

Various aspects of Taxability of

Deemed Dividend

covered u/s 2(22)(e) of Income Tax Act, 1961

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Dividend u/s 2(22)(e) is Taxable in the hands of.....

Shareholder

- ▶ Such dividends shall be taxable in the hands of the shareholder at normal tax rate u/s 56 of I.T. Act, 1961.

and

Company

- ▶ Shall not required to pay tax on such deemed dividend u/s 115 O of I.T. Act.

Note: Where as dividend u/s 2(22) (a), (b), (c), or (d) is exempt in the hands of shareholder u/s 10 (34) , the company shall pay CDT on it u/s 115 O of the I. T. Act.

Provisions of Deemed Dividend u/s Section 2(22)(e) of the Income Tax Act, 1961.....

Any payment by a company, not being a company in which the public are substantially interested, of any sum by way of advance or loan to.....

A
Shareholder

- ▶ being the beneficial owner of shares
- ▶ holding not less than 10% of voting power

or

Any Concern

- ▶ in which such shareholder is a member or a partner
- ▶ and in which he has a substantial interest

or

Any Person

- ▶ on behalf, or for the individual benefit of any such shareholder

to the extent to which the company possesses Accumulated profits.

“Substantial interest” in a concern - as per Explanation 3 of Sec. 2(22)(e).....

- 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 20% of the income of such concern.
- In the case of Company-a person should beneficially hold at least 20% Equity Share capital of the company.
 - To determining the Total no. of shares held in a company– shares held by a shareholder in his own name and held as guardian to be considered.

[Case law: CIT vs. Sokkalal (T.P.S.H) 236 ITR 981 (Mad.)(1999)]

Issues

▶ **Share Holder should have a Substantial Interest In the concern.**

The provision of section 6 of Hindu Succession Act, which came in force from 9-9-2005 brought 'daughter' of 'a coparcener' on par with son of a coparcener. For becoming 'coparcener' of the Mitakshara Joint Hindu family it was wholly immaterial as to whether on the date on which the Amendment Act came in force the daughter was married or unmarried. It was not even necessary but the daughters were born to a coparcener after 9-9-2005. In view of the above, with effect from 9-9-2005 when the Amendment Act, 2005 came into force, the two daughters of assessee-HUF two daughters of, one 's' and one daughter of 'su' became coparcener of assessee HUF on account of their birth to the respective coparceners in their own right and, therefore, each one of them had share in the income of assessee HUF which was earned during the year under appeal besides the son of 'S'.

- ▶ Thus, ten individuals were members/co-parceners of assessee HUF and each was having beneficial rights and interest in the assessee HUF. Thus, none of them could hold share in the HUF income exceeding 20 per cent as required by Explanation 3(b) to section 2(22)(e) and hence, the condition of Explanation 3(b) of section 2(22)(e) was not fulfilled in this case and, therefore, section 2(22)(e) had no application.

S.M. Gupta, HUF v. Assistant Commissioner of Income-tax, Circle-56, Kolkata, [2011] 10 taxmann.com 276 (Kol. - ITAT).

Meaning of “Concern” - as per Explanation 3 of Sec. 2(22)(e).....

for this purpose “Concern” may be

- HUF
- Sole Proprietor
- Firm

- AOP
- BOI
- Company

- ▶ To determined the substantial interest of a person in a concern—*share held by him/her in two different capacities, e.g. as individual and as HUF cannot be clubbed.*

[Case law: CIT vs. Kunal Organics (P.O Ltd. 164 taxman 169 [2007] (Ahd.)]

Following conditions are required to be fulfilled for the applicability of Sec. 2(22)(e).....

- **Company**—should be one in which the public are not substantially interested i.e. should be a closely held company.
- **Person**—should be a shareholder having not less than 10% of voting power.
- **Payment**—should be by way of advance or loan.
and
made out of accumulated profits of the company.
- **In case loan or advance is to a concern**, shareholder should have a substantial interest in that concern **at any time during the year.**

- ▶ **Shareholder should be Both**
Registered & Beneficial
Shareholder.

- Where a loan is advanced to a shareholder, he/it ***Must*** be the registered as well as a beneficial owner of shares. However, where the shareholder is a beneficial holder but not the registered holder of shares, even then section 2(22) (e) would not attract to him.

- ▶ *[Case law: Rameshwarlal Sanwarmal vs. CIT 122 ITR 1 [1980] (SC) further referred in Deputy Commissioner of Income-tax, Circle 24(1), New Delhi v. National Travel Services, [2009] 31 SOT 76 (DELHI)] also see ITO v. Sagar Sahil Investment (P.) Ltd [2010] 37 SOT 1 (Mum.) (URO).*

- ▶ *Loan to HUF, where members are shareholders.*
- ▶ The Tribunal held that the loan advanced by a private company to HUF of which the members were directors in the company cannot be deemed as 'Dividend' in the hands of HUF as HUF was not a registered shareholder.
- ▶ *ITO v. S.S. Shetty 14 TTJ 71 (Bom) also see Harish Chand Golecha v. CIT [1981] 132 ITR 0030 (Raj).*

Taxable in the Hands of Ultimate
Recipient-
who must be a Shareholder

Deemed dividend u/s 2(22)(e) is taxable in hands of the **Ultimate Recipient** of the loan amount....

