A.F.R.

RESERVED

Case :- INCOME TAX APPEAL No. - 23 of 2013
(Assessment Year 2008-09)
Appellant :- Krishna Gopal Maheshwari
Respondent :- Addl. Commissioner Of Income Tax, Firozabad
Counsel for Appellant :- Rishabh Agarwal,Ravi Kant
Counsel for Respondent :- C.S.C.,Shambhoo Chopra

Hon'ble Ashok Bhushan,J.
Hon'ble Dr. Satish Chandra,J.

(Delivered by Dr. Satish Chandra, J.)

1. The present appeal is filed by the assessee against the judgment and order dated 23.10.2012, passed by the Income Tax Appellate Tribunal, Agra in ITA NO.82/Agra/2012, for the assessment year 2008-09.

2. On 12.2.2013, a coordinate Bench has admitted the appeal on the following substantial questions of law:-

> "(i) *Whether on the facts and circumstances of the case the findings of the Income Tax Appellate Tribunal that money lending does not constitute 'substantial business' of the lending company, is correct ?*
>
> *(ii) Whether the Tribunal had erred in law in plainly drawing negative inferences on the basis of manner of recording entries in the books of accounts without appreciating the true nature and character of the transaction/account ?*
>
> *(iii) Whether in the facts and circumstances of the case, it is correct on the part of the Tribunal to draw unconstructive supposition against the financing business of the company when it is not the case of the revenue/department that financing was ultra vires the object of the lending company ?*
>
> *(iv) Whether in the absence of a finding that the company had accumulated profits, the impugned transaction could be treated as a deemed dividend ?"*

3. The brief facts of the case are that the assessee has the income from the house property, share from firm and from trading of shares of companies. During the assessment year under consideration, the assessee has taken unsecured loan from M/s Krishna Bead Industries Private Limited Company (hereinafter known as 'Company') of Rs.37,28,059/-. The assessee is a Director and having a substantial interest in the company. The A.O. applied

the provisions of Section 2(22)(e) of the Income Tax Act, 1961, pertaining to the advances of Rs.37,28,059/- and brought the same under the clutches of the deemed dividend. The same was upheld not only by the first appellate authority but also by the Tribunal. Still not being satisfied, the assessee has filed the present appeal.

4. With this background, Sri Ravi Kant, Senior Advocate assisted by Sri Rishabh Agarwal, counsel for the assessee submits that the assessee has paid the interest of Rs.62,280/- on the amount of the loan taken from the company. He also submits that company has not made any significant progress in export business hence the amount of the funds were lying idle with the company. The same was supposed to be invested in the FDRs etc. at the lower rate, therefore, the loan was given to the Director at much higher rate of interest, likely to be earned on the FDRs. So the loan given by the company cannot be treated as deemed dividend in the hands of the assessee. For the purpose, he read out the provisions of Section 2(22)(e) of the Act.

5. It is also a submission by learned counsel for the assessee that in the case of ***CIT Vs. Parle Plastics Ltd. and another, (2011) 332 ITR 63 (Bombay)***, it was observed that:-

> *"A plain reading of clause (ii) of section 2(22)(e) of the Act shows that any advance or loan made by a company to a shareholder or a concern in which the shareholder has a substantial interest would not be regarded as a dividend if the advance or loan was made by the lending company, if two conditions are satisfied namely, (i) that the loan or advance was made by the lending company in the ordinary course of its business and (ii) lending of money was a substantial part of the business of the lending company. The expression used under clause (ii) of section 2(22)(e) is "substantial part of the business". The expression "substantial part" does not connote an idea of being the "major part" or the part that constitutes majority of the whole. If the Legislature intended that a particular minimum percentage of the business of a lending company should come from the business of lending, the Legislature could have specifically provided for that percentage while drafting clause (ii) of section 2(22)(e) of the Act. The Legislature had deliberately used the word "substantial" instead of using the word "major" and/or specifying any percentage of the business or profit to be coming from the lending business of the lending company for the purpose of clause (ii) of Section 2(22)(e). Any business of a company 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 would be required to be looked into while considering whether a part of the business of a company is its substantial business. Sometimes a portion while contributes a substantial part of the turnover, though it contributes a relatively small portion of the profit, would be a substantial part of the business. Similarly, a portion which is relatively small as compared to the total turnover, but generates a large portion, say more than 50 per cent of the total profit of the company would also be a substantial part of its business. Percentage of turnover in relation to the whole as also the percentage of the profit in relation to the whole and sometimes even percentage of manpower used for a particular part of the business in relation to the total manpower or working force of the company would be required to be taken into consideration. Employees of a company are now called its "human resources" and, therefore, the percentage of human resources used by the company for carrying on a particular division of business may also be required to be taken into consideration while considering whether a particular business forms a substantial part of its business. Undisputedly, the capital employed by a company for carrying on a particular division of its business as compared to the total capital employed by it would also be relevant while considering whether the part of the business of the company constitutes "substantial part of the business" of the company."*

6. Learned counsel further submits that the expression used under clause (ii) of section 2(22)(e) is "substantial part of the business". To ascertain the meaning of the word "substantial", appearing in the expression "substantial part of the business", Stroud's Judicial Dictionary, Fifth Edition, gives the first meaning of the word "substantial" as "A word of no fixed meaning, it is an unsatisfactory medium for carrying the idea of some ascertainable proportion of the whole".

