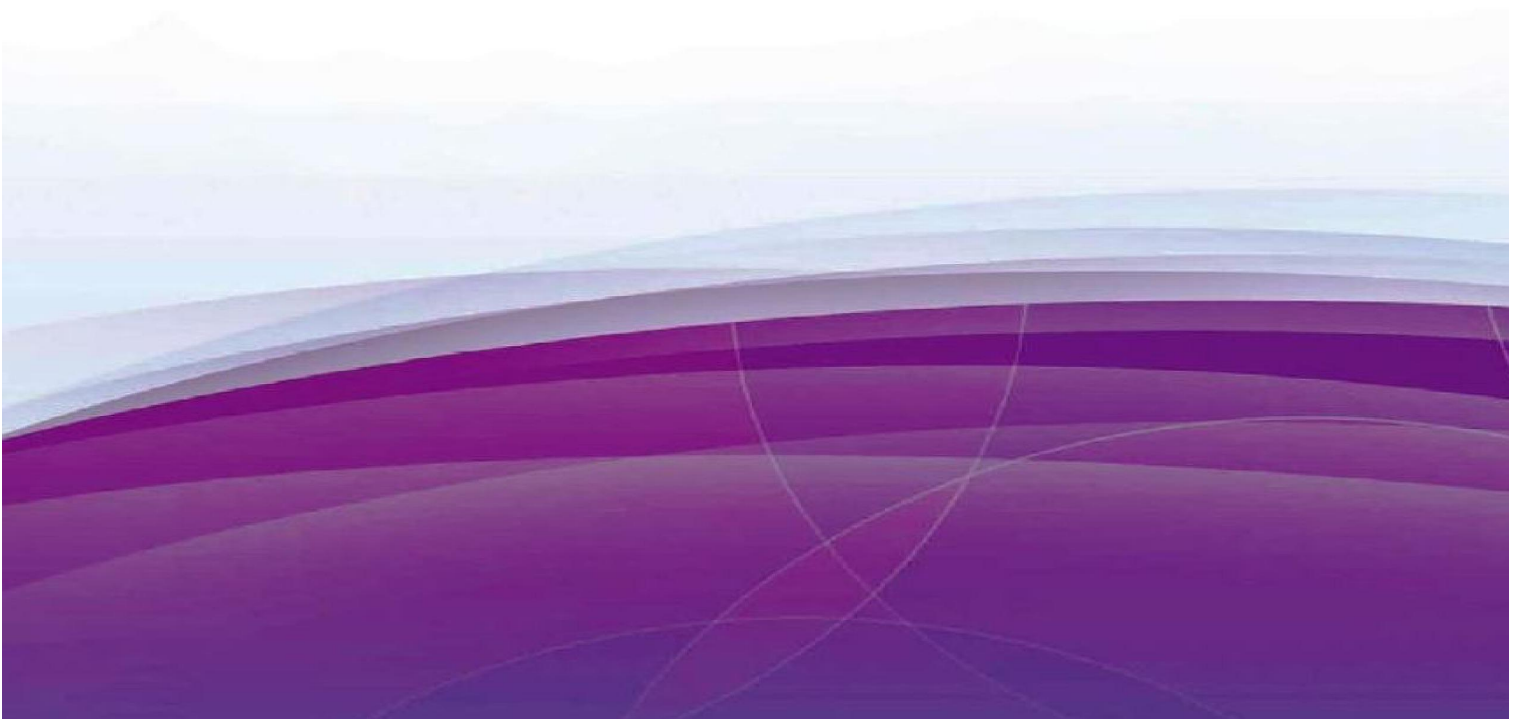




Rajput Jain & Associates
Chartered Accountants

Deemed Dividend



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STATUTORY SUMMARY

Dividend is an income under the Income-tax Act, 1961. The term 'dividend' is inclusively defined in section 2(22), vide five clauses, (a) to (e). These clauses primarily provide for treatment of certain distribution or payments, by the company, as dividend. Clause (e) provides for payment of certain loans and advances by a company to a certain category of shareholders or for the benefit of this category of shareholders, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (popularly referred to as 'deemed dividend'). We are covering deemed dividend under section 2(22)(e) of the Income Tax Act 1961 only in this document.