- ▶ Deemed dividend can be assessed only in hands of a person who is a shareholder of lender company and not in hands of a person other than a shareholder.

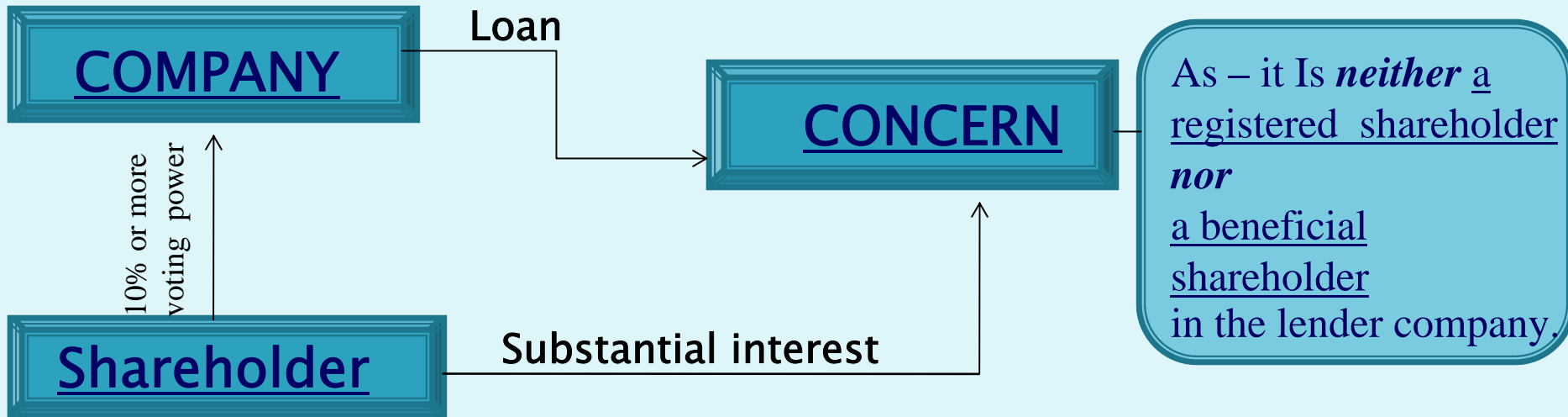
Where a loan or advance is made to a concern in which shareholder as referred in the section is substantially interested, taxability should not arise in the hands of that concern but in the hands of the shareholder having beneficial interest in the concern and that too when the money is finally received by that shareholder.

[Asst. CIT v. Bhaumik Colour P. Ltd. 313 ITR 146 (ITAT-Mum.)(S)(2009) further approved by Mumbai High Court in CIT vs. Universal Medicare Private Limited (324 ITR 263) also see ACIT vs. M/s M J INTERNATIONAL 2010 TIOL 693 ITAT MUM, C R BUILDING, NEW DELHI Vs M/s MADHUR HOUSING & DEVELOPMENT CO 2010-TIOL-635-ITAT-DEL, ACIT vs. M/s SHIVA COMMODITIES & DERIVATIVES, 2010 TIOL 388 ITAT DEL, see also CIT vs. Ankitech PVT. Ltd. ITA No.462 of 2009 (Del)]

Deeming fiction of s. 2(22)(e) can be applied only in the hands of the shareholder and not the non-shareholder [Section 2(22) of the Income-tax Act, 1961

[Sadana Brothers Sales (P.) Ltd. v. Asstt. CIT [2011] 10 taxmann.com 122 (Indore - ITAT)

A loan/advance made by a company to a concern in which its shareholder has a substantial interest.....



Is Not taxable in the hands of Concern as deemed dividend u/s 2(22)(e).

[Case law: CIT v. Hotel Hilltop 313 ITR 116 (Raj.) (2009)]

[Shruti Properties P. Ltd. V. ITO 004 ITR 186 (ITAT-Mum.)(2010)]

Issues – S. 2(22)(e) will not attract

- Interest free advance to sub contractor i.e. firm – No deemed dividend in the hands of the firm.

[Case law: CIT vs. Raj Kumar Singh & Co. 149 TAXMAN 254 [2005] (All.)]

- An advance is made by a closely held Indian company to a foreign subsidiary – No deemed dividend in the hands of Foreign Subsidiary, where it not itself hold any shares in it but its foreign holding company together with other subsidiaries has substantial interest in the Indian company).
- **[Case law: Madura Coats P. Ltd. 274 ITR 609 AAR (2005)]**

Issues – S. 2(22)(e) will not attract

- A company has made a loan to its shareholders who are the partners of a firm. The shares held by them are shown as stock in trade of the firm and the amount received by the partners are shown as deposit made by the company in the books of the firm. Then the loan could not be deemed dividend in the hands of the firm u/s 2(22)(e).

[Case law: ITO vs. Chandmull Batia 115 ITR 388 (1978)]

- A company made a loan to the HUF and a member of HUF purchased shares of the company with the funds of family. The said amount could not be considered as deemed dividend in the hands of the firm.

