

[2009] 27 SOT 270 (MUM.)(SB)
IN THE ITAT MUMBAI BENCH 'E' (SPECIAL BENCH)
Assistant Commissioner of Income-tax, Circle-33

v.

Bhaumik Colour (P.) Ltd.*

G.C. GUPTA AND N.V. VASUDEVAN, JUDICIAL MEMBER AND S.V. MEHROTRA,
ACCOUNTANT MEMBER
IT APPEAL NO. 5030 (MUM.) OF 2004
[ASSESSMENT YEAR 1997-98]
NOVEMBER 19, 2008

ORDER

N.V. Vasudevan, Judicial Member. - The facts and circumstances under which the reference came to be made by the Hon'ble President, ITAT to a Special Bench to decide questions formulated for consideration are as follows :

2. The assessee in ITA No. 5030/Mum./04, viz., Bhaumik Colour Pvt. Ltd. (BCPL) is a company engaged in the business of manufacture of pencil-paints. BCPL took an interest bearing loan of Rs. 9 lakhs from M/s. Umesh Pencils Pvt. Ltd. (UPPL). It was observed by the Assessing Officer that though BCPL is not a shareholder of UPPL, both the companies had one common shareholder *i.e.* Narmadaben Nandlal Trust (NNT). The said trust was holding 20 per cent shares in BCPL *i.e.*, holding substantial interest and 10 per cent shares in UPPL. The Assessing Officer was of the view that the said transaction was covered by the second limb of provisions of section 2(22)(e) (in italic letters), relevant part of which reads :—

“(e) any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part or otherwise) (made after 31-5-1987), by way of advance or loan to a shareholder, being a person who is the beneficial owners of the shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest.....”

According to the assessee the shares were held in the name of three trustees for and on behalf of the Trust NNT and that the beneficiaries of the trust were five in number and none of the trustees were also beneficiaries of the trust. The assessee contended that to invoke the second limb of the provisions of section 2(22)(e) the primary condition was that NNT must be both a registered shareholder and also beneficial shareholder. Since the Trustees of NNT held the shares on behalf of the Trust only as legal owners and were not the beneficial owners of the shares, the provisions of section 2(22)(e) could not be invoked. The Assessing Officer however did not agree with the contentions on behalf of the assessee and taxed Rs. 9 lakhs in the hands of BCPL as deemed dividend.

3. On appeal by the assessee the CIT(A) deleted the addition made by the Assessing Officer for the reason that NNT was not beneficial shareholder of shares in BCPL or UPPL and therefore the second limb of the provisions of section 2(22)(e) could not be applied *vis-a-vis* the assessee.

*In favour of assessee.

4. Aggrieved by the order of CIT(A) the revenue has preferred the aforesaid appeal before the Tribunal raising the following grounds of appeal :

“1. Whether on the facts and in the circumstances of the case and in law, the Id. CIT(A) is right in deleting the addition of Rs. 9 lakhs made on account of deemed dividend ignoring provision of section 2(22)(e).

2. The appellant craves leave to add, to amend and/or alter any of the grounds of appeal, if need be.”

5. When the appeal was heard by the Division Bench, the revenue contended that the case of the revenue is that the issue is covered in its favour by the decision of the Mumbai Tribunal in the case of *Dy. CIT v. Nikko Technologies (I) (P.) Ltd.* [IT Appeal No. 4077 (Mum.) of 2002, dated 30-12-2005]. It was stated that the case cited was similar to the present case and in that case also the issue involved was pertaining to the second limb of the provisions of section 2(22)(e) and it was held that the loan or advance was taxable in the hands of the concern receiving the loan as deemed dividend.

6. The case of the assessee, on the other hand, was that in the case of *Nikko Technologies (I) (P.) Ltd. (supra)*, the Tribunal had chosen not to follow an earlier decision of the Mumbai Tribunal in *Seamist Properties (P.) Ltd. v. ITO* [2005] 1 SOT 142 which had taken the view that dividend under section 2(22)(e) could not be taxed in the hands of a person other than a shareholder.

7. As there was a direct conflict between the decisions in *Nikko Technologies (I) (P.) Ltd.*'s case (*supra*) and in the case of *Seamist Properties (P.) Ltd.*'s case (*supra*) the Division Bench was of the considered opinion that that the matter should be recommended and placed before Hon'ble President for constitution of a Special Bench on the following questions :

(1) Whether deemed dividend under section 2(22)(e) of the Income-tax Act, 1961 can be assessed in the hands of a person other than a shareholder of the lender ?