- ❖ Applicable to all companies except co. in which public are substantially interested i.e. applicable to a closely held company only.
- ❖ Any payment of any sum by way of loan or advance to
 - (a) A shareholder who is a beneficial owner of not less than 10% of voting power.
 - (b) Any concern in which such shareholder is a member/partner and in which he has substantial interest.
 - (c) Company – Shareholder has at least 20% voting power.
 - (d) A Concern (other than company) - Shareholder has at least 20% interest.
 - (e) Any payment by such company on behalf or for the individual benefit of any such shareholder.
- ❖ Dividend would be to the extent of accumulated profits.
- ❖ Specific exclusions - When given in ordinary course of business where lending is substantial part of business.
- ❖ Any dividend is paid which is set-off against previously paid amount and treated as deemed dividend Directorship is no basis to treat a payment as deemed dividend. It's the shareholding which is to be considered.
- ❖ Such dividend is not subject to the dividend distribution tax u/s.115-O, and is therefore a taxable income, not exempt u/s. 10(34) of the Act.
- ❖ However, there would be a liability to deduct tax u/s 194 of the Act.

ADVANCE FOR BUSINESS TRANSACTION

Any amount paid ahead of time when is due to be paid is an advance. Whether any advance made for business transactions by a closely held company to its shareholder having required interest would amount to deemed dividend. Certain judicial pronouncements on the issue are as under:

1. Delhi High Court in case of CIT vs. Arvind Kumar Jain ITA No.589/2011 [2011-ITRV-HC-DEL-270] has held that if the payments are made by a company to its shareholder having substantial interest but are result of business transactions between the parties (trade advances), the such payment cannot be treated as loan and advance and the money so received cannot be treated as deemed dividend within the meaning of section 2(22)(e).
2. Calcutta High Court in the case of M.D. Jindal vs. CIT [1986] 28 Taxman 509 (Cal.) has held that building material advanced to shareholder for construction advance to be set off against purchase consideration when the company buys some flats from assessee later on value of advance in kind is also taxable as deemed dividend.
3. Chandigarh ITAT Bench in case of DCIT vs. Lakhra Brothers (2007) 106 TTJ (Chd.); 250/162 Taxman 170 (Mag.) has held that amount was advanced during the ordinary course of business for business expediencies. So it cannot be said that there was intention of the company to give a loan, the such advanced cannot be treated as loan and advance and the money so received cannot be treated as deemed dividend within the meaning of section 2(22)(e).
4. Chennai ITAT in case of Farida Holding P. Ltd. vs. DCIT, 51 SOT 452 has held that assessee company manages the financial affairs of its subsidiary company in its ordinary course of business and assessee company involved in the activities of taking loan from the subsidiaries and advancing it to other subsidiaries in ordinary course of business cannot be treated as deemed dividend.
5. Apex court in case of Bombay Steam Navigation Company P. Ltd. vs. CIT (1965) 56 ITR 52 (SC) has held that every sale of goods on credit does not amount to a transaction of loan. A loan contracted no doubt creates a debt but there may be a debt without contract a loan.
6. Karnataka High Court in the case of Bagmane Constructions Pvt. Ltd. (ITA No.473/2013) held that loan or advance given to shareholder or to any sister concern as a consideration for the goods or for purchase of a capital asset, which indirectly would benefit the company advancing the loan, the same cannot be treated as deemed dividend u/s 2(22)(e).
7. In CIT vs. P. K. Abukar (2003) 259 ITR 507 (Mad) it was held that where advance was given to shareholder for construction of building which was to be let out to company and advance was to be adjusted against future rent was covered u/s 2(22)(e).