7. Further, he submits that company has incorporated the financing and investing activities such as money lending interest etc. as its main object. There is nothing unusual in the instant case where the loan was given by the company to the Director on interest. Finally, he made a request to delete the addition.

8. On the other hand Sri Shambhoo Chopra, learned counsel for the department has justified the impugned order. He submits that the assessee has miserably failed to establish that the substantial part of the business of the company is money lending and the loan and advances received by the assessee is in the ordinary course of money lending business. He further

submits that unless the assessee establishes that money lending was the substantial part of the business of the company and the loans and advances received during the course of money lending business, the assessee will not fall under the exceptional circumstances provided in Section 2(22)(e)(ii) for the purpose not to include the calculation of deemed dividend. More over, by merely stating the financial activities in the object clause, the assessee company will not fall under the exceptional circumstances, not to treat the deemed dividend. He relied on the ratio laid down in the case of ***CIT Vs. S.R. Talwar, (2008) 305 ITR 286 (All),*** where it was held that loans and advances received from a company in which the assessee is a director and the company is having accumulated profits, the loan received is definitely to be treated as deemed dividend. Lastly, he justified the impugned order.

9. We heard both the parties at length and gone through the material available on record.

10. In the instant case, it appears that neither the company nor the assessee having the license of money lending business. Further, as per the balance sheet of the company, total loans and advances are only Rs.47,90,339/- out of which loan to the extent of Rs.37,28,029/- was given to the assessee. Hence a substantial part of the loan has been taken by the assessee. In the circumstances, there is no chance to accumulate the profits pertaining to the available funds. Therefore, the question (iv) cannot be answered.

11. It also appears from the record that not a single rupee income has been shown from the money lending activity. The interest earned on FDRs no stretch imagination, can be said to have been earned from money lending business. What is now being claimed i.e. an interest of Rs.62,280/- from the appellant on the advances given. Thus, the explanation being offered by the assessee is contrary to the facts on record. Further, it is also evident that assessee did not take interest bearing loans, from advances or different

parties. The auditor has claimed that the company has not granted but taken unsecured loan interest free from other parties covered in the register maintained under Section 30A of the Companies Act, 1956. In money lending business the transaction are taken and given money to earn interest. Hon'ble Supreme Court in the case of ***State of Gujarat Vs. Raipur Manufacturing Company Ltd., (1967) 19 STC 1 (SC),*** has held that the word "Business" used in the sense of an occupation, or profession which occupies the time, attention and labour of a person, normally with the object of making profit. To regard an activity as "business" there must be a course of dealings, either actually continued or contemplated to be continued with a profit motive, and not for sport or pleasure.

12. It may be mentioned that the word "Dividend" in its ordinary meaning, is a distributive share of the profits or income of a company given to its shareholders. It may be in the form of advance, or loan, or payment for the benefit of the shareholders. The word "deemed dividend" is not defined in the Income Tax Act, but the same has come into existence through judicial interpretation.

13. However, the "dividend" is taxable and covered by the definition of Section 2(24) of the Act, where the **income** is defined as including "dividend". What is taxable as "dividend" need not necessarily be paid in money; it may be paid in money's worth by the delivery, say, of goods or securities or shares in another company and the amount of the "dividend" should be taken to be the market value of the money's worth on the date the "dividend" is declared as per the ratio laid down in the case of ***CIT vs. Central India Industries Ltd., (1971) 82 ITR 555 (SC).***

14. Under the Companies Act, 1956, a company cannot pay dividend otherwise than out of the profits of the year or any other undistributed profits. But "there is nothing in law to prevent a company using an income receipt as cash in its hands to discharge a capital liability or to purchase a

capital asset, and then, after the close of its financial year, paying a dividend out of other cash, or borrowing for the purpose, to the extent of the credit balance standing on profit and loss account". In any event, dividend does not lost its taxable character as dividend merely because it is paid out of capital in violation of the law. Similarly, non-observance by the company of the formalities required by the company law for declaration of dividend would not affect the shareholder's liability to taxation in respect of the dividend.

15. A shareholder is liable to pay tax on his dividend income without any credit for the tax paid by the company on its own profits; and further, the company must deduct, under Section 194 (except as otherwise provided in that section), the shareholder's tax at source while paying the dividend.

16. For the purpose of this section, the shareholders must have 10% or more voting power in the closely held company. Therefore, for example if a closely held company gives a loan to its director who holds 10 % of the voting power of the company, then the amount received by the director from the company will be taxed in his hands. In the present case, this condition is fulfilled.

17. A 'dividend' is not capital but the produce of capital. Subject to well recognised limitations, 'dividend' is a word of general and indefinite meaning without any narrow, technical or rigid significance. As explained above, the term 'dividend' is applied to a distributive sum, share or percentage arising from some joint venture as profits of a corporation. In the second sense, it is proportionate amount paid on liquidation of a company. In this context, 'dividend' is referred to as corporate profits set apart for rateable division amongst the shareholders being surplus assets obtained in excess of capital.