(2) Whether the words “such shareholder” occurring in section 2(22)(e) refer to a shareholder who is both the ‘registered’ shareholder and the beneficial shareholder ?

8. The President by order dated 10-10-2007 has directed the hearing of the entire appeal and the two questions formulated as above for consideration by the Special Bench.

9. M/s. Weaveland, Panipat, Haryana, have sought permission and were granted permission to appear as intervener before the Special Bench. The facts in the case of the intervenor *viz., Asstt. CIT v. Weaveland* [IT Appeal No. 5036 (Delhi) of 2008] are as follows : Weaveland is a partnership firm. It had various transactions of receipts and payments of money with Paliwal Industries Pvt. Ltd. (PIPL). There were four partners in the firm Weaveland. These four partners held shares in PIPL the details of which were as follows :

1. Mr. Avinash Chander Sharma	:	30%
2. Mrs. Rani Paliwal	:	27.50%
3. Mr. Abhishek Paliwal	:	30%
4. Mr. Sandeep Goyal	:	12.5%

The above four persons shared the profits of the partnership also in the same proportion set out above. The Assessing Officer applied the provisions of section 2(22)(e) in respect of the net outstanding by M/s. Weaveland to PIPL and brought the same to tax in the hands of M/s. Weaveland. The order of Assessing Officer was reversed by the CIT(A) on the ground that Deemed Dividend under section 2(22)(e) cannot be brought to tax in the hands of a non-shareholder. The revenue is in appeal against the said order in which the first

question formulated for consideration by the Special Bench arises for consideration.

10. Mr. Arvind Sonde, Advocate appeared on behalf of the assessee. Mr. Satish K. Goel, Advocate filed written submissions on behalf of the intervener. Mr. Pahwa, CIT (D.R.) appeared on behalf of the revenue.

11. The learned counsel for the assessee furnished a chart to the Bench showing the comparison between the provisions of section 2(22)(e) as appearing in the Income-tax Act, 1961 and section 2(6A)(e) as appearing in the Income-tax Act, 1922. He emphasized that by replacing section 2(6A)(e) by section 2(22)(e), the scope of the word 'shareholder' was narrowed to include only shareholders who were also beneficial owners. He pointed out that at all stages of the law, the word "Shareholder" exists. However, the overall scope of the section was widened to tax loan received by any concern, having common shareholders as deemed dividend. He also laid emphasis on the words 'such shareholder' used in the said section by stating that the words 'such shareholder' must necessarily be correlated to the word 'shareholder' when it occurs for the first time in section 2(22)(e). The word 'shareholder' when it occurs for the first time in section 2(22)(e) is also used in section 2(6A)(e). In this context learned counsel relied on the judgment of Hon'ble Apex Court in the case of *Rameshwarlal Sanwormal v. CIT* [1980] 122 ITR 1¹, which dealt with section 2(6A)(e) wherein it was held that the amount of the loan would not fall within the mischief of this section if it is granted to a beneficial owner of the shares who is not the registered shareholder. In nutshell, the contention of the learned counsel was that with the introduction of section 2(22)(e) the following are two condition precedent for invoking section 2(22)(e) :

- (i) The shareholder should be a registered shareholder, and
- (ii) The shareholder should also be a beneficial owner of the shares.

Thus according to him the second question formulated for consideration by the Special Bench has to be answered as above. It was submitted by him that in the case of the assessee, the common shareholder was a Trust. Share certificate are in the name of the trustees. Thus, the registered holders are the trustees, whereas the beneficial owners are the beneficiaries of the trust. The trustees and beneficiaries were different individuals. Hence, the primary condition for invoking section 2(22)(e) is not fulfilled and consequently section 2(22)(e) does not apply to the case of the assessee.

12. On the first question formulated for consideration by the Special Bench, according to him the same does not arise for consideration in his case but nevertheless, he relied on the decision of the Hon'ble Rajasthan High Court in the case of *CIT v. Hotel Hill Top* [IT Appeal No. 25 (Raj.) of 2005, dated 17-3-2008] wherein it has been held by the Hon'ble Rajasthan High Court that deemed dividend cannot be brought to tax in the hands of a non-shareholder.

13. The learned counsel for the intervener filed written submissions. His submissions on the issues for consideration before the Special Bench were identical. The summary of the same is as follows :

- (i) Section 2(22)(e) is a deeming provision and it extends the normal meaning of dividend and enlarges its scope.
- (ii) Those provisions do not spell out as to in whose hands the dividend or such deemed dividend are to be taxed.
- (iii) Normally dividend is taxable only hands of a shareholder and not in the hands of a non-shareholder.