[Case law: CIT vs. Sarathy Mudaliar (C.P) 83 ITR 170 (1972)]

Issue

- ▶ Income tax - Sec 2(22)(e) - held, deemed dividend cannot be assessed in the hands of a person other than a shareholder of the lender company - since the assessee is not a shareholder, Sec 2(22)(e) is not applicable in this case.

Case Law : ACIT Vs CARGO MOTORS PVT LTD 2009 TIOL 539 (ITAT-DEL)

Loan & Advances
Whether Deemed Dividend ?

Meaning of Loan & advances.....

According the Black's Law Dictionary

- **Loan** means a lending, delivery by one party to and receipt by another party of sum of money upon agreement, express or implied, to repay it with or without interest.
- **Advances** means something which is due to a person but which is paid to him ahead of time when it is due to be paid.

Some Important point to be considered.....

- ▶ If loan amount $<$ Accumulated profits then entire amount of loan is considered as deemed dividend.
- If a loan is given by a company to a shareholder, the amount of loan to the extent of entire Accumulated profits (and not to the extent of his share in Accumulated profits) will be treated as dividend.

[Case law: CIT v. Arati Debi [1978] 111 ITR 277 (Cal.)]

[CIT v. Mayur Madhukant Mehta [1972] 85 ITR 230 (Guj.)]

Note: Deemed dividend is taxable on Accrual basis i.e. in the “previous year” in which the payment was made (Sec. 8(a)).

Issues – When 2(22)(e) attracts.

- Every debt does not involve a loan.

[Case law: Bombay Steam Navigation Co. (P) Ltd. V. CIT 56 ITR 52 (1953) (SC)]

- Duration of Loan is not material.

[Case law: Walchand & Co. Ltd. vs. CIT (1975) 100 ITR 598 (Bom) also see Case Law : CIT vs. Bhagwat Tiwari (105 ITR 62)]

- An overdraft taken by shareholder from the company is treated as loan and taxable as deemed dividend.

[Case law: CIT vs. K. Srinivasan 50 ITR 788 (1963) (Mad.)]

Issues– When 2(22)(e) attracts.

- Loan obtained through proprietary concern would be treated as deemed dividend u/s 2(22)(e).

[Case law: CIT V. K. Srinivasan 50 ITR 788 (1963) (Mad) also see Nandlal Kanoria v. CIT [1980] 122 ITR 0405 (Cal)]

- Withdrawal over and above of credit balance is to be treated as deemed dividend.

[Case law: CIT V. P. Sarada (1998) 229 ITR 444 (SC)]

- Payment towards the personal expenses of the shareholder would be treated as deemed dividend.

[Case law: CIT V. K. Srinivasan 50 ITR 788 (1963) (Mad)]

Issues – When 2(22)(e) attracts.

- Loans made by the company to the employee i.e. the managing director, therefore, assessable as deemed dividends in his hands.

[Case law: CIT V. L. Alagusundaram Chatter 252 ITR 893 (SC)]

- A loan in kind attract the provisions of deemed dividend – Any payment by a company of any sum representing a part of the assets by way of advance made by the company to the shareholder by the transfer of goods would come in to the provisions of sec. 2(22)(e).

[Case law: M.D. Jindal vs. CIT 164 ITR 028 (Cal.)(1987)]

Issues – When 2(22)(e) attracts.

- When a Shareholder doing business with company & always having debit balance, the amount would be regarded as loan by the company and to the extent of Accumulated profits to cover the debit balance, would be regarded as deemed dividend u/s 2(22)(e).

[Case law: CIT vs. Jamnadas Khimji Kothari 92 ITR 105 (1973) (Bom) see also CIT vs. Mrs. Maya B. Ramchand (1986) 53 CTR (Bom) 66 : (1986) 162 ITR 460 (Bom), Sadhana Textiles Mills (P) Ltd. vs. CIT (1991) 188 ITR 318 (Bom), CIT vs. P.K. Badiani (1970) 76 ITR 369 (Bom)]

Issues – When 2(22)(e) attracts.

- Repayment of an earlier loan could not be adjusted against advancement of fresh loan, which had been deemed to be dividend under section 2(22)(e) of the Income-tax Act.

Income-tax Officer v. Kalyan Gupta[2007] 293 ITR (A.T.) 0249-ITAT (Mum)

- Provisions of Deemed Dividend shall not be applicable to loan received prior bearing substantial and beneficial interest in a concern.

Ravindra D. Amin v. Commissioner of Income tax[1994] 208 ITR 0815 [Gujarat High Court]

Issues

- Sec. 2(22)(e) covers **only the amount received during the P.Y. by way of loans/advances** and not amounts received in an earlier year. Further, increase in the outstanding on account of provision for interest is not covered

[Case law: CIT V. Parle Plastics Ltd (ITA No. 37 of 2002) (Bom.) see also (ITO v. Usha Commercial (P.) Ltd., (2009) 120 TTJ (Kol.) 1004; A.R Chadha & Co. India (P.) Ltd. V. Dy. CIT (2010) 133 TTJ (Del.) 490.]

- Amount credited in the loan account by way of remuneration to the a shareholder cannot be set off against loan.

