

IN THE INCOME TAX APPELLATE TRIBUNAL "C" BENCH : KOLKATA

[Before Hon'ble Sri N.V.Vasudevan, JM & Dr.Arjun Lal Saini, AM]

I.T.A No. 38/Kol/2014

Assessment Year : 2010-11

D.C.I.T., Central Circle-VIII,
Kolkata

-vs.-

M/s. East End Silks (P)Ltd.
Kolkata

[PAN : AAACE 5742 L]

(Appellant)

(Respondent)

For the Appellant : Shri Rajat Kumar Kureel, JCIT. Sr.DR
For the Respondent : Shri Anil Kochar, AR

Date of Hearing : 04.08.2016.

Date of Pronouncement : 10.08.2016.

ORDER

Per N.V.Vasudevan, JM

This is an appeal by the Revenue against the order dated 29.11.2013 of CIT(A)-Central-I, Kolkata relating to AY 2010-11.

2. The undisputed facts are that the assessee had received loan from M/s Pataka Industries (P) Ltd., of Rs.3,62,46,645/-. The AO was of the view the said amount received as loan should be treated as deemed dividend u/s. 2(22)(e) of the Income Tax Act, 1961 (Act). The assessee submitted that it was not a shareholder in M/s.Pataka Industries (P) Ltd., and consequently the amount could not be held to be deemed dividend by applying the provisions of section 2(22)(e) of the Act.

3. The AO however, was of the view that though the Assessee was not a shareholder in M/s.Pataka Industries (P) Ltd., one Shri.Abdul Kalam was a common shareholder in both the Assessee and M/s.Pataka Industries (P) Ltd., holding 12.93% and 20% paid up share capital respectively in the aforesaid two companies and

therefore the provisions of Sec.2(22)(e) of the Act would be attracted. The AO ultimately passed an order treating the loan in question as a deemed dividend in the hands of the Assessee.

4. On appeal by the Assessee the CIT(A) deleted the addition made by the AO following the order of the Tribunal in Assessee's own case in the earlier year on identical issue. The following were the relevant observations of the CIT(A) in this regard:

"5. The Ld. AR has submitted that the provisions of section 2(22)(e) was not attracted as the assessee was not a shareholder in M/s. Pataka Industries (P)Ltd from which loan was received. He had further submitted that the issue was covered by the order of jurisdictional ITAT for the assessment year 2006-07. For in that year, similar addition was made by the AO in his assessment order u/s 263/143(3) in consequence to an order u/s 263 passed by the Ld. CIT, Central-I, Kolkata. But then, the said order u/s 263 was quashed by the Hon'ble ITAT vide its order dated 29-02-2012 in ITA No.533/Kol/2011 read with its order dated 31-07-2012 in MA No.35/Kol/2012). In its order, the Hon'ble ITAT 'A' Bench, Kolkata has held as under :-

"3. Before us the learned counsel for the assessee submitted that on identical set of facts the decision of the Hon'ble Rajasthan High Court in the case of CIT vs Hotel Hilltop reported in 313 ITR 116 (Raj) is directly in favour of the assessee is not a shareholder of Pataka Industries (P)Ltd and accordingly, proceedings u/s 2(22)(e) could not be initiated against the assessee and the amount of loan could not be treated as deemed dividend in the hands of the assessee. However, the learned DR relied on the order u/s 263 of the learned Commissioner of Income Tax.

4. On consideration of rival submissions, we are of the view that the view taken by the Assessing Officer that transaction will attract the section 2(22)(e) for deemed dividend and it could be taxed in the hands of the assessee, who is other than shareholder, is not correct. The said decision of Hon'ble Rajasthan High Court is directly on the issue. Respectfully following same, we quash the impugned order passed u/s 263 of the learned Commissioner of Income Tax and allow the appeal of the assessee.

6. The Ld AR has further submitted that the issue was again decided in favour of the assessee in its own case for the assessment year 2009-10 by the jurisdictional ITAT 'A' Bench, Kolkata in ITA No.1803/Kol/2012. I have perused the relevant orders and considered the submissions made on behalf of the assessee. The contention that the assessee company was not a shareholder in M/s. Pataka Industries (P)Ltd. From which loan was received has not been disputed by the AO in his assessment order. In such factual background, I find that the issue is covered by the decision of the jurisdictional ITAT in assessee's own case in ITA No.533/Kol/2011 read with MA No.35/kol/2012. Respectfully following the decision of the jurisdictional ITAT, it is to be held that the sum

of Rs.3,62,46,645/- is not assessable as deemed dividend u/s 2(22)(e). The addition of Rs.3,62,46,645/- is deleted. Ground No.2 and 3 is allowed.”

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

6. We have heard the submission of the learned DR who relied on the order of the AO. The learned counsel for the Assessee relied on the order of the CIT(A) and filed before us copy of the order of the Hon’ble High Court of Calcutta, in G.A.No.3188 of 2013 dated 11.11.2014 wherein the Hon’ble High Court dismissed the appeal preferred by the Revenue against the order of the Tribunal in ITA No.1803/Kol/2012 dated 16.5.2013 based on which the CIT(A) allowed relief to the Assessee in AY 2009-10.