- (iv) The legal fiction by which a loan or advance or any payment for the benefit of a shareholder is treated as dividend cannot be extended so as to apply to a non-shareholder. In this regard decision of the Hon'ble Supreme Court in the case of *CIT v. Moon Mills Ltd.* [1966] [59 ITR 574](#) was relied upon.
- (v) Under the Companies Act, 1956 dividend cannot be paid to any person other than the registered shareholder.
- (vi) The normal commercial meaning of the term 'dividend' has been extended to cover certain other payments also but only to a shareholder and not to a non-shareholder.

14. The learned D.R. submitted as follows :

- (i) The expression "being a person who is the beneficial owner of shares" found in section 2(22)(e) qualifies the word "shareholder" appearing before that expression. Therefore the above expression only restricts the meaning of the word "shareholder" so as to include a beneficial owner of shares also. Therefore in the case of the assessee both in UPPL and BPCL, the beneficial owners were one and the same individuals viz., beneficiaries of the Trust NNT and therefore the provisions of section 2(22)(e) would apply.
- (ii) The provisions of section 2(22)(e) contemplates three situations under which payment of advance or loan or any payment for the benefit of shareholder can be called dividend viz., (a) any payment by way of advance or loan to a shareholder was considered as dividend paid to shareholder or (b) any payment by any such company on behalf or for the individual benefit of a shareholder was considered as dividend and (c) to any concern in which such shareholder is a member or a partner and in which he has a substantial interest. The three situations have to be seen disjoint and not as interconnected. Situation (c) referred to above if read disjoint will apply even to payments to non-shareholders.
- (iii) According to him it is not correct to say that dividend is always linked to a payment by a company to its shareholders. In this regard he referred to the provisions of section 8(a) of the Act which lays down that for the purposes of inclusion in the total income of an assessee any dividend declared by a company or distributed or paid by it within the meaning of sub-clauses (a) to (e) of clause (22) of section 2 shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be. It was submitted by him by the aforesaid provisions a charge to tax in the hands of the non-shareholder is also possible.
- (iv) According to him the Hon'ble Rajasthan High Court in the case of *Hotel Hill Top (supra)* has not dealt with the 2nd limb of section 2(22)(e) of the Act and that case only dealt with the third limb of section 2(22)(e) of the Act.

15. We have considered the rival submissions. The historical background of section 2(22)(e) is as follows :

- (a) Section 2(6A)(e) of the Indian Income-tax Act, 1922 as introduced by the Finance Act, 1955 corresponding to section 2(22)(e) of the Income-tax Act, 1961 was as follows :

"Any payment by a company, not being a company in which the public are substantially interested within the meaning of section 23A, of any sum (whether as representing a part of the assets of the company or otherwise) by way of advance or loan to a shareholder, or any payment by any such company on behalf, or for the individual benefit, of a shareholder, to the extent to which the company in either case possesses accumulated profits."

(b) Section 2(22) of the Income-tax Act, 1961 defines dividend. Section 2(22)(e) of the Act, which is equivalent to section 2(6A)(e) of the 1922 Act, as it existed originally in the Income-tax Act, 1961, read as follows:

“Section 2(22) “dividend” includes—

(a) to (d)**

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(e) Any payment made by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) by way of advance or loan to a shareholder, being a person who has a substantial interest in the company, or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits.”

(c) The aforesaid clause (e) of the Act has been amended with effect from 1-4-1988 the amended clause (e) of the Act reads as follows :

“(e) Any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) made after 31-5-1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern) or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits.”

Explanation-3 to section 2(22)(e) is as follows :

“*Explanation-3* : For the purpose of this clause—

(a) ‘concern’ means a Hindu Undivided Family, or a firm or an association of persons or a body of individuals or a company;

(b) A person shall be deemed to have a substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the income of such concern;”

Section 2(32) defines the expression “person who has a substantial interest in the company”, in relation to a company, means a person who is the beneficial owner of shares, not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits, carrying not less than twenty per cent of the voting power.

16. Under the 1922 Act, two categories of payment were considered as dividend *viz.*, (a) any payment by way of advance or loan to a shareholder was considered as dividend paid to shareholder or (b) any payment by any such company on behalf or for the individual benefit of a shareholder was considered as dividend.

17. In the 1961 Act, the very same two categories of payment were considered as dividend but an additional condition that payment should be to a shareholder being a person who is the beneficial owner of shares and who has a substantial interest in the company *viz.*, shareholding which carries not less than twenty per cent of the voting power, was introduced.