[Case law: Rajesh P. Ved vs. Asst. CIT 001 ITR 275 (2010) (ITAT-Mum.)]

Issues

- Repayment of loan can't be reduced from deemed dividend. [**Case law: Rajesh P. Ved v. Asst. CIT 001 ITR 275 (ITAT-Mum.)(2010)**].
- Repayment of a deposit made by a shareholder with the company does not attract the provisions of Sec. 2(22)(e).
[**Case law: Mohan Anand vs. CIT 82 ITD 708 (Del.)(2002)**]

Issues

In the case where there was no finding that payment is made out of Accumulated profits or the company possessed accumulated profits, then the loan to the shareholder is not assessable as deemed dividend.

[Case law: CIT vs. Nitin Shantilal Parikh 319 ITR 437 (2009) (Guj.)]

- ▶ Receipt in the nature of share application money cannot be construed as loan or advance and therefore, it falls beyond the Ken of S. 2(22)(e).

[Case Law : Ardee Finvest (P) Ltd vs. DCIT – ITAT - 70 TTJ (Del) 378]

Issues

- ▶ Company charges interest equal to the market rate of interest from its shareholder on loans or advances given to him.
- ▶ Advance is given for expense & advance is adjusted against expense.
- Loan is repaid before the end of the previous year .i.e. liability is attracted at the movement the loan is given.

[Case law: Tarulata Shyam vs. Cit 108 ITR 345 (1977) (SC)]

Note: TDS shall be deducted by the company on such payment.

S. 2(22)(e) gets attracted even if...

- A closely held company paid a sum to a firm in which its major shareholder is a partner and he withdraw a sum from his capital account and make investment. Then said sum is assessed as deemed dividend in the hands of the shareholder.

[Case law: CIT vs. Mukundray K. Shah 290 ITR 433 (2007) (SC)]

- Company paid any amount to a shareholder and the same is disclosed by the shareholder as **loan** in his balance-sheet, subject to fulfillment of the conditions of Sec. 2(22)(e) is deemed dividend.

[Case law: Asst. CIT V. Ajay Jadeja 005 ITR 233 (2010) (ITAT-Del.)]

S. 2(22)(e) gets attracted even if...

- ▶ Where Shareholders were given huge deposits in the imprest account but there was no withdrawal indicating utilization of those funds during the year under consideration, such funds was in fact a short term loan and therefore this amount is liable to tax as deemed dividend in the hands of said shareholder.

**[ITO vs. Ajanta Cycle (P) Ltd. 99 TTJ 1159
(Chd).]**

S. 2(22)(e) gets attracted even if...

- ▶ That advance made by the company to the assessee director under a MOU whereby assessee was to purchase land and transfer a portion thereof under a lease to the company could not be regarded as a genuine transaction as no action has been taken either by the company or by the assessee either for getting lease deed executed in favour of the company after purchasing the land or returning the advance and the MOU is merely a colourable device whereby accumulated profits of the company have been transferred to the assessee as a loan for indefinite period and therefore advance given to the assessee constituted deemed dividend under section 2(22)(e).

**[Dr. Shiv Kant Mishra vs. DCIT 118 ITD 347
(Luck).]**

Issues – 2(22)(e) when not attracted ...

- **Amount given as advance for entering in to dealings through shareholder.**

If an amount is given to a Shareholder for the purposes of making an advance in respect of certain land dealings which were proposed to be entered into by the company through him. the same could not be treated as deemed dividend under Section 2(22)(e) of the said Act.

[Case law: CIT V. Sunil Sethi 26 SOT 95 (ITAT-Del.) (2010)]

- **Amount given as Imprest under Board Resolution.**

- The amount of Rs. 30 Lac was handed over to assessee, the director of company, under Board resolution as an imprest amount to enter into a transaction for benefit of company which was returned within a week when the transaction was not materialized, the same could not be treated as deemed dividend in the hands of the assessee.

[Sunil Chopra vs. DCIT, 26 SOT 95 (Del)]

Issues - 2(22)(e) when not attracted ...

Mere book entries do not constitute payment by the company.

On death of a shareholder, debit balance standing in his account was transferred to account of his wife. Department wanted to tax it as deemed dividend. High Court held it could not be done so and observed “it is difficult to introduce another fiction in respect of the words ‘Payment by the Company’ by construing even a transfer entry as amounting to payment.

**CIT vs. Smt. Savithri Sam (1998) 144 CTR (Mad) 17 :
(1999) 236 ITR 1003 (Mad.)**

Issues – 2(22)(e) when not attracted ...

- ▶ **Transaction of Purchase of Car in the name of Director** – where loan for the car, repayment of the installment of loan, showing loan as secured liability and the car as an asset in the books of the company do not suggest that the transaction of the company with the Director was in a way arranged to give any benefit to the Director of the company, and accordingly the amount cannot be considered as deemed dividend in the hands of the assessee and hence deleted.

**[Shri Brij Securities (P) Ltd. (2009) TIOL 720
ITAT (Mum)]**

Issues – 2(22)(e) when not attracted ...