ADVANCE TO PARTNERSHIP FIRM

A partnership firm is not a legal person hence it may hold shares in name of its partners. If a company advances money to the firm in which partners hold shares of that company, would the provisions of section 2(22)(e) be triggered? Certain judicial pronouncements on the issue are as under:

1. Calcutta High Court in the case of Mukundray K. Shah vs. CIT (2005) 197 CTR (Cal) 563 has held that payment by company to a firm in which shareholder is partner for repayment of advances in regular course of business cannot be deemed dividend under section 2(22)(e).
2. Delhi High Court in CIT vs. National Travel Services [2011-ITRV-HC-DEL-224] has held that for the purposes of deemed dividend u/s 2(22)(e), firm is “shareholder” though shares are held in names of partner.

INTER CORPORATE DEPOSITS

The corporate having surplus funds would lend to another corporate in need of funds. Whether the Inter corporate deposits would be deemed as deemed dividend in the hands of shareholder? Judicial pronouncements on the issue are as under:

1. Kolkata ITAT Bench in case of IFB Agro Industries Ltd. vs. JCIT ITA No.1721/Kol/2012 [2013-ITRV-ITAT-KOL-172] has held interest on Inter Corporate Deposits is not an interest on loan or advance and would be not includible in the chargeable interest under the interest tax act. So, Inter-corporate deposits cannot be treated as a loan falling within the preview of section 2(22)(e).
2. Bombay ITAT in Bombay Oil Industries Ltd Vs DCIT 2009-TIOL-297-ITAT-MUM; (2009) 28 SOT 383 (Mum) has held that Inter-corporate deposits are not deemed dividend under section 2(22)(e) of the Income Tax Act; It is clear there is distinction between deposits Vis - a- vis loans/advances.



NOT TO SHAREHOLDER

Deemed dividend is assessable in the hands of the shareholder only. Few judicial pronouncements on the same are as under:

1. Bombay High Court in case of CIT vs. Jignesh P. Shah ITA No.197/2013 [2015-ITRV-HC-MUM-108] has held that the provision of section 2(22)(e) cannot be invoked unless the assessee itself is the shareholder of the company who was lending money to him.
2. Delhi High Court in CIT vs. Ankitech P. Ltd. [2011-ITRV-HC-DEL-109] has held that section 2(22)(e) “deemed dividend” not assessable if recipient is not shareholder.
3. Apex court in the case of L. Alagusundaram Chettiar vs. CIT [2001] 252 ITR 893 (SC) has held that where “Company advancing large amount to low-paid employee. Employee advancing loan to assessee, the Managing Director of the said company. Deemed dividend to be assessed in the hands of assessee.
4. Delhi High Court in case of CIT vs. Mcc Marketing Pvt. Ltd. ITA No. 599/2011 has held that provision of section cannot be invoked in case of amount advance by one company to another, who is not a shareholder of the company; shareholding of common director cannot be taken into consideration for that purpose.
5. Bombay High Court in CIT vs. Impact Containers Pvt. Ltd [2014-ITRV-HC-MUM-112] has held that the law laid down in Universal Medicare 324 ITR 263 (Bom) (approving Bhaumik Colour 313 ITR 146 (SB)), that section 2(22)(e) does not apply to a non-shareholder, is a good law.
6. Ahmadabad ITAT Bench in case of Krupeshbhai N. Patel vs. DCIT (2013) 140 ITD 176(Ahd.) (Trib.) has held that Legal fiction created u/s 2(22)(e) does not extend further for broadening concept of shareholder so as to tax loans and advances as deemed dividend in hands of deeming shareholder.
7. Delhi High Court in case CIT vs. Gopal Clothing Co. Ltd. ITA No.333/2006 has held that provision of section 2(22)(e) cannot be invoked in respect of the unsecured loan taken by the assessee from the other company if the assessee does not possess the prescribed voting rights in that company, shareholding of the common shareholder or director cannot be taken into consideration for that purpose.