18. By the 1987 Amendment with effect from 1-4-1988, the condition that payment should be to a shareholder who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power was substituted. Thus the percentage of voting power was reduced from twenty per cent to ten per cent. By the very same amendment a new category of payment was also considered as dividend *viz.*, payment to any concern in which such shareholder is a member or a partner and in which he has a substantial interest. Substantial interest has been defined to mean holding of shares carrying 20 per cent of voting power.

19. The provisions of section 2(22)(e) creates a fiction bringing in amounts paid otherwise than as dividend into the net of dividends. Therefore this clause must be given a strict interpretation as held by the Honourable Supreme Court in the case of *CIT v. C.P. Sarathy Mudaliar* [1972] [83 ITR 170](#). In the case of the assessee as well as the intervener there is not dispute that the companies which gave the loan or advance were one in which public are not substantially interested. Nor is there any dispute that these companies possess accumulated profits to the extent of the loan or advance. The three limbs of section 2(22)(e) are as follows :

“Any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) made after 31-5-1987, by way of advance or loan

First limb

- (a) to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power,

Second limb

- (b) or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern)

Third limb

- (c) or any payment by any such company on behalf, or for the individual benefit, of any such shareholder,

to the extent to which the company in either case possesses accumulated profits.”

20. In the case of *C.P. Sarathy Mudaliar (supra)* provisions of section 2(6A)(e) of the Act, 1922, which was synonymous to section 2(22)(e) of the Income-tax Act, 1961 came up for consideration. In the said case, members of HUF acquired shares in a company with the fund of the family. Loans were granted to HUF and the question was whether the loans could be treated as dividend income of the family falling within section 2(6A) (e) of the Act, 1922. The Apex Court held that only loans advanced to shareholders could be deemed to be dividends under section 2(6A)(e) of the 1922 Act, the HUF could not be considered to be a ‘shareholder’ under section 2(6A)(e) of the Act and hence, loans given to the HUF will not be considered as loans advanced to “shareholder” of the company and could not, therefore, be deemed to be its income. The Apex Court further held that when the Act speaks of shareholder it refers to the registered shareholder.

21. The aforesaid decision of the Apex Court in the case of *C.P. Sarathy Mudaliar (supra)* has been followed by the Apex Court in the case of *Rameshwarlal Sanwamal (supra)*. In this case, the company advanced the loans to the assessee Hindu undivided family who was the beneficial owners of the shares in the company, but the shares were registered in the name of the individual karta, who held the shares for and on behalf of the Hindu undivided family. On the above facts, the question before the Supreme Court was whether the loans advanced to the Hindu undivided family - beneficial owner of the shares - would be taxed as deemed dividend in the hands of the Hindu undivided family. The Supreme Court held that the Hindu undivided family being only the beneficial shareholder and not a registered shareholder would not fall within the purview of section 2(6A)(e) of the 1922 Act. The Apex Court observed as follows :

“... What section 2(6A)(e) is designed to strike at is advance or loan to a ‘shareholder’ and the word ‘shareholder’ can mean only a registered shareholder. It is difficult to see how a beneficial owner of shares whose name does not appear in the register of shareholders of the company can be said to be a ‘shareholder’. He

may be beneficially entitled to the share but he is certainly not a 'shareholder'. It is only the person whose name is entered in the register of the shareholders of the company as the holder of the shares who can be said to be a shareholder *qua* the company and not the person beneficially entitled to the shares. It is the former who is a 'shareholder' within the matrix and scheme of the company law and not the latter. We are, therefore, of the view that it is only where a loan is advanced by the company to a registered shareholder and the other conditions set out in section 2(6A)(e) are satisfied that the amount of the loan would be liable to be regarded as 'deemed dividend' within the meaning of section 2(6A)(e)."

22. It is thus clear from the aforesaid pronouncement of the Hon'ble Supreme Court that to attract the first limb of the provisions of section 2(22)(e) the payment must be to a person who is a registered holder of shares. As already mentioned the condition under the 1922 Act and the 1961 Act regarding the payee being a shareholder remains the same and it is the condition that such shareholder should be beneficial owner of the shares and the percentage of voting power that such shareholder should hold that has been prescribed as an additional condition under the 1961 Act. The word "Shareholder" alone existed in the definition of dividend in the 1922 Act. The expression "Shareholder" has been interpreted under the 1922 Act to mean a registered shareholder. This expression "Shareholder" found in the 1961 Act has to be therefore construed as applying only to registered shareholder. It is a principle of interpretation of statutes that where once certain words in an Act have received a judicial construction in one of the superior courts, and the Legislature has repeated them in a subsequent statute, the Legislature must be taken to have used them according to the meaning which a court of competent jurisdiction has given them.