7. We have heard the submissions of the learned counsel for the Assessee. The provisions of 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 31-5-1987, 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 Section 2(22)(e) is as follows:

“Explanation-3: For the purpose of this clause-

- (a) “concern” means a Hindu Undivided Family, or a firm or an association of persons or a body of individuals 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 percent of the income of such concern;”*

7.1. Section 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 percent of the voting power.

7.2. An analysis of the above provisions shows that there are three limbs to Sec.2(22)(e) which 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 31-5-1987**, 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.”

7.3. In the present appeal we are concerned with the second limb of Sec.2(22)(e) of the Act, viz., “to any concern in which such shareholder is a member or a partner and in which he has a substantial interest”. The following conditions are required to be satisfied for application of the above category of payment to be regarded as Dividend.

They are:-

(a) There must be a payment to a concern by a company.

(b) A person must be Shareholder of the company being a registered holder and 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. This is because of the expression “Such Shareholder” found in the relevant provision. This expression only refers to the shareholder referred to in the earlier part of Sec.2(22)(e) viz., a registered and a beneficial holder of shares holding 10% voting power.

(c)The very same person referred to in (b) above must also be a member or a partner in the concern holding substantial interest in the concern viz., when the concern is not a company, he must at any time during the previous year, be beneficially entitled to not less than twenty percent of the income of such concern; and where the concern is a company he must be the 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

(d) If the above conditions are satisfied then the payment by the company to the concern will be dividend.

7.4. The Special Bench of ITAT, Mumbai, in the case of Bhaumik Color Labs ITA 5030/M/04, 118 ITD 1 (SB) (Mum), considered the question Whether deemed dividend u/s. 2(22)(e) of the Income Tax Act, 1961 can be assessed in the hands of a person other than a shareholder of the lender? The Special Bench held that deemed dividend can be assessed only in the hands of a person who is a shareholder of the lender company and not in the hands of a person other than a shareholder. The Special Bench on the above issue has observed as follows:-

“30. At the outset it has to be mentioned that provisions of Sec.2(22)(e) which brought in a new category of payment which was to be considered as dividend as introduced by the Finance Act 1987 w.e.f.1-4-88 viz., payment by a company “to any concern in which such shareholder is a member or a partner and in which he has a substantial interest” do not say as to in whose hands the dividend has to be brought to tax, whether in the hands of the “concern” or the “shareholder”. We have already seen the divergent views on this issue which have been referred to in the earlier part of this order.

31. The above provisions were subject matter of consideration before the Hon’ble Rajasthan High Court in the case of CIT Vs. Hotel Hilltop. 217 CTR 527(Raj). The facts of the case before the Hon’ble Court were as follows. The Assessee was one M/S.Hotel Hilltop a partnership firm. This firm received an advance of Rs.10 lacs from a company M/S.Hilltop palace Hotels (P) Ltd. The shareholding pattern of M/S.Hilltop Palace Hotels (P) Ltd., was as follows:

- | | |
|------------------------------|--------|
| 1. Shri Roop Kumar Khurana : | 23.33% |
| 2. Smt.Saroj Khurana : | 4.67% |
| 3. Vikas Khurana : | 22% |
| 4. Deshbandhu Khurana: | 25% |

5. *Shri.Rajiv Khurana* : 25%

The constitution of the firm Hotel Hill Top was as follows:

1. *Shri Roop Kumar Khurana*: 45%
2. *Shri.Deshbandhu Khurana*: 55%

The AO assessed the sum of Rs.10 lacs as deemed dividend u/s.2(22)(e) of the Act in the hands of the firm because the two partners of M/S.Hotel Hill Top were holding shares by which they had 10% voting power in M/S.Hill Top Palace Hotels (P) Ltd. They were also entitled to 20% of the income of the firm M/S.Hotel Hill Top. Therefore the loan by M/S.Hill Top Palace Hotels (P) Ltd. To the firm M/S.Hotel Hill Top was treated as deemed dividend in the hands of M/S.Hotel Hill Top, the firm under the Second limb of Sec.2(22)(e) of the Act. The CIT(A) held that since the firm was not the shareholder of the company the assessment as deemed dividend in the hands of the firm was not correct. The order of the CIT(A) was confirmed by the Tribunal. On Revenue's appeal before the Hon'ble High Court, the following question of law was framed for consideration:-

“Whether on the facts and in the circumstances of the case and in law the learned Tribunal was justified in upholding the order of learned CIT(A) deleting the addition of Rs.10 lacs as deemed dividend under Section 2(22)(e) of the IT Act? ”

