, makes no difference to the purpose

for which the incentive was granted. The incentive was not aimed at saving the amount of sales tax on products manufactured with a view to earn higher profits by the manufacturer. The incentive was granted to promote setting up of the new industrial units at backwards areas of the State. The manner of provision of incentive by adjusting the same against sales tax liability post-production was merely a form or the mechanism, through which the subsidy was routed and the same has absolutely no relevance for determining the 'purpose' for which the incentive was provided.

41. In the case of ***CIT vs. Chaphalkar Brothers***, though the incentive was provided for promoting construction of new cinema halls/multiplexes, the actual incentive became payable only on sale of tickets after the construction was complete. Despite this, the Apex Court held that the form of payment of incentive was irrelevant so long as the purpose of giving incentive was to industrialize the State. Similarly in ***CIT vs. Ponni Sugars & Chemicals Ltd.*** also, the incentive was actually paid in the twin forms of - (i) allotting higher quota for free sale sugar and (ii) by allowing the manufacturer to collect excise duty on sale price of free sale sugar in excess of normal quota but to pay Government only the excise duty payable on price of levy sugar. The differential amount of sales tax, so collected and retained by the manufacturer, was to be utilized for repayment of term loan availed for setting up of new units/expansion of existing business. Thus the incentive was

ultimately payable upon actual manufacture of sugar. Despite this, the Apex Court held that the purpose of grant of incentive under the scheme was to promote setting up of new units or expansion of existing units, as the amount of subsidy was compulsorily required to be utilised only for repayment of term loans availed for setting up of a new units. In the present cases as well, mere grant of incentive by adjusting the same against Assessee's sales tax liability upon commencement of production, did not alter the purpose of the Scheme. In our view, the issue involved in the present Appeals is squarely answered by the judgments of the Apex Court in ***CIT vs. Ponni Sugars & Chemicals Ltd.*** and ***CIT vs. Chaphalkar Brothers.***

42. The Delhi High Court had the occasion of considering the issue of treatment of sales tax subsidy receipt under the 1993 Scheme introduced by the Government of Maharashtra in ***CIT IV vs. M/s. Indo Rama Textiles Ltd.*** (supra). The Division Bench of Delhi High Court rejected the contention of the Revenue that the sales tax subsidy/incentive was granted to assist the Assessee in carrying of the business/operations or to make the industry more profitable. The Division Bench held in paragraphs 24 and 25 as under:-

24. Therefore, the argument that the sales tax subsidy/incentive was granted to assist in carrying on business operations and thereby help make the industries more profitable, both on facts and in law is untenable.

25. At the risk of repetition, it must be stated that the sole purpose of the 1993 Scheme was to set up new units and/or expand existing units in underdeveloped and developing areas ; an aspect which also emerges on perusal of classification of areas given in paragraph 1.3 of the 1993 Scheme.

25.1 In the categorisation, a clear distinction has been drawn between developed areas [Group A] and those where some development has taken place [Group B] or are less developed than those falling under Group B [Group C], those which are the least developed areas of the State not covered under Group A/ Group B/ Group C [Group D] and the areas which are least developed lacking basic infrastructure and covered under Group A, Group B, Group C and Group D [Group D+].

43. In fact, the very same issue arose in the case of ***Deputy CIT vs. Reliance Industries Limited***¹¹ before the Special Bench of ITAT Mumbai, which has answered the issue in following terms:

The scheme framed by the Government of Maharashtra in 1979 and formulated by its resolution dated January 5, 1980, has been analysed in detail by the Tribunal in its order in RIL for the assessment year 1985-86 which we have already referred to in extenso. On an analysis of the scheme, the Tribunal has come to the conclusion that the thrust of the scheme is that the assessee would become entitled for the sales tax incentive even before the commencement of the production, which implies that the object of the incentive is to fund a part of the cost of the setting up of the factory in the notified backward area. The Tribunal has, at more than one place, stated that the thrust of the Maharashtra scheme was the industrial development of the backward districts as well as generation of employment thus establishing a direct nexus with the investment in fixed capital assets. It has been found that the entitlement of the industrial unit to claim eligibility for the incentive arose even while the industry was in the process of being set up. According to the Tribunal, the scheme was oriented towards and was subservient to the investment in fixed capital assets. The sales tax incentive was envisaged only as an alternative to the cash disbursement and by its very nature was to be available only after production commenced. Thus, in effect, it was held by the Tribunal that the subsidy in

¹¹ [2004] 88 ITD 273

the form of sales tax incentive was not given to the assessee for assisting it in carrying out the business operations. The object of the subsidy was to encourage the setting up of industries in the backward area.

44. The Division Bench of this Court upheld the above findings in *CIT-3 Mumbai vs. Reliance Industries Limited*¹² holding that object of the subsidy was to set up new unit in backward areas to generate employment and that therefore the subsidy was clearly on capital account. Therefore, substantial question of law on this issue was not framed by the Division Bench while admitting the Appeal on other questions of law. It is contended by the Revenue that in Special Leave Petition filed by the Revenue challenging order of the Division Bench, the Appeal has been remanded for deciding framing of question of law on the above issue and the matter is pending. We need not delve deeper into this aspect as we are convinced after consideration of ratio of various judgments as quoted above that the purpose of both the Schemes was to promote setting up of new industries and not to assist the Assessee to make the business more profitable. Incentive/subsidy received under the scheme would therefore be on capital account and not on revenue account.

G. CONCLUSION

45. Question of law No.3 in Income Tax Appeal No.156 of 2003 and both the Questions of law in Income Tax Appeal No.505 of 2003 are answered by holding that the incentive/subsidy

¹² [2011] 339 ITR 632 (Bombay)

received by the Assesseees under 1979 Scheme and 1983 Scheme were on the capital account not chargeable to tax.

H. ORDER

46. Income Tax Appeal No.156 of 2003 filed by the Revenue is accordingly **dismissed**. Income Tax Appeal No.505 of 2003 filed by the Assessee is accordingly **allowed** by setting aside the judgment and order dated 31 December 2002 passed by the ITAT. Consequently the orders passed by the Assessing Officer as well as by the CIT-Appeals in respect of disallowing Appellant's claim in respect of incentive/subsidy received under the Scheme are set aside and the Revenue, is directed to treat the amount of incentive/subsidy as capital receipt not chargeable to tax.

47. With the above directions both the Appeals are **disposed of**.

(SANDEEP V. MARNE, J.)

(CHIEF JUSTICE)