23. In the 1961 Act the word "Shareholder" is followed by the following words "being a person who is the beneficial owner of shares". This expression used in section 2(22)(e) both in the 1961 Act and in the amended provisions with effect from 1-4-1988 only qualifies the word "Shareholder" and does not in any way alter the position that the shareholder has to be a registered shareholder. These provisions also do not substitute the aforesaid requirement to a requirement of merely holding a beneficial interest in the shares without being a registered holder of shares. The expression "being" is a present participle. A participle is a word which is partly a verb and partly an adjective. In section 2(22)(e), the present participle "being" is used to describe the noun shareholder like an Adjective. The expression "being a person who is the beneficial owner of shares" is therefore a further requirement before a shareholder can be said to fall within the parameters of section 2(22)(e) of the Act. In the 1961 Act, section 2(22)(e) imposes a further condition that the shareholder has also to be beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power. It is not possible to accept the contention of the learned D.R. that under the 1961 Act there is no requirement of a shareholder being a registered holder and that even a beneficial ownership of shares would be sufficient.

24. The expression "shareholder being a person who is the beneficial owner of shares" referred to in first limb of section 2(22)(e) refers to both a registered shareholder and beneficial shareholder. If a person is a registered shareholder but not the beneficial shareholder than the provisions of section 2(22)(e) will not apply. Similarly if a person is a beneficial shareholder but not a registered shareholder then also the first limb of provisions of section 2(22)(e) will not apply.

25. The new category of payment which was considered as dividend introduced by the Finance Act, 1987 with effect from 1-4-1988 by the second limb of section 2(22)(e) is payment "to any concern in which such shareholder is a

member or a partner and in which he has a substantial interest". It is this category of payment with which we are concerned in this reference.

26. The following conditions are required to be satisfied for application of the above category of payment to be regarded as dividend. They are :

- (a) There must be a payment to a concern by a company.
- (b) A person must be shareholder of the company being a registered holder and beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power. This is because of the expression "such shareholder" found in the relevant provision. This expression only refers to the shareholder referred to in the earlier part of section 2(22)(e) viz., a registered and a beneficial holder of shares holding 10 per cent voting power. The Hon'ble Rajasthan High Court in the case of *Union of India v. Wazir Singh* AIR 1980 Raj. 252, while dealing with an expression "No Such Application" in the context of rule 97 of the Rajasthan High Court Rules, 1952 has held as follows :

"Generally the word 'such' refers only to previously indicated, characterized or specified. 'Such' is an adjective meaning the one previously indicated or refers only to something which has been said before."

The Hon'ble Allahabad High Court in the case of *Mohan Lal v. Grain Chambers Ltd.* AIR 1959 All. 279 has held as follows :

"In fact it appears to us that the word 'Such' is used before a noun in a later part of a sentence, the proper construction in the English language is to hold that the same noun is being used after the word 'Such' with all its characteristics which might have been indicated earlier in the same sentence."

- (c) The very same person referred to in (b) above must also be a member or a partner in the concern holding substantial interest in the concern viz., when the concern is not a company, he must at any time during the previous year, be beneficially entitled to not less than twenty per cent of the income of such concern; and where the concern is a company he must be the owner of shares, not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits, carrying not less than twenty per cent of the voting power.
- (d) If the above conditions are satisfied then the payment by the company to the concern will be dividend.

27. In the case of the assessee it is seen that conditions (b) and (c) are not satisfied inasmuch as NNT held shares in UPPL and BCPL only as a legal and registered owner but not as a beneficial owner. In the case of the assessee it is seen that the three trustees of NNT held shares in UPPL and BCPL only as a legal and registered owner. They held shares for and on behalf of 5 beneficiaries of the trust who are different individuals. They were therefore not beneficial owners of the shares. Trust ownership is a peculiar instance of duplicate ownership. Trust property is, in fact, owned by two persons simultaneously in the sense that one is under an obligation to use the property for the benefit of the other. The ownership of the trustee called trust ownership is nominal rather than real. The beneficiary interest is called the beneficial interest. The trustee is to administer the property of another person but the ownership right in the trustee is to be used only on behalf of the real owner. As between trustee and third party ownership conferred on the trustee fictitiously by law prevails, that is, the trustee is clothed with the rights of the beneficiary and is so enable to personate or represent him in dealings with the world at large. The main purpose of Trusteeship is to protect the rights and interest of person who for any reason are unable effectively to protect them for

themselves. Such protection is required for four classes of people, (a) unborn persons; (b) infants, lunatics, or other disqualified persons; (c) a large number of persons who are interested in common; and (d) persons having conflicting interest in the same property, *i.e.*, an owner and an encumbrancer or different kinds of encumbrancers. Therefore the first requirement of holding of shares both as a legal registered owner and beneficial owner of such shares is not satisfied in the case of the assessee. Therefore provisions of section 2(22)(e) would not be applicable at all to the case of the assessee.