- Any money transferred to any concern in which the shareholder had a substantial interest, from the funds defalcated by the said shareholder and allowed as business loss to the company. The said amount is not a deemed dividend in the hands the concern.

[Case law: CIT V. Universal Medicare Pvt. Ltd. 324 ITR 263 (2010)(Bom.)]

Issues – 2(22)(e) when not attracted ...

- ▶ Payment of interest free security deposits for the purpose of leasing of the property credited to the account of the Director on which date he was holding shares less than 10% and against the aforesaid amount further shares were allotted which had made the shareholding 44.57% was not taxable as deemed dividend.

**[CIT v. Late Shri C.R. Dass ITA No. 610/2009 decided on
17.03.2011**

Issues

- ▶ Recipient should be a Shareholder *on the date* the loan was advanced.

[Case law: CIT vs. Mittal (H.K.) 219 ITR 420 (All.)(1996)]

- Subsequent adjustments in the shareholder's account on the last day of accounting year would not alter the position that the shareholder had received notional dividends during the relevant period.

[Case law: Sarada (P.) (Miss.) vs. CIT 229 ITR 444 (SC)(1998)]

Issues

- Deemed dividend assessed, if any in the hands of the shareholders in the past assessment years should be deducted from the surplus while determining the accumulated profits in the hands of the company.

[Case law: CIT V. G. Narasimhan 102 Taxman 66/236 ITR 327 (1999) (SC)]

- If there is no transaction between shareholder and company during the relevant accounting period. The debit balance of shareholder's account in the books of a company is not assessed as deemed dividend u/s 2(22)(e).

[Case law: Asst. CIT vs. Smt. Lakshmi Kutty Narayanan 303 ITR 212 (ITAT- Coch.)]

❖ Exceptions
to Section 2(22)(e)
of Income Tax Act, 1961

1. *Business Transactions are out of the preview of provisions of Sec. 2(22)(e)....*

As per the exceptions to clause (e) to section 2(22) provides as under:

- ▶ But “dividend” does not include -----
- ▶ (ii) any advance or loan made to a shareholder or the said concern by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.

What constitutes "Substantial part of the company's business"?.....

“Substantial part of the company's business” has not been defined under the I.T. Act.

- Ratio of money lending business should be 20% or more to be considered "substantial part of the company's business."

[Case law: Mrs. Rekha Modi v. ITO 13 SOT 512 (2007)(ITAT-Delhi)]

Note: Factual position of the company for the relevant 'previous year' i.e., the year in which the loan or advance was made, should be considered.

- “substantial part” does not connote an idea of being the “major part” or the part that constitutes majority of the whole. Any business which the company does not regard as small, trivial, or inconsequential as compared to the whole of the business is substantial business.
 - Various factors and circumstances such as turnover, profit, employees, capital employed etc are required to be looked into while considering whether a part of the business of a company is a “substantial part of its business”

[Case law: CIT V. Parle Plastics Ltd (ITA No. 37 of 2002)
(Bom.)]

Business transaction.....

- Therefore, the provisions of sec2(22)(e) shall not apply if....
 - ▶ 1. payment is in the nature of an **advance or loan** and
 - ▶ 2. loan is in the **ordinary course of business** of money lending.

[Case law: ITO vs. Krishnonics Ltd 308 ITR 008 (ITAT-Ahm.) (2009)]

- **In the case of CIT vs. Badiani (P.K.) 76 ITR 369 (1970) (Bom.), it is held that.....**

“What has to be considered is not the balance in account but the position of every payment, and , therefore, the debit balance of the shareholder with the company at any point of time could not be taken to represent an advance or loan by the company to the shareholder; nor could the amount outstanding at the end of the accounting year alone be taken as loan within the meaning of section 2(22)(e).”

Contd.....

- Onus is on the Assessee to prove the fact that the loan or advance is in the "Ordinary Course of Business" and Lending of money constitutes substantial part of the company's business.

[Case law: Walchand & Co. Ltd. V. CIT 100 ITR 598 (1975) (Bom.)]

- No interest is charged by a company on loan/advance made by it in the "Ordinary Course of Business" and Lending of money is the sole business activity but charged commission, etc even then it is not covered under deemed dividend.

[Case law: Jhamu U. Sughand vs. Dy. CIT 284 ITR 082 (ITAT-Mum.) (2006)]

Issues

- ▶ **Financial Transactions in day to day business will not attract provisions of S. 2(22)(e) of IT Act.**
- ▶ The assessee was a travel agency and the above two concerns that it had dealings with, that is, M/s. Holiday Resort (P.) Ltd. and M/s. Ambassador Tours (I) (P.) Ltd. were also in the tourism business. The assessee was involved in the booking of resorts for the customers of these companies and entered into normal business transactions as a part of its day-to-day business activities. The financial transactions cannot in any circumstances be treated as loans or advances received by the assessee from these two concerns.

