

*Various aspects of Taxability of*  
**Deemed Dividend**  
*covered u/s 2(22)(e) of Income Tax Act, 1961*  
*(Updated)*

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## Object of section 2(22)(e) of the Act.....

- The object behind enactment of provisions of Section 2(22)(e) is that the **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.

## Object of section 2(22)(e) of the Act.....

Condt...

- **The intention is to tax dividend in the hands of shareholders. The deeming provision 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 loans or advances would ultimately be made available to the shareholders of the company giving the loan or advance.**

# 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.**

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

- **Type of 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**.

## “Substantial interest” in a concern –Explanation 3 of Sec. 2(22)(e)

- 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 number of shares held in a company- shares held by a shareholder in his own name and held as guardian to be considered. **[CIT vs Sakkalal (T.P.S.H) 236 ITR 981 (Mad.)(1999)]**

# Meaning of “Concern” - 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. [CIT vs. Kunal Organics (P.O Ltd. 164 taxman 169 [2007] (Ahd.)]

## Scope of Section 2(22)(e) of the Act .....

- To attract the provisions of Section 2(22)(e), the payment must be to a person who is registered holder of shares. In the I.T. Act, 1961, the word "shareholder" in Section 2(22)(e) is followed by the words "being a person who is a beneficial owner of shares".
- This expression only qualifies the word "shareholder" and does not in any way alter the position that the shareholder has to be a registered holder not substitutes the requirement of merely holding a beneficial interest in shares without being a registered holder of shares.
- The provision contemplates a charge to tax in the hands of the shareholders and not in the hands of a shareholder, viz., the concerns. The ordinary and natural meaning of the term dividend would be a share in profit to an investor in the share capital of a limited company. 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. Deemed dividend under section 2(22)(e) can be assessed only in the hand of a shareholder of a lender company and not in the hands of any other person.

**\*\*Note:** Circular No.495 dated 22-9-1987 issued by the CBDT to the extent it says that deemed dividend would be taxed in the hands of a concern (non shareholder) also if the conditions mentioned in the section are satisfied is not binding.

**[Makhija Construction Co. v. Asstt. CIT [2011] 16 taxmann.com 230 (ITAT- Indore)]**

Shareholder Must 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

- The expression "shareholder being a person who is the beneficial owner of shares" referred to in the first limb of Section 2(22)(e) refers to both a registered shareholder and beneficial shareholder.
- It is only where a loan is advanced by the Company to the registered shareholder and the other conditions set out in Section 2(22)(e) of the Act are satisfied, that amount of loan would be liable to be regarded as deemed dividend within the meaning of this section. Chief CIT v. Sarva Equity (P.) Ltd [2014] 44 taxmann.com 28 (Karnataka)

- If a person is a registered shareholder but not the beneficial then the provision of Section 2(22)(e) will not apply.

**Rameshwari Sanwari vs. CIT 122 ITR 1 [1980] (SC)**

**CIT v. Navinbhai N. Patel [2013] 35 taxmann.com 312 (Gujarat)**

**Dy. CIT v. National Travel Services, [2009] 31 SOT 76 (Delhi)**

**DCIT v. Madhusudan Investment & Trading Co. (P.) Ltd. [2011] 15 taxmann.com 252 (ITAT-Kol.)**

**ITO v. Sagar Sahil Investment (P.) Ltd [2010] 37 SOT 1 (Mum.) (URO)**

- 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.

**CIT v. Standipack (P.) Ltd. [2012] 20 taxmann.com 19 (Delhi)**

**Makhija Construction Co. v. ACIT [2011] 16 taxmann.com 230 (ITAT-Indore)**

## Issue - 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 even the share purchased with family fund.

**ITO v. S.S. Shetty 14 TTJ 71 (Bom) also see Harish Chand Golecha v. CIT [1981] 132 ITR 0030 (Raj) and CIT vs. C.P Sarathy Mudaliar 83 ITR 170 (1972) (SC)**

Issue- Where shares settled shares to a genuine trust and assessee ceased to have any beneficial interest.....

Where the shares in question stood settled on genuinely created trust & assessee was no more beneficial owner of the shares, loan given by such company to assessee could not be held as deemed dividend under section 2(22)(e) in the hands of the assessee.