28. The answer to the second question referred to the Special Bench is that the expression shareholder referred to in section 2(22)(e) refers to both a registered shareholder and beneficial shareholder. If a person is a registered shareholder but not the beneficial shareholder then the provisions of section 2(22)(e) will not apply. Similarly if a person is a beneficial shareholder but not a registered shareholder then also the provisions of section 2(22)(e) will not apply.

29. In view of the fact that the assessee was not holding beneficial interest in shares of BPCL and UPPL, there is no requirement of answering the first question that arises for consideration in the case of the assessee *viz.*, as to whether deemed dividend under section 2(22)(e) of the Income-tax Act, 1961 can be assessed in the hands of a person other than a shareholder of the lender ? However in the case of the intervenor, *viz.*, *Weaveland (supra)* this question needs to be answered. The facts in the case of the intervenor have already been narrated earlier and are not being repeated here.

30. At the outset it has to be mentioned that provisions of section 2(22)(e) which brought in a new category of payment which was to be considered as dividend as introduced by the Finance Act, 1987 with effect from 1-4-1988 *viz.*, payment by a company "to any concern in which such shareholder is a member or a partner and in which he has a substantial interest" do not say as to in whose hands the dividend has to be brought to tax, whether in the hands of the "concern" or the "shareholder". We have already seen the divergent views on this issue which have been referred to in the earlier part of this order.

31. The above provisions were subject-matter of consideration before the Hon'ble Rajasthan High Court in the case of *Hotel Hill Top (supra)*. The facts of the case before the Hon'ble Court were as follows. The assessee was one M/s. Hotel Hill Top a partnership firm. This firm received an advance of Rs. 10 lakhs from a company M/s. Hill Top Palace Hotels (P.) Ltd. The shareholding pattern of M/s. Hill Top Palace Hotels (P.) Ltd., was as follows :

1. Shri Roop Kumar Khurana	:	23.33%
2. Smt. Saroj Khurana	:	4.67%
3. Vikas Khurana	:	22%
4. Deshbandhu Khurana	:	25%
5. Shri Rajiv Khurana	:	25%

The constitution of the firm Hotel Hill Top was as follows :

1. Shri Roop Kumar Khurana	:	45%
2. Shri Deshbandhu Khurana	:	55%

The Assessing Officer assessed the sum of Rs. 10 lakhs as deemed dividend under section 2(22)(e) of the Act in the hands of the firm because the two partners of M/s. Hotel Hill Top were holding shares by which they had 10 per cent voting power in M/s. Hill Top Palace Hotels (P.) Ltd. They were also entitled to 20 per cent of the income of the firm M/s. Hotel Hill Top. Therefore the loan by M/s. Hill Top Palace Hotels (P.) Ltd. to the firm M/s. Hotel Hill Top was treated as deemed dividend in the hands of M/s. Hotel Hill Top, the firm

under the second limb of section 2(22)(e) of the Act. The CIT(A) held that since the firm was not the shareholder of the company the assessment as deemed dividend in the hands of the firm was not correct. The order of the CIT(A) was confirmed by the Tribunal. On revenue's appeal before the Hon'ble High Court, the following question of law was framed for consideration.

Whether on the facts and in the circumstances of the case and in law the learned Tribunal was justified in upholding the order of learned CIT(A) deleting the addition of Rs. 10 lakhs as deemed dividend under section 2(22)(e) of the Income-tax Act ?

The Honble Court held as follows :

"The important aspect, being the requirement of section 2(22)(e) is, that 'the payment may be made to any concern, in which such shareholder is a member, or the partner, and in which he has substantial interest, or any payment by any such company, on behalf or for the individual benefit of any such shareholder.....' Thus, the substance of the requirement is that the payment should be made on behalf of or for the individual benefit of any such shareholder, obviously, the provision is intended to attract the liability of tax on the person, on whose behalf, or for whose individual benefit, the amount is paid by the company, whether to the shareholder, or to the concerned firm. In which event, it would fall within the expression 'deemed dividend'. Obviously, income from dividend is taxable as income from the other sources under section 56, and in the very nature of things the income has to be of the person earning the income. The assessee in the present case is not shown to be one of the persons, being shareholder. Of course, the two individuals being R and D. are the common persons, holding more than requisite amount of shareholding and are having requisite interest, in the firm, but then, thereby the deemed dividend would not be deemed dividend in the hands of the firm, rather it would obviously be deemed dividend in the hands of the individuals, on whose behalf, or on whose individual benefit, being such shareholder, the amount is paid by the company to the concern. Thus, the significant requirement of section 2(22)(e) is not shown to exist. The liability of tax, as deemed dividend, could be attracted in the hands of the individuals, being the shareholders, and not in the hands of the firm."