Commissioner of Income-tax v. Ambassador Travels (P.) Ltd. [2008] 173 TAXMAN 407 (DELHI)

Issues

- ▶ *The law does not prohibit business transaction between related parties and, therefore, payment made in ordinary course of business cannot be treated as loans and advances.*
- ▶ Payment made by a company through a running account in discharge of its existing debts or against purchase or for availing of services, in the ordinary course of business carried on by both the parties, could not be treated as deemed dividend for the purpose of section 2(22)(e).
- ▶ [\[MTAR Technologies \(P.\) Ltd. v. Assistant Commissioner of Income-tax, Circle 14\(2\), \(TDS\), Hyderabad, \[2010\] 39 SOT 465 \(HYD.\). also See Mr OHANLAL PILLAI Vs INCOME TAX OFFICER 2011 TIOL 90 ITAT MUM, DEPUTY COMMISSIONER OF INCOME TAX Vs GHARDA CHEMICALS LTD 2011 TIOL 127 ITAT-MUM. NH Securities Ltd. v. Deputy Commissioner of Income-tax, Cent. Cir. 40, Mumbai \[2007\] 11 SOT 302 \(MUM., Sri Satchidanand S. Pandit V. ITO \[19 SOT 213 \(Bom\).\]](#)

Issues

- ▶ The assessee had agreed to sell a plot of land to SEL and the assessee had agreed to sell the land against part consideration at the time of agreement and remaining during final sale deed, that the amount was advanced by SEL towards part consideration of a property intended to be sold by the assessee to the SEL, it cannot be said that the SEL had advanced money to its shareholders within the meaning of section 2(22)(e) merely because the seller of the property happens to be the shareholder of SEL. Assessee was also transporting goods belonging to the SEL. the total amount outstanding on the relevant day was approximately Rs.17,00,000/- and in those circumstances, it was quite natural for the assessee to ask SEL to clear its outstanding bills and give some advance against the transportation work to be done.

[THE COMMISSIONER OF INCOME TAX-II, NAGPUR Vs SHRI SATYANARAYAN NUWAL, 2010-TIOL-673-HC-MUM-IT

Issues

▶ **Trade Advances given by the company – will not attract provisions of S. 2(22)(e).**

- The advances which are in the nature of trade advances are outside the ambit of provisions of Sec. 2(22)(e) of the I.T. Act, 1961.

[Case law: CIT vs. Rajkumar 318 ITR 462 (Del) (2009) also see Case law: CIT vs. Nagindas M. Kapadia 177 ITR 393 (1989) (Bom)].

- Any advance paid by a company to its sister concern holding 50% of shareholding in the company and latter adjust the advance against dues for job work to be done by the company , is a business transaction.

[Case law: CIT vs. Creative Dyeing and printing Pvt. Ltd. 318 ITR 476 (Del) (2009) also see Bharat C. Gandhi v. Assistant Commissioner of Income-tax, Circle 13(1) [2009] 178 TAXMAN 83 (MUM.) (MAG.)]

Issues

- ▶ **Amount received as advance for investment in Real Estate against brokerage – S. 2(22)(e) will not attract.**
- ▶ Where nature of assessee's business was such that he was earning income from brokerage of real estate and he claimed that companies in which he had substantial investment, had advanced money for investment in real estate, addition of such loan amount as deemed dividend in assessee's hands was not justified.
- ▶ **ITO vs M/s International Land Development (P) Ltd, ITA Nos.3390/Del/2010, ITAT – Delhi.**

Issues

- ▶ **Secured deposit given coupled with certain obligation.**
- ▶ Where the assessee-firm (Concern) was not the shareholder of the lender company the amount received by the assessee as security deposit under an agreement coupled with certain obligations to be complied with could not be regarded to be the payment by the company by way of advance or loan to a shareholder and therefore, could not be assessed to tax in the hands of the assessee u/s 2(22)(e)
- ▶ **Dy. CIT v. Atul Engineering Udyog [2011] 10 taxmann.com 162 (Agra - ITAT).**
- ▶ Security Deposit by exporters with assessee, buying agent of foreign principal in India to ensure quality of ensure quality of goods exported after securing clearance from the principal and linked with the endorsement of letter of credit cannot be treated as loan or advance for purpose of s. 2(22)(e).
- ▶ **[ACIT vs. Global Agencies (P) Ltd. 87 TTJ 1086 (Del.)]**

Issues

- ▶ *The advances cannot be deemed to be dividend where monies were advanced in pursuance of the memorandum of agreement for developing plots of land into commercial buildings.*

The plots belonged to the assessee which were to be handed over to the company for construction as per approved plans. It was the business of the company to undertake real estate construction business. In a way, the assessee became a partner with the company to carry on real estate business, during the course of which the advances were received.

ACIT vs. S. Joginder Singh, Prop. ITA No. 3943(Del)/2009

Issues

Nexus of Funds have to be established.

The Tribunal held that when loan granted to managing director by firm holding funds on behalf of company as collection agent, the loan was not held to be deemed dividend as there was no linkage that the funds were exclusively advanced out of the funds collected by the firm on behalf of the company. It was further held that the burden is on the Revenue to prove that the case fell within the mischief of deeming provisions.

[Subrata Roy Sahara vs. ACIT 109 ITD 1 (Luck) (TM)]

3. Inter-Corporate Deposits (ICDs).....

- ICDs are different from loans or advances & would not come within preview of deemed dividend u/s 2(22).

