Subvention receipts

By Gayatri Sridharan

Many OECD countries have some sort of formal group taxation system. No common approach to consolidation or group taxation, in general, is followed. There are usually two approaches:

- *Consolidation system* also called *fiscal unity system* which taxes the members of the corporate group as if they were one entity and all their profits and losses are consolidated.

- The other approach is the *loss transfer system* also called the *group relief system* whereby one member of a group transfers its losses to another group company. The identity of the members is kept intact. By setting off the losses of one entity against the profits of another entity the overall taxable profits of the corporate group is brought down.

In Germany the *Organschaft* system requires that the profits and losses of the subsidiaries are rolled up into the parent company's profits. The parent company is required to enter into contracts with each of its subsidiaries in this regard. In Finland also, there is a subvention system providing for shifting of taxable income between groups.

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One notices variation in the percentage of common ownership required for group members to participate in the system. Many countries have ownership thresholds of 90 percent or higher. The Bombay High Court had occasion to point out in the case of Indian Textile Engineers (P) Ltd., as reported in [1983] 141 ITR 69 that subvention payment related to the deficit, expressly made in an agreement between the paying company and the payee company, is governed by Section 20 of the Finance Act, 1953 (UK).

Subvention payments came up again for scrutiny recently once by the Income Tax Appellate Tribunal at Delhi, in the case of *Deputy Commissioner of Income Tax* v. *Lurgi India Co. Ltd* reported in 302 ITR (AT) 67 (Delhi bench) and yet again by another bench of the same Tribunal in an unreported decision in the case of *Assistant Commissioner of Income Tax Circle 10(1)* v. *M/s Deutsche Post Bank Home Finance Ltd., [formerly known as BHW Home Fin. Ltd.]* in ITA 1405 (Del) of 2010 for the Assessment Year 2005-06 vide order 14th October 2011 which held that such receipts in the hands of the subsidiaries would amount to capital receipts.

In the latter case, the assessee was a 100% subsidiary of BHW Holding AG Germany. It received an amount of Rs. 11,22,38,874/- as subvention payment towards restoration of net worth of the assessee, which was eroded due to losses suffered by the assessee. The assessee furnished copies of letters dated 24th September, 2004 and 4th February, 2005, of the holding company. According to letter dated 24th September, 2004 a sum of Euro two million would be paid to BHW as subvention payment towards restoration of net worth of the company expected to be partly eroded by losses suffered /projected by the company for the financial year 2004-05. In the letter dated 4th February, 2005 there is a mention of transfer of Euro Five Lakhs for restoration of the net worth of the company.

The Departmental Representative contended that, as per conventional theory, the subvention money comes into play between any two entities and (i) to enable the holding company to provide subvention, the subsidiary company should submit the claim on what ground it needs such support; (ii) the claims are, generally, accompanied by a statutory auditor's certificate certifying that the claims for subvention are true and correct; (iii) there is a basis of calculation of subvention money according to which subvention money is disbursed considering the quantum of loss suffered by the assessee and (iv) also there are certain specifications and the manner in which such sum is used for business.

The Tribunal, however, took note of the fact that the assessee had filed a copy of the confirmation received through e-mail wherein the holding company had certified that they had not claimed the subvention payment as expenditure in their return of income and no tax benefit was received by them in respect of subvention payment. BHW Holding AG had capitalized the amount in their books of accounts and further, the subsidiary company was not required to reimburse the payment.

The Tribunal also relied on its earlier decision in the case of *Deputy Commissioner of Income Tax* v. *Lurgi India Co. Ltd* reported in 302 ITR (AT) 67 (Delhi Bench) which followed the decision of the Delhi High Court in the case of *Handicrafts and Handloom Corporation of India* v. *CIT* reported in [1983] 140 ITR532 which distinguished government grants from grants received by the parent company. In that case the State trading Corporation of India had provided cash assistance of Rs. 11, 70,000/- to its subsidiary as a percentage of its export earnings to recoup its losses. The High Court had held that such receipts were on a footing different from Government grants where the grant was received because the person was a trader and required assistance in his business of trading where as in the case of a parent company providing assistance to its subsidiary the consideration was their close connection with each other. It cannot therefore be termed as a revenue receipt. This is a refreshing view on intra group transfers. The receipts would most certainly have affected the book profits of the loss making company and possibly attracted the MAT provisions under the Indian Income Tax Act if the receipts were treated as revenue receipts.

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