32. The aforesaid decision of the Hon'ble Rajasthan High Court which is the only decision of High Court, should be sufficient to answer question No. 2 which has been referred to the Special Bench by holding that deemed dividend can be assessed only in the hands of a person who is a shareholder of the lender company and not in the hands of a person other than a shareholder. The argument of the learned D.R. that the Hon'ble Rajasthan High Court did not deal with the second limb of section 2(22)(e) of the Act is not correct.

33. We may also touch upon certain other aspects of the issue in the light of the submissions made before us. The Tribunal in the case of *Nikko Technologies (I) (P.) Ltd. (supra)*, while holding that the payment made by a company even to a non-shareholder can be brought to tax in the hands of the non-shareholder has made the following observations :

"12. . . . Section 2(22)(e) only specifies the circumstances under which a payment by way of loan/advance is to be treated as deemed dividend. Once it is determined that any payment by way of loan/advance falls within the ambit of section 2(22)(e), then, it has to be treated as dividend even though such payment in the ordinary circumstances may not be considered as dividend. At this point of time, role of section 2(22)(e) ends. It nowhere provides as to who is to be taxed in respect of such income. It is to be borne in mind that the tax can only be assessed in the hands of right person as held by the Apex Court in the case of *ITO v. Ch. Atchiaiah* [218 ITR 239](#), at pages 243-244.

13. In order to find out the right person, one has to examine the charging provisions of the Act. Sections 4 and 5 of the Act are the charging provisions."

Thereafter, the Tribunal has referred to the provisions of section 5(1) of the Act and has concluded that income accrues to the person who is the recipient of the payment from the company. The Tribunal has thereafter referred to Circular No.

495, dated 22-9-1987 of the CBDT wherein it has been opined that deemed dividend would be taxed in the hands of a concern (non-shareholder) also if the conditions mentioned in the section are satisfied.

34. We are of the view that the provisions of section 2(22)(e) does not spell out as to whether the income has to be taxed in the hands of the shareholder or the concern (non-shareholder). The provisions are ambiguous. It is therefore necessary to examine the intention behind enacting the provisions of section 2(22)(e) of the Act.

35. The intention behind enacting provisions of section 2(22)(e) are that closely held companies (*i.e.* companies in which public are not substantially interested), which are controlled by a group of members, even though the company has accumulated profits would not distribute such profit as dividend because if so distributed the dividend income would become taxable in the hands of the shareholders. Instead of distributing accumulated profits as dividend, companies distribute them as loan or advances to shareholders or to concern in which such shareholders have substantial interest or make any payment on behalf of or for the individual benefit of such shareholder. In such an event, by the deeming provisions such payment by the company is treated as dividend. The intention behind the provisions of section 2(22)(e) is to tax dividend in the hands of shareholder. The deeming provisions as it applies to the case of loans or advances by a company to a concern in which its shareholder has substantial interest, is based on the presumption that the loan or advances would ultimately be made available to the shareholders of the company giving the loan or advance. The intention of the Legislature is therefore to tax dividend only in the hands of the shareholder and not in the hands of the concern.

36. The basis of bringing in the amendment to section 2(22)(e) of the Act by the Finance Act, 1987 with effect from 1-4-1988 is to ensure that persons who control the affairs of a company as well as that of a firm can have the payment made to a concern from the company and the person who can control the affairs of the concern can draw the same from the concern instead of the company directly making payment to the shareholder as dividend. The source of power to control the affairs of the company and the concern is the basis on which these provisions have been made. It is therefore proper to construe those provisions as contemplating a charge to tax in the hands of the shareholder and not in the hands of a non-shareholder *viz.*, concern. A loan or advance received by a concern is not in the nature of income. In other words there is a deemed accrual of income even under section 5(1)(b) in the hands of the shareholder only and not in the hands of the payee *viz.*, non-shareholder (Concern). Section 5(1)(a) contemplates that the receipt or deemed receipt should be in the nature of income. Therefore the deeming fiction can be applied only in the hands of the shareholder and not the non-shareholder *viz.*, the concern.