[Case law: Bombay Oil Industries Ltd. V. Dy. CIT 28 SOT 383 (Mum) (2009)]

4. Financial transaction.....

- Financial transactions in any circumstances could not be treated as loans or advances and therefore not come into the provisions of deemed dividend.

[Case law: CIT vs. Ambassador Travels P. Ltd. 318 ITR 376 (Del) (2009)]

Income shall be excluded from
Accumulated profits....

Accumulated Profits

- *“Accumulated profits within the meaning of clause (e) will necessarily be comprised of the amount available for being distributed as profits. The word 'accumulated' means the profit earned bit by bit and accumulated. It does not mean that it should be carried forward from year to year. Profits can accumulate even within a single year. The entire amount which is available for distribution as profits on a particular date would be the accumulated profit and any amount paid as advance or loan to the shareholder to the extent of this amount of accumulated profits will be dividend within the meaning of section 2(6A)(e).”*

[Case law: CIT v. Roshan Lal 98 ITR 349 (1975) (ALL.)]

1. Non-taxable Accumulated Capital Gains.....

- Accumulated profits would not include capital gains which are not chargeable to tax even during the period the capital gains tax is in force. Distribution made to the shareholder of a company out of non-taxable accumulated capital gains of a company would not be dividend.”

[Case law: Tea Estate India P. Ltd. vs. CIT 103 ITR 0785 (1976) (SC)]

2. Tax Free Income.....

- The basic intention behind the section is to tax that part of profits which could otherwise be distributed as dividend reach in the hands of shareholders in the form of loan or advances.

Thus, it was to tax that income which could be taxed. In view of this, where a part of that profits comprises of the income which is not chargeable to tax or which is tax free, same should be excluded while applying the provisions of section 2(22)(e).

[Case law: CIT vs. Mangesh J. Sanzgiri 119 ITR 0962 (1979)(Bom.)]

3. Share Premium Account.....

The Income Tax Act, 1961 does not specifically define accumulated profits.....

- ▶ But Explanation 2 to section 2(22) of the Act, provides to include in the accumulated profits, **all the profits up to the date of distribution.**
- ▶ **Share forfeiture receipts** – are not accumulated profits.

[Case law: Jai Kishan Dadlam (2005) 4 SOT 138 (Mum)]

As per Schedule VI of the Companies Act, 1956, Accumulated profits is not defined but it considers Reserves and Surplus comprising of the following:

- ▶ (1) Capital Reserves
 - ▶ (2) Capital Redemption Reserve
 - ▶ (3) **Share Premium Account**
 - ▶ (4) Other reserves specifying the nature of each reserve and the amount in respect thereof.
 - Less: Debit balance in profit and loss account (if any).
 - ▶ (5) Surplus, i.e., balance in profit and loss account after providing for proposed allocations, namely :–
 - Dividend, bonus or reserves
 - ▶ (6) Proposed additions to reserves
- Thus, reserves in (1) to (3) are specifically assigned a purpose.
- However, reserves from (4) to (6) are the reserves which can be used for distribution of dividend i.e. these are distributable profits of the company.

Provisions of Sub Sec. (2) of Sec. 78 of the Companies Act, 1956.....

Specifically imposes a restriction on the utilization of Securities Premium Account providing as under:

The “Securities Premium Account” may, notwithstanding anything contained in sub-section (1), be applied by the company-

- In paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;
- In writing off the preliminary expenses of the company;
- In writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; or
- In providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company.

Contd.....

- *“since section 78 of Companies Act, 1956 puts a statutory bar on share premium account being used for distribution of dividend, deeming provisions of section 2(22)(e) cannot apply and, hence, payment made by a company out of its share premium account could not be brought to tax in hands of receiver as deemed dividend under section 2(22).”*

[Case law: DCIT vs. MAIPO India Ltd., 116 TTJ 791(Del-ITAT)]

[Case law : CIT vs. Urmila Ramesh (1998) 230 ITR 422 (SC)]

Contd

Anil Kumar Agrawal v. ITO, [2011] 9 taxmann.com 131 (MUM. - ITAT).

Amounts given by a company to an assessee against his debenture account cannot be treated as loans or advances for purposes of section 2(22)(e).

Contd.....

Accumulated profits includes.....

- **General Reserve** [Case law: CIT vs. K. Srinivasan 50 ITR 788 (Mad.)(1963)]
- **Development Rebate reserve, Development Allowance Reserve and Investment Allowance Reserve**, as these reserves are in the nature of any expenditure or outgoing. [Case law: P.K. Badiani vs. CIT 105 ITR 642 (1976)(SC)].
- **Building Reserve Fund** [Case law: CIT vs. Jaldu Rama Rao 11 Taxman 203 (1982)(AP)]

- While calculating Accumulated profits an allowance for **Depreciation and additional depreciation** at the rates provided by the I.T. Act itself has to be made by way of deduction.
- ▶ [Case law: **Navnital C. Jhaveri V. CIT 80 ITR 582 (1971)** (Bom) also see **Assistant Commissioner of Income-tax v. Yasin Hotels (P.) Ltd [2009] 121 TTJ 713 (CHENNAI), CIT vs. Jamnadas 92 ITR 105**].

