

Deemed Dividend

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Dividend General Meaning

- 'Dividend', in its ordinary connotation, means the sum paid to or received by a shareholder proportionate to his shareholding in a company out of the total sum of profit distributed.
- Section 2[22] of the Act, fictional provision envisaging 5 different situations.
- Provisions attracted only where there is 'accumulated profits'

Legislative history & Statute

- Provisions in 1922, Act.
- Original section 2[22][e]
- Post amended, present date.

“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 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;”

Deemed Dividends Sec 2[22][e]

- There must be a payment by way of a loan or advance
- Payment by a closely-held company
- Payment either to a registered shareholder or to a concern in which he holds substantial interest or for individual benefit of Shareholder.
- Payment treated to the extent company possess **'Accumulated Profits'**

Exceptions

- The loan should not have been made in the ordinary course of business, and money-lending should not form a substantial part of the company's business.
- Subsequent dividend to the extent it is so set-off against any loan or advance deemed as dividend is not taxable.

Deemed Dividends Sec 2[22][e]

■ Intention

To bring within the tax net monies paid by closely held companies to their principal shareholders in the guise of loans and advances to avoid payment of tax by such principal shareholders.

■ Distinction between Loan and Advance

In a Loan, the debtor seeks the creditor for repayment.

A. M. Shamsudeen v. UOI 244 ITR 266 (Mad)

The word "Advance" which appears after the word "loan" could only mean such advance which carries with it an obligation of repayment.

CIT v/s Raj Kumar 318 ITR 462(Del.)

Deemed Dividends Sec 2[22][e]

- The threshold condition is that **there should be accumulated profits**. Where there was no finding that the company was possessed of accumulated profits or such loans were made out of such profits, section 2(22)(e) would have no application.

CIT v. Nitin Shantilal Parikh [2009] 319 ITR 437 (Guj)

- **Onus of proving** nexus between assessee and loanee **on the Revenue**.

Subrata Roy Sahara v. ACIT 294 ITR (AT) 135 [Luck.ITAT]

- "Shareholder" Must be both registered and beneficial shareholder for provision to apply

Circular No. 495, nullified by Judicial Pronouncements

313 ITR(AT) 146 (Mum-SB) v. Bhaumik Colour P. Ltd.

Also refer Universal Medicare [BHC], Hotel Hilltop (Raj. HC)

■ Substantial Interest

(Explanation 3 to section 2[22][e] Also section 2[32])

- Share Application money cannot be held as Loan or advance Ardee Finvest (P) Ltd. vs. DCIT ITAT, Delhi 70 TTJ (Del) 378
- Payment made to shareholder to whom, company already owes amounts. CIT Vs. P. K. Badiani (76 ITR 369)
- Loan / Advances, given directly or Indirectly. (Madura Coats P Ltd 274 ITR 609 (AAR))

ACCUMULATED PROFITS

- Tax profits/ **Commercial profits**, Tea Estate Vs. CIT (103 ITR 785)
- Share premium cannot be regarded to be part of accumulated profit DCIT vs. Maipo India Ltd. ITAT, Delhi 116 TTJ (Del) 791
- Undisclosed income assessed in block assessment cannot form part of accumulated profits-Parmod Kumar Dang vs. JCIT ITAT, 105 TTJ (Del) 511
- Does it, includes current profits . M.B. Stock Holding (P) Ltd. vs. Asstt. CIT (2002) 75 TTJ (Ahd) 898: (2003) 84 ITD 542 (Ahd)

FALLOUTS

- Reopening of Assessment of shareholders. Taxability ratio not clear.
- Penalty u/s 271C for violation of section 194.
- Charging of Interest u/s 201(1A).
- No disallowance u/s 40(a)(ia), since dividend not referred therein.

LATEST CASE LAW

CIT V/S NATIONAL TRAVEL SERVICE ITA 223/2010 DTD 11.07.11

“While it is correct that the person to whom the payment is made should not only be a registered shareholder but a beneficial share holder, the argument that a firm cannot be treated as a “shareholder” only because the shares are held in the names of its partners is not acceptable. If this contention is accepted, in no case a partnership firm can come within the mischief of s. 2(22)(e) because the shares would always be held in the names of the partners and never in the name of the firm. This would frustrate the object of s. 2(22)(e) and lead to absurd results. Accordingly, for s. 2(22)(e), a firm has to be treated as the “shareholder” even though it is not the “registered shareholder”

Deemed Dividends -Exclusions

- Trade Advances, advances adjustable against business transactions -Excluded

318 ITR 462 (Del.),

318 ITR 476 (Del.)

- Financial Transactions in day to day business-Excluded

318 ITR 376 (Del.) CIT v. Ambassador Travels P. Ltd.

- Not Applicable to debit balance of earlier years.

ACIT v. Lakshmikutty Narayanan 303 ITR [AT] 212
[Cochin ITAT]



THANK YOU !!!

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