Grant Thornton
An instinct for growth™

Subsidy received by Indian JV partner from foreign JV partner for making investment in the JV not taxable: Madras HC

Issued on: 23 May 2019

Summary

The Madras High court (HC) in a recent decision[1] has held that subsidy received from a foreign joint venture (JV) partner to enable the Indian company to contribute its share in the capital of the JV is a capital receipt and hence not taxable under the Act.

Facts of the case

- The Indian company (taxpayer) entered into a JV agreement with Royal and Sun Alliance Insurance Plc (RSA), a UK-based insurance company. The JV was formed for the purpose of entering the insurance market and was formed as a company.
- Under the JV agreement, the JV was to be funded in the following manner:
  - RSA to contribute towards 26% shares of the JV
  - The taxpayer to subscribe 50% shares of the JV
  - Balance shares to be subscribed by one or more third parties to be mutually agreed by JV partners
- Further, the JV agreement provided that if the taxpayer was required to further infuse equity during the initially agreed payback period, RSA would compensate[2] the taxpayer before the finalisation of the shareholder agreement.
- Pursuant to the above, the taxpayer received compensation from RSA amounting to INR 2.11 crore. The taxpayer contended that the compensation was in the nature of capital subsidy received for making investment in the JV.
- The tax officer treated the subsidy to be in the nature of revenue receipt and taxed the same in the hands of the taxpayer.
- The Income Tax Appellate Tribunal (ITAT) confirmed the decision of the tax officer and noted that the taxpayer failed to produce the basis of working of the

[1] Sundaram Finance Ltd v ACIT [2019] 104 taxmann.com 282 (Madras)
[2] Amount of compensation was to be mutually agreed between the parties

compensation. The ITAT further held that the payment was made as consideration towards broad clientele base, network, distribution technique and management expertise of the taxpayer, and therefore liable to tax as a revenue receipt.

Taxpayer's contention before HC

- The taxpayer indicated the terms of the JV agreement and contended that the payment was to enable it to contribute to the share capital of the JV. It was also pointed out that the tax officer in his assessment order had noted that the payment was received for making investment in the JV. Thus, the taxpayer argued that the compensation was a capital subsidy for making investment and accordingly should not be taxed under the Act.
- Further, the taxpayer placed reliance on an Apex Court decision[3] where it was held that voluntary subvention payment received from the parent company to its loss-making subsidiary could not be treated as a revenue receipt. Thus, the taxpayer argued that the amount received by it from RSA should not be treated as a revenue receipt following the same analogy.

Held by the HC

- The HC observed that the Tax Department had failed to furnish evidence to show that the capital subsidy received by the taxpayer during the year was diverted for any other purpose. It thus concluded that the money was utilised for making investment in the JV.
- As regards the observation made by the ITAT, the HC noted that the insurance business of the JV had already started and no evidence had been brought on record to suggest that the payment was made for any services rendered by the taxpayer.
- The HC noted that the tax officer had recorded that the amount was actually invested in the share capital of the JV. Thus, it held that the amount received by the taxpayer was a capital receipt and accordingly not taxable under the Act.

Our comments

Taxability of any amount received as a subsidy has always been a subject matter of debate in various cases before the courts. The decision of the HC in the present case should bring in clarity in those cases wherein the amount received as subsidy is utilised towards capital contribution as agreed between the parties.

[3] Siemens Public Communication Networks (P.) Ltd v CIT [2017] 390 ITR 1 (SC)

Contact us

To know more, please visit **www.grantthornton.in** or contact any of our offices as mentioned below:

NEW DELHI	NEW DELHI	AHMEDABAD	BENGALURU	CHANDIGARH
National Office Outer Circle L 41 Connaught Circus, New Delhi 110001 T +91 11 4278 7070	6th floor, Worldmark 2, Aerocity, New Delhi – 110037 T +91 11 4952 7400	7th Floor, Heritage Chambers, Nr. Azad Society, Nehru Nagar, Ahmedabad - 380015	5th Floor, 65/2, Block A, Bagmane Tridib, Bagmane Tech Park, C V Raman Nagar, Bengaluru – 560093 T+91 80 4243 0700	B-406A, 4th Floor, L&T Elante office Industrial area, Phase-I Chandigarh 160002 T +91 172 4338 000
CHENNAI	**DEHRADUN**	**GURGAON**	**HYDERABAD**	**KOCHI**
7th Floor, Prestige Polygon 471, Anna Salai, Teynampet Chennai - 600 018 T +91 44 4294 0000	Suite 2211, Michigan Avenue, Doon Express Business Park, Saharanpur Road, Dehradun – 248002 T +91 135 264 6500	21st Floor DLF Square, Jacaranda Marg, DLF Phase II, Gurgaon 122002 T +91 124 462 8000	7th Floor, Block III White House Kundan Bagh, Begumpet Hyderabad 500016 T +91 40 6630 8200	7th Floor, Modayil Centre Point, Warriam road junction, M.G. Road Kochi 682016 T +91 484 406 4541
KOLKATA	**MUMBAI**	**MUMBAI**	**NOIDA**	**PUNE**
10C Hungerford Street 5th Floor, Kolkata 700017 T +91 33 4050 8000	16th Floor, Tower II Indiabulls Finance Centre SB Marg, Elphinstone (W) Mumbai 400013 T +91 22 6626 2600	9th Floor, Classic Pentagon, Nr Bisleri, Western Express Highway, Andheri (E) Mumbai 400099 T +91 22 6176 7800	Plot No. 19A, 7th Floor Sector – 16A, Noida 201301 T +91 120 4855 900	3rd Floor, Unit No 309 to 312, West Wing, Nyati Unitree Nagar Road, Yerwada Pune- 411006 T +91 20 6744 8800

For more information or for any queries, write to us at **contact@in.gt.com**

Follow us @GrantThorntonIN

Grant Thornton
An instinct for growth™

© 2019 Grant Thornton India LLP. All rights reserved.

"Grant Thornton in India" means Grant Thornton India LLP, a member firm within Grant Thornton International Ltd, and those legal entities which are its related parties as defined by the Companies Act, 2013.

Grant Thornton India LLP is registered with limited liability with identity number AAA-7677 and has its registered office at L-41 Connaught Circus, New Delhi, 110001.

References to Grant Thornton are to Grant Thornton International Ltd (Grant Thornton International) or its member firms. Grant Thornton International and the member firms are not a worldwide partnership. Services are delivered independently by the member firms.