18. Needless to mention that the definition of the word "dividend" is inclusive and not exhaustive and since it creates an artificial liability to tax, it should be strictly construed, as per the ratio laid down in the case of ***Kantilal***

vs. CIT, (1961) 41 ITR 275 SC. It merely extends the connotation of the word "dividend", so as to comprise items of distribution or payment by a company which normally may not be regarded as "dividend".

19. It is clarified that **deemed dividend** under Section 2(22)(e) of the Act is not dividend for all purposes of the Act, but only for the purpose of making an assessment on the amount of loan advanced by the company in favour of the shareholder, to the extent of accumulated profits of the company, as per the ratio laid down in the case of ***CIT vs. T.P.S.H. Selva Saroja***, ***(2000) 244 ITR 671, 686 (Mad).***

Hon'ble Court in the case of ***CIT vs. Alga Sundaram Chettiar, (1977) 109 ITR 508 (Mad)***, held that the term "payment" must not be given a literal interpretation but it must be seen whether a jural relationship of debtor and creditor was created between the parties and it was not necessary that payment should have been made in cash or in kind to the assessee.

20. As per provision of sub section (e) of Section 2(22) of the Act, by way of loan to a share-holder amounts to dividend. Section 2(22)(e) of the Act defines as under:

> ***"Section 2(22)-dividend includes-***
>
> ***(a) * * ****
>
> ***(b) * * ****
>
> ***(c) * * ****
>
> ***(d) * * ****
>
> ***(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 the 31st day of May, 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."

Thus, for a dividend to arise under this sub-clause, the following conditions should be fulfilled:

(i) the company must be a company shares of which are closely held.
(ii) money (not money's worth) should be paid by the company.
(iii) the money must form a part of the assets of the company.
(iv) it may be paid either by way of advance or loan or it may be "any payment".
(v) (a) the payee must be a shareholder of the company having substantial interest in the company, or
(b) the payee must be a person who is acting on behalf of or for the individual benefit of such shareholder.

21. The expression "person who has a substantial interest in the company" is defined in section 2(32), as meaning "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 percent of the voting power."

If these conditions are fulfilled, then a dividend would arise to the extent to which the company possesses accumulated profits.

22. Further, from the Assessment Year 1988-89 (onwards) the provisions of Section 2(22)(e) have undergone modification by the Finance Act, 1987. Accordingly, it also includes advances or loans made to any concern in which such shareholder is a member or partner and in which he has a substantial interest. In the latter case, the advance or loan will logically have to be treated as dividend in the hands of the shareholder concerned and not the concern because the scope of the sub-clause is only to rope in benefits given by a closely-held company to certain shareholders, directly or

indirectly. This construction, however, will create difficulties in a case where more than one shareholder has a substantial interest in the concern. It would, therefore, be more logical to tax the concern which enjoys benefit from the advance or loan though it has directly nothing to do with the closely-held company. It is also conceivable that payments made to a concern in which the shareholder has no interest or even less than substantial interest if they can be shown to have been made on behalf of or for the individual benefit of such shareholder so as to attract the second part of the sub-clause is discussed by the author in ***(2013) 359 ITR 13 (Journal)***.

23. In the case of ***CIT vs. Alagusundaram Chettiar,*** (supra) it was observed that the provisions of this clause are attracted to any payment by a company, of any sum (whether as representing a part of the assets of the company or otherwise) by way of (1) advance; or (2) loan; (3) any payment on behalf of any shareholder; or (4) any payment for the individual benefit of any shareholder. The first two cases deal with a payment to the shareholder directly. The last two cases contemplate payment by a company not to the shareholder but to a third party on behalf of or for the individual benefit of the shareholder.

On the date when the loan is advanced, the recipient should be a shareholder. If it is not so established, the provisions of section 2(22)(e) will not apply as observed in the case of ***CIT vs. H.K. Mittal, (1996) 219 ITR 420 (All.)***

24. Thus, any payment by any company of any sum representing a part of the assets by way of advance would come within the mischief of deemed dividend. It would seem that deposits made by a closely-held company would also be covered by the expressions advance or loan.

Advances given by a company to its shareholders should be treated as payment out of accumulated profits of the company, whether capitalised or not, and must be treated as dividend and would go to reduce the tax liability,

whenever such tax liability is required to be determined as observed in the case of ***CIT vs. Narasimhan G., (1999) 236 ITR 327 (SC).***

25. In view of above discussion, the assessee has failed to establish that substantial part of the business of the company is money lending. When it is so then we finds no reason to interfere with the impugned order passed by the lower authorities who have rightly observed that the amount of Rs.37,28,059/- is to be included in the income of assessee as deemed dividend under Section 2(22)(e) of the Act. Hence, the impugned order is hereby sustained along with the reasons mentioned therein.

The answer to the substantial question of law 1 to 3 are in favour of the revenue and against the assessee. The answer to the substantial question no.4 is not needed in view of above discussion especially when the same is not emerging from the impugned order.

In the result, the appeal filed by the assessee is hereby dismissed.

Order Date :- 10.3.2014
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