IN THE ITAT BANGALORE BENCH 'B'

Assistant Commissioner of Income-tax, Circle-12(3), Bangalore

v.

Source Hub India (P.) Ltd.*

N.V. VASUDEVAN, JUDICIAL MEMBER
AND JASON P. BOAZ, ACCOUNTANT MEMBER
IT APPEAL NO. 642 (BANG.) OF 2012
CO NO. 96 (BANG.) OF 2012
[ASSESSMENT YEAR 2006-07]
SEPTEMBER 6, 2013

ORDER

1. ITA No.642/Bang/2012 is an appeal by the revenue against the order dated 28.02.2012 of the CIT(Appeals)-II, Bangalore relating to assessment year 2006-07. The assessee has filed a cross-objection viz., CO No.96/Bang/2012 which is purely supportive of the order of the CIT(Appeals).

2. The only issue that arises for consideration in the revenue's appeal is as to whether the CIT(Appeals) was justified in deleting the addition of Rs.44,03,789 made by the AO by invoking the provisions of section 2(22)(e) of the Act.

3. The factual background of the case is as follows. The assessee is a company. It is engaged in the business of providing computer services. In the course of assessment proceedings, the AO noticed that a company by name M/s. Value Point Systems Pvt. Ltd. ["VPSPL" for short] had given a loan of Rs.81,90,247 to the assessee. The shareholding pattern of VPSPL is as follows:

Mr. R.S. Shanbhag	- 50%
Mr. Sampath Kumar	- 50%

As far as the assessee company is concerned, its shares were held in the following manner:-

VPSPL	: 64.53%
V.C. Kamath	: 33.33%
R.S. Shanbhag	: 1.07%
Sampath Kumar	: 1.07%

4. Sec. 2(22) of the IT Act, 1961, defines dividend. Sec. 2(22)(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 the 31st 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."

Explanation 3 to s. 2(22)(e) is as follows :

'Explanation 3 : For the purpose of this clause,—

(*a*) "concern" means an HUF, or a firm or an AOP or a BOI 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.

Sec. 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.'

5. The three limbs of s. 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 the 31st May, 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."

6. In the present case admittedly the Assessee does not own any shares in VPSPL and therefore the 1st limb will not be attracted. It is not the case of the Revenue also before us that the 1st limb referred to above will apply.

7. As far as the applicability of the second limb of Sec.2(22)(e) of the Act is concerned, the common shareholders in the Assessee company and VPSPL should hold substantial interest in both the Assessee company and VPSPL. Substantial interest has been defined to mean holding of 20% voting power or right to share of profits to the extent of 20%. The two common

shareholders of the Assessee and VPSPL, hold 50% shares of VPSPL and therefore satisfy the condition as far as VPSPL is concerned. As far as the Assessee is concerned, they hold only 1.07% share capital and therefore do not satisfy the test of holding substantial interest in Assessee company. Therefore the second limb is also not attracted or satisfied in the present case.

8. This factual position is accepted by the AO also. Nevertheless, the AO invoked the provisions of Sec.2(22) (e) by observing that the conditions laid down in the Second limb were indirectly satisfied for the reasons that Sri Shanbhag and Sri Sampathkumar hold more than 20% share holding in VPSPL and by virtue of the holding of 66% of the shares of the Assessee by VPSPL are deemed to hold more than 20% shares of the Assessee as well. He was also of the view that the entire payment is a made up affair as M/s. Value Point Systems (Pvt.) Ltd. could have distributed dividends out of accumulated profits to share holders after payment of dividend distribution tax and in turn these share holders could have given the loans to M/s. Sourcehub India Pvt. Ltd., if needed. However, the transaction of loan herein is such wherein surplus from M/s Value Point Systems (Pvt.) Ltd. is transferred to M/s. Sourcehub directly in the form of loan, thereby achieving two goals of avoiding dividend distribution tax but at the same time achieving the intention of the above mentioned individuals to use the surplus in the holding company for the benefit of the subsidiary/sister concern and hence this is nothing but a made-up affair and hence cannot be accepted and has to be taxed accordingly as deemed dividend.

9. The AO accordingly considered the loan given by VPSPL to the assessee as deemed dividend u/s. 2(22)(e) of the Act. The AO found that out of loan of Rs.81,90,247 shown as loan outstanding against the assessee, only a sum of Rs.44,03,789 was loan given during the previous year. Accordingly, the loan received by the assessee during the previous year amounting to a sum of Rs.44,03,789 was treated as deemed dividend u/s. 2(22)(e) of the Act and brought to tax by the AO.