- **CIT .v. Krupeshbhai N. Patel (2014) 99 DTR 209 (Guj.)(HC)**

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.

CIT vs. Ankitech Pvt. Ltd. ITA No.462 of 2009 (Del), [2011] 199 Taxman 341

ACIT v. Bhaumik Colour P. Ltd. 313 ITR 146 (ITAT-Mum.)(S)(2009) further approved by Mumbai HC in CIT vs. Universal Medicare Private Limited (324 ITR 263)

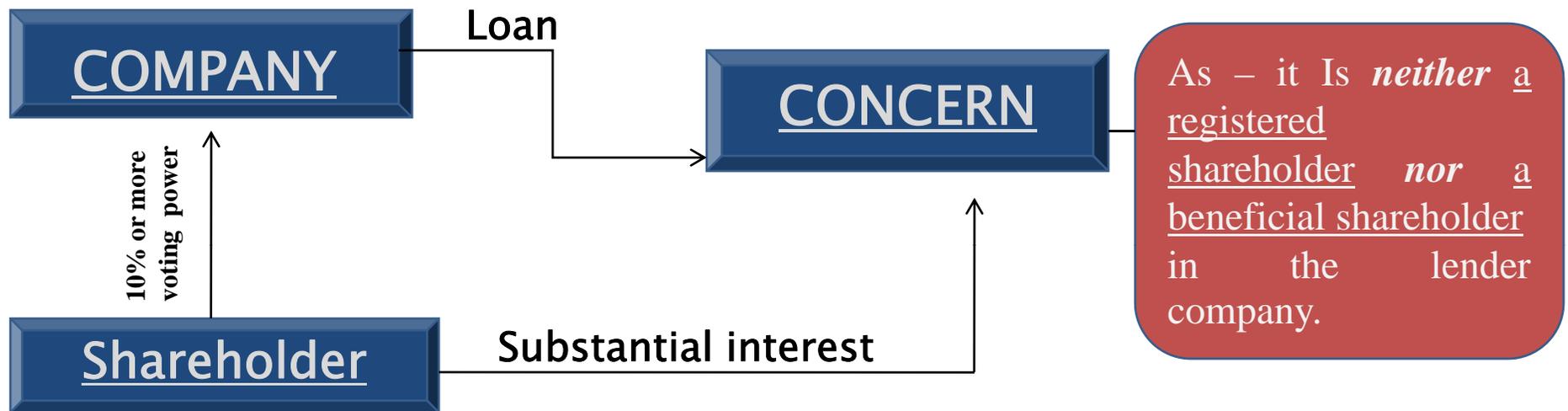
ACIT vs. M/s M J International 2010 TIOL 693 ITAT MUM,

ITO vs M/s Madhur Housing & Development Co 2010-TIOL-635-ITAT-DEL,

ACIT vs. M/s Shiva Commodities & Derivatives, 2010 TIOL 388 ITAT DEL,

- Deeming fiction of s. 2(22)(e) can be applied only in the hands of the shareholder and not the non-shareholder. 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).

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

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

[ACIT v. Color Crafts (P) Ltd. [2012] 27 taxmann.com 123 (Chandigarh- Trib.) ]

## Shareholding of COMMON shareholder could not be taken into consideration for applying sec.2(22)(e).....

- Where assessee-company was not shareholder of lending company, loan advanced by lending company could not be treated as deemed dividend u/s 2(22)(e) in hands of assessee-company merely on the ground that shareholders of both companies were same.
- In terms of sec. 2(22)(e) dividend income is assessable only in hands of shareholders of lending company

DCIT v. Octave Apparels[2012] 17 ITR (Trib.) 307 (ITAT- Chd.)

CIT v. Gopal Clothing Company (P.) Ltd. 21 taxmann.com 65 (Delhi) [2012]

CIT v. MCC Marketing (P.) Ltd. [2011] 343 ITR 350 (Delhi)

CIT v. Ankitech (P.) Ltd. [2011] 199 Taxman 341 (Delhi)

CIT v. Sharman Woolen Mills Ltd. [2011] 16 taxmann.com 171 (P & H)

ITO v. Anand Rathi Direct India (P.) Ltd. [2012] 23 taxmann.com 212 (ITAT-Mum.)

CIT v. AR Magnetics (P.) Ltd. [2013] 40 taxmann.com 392 (Delhi)