The Hon'ble Court held as follows:-

“ The important aspect, being the requirement of section 2(22)(e) is, that 'the payment may be made to any concern, in which such shareholder is a member, or the partner, and in which he has substantial interest, or any payment by any such company, on behalf or for the individual benefit of any such shareholder “ Thus, the substance of the requirement is that the payment should be made on behalf of or for the individual benefit of any such shareholder, obviously, the provision is intended to attract the liability of tax on the person, on whose behalf, or for whose individual benefit, the amount is paid by the company, whether to the shareholder, or to the concerned firm. In which event, it would fall within the expression 'deemed dividend'. Obviously, income from dividend, is taxable as income from the other sources under section 56, and in the very nature of things the income has to be of the person earning the income. The assessee in the present case is not shown to be one of the persons, being shareholder. Of course, the two individuals being R and D. are the common persons,

holding more than requisite amount of shareholding and are having requisite interest, in the firm, but then, thereby the deemed dividend would not be deemed dividend in the hands of the firm, rather it would obviously be deemed dividend in the hands of the individuals, on whose behalf, or on whose individual benefit, being such shareholder, the amount is paid by the company to the concern. Thus, the significant requirement of section 2(22)(e) is not shown to exist. The liability of tax, as deemed dividend, could be attracted in the hands of the individuals, being the shareholders, and not in the hands of the firm.”

32. The aforesaid decision of the Hon'ble Rajasthan High Court which is the only decision of High Court, should be sufficient to answer question No.2 which has been referred to the Special Bench by holding that deemed dividend can be assessed only in the hands of a person who is a shareholder of the lender company and not in the hands of a person other than a shareholder. The argument of the learned D.R. that the Hon'ble Rajasthan High Court did not deal with the second limb of Sec.2(22)(e) of the Act is not correct.”

7.5. The Special Bench further held as follows:-

“34. We are of the view that the provisions of Sec.2(22)(e) does not spell out as to whether the income has to be taxed in the hands of the shareholder or the concern(non-shareholder). The provisions are ambiguous. It is therefore necessary to examine the intention behind enacting the provisions of Sec.2(22)(e) of the Act.

35. The intention behind enacting provisions of section 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 section 2(22)(e) is to tax dividend in the hands of shareholder. The deeming provisions as it applies to the case of loans or advances by a company to a concern in which it's 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 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 concern.

36. The basis of bringing in the amendment to Sec.2(22)(e) of the Act by the Finance Act, 1987 w.e.f 1-4-88 is to ensure that persons who control the affairs of a company as well as that of a firm can have the payment made to a concern from the company and the person who can control the affairs of the concern can draw the same from the concern instead of the company directly making payment to the shareholder as dividend. The source of power to control the affairs of the company and the concern is the basis on which these provisions have been made. It is therefore proper to construe those provisions as contemplating a charge to tax in the hands of the shareholder and not in the hands of a non-shareholder viz., concern. A loan or advance received by a concern is not in the nature of income. In other words there is a deemed accrual of income even u/s.5(1)(b) in the hands of the shareholder only and not in the hands of the payee viz., non-shareholder (Concern). Sec.5(1)(a) contemplates that the receipt or deemed receipt should be in the nature of income. Therefore the deeming fiction can be applied only in the hands of the shareholder and not the non-shareholder viz., the concern.

37. The definition of Dividend U/s.2(22)(e) of the Act is an inclusive definition. Such inclusive definition enlarges the meaning of the term "Dividend" according to its ordinary and natural meaning to include even a loan or advance. Any loan or advance cannot be dividend according to its ordinary and natural meaning. The ordinary and natural meaning of the term dividend would be a share in profits to an investor in the share capital of a limited company. To the extent the meaning of the word "Dividend" is extended to loans and advances to a shareholder or to a concern in which a shareholder is substantially interested deeming them as Dividend in the hands of a shareholder the ordinary and natural meaning of the word "Dividend" is altered. To this extent the definition of the term "Dividend can be said to operate. 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. In the light of the intention behind the provisions of Sec.2(22)(e) and in the absence of indication in Sec.2(22)(e) to extend the legal fiction to a case of loan or advance to a non-shareholder also, we are of the view that loan or advance to a non-shareholder cannot be taxed as Deemed Dividend in the hands of a non-shareholder."

7.6. The aforesaid view has since been approved in several decisions rendered by Hon'ble High Court of Bombay and Delhi in the case of CIT Vs. Universal Medicare Pvt. Ltd., 324 ITR 263 (Bom) and CIT Vs. Ankitech Pvt.Ltd. & others 340 ITR 14

(Del.). Since the Assessee in the present case is not a shareholder in the lender company, we are of the view that the above decision is squarely applicable to the facts of the Assessee's case.

7.7. In view of the aforesaid decision, we are of the view that the order of CIT(A) is just and proper and calls for no interference. We therefore uphold the order of the CIT(A) and dismiss the appeal by the Revenue.

8. In the result the appeal by the Revenue is dismissed.

Order pronounced in the Court on 10.08.2016.

Sd/-
[Dr.Arjun Lal Saini]
Accountant Member

Sd/-
[N.V.Vasudevan]
Judicial Member

Dated : 10.08.2016.

[RG PS]

Copy of the order forwarded to:

1. M/s. East End Silks (P)Ltd., 97, Park Street, Kolkata-700016.
2. D.C.I.T., Central Circle-VIII, Kolkata.
3. CIT(A)-Central-I, Kolkata. 4. CIT, Central-I, Kolkata
5. CIT(DR), Kolkata Benches, Kolkata.

True copy

By Order

Asstt.Registrar, ITAT, Kolkata Benches