EXTENT OF ACCUMULATED PROFITS

The loan or advance would be deemed to be dividend to the extent of accumulated profits. Judicial pronouncements on the same are as under:

1. Apex court in the case of *Tarulata Shyam v. CIT* [1997] 108 ITR 345 (SC) has held that under section 2(22) the liability to tax attaches to any amount taken as loan by the shareholder from a controlled company to the extent it possesses accumulated profits at the moment the loan is borrowed and it is immaterial whether the loan is repaid before the end of the accounting year.
2. It was held in *CIT vs. G. Sarsinham (Died)* (1999) 236 ITR 327 (SC) and *ITO vs. Gordhadas Khimji* (1985) 11 ITD 158 (Cochin) that loans given in earlier years are to be reduced to calculate accumulated profits.

LOAN REPAYED INSTANTLY

If the closely held company had advanced loan to shareholder and the same had been repaid during the same financial year, whether then also the provision of section 2(22)(e) would apply? Judicial pronouncements on the same are as under:

1. In *Tarulata Shyam & Ors. Vs CIT* (SC)108 ITR 345 it was held that if loan advanced to a shareholder was re-paid within 23 days it shall still be deemed as dividend u/s 2(22)(e). If the assessee comes under the letter of law, he has to be taxed, however great the hardship may appear to the judicial mind to be.
2. In *Walchand & Co. P. Ltd vs. CIT* (1993) 204 ITR 146 (Bom) it was held that loan taken and repaid by declaration is also covered u/s 2(22)(e).



SHARE APPLICATION MONEY

If the assessee company has paid share application money, whether such share application can also be treated as loans and advances u/s 2(22)(e) of the Act? The judicial pronouncement on the same issue is as under:

1. Mumbai ITAT Bench in case of DCIT vs. Vikas Oberoi ITA No.4364/M/2011 [2013-ITRV-ITAT-MUM-051] has held that as original intention of payment of share application money is towards the allotment of shares of any kind, the same cannot be deemed as loan and advance unless the mala fide intentions are exposed by AO with evidence.

BUSINESS EXPEDIENCY / NON-GRATUITOUS ADVANCE

1. Chennai ITAT bench in ACIT vs. Smt. G. Sreevidya [2012-ITRV-ITAT-CHE-276] has held that there would be no section 2(22)(e) “Deemed Dividend” if loan to shareholder is given as quid pro quo. It was held that:

“Every payment by a company to its shareholders may not be a loan/ advance so as to come within the ambit of section 2(22)(e). In the present case, the amount was withdrawn by the assessee from the company only to meet her short term cash requirements. By virtue of offering personal guarantee and collateral security for the benefit of the company, the liquidity position of the assessee had gone down. In the strict sense, the amount forwarded by the company to the assessee was not in the shape of advances or loans. The arrangement between the assessee and the company was merely for the sake of convenience arising out of business expediency”

2. Calcutta High Court in Pradip Kumar Malhotra vs. CIT ITA No.219/2003 [2011-ITRV-HC-KOL-274] has held that “non-gratuitous” advances to substantial shareholder is not deemed dividend u/s 2(22)(e). It was held:

“The phrase “by way of advance or loan” section 2(22)(e) must be construed to mean those advances or loans which a shareholder enjoys simply on account of being a person who is the beneficial owner of shares. If such loan or advance is given to such share holder as a consequence of any further consideration received from the shareholder, then such advance or loan cannot be said to be “deemed dividend” u/s 2(22)(e). Thus, while gratuitous loan or advance given by a company to a substantial shareholder comes within the purview of section 2(22)(e), a case where the loan or advance is given in return to an advantage conferred upon the company by the shareholder does not. On facts, as the advance was in lieu of the

company being permitted to mortgage the assessee's fault, it was not "gratuitous" and so not assessable as "deemed dividend".

OTHER IMPORTANT PRONOUNCEMENTS

1. Chandigarh ITAT Bench in case of DCIT vs. Radhe Shyam Jain (2013) 140 ITR 244(Chandigarh) (Trib.) has held that credit balance in capital account and non encashment of cheque the amount is credited back to company account cannot be assessed as deemed dividend.
2. Bombay High Court at Goa in CIT vs. Parle Plastics Ltd [2010-ITRV-HC-MUM-098] has held that section 2(22)(e) applicable only to loans given in the year section 2(22)(e) is not applicable if lending is not "trivial" part of business.

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