37. The definition of 'Dividend' under section 2(22)(e) of the Act is an inclusive definition. Such inclusive definition enlarges the meaning of the term "Dividend" according to its ordinary and natural meaning to include even a loan or advance. Any loan or advance cannot be dividend according to its ordinary and natural meaning. The ordinary and natural meaning of the term 'dividend' would be a share in profits to an investor in the share capital of a limited company. To the extent the meaning of the word "Dividend" is extended to loans and advances to a shareholder or to a concern in which a shareholder is substantially interested deeming them as dividend in the hands of a shareholder the ordinary and natural meaning of the word "Dividend" is altered. To this extent the definition of the term "Dividend" can be said to operate. If the definition of "Dividend" is extended to a loan or advance to a non-shareholder

the ordinary and natural meaning of the word dividend is taken away. In the light of the intention behind the provisions of section 2(22)(e) and in the absence of indication in section 2(22)(e) to extend the legal fiction to a case of loan or advance to a non-shareholder also, we are of the view that loan or advance to a non-shareholder cannot be taxed as deemed dividend in the hands of a non-shareholder.

38. The basic characteristic of dividend as held by the Apex Court in the case of *Kantilal Manilal v. CIT* [1961] [41 ITR 275](#) is a share of profits of the company given to its shareholders. Further section 206 of the Companies Act, 1956 prohibits payment of dividend to any person other than the registered shareholder. If one were to break up the natural meaning the following to components emerge (a) dividend is a share of profits of the company (b) paid to its shareholders. Section 2(22) of the Act artificially extends the scope of dividend from being more than only a distribution of profits to cover certain other types disbursements such as loans paid etc. (the first ingredient mentioned above). It does not however alter the second component of its natural meaning viz. paid to its shareholder. In other words all that section 2(22) seeks to do is to expand the various types payments that may be regarded as dividend. The Apex Court while considering what can come within the artificial definition of dividend under section 2(22) in the case of *CIT v. Nalin Beharilal Singha* [1964] [74 ITR 849](#) (SC), described the scope of the definition of dividend thus —

“The definition is, it is true, an inclusive definition and a receipt by a shareholder which does not fall within the definition may possibly regarded as dividend within the meaning of the Act unless the context negatives that view.”

The contention of the D.R. that provisions of section 8(a) of the Act creates a fiction by which even payments to non-shareholders can be construed as dividend cannot be accepted. Those provisions merely fix the year in which dividend has to be taxed. It is therefore clear that the shareholder alone can, if at all, be subjected to tax for having earned dividend.

39. In the decision of the Tribunal in the case of *Nikko Technologies (I) (P.) Ltd.* (*supra*) reliance has been placed on Circular No. 495, dated 23-9-1987 which states as follows :—

“Further deemed dividend would be taxable in the hands of the concern, where all the following conditions are satisfied...”

We are of the view that Circular of CBDT to the extent that they do not tone down the rigor of the provisions of the Act in the sense to the extent they are not benevolent are not binding.

40. Apart from the above, it is also noticed that section 2(22)(e)(iii) provides relief to a shareholder as follows :—

“Dividend does not include :—

- (i) & (ii) ** ** *
- (iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e) to the extent to which it is so set off.”

In the event of the payment of loan or advance by a company to a concern being treated as dividend and taxed in the hands of the concern then, the benefit of set off cannot be allowed to the concern, because the concern can never receive dividend from the company which is only paid to the shareholder, who has substantial interest in the concern. The above provisions also therefore contemplate deemed dividend being taxed in the hands of a shareholder only. For the reasons stated above, we are of the view that the law laid down in the case of *Nikko Technologies (I) (P.) Ltd.* (*supra*) is not correct. We therefore hold

that deemed dividend under section 2(22)(e) of the Income-tax Act, 1961 can be assessed only in the hands of a shareholder of the lender company and not in the hands of any other person.

41. In the light of the above discussion, the questions referred to the Special Bench are answered as follows :

On the first question : Deemed dividend can be assessed only in the hands of a person who is a shareholder of the lender company and not in the hands of a person other than a shareholder.

On the second question : The expression 'shareholder' referred to in section 2(22)(e) refers to both a registered shareholder and beneficial shareholder. If a person is a registered shareholder but not the beneficial shareholder then the provisions of section 2(22)(e) will not apply. Similarly if a person is a beneficial shareholder but not a registered shareholder then also the provisions of section 2(22)(e) will not apply.

42. In view of the above discussion, there is no merit in this appeal by the revenue and the same is therefore dismissed.

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