10. The CIT(Appeals), however, was of the view that to invoke provisions of section 2(22)(e) of the Act, the assessee must be a shareholder in the company which gives loan and since the assessee was not such a shareholder, the CIT(A) held that the loan in question cannot be treated as deemed dividend in the hands of the assessee u/s. 2(22)(e) of the Act. In coming to the aforesaid conclusion, the CIT(A) relied on the decision of the Hon'ble Delhi High Court in the case of *CIT* v. *Ankitech (P.) Ltd.* [2012] 340 ITR 14/[2011] 199 Taxman 341/11 taxmann.com 100. The CIT(A) also held as follows:—

> "In the appeal before us, it is an undisputed fact that the recipient concern is not a shareholder in the payer concern. As such, by a plain reading of the law, the deemed dividend cannot be assessed in the hands of the recipient concern. I am inclined to the view that the AO adopted the concept of a deemed shareholding with reference to Sec 2(22)(e) which appears to travel beyond the scope of the section. The Ld. Delhi High Court has opined that if the Legislature had this intention, it would have inserted the same by way of a deeming provision. Respectfully considering the decision of the Delhi High Court which is squarely on this issue, I am of the view that the addition made by the AO, though occasioned by the bonafide zeal to safeguard the interests of the revenue from what could well have ingredients of a "made up affair", is not within the scope of the law as found in Sec 2(22)(e) and interpreted by the Delhi High Court as above. As such, I am unable to uphold the addition made by the AO on this account, and the same is accordingly deleted."

11. Aggrieved by the order of the CIT(Appeals), the revenue has preferred the present appeal before the Tribunal.

12. We have heard the submissions of the ld. DR, who relied on the order of the Assessing Officer. We have considered his submissions and are of the view that the reasoning given by the AO for making the impugned addition was rightly held to be not proper by the CIT(Appeals). As rightly held by the CIT(A), the case made out by the AO that the affairs of the assessee have been arranged in such a way to get out of the provisions of section 2(22)(e) of the Act cannot be the basis to bring to tax the sum given as loan. We have already seen that in the present case neither the first limb or the second limb of Sec.2(22)(e) of the Act are applicable. The case of the AO is that the second limb is applicable because the transaction can give benefit to the Assessee because the two individuals viz., Mr. Shanbhag and Mr. Sampathkumar hold the entire shares of VPSPL which in turn held 66% of shares of the Assessee. As rightly held by the CIT(A), the provisions of Sec.2(22)(e) of the Act have to be applied as it is. Those provisions do not contemplate looking behind the corporate veil. If the argument of the AO is accepted, then that would be ignoring the corporate personality of the Assessee and treating it as two individuals viz., Mr. Shanbhag and Mr. Sampathkumar. The intention behind enacting provisions of s. 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 s. 2(22)(e) of the Act is to tax dividend in the hands of shareholder. 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 loan or advances would ultimately be made available to the shareholders of the company by 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 Assessee which is not shareholder in the company that has given loan or advance. Since the Assessee in the present case was not a shareholder in VPSPL, the deeming provisions of Sec.2(22)(e) of the Act were not applicable. The CIT(A) has rightly relied on the decision of the Hon'ble Delhi High Court in the case of *Ankitech (P.) Ltd.* (*supra*). The Hon'ble Court in the aforesaid decision held that under normal circumstances, a loan or advance given by a company to the shareholders or to a concern would not qualify as dividend. It has been made so by legal fiction created under s. 2(22)(e). This legal provision relates to "dividend" and it is the definition of dividend which is enlarged by this deeming provision. Definition of shareholder is not enlarged by any fiction. The conclusion is that the loan or advance given under the conditions specified under s. 2(22)(e) has to be treated as dividend. Fiction has to stop here and is not to be extended further for broadening the concept of shareholders by way of legal fiction. Intention behind the provisions of s. 2(22)(e) is to tax dividend in the hands of shareholders. A concern which is given loan or advance by a company cannot be treated as shareholder/member of the latter simply because a shareholder of the lender company holding voting power of 10 per cent or more therein has substantial interest in such concern. If the intention of the legislature was to tax such loan or advance as deemed dividend at the hands of "deeming shareholder", it would have inserted deeming provision in respect of shareholder as well.

13. Since none of the conditions for invoking the provisions of section 2(22)(e) of the Act were present in the instant case, the CIT(A) was justified in deleting the addition made by the AO. The order of the CIT(A) does not call for any interference. Consequently, the appeal by the revenue is dismissed.

14. The CO by the assessee which is purely supportive of the order of the CIT(A) is also dismissed, in view of the dismissal of the appeal of the revenue.

15. In the result, the appeal as well as the CO is dismissed.