- ▶ Therefore..... Dividend can be declared by the company only out of revenue reserves and not from the capital reserves.
- ▶ Notification [GSR No. 427(E), dated July 24, 1975] of Companies (Declaration of Dividend out of Reserves) Rules, 1975, Puts a restriction on the utilization of capital reserves for the purpose of dividend declaration.

also not includes

- Provisions for Taxation & Dividend.

[Case law: CIT vs. Damodaran 85 ITR 590 (1972)(Ker.)]

- Balancing charge u/s 41(2) is not part of accumulated profits.

[Case law: CIT vs. Urmila Ramesh 96 Taxman 533 (1998)(SC)]

- Subsidy on capital account.

[Case law: CIT vs. Rajasthan Wires (P.) Ltd 130 Taxman 93 (2003) (Jp.) (Mag.)]

Reduction of Accumulated Profits by amounts deemed as dividend u/s 2(22)(e).

Once an amount goes out of accumulated profits as a loan and the loan is to be deemed to be dividend, the same amount when repaid cannot again be capable of attracting the fiction and be deemed to be dividend. “To illustrate, suppose accumulated profits are Rs. 10000. A shareholder having substantial interest in the company takes a loan of Rs. 7000. this is deemed dividend. It is returned in the same year and another loan of Rs. 5000 is taken. The second loan will be hit by the provisions of section 2(22)(e) to the extent Rs. 3000 only because the earlier loan returned by the shareholder does not augment accumulated profits. But if accumulated profits are capitalized, there can be no deemed dividend as the words “whether capitalized or not” which occur in clauses (a) to (d) of section 2(22)(e) are conspicuously absent from clause (e).

[P.K. Badiani vs. CIT (1976) 105 ITR 642 (SC)]

Deemed Dividend in the hands of a Non-Resident Shareholder.....

- ▶ Sec. 2(22)(e) does not distinguish between a Resident or Non-resident shareholders.
- ▶ Further, it is pertinent to note that by virtue of Clause (iv) sub-sec. (1) of sec. 9,
 - “any dividend paid by an Indian company outside India” is ‘Income deemed to accrue or arise in India’.
 - Therefore, Deemed Dividend u/s 2(22)(e) is subject to tax in India in the hands of a NR Shareholder subject to DTAA relief.

- ▶ Where the applicant had no permanent establishment in India, whether the applicant would be taxable in India in respect of such dividends.
- ▶ That the germane parts of section 245N(a)(ii) were : (a) a transaction undertaken or proposed to be undertaken by a resident with the non-resident applicant ; (b) the determination of the Authority should relate to the tax liability of such non-resident on the application of the resident. Though the applicant was a non-resident and the transaction of loan was undertaken by two Indian companies of which the applicant was the holding company, the non-resident and the residents were independent legal entities. The question of taxability of the non-resident did not arise on that transaction. Therefore, no determination under sub-clause (ii) of section 245N(a) could be made.

X Ltd., The Netherlands, In re v. SYED SHAH MOHAMMED QUADRI J. (CHAIRMAN) and NARANG A.S. (MEMBER) JJ. [2005] 275 ITR 0327- [Authority for Advance Ruling]

Reporting of Deemed Dividend by the Auditor – in case of Audit u/s 44AB of the Income Tax Act....

- ▶ There is no specific provision in the Audit Report Form No. 3CD prescribed by the I.T. Rules, 1962 for reporting of 'Deemed Dividend' paid by a Company.
- ▶ **Clause 27 of Form No. 3CD** requires the auditor to disclose whether the assessee has complied with the provisions of Chapter XVII-B relating to Deduction of Tax at Source.
- ▶ Since, Tax is required to be deducted by the principal officer of an Indian Company u/s 194, the Auditor is obliged to report of Non-deduction of TDS u/s 194 in the Audit Report Form No. 3CD.

(Also See Anz Reality (P) Ltd. Vs. ITO – ITAT, 120 TTJ 142 (Jaipur).]

Note : No TDS on amount of loan given to sister concern as the loan is not taxable in the hands of sister concern u/s 2(22)(e). CIT vs. M/s Salarpuria Properties Pvt. Ltd., ITA no. 401 of 2009, Karnataka High Court.

Direct Tax Code

vs.

Income Tax Act, 1961

DTC vs. IT Act, 1961

S. 2(22)(e) of IT Act, 1961	Clause 81(e) of DTC
Any payment by a <u>company in which public not substantially interested</u> , after 31/05/1987.	Clause (e) - Any payment by a <u>closely held company</u> , to the extent of its accumulated profits.
By way of advance or loan to a shareholder.	Sub Clause (i) – Same effect.
being a person who is the beneficial owner of the shares holding at least 10% of Voting Power.	
Or to a <u>concern</u> in which such shareholder is a member or partner and has a substantial interest.	Sub Clause (ii) – Payment to <u>HUF, Firm, AOP, BOI or Company</u> , in which such shareholder is a member or partner and has a substantial interest.
Or any payment on behalf , or for the individual benefit of any such shareholder.	Sub Clause (iii) – Same effect.
To the extent to which the company in either case possesses accumulated.	

Thank You

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