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

[Before Hon'ble Sri N.V.Vasudevan, JM & Shri Waseem Ahmed, AM]

I.T.A No. 423/Kol/2014
Assessment Year : 2009-10

D.C.I.T., Circle-1, Kolkata	-vs.-	M/s. The Hooghly Mills Co.Ltd. Kolkata [PAN : AAACT 9780 F]
(Appellant)		(Respondent)

For the Appellant : Shri Niraj Kumar, CIT(DR)
For the Respondent : Shri S.Jhajharia, FCA

Date of Hearing : 25.05.2017
Date of Pronouncement : 02.06.2017.

ORDER

Per N.V.Vasudevan, JM

This is an appeal by the Revenue against the order dated 16.12.2013 of CIT(A)-Central-I, Kolkata, relating to AY 2009-10.

2. Ground No.1 raised by the revenue reads as follows :-

" 1. That, on the facts and in the circumstances of the case, the CIT(A) has erred in deleting the addition of Rs.10,20,00,000/- made by the AO u/s 2(22)(e).

3. The Assessee is a company engaged in the manufacture and sale of jute goods. In the course of assessment proceedings u/s 143(3) of the Income Tax Act, 1961 (Act) the AO noticed that the assessee had during the previous year accepted the loans of Rs.10,20,00,000/- from M/s. Mega Resources Ltd. It is not in dispute that the Assessee held shares in the share capital of M/s. Mega Resources Ltd., that conferred 1.7% of the voting power in M/s. Mega Resources Ltd. The AO also noticed that another subsidiary company of the assessee by name M/s. Hooghly Mills Projects Ltd held 13,90,100 equity shares out of the total paid equity shares of .1,20,00,000/- of M/s. Mega Resources Ltd. The AO after making a reference to the pattern of share

holding of the assessee and its subsidiary M/s. Hooghly Mills Projects Ltd., in share capital of M/s. Mega Resources Ltd concluded that the assessee held more than 10% of the voting power in M/s. Mega Resources Ltd,. and therefore the provision of section 2(22)(e) of the Act were attracted to the loan given by M/s. Mega Resources Ltd., to the assessee and the same was liable to be treated as deemed dividend and chargeable to tax in the hands of the assessee. Section 2(22)(e) of the Act, lays down as follows:

"Section 2(*22*) "dividend" includes—

(*a*)to (*d*)******

(*e*)Any payment made 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) by way of advance or loan to a shareholder, being a person who has a substantial interest in the company, 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."

(*c*)The aforesaid clause (*e*) of the Act has been amended with effect from 1-4-1988 the amended clause (*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 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 per cent of the income of such concern;"

Section 2(*32*) defines the expression "person who has a sub- stantial 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.

4. Section 2(22)(e) of the Act has the following three limbs :-

" 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 holding not less than 10% of the voting power 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 holding not less than 10% of the Voting power to the extent to which the company in either case possesses accumulated profits."

A perusal of the order of the AO shows that the AO has applied the first limb of Sec.2(22)(e) in the present case.

5. Aggrieved by the order of the AO, the Assessee preferred appeal before CIT(A). Before CIT(A) the Assessee contended that it is only shares held by the Assessee as a beneficial owner in the share capital of M/s. Mega Resources Ltd., which confers voting power in M/s. Mega Resources Ltd., that has to be considered and if done so, the voting power of the assessee was less than 10% in M/s. Mega Resources Ltd.. and therefore provision of section 2(22)(e) of the Act were attracted. The Assessee contended that the share holding of its subsidiary M/S.Hoogly Mills Projects Ltd., in the share capital of M/S.Mega Resources Ltd., is totally irrelevant for applying the

provisions of Sec.2(22) (e) of the Act. The CIT(A) agreed with the aforesaid submission of the Assessee and deleted the addition made by the AO. The following were the relevant observations of CIT(A) :-

> " 8. I have perused the assessment order and the material on record. I have also considered the submissions of the assessee. I find that the facts in this appeal are not in dispute. The AO has noted in the assessment order that the assessee company held 2,21,500 equity shares of the lending company M/s Mega Resources Ltd having total paid-up equity shares of 1,20,00,000. The share-holding of the assessee company thus constituted 1.7% of the total paid-up equity shares of the lending company. In other words, the assessee company was holding less than 10% of the voting power as required in section 2(22)(e). However, the AO has added-up the share-holding of the subsidiary company M/s Hooghly Mills Projects Ltd to make-up for the shortage in as much as the assessee company and its subsidiary company together held more than 10% of the voting power. The AO has given no reasons as to why he has included the share-holding of the subsidiary company in computing the voting power of the assessee company. I find that the AO has not even discussed the issue in his assessment order. The AO has' simply stated that the assessee company and its subsidiary company together held more than 10% of the voting power; and then, invoked section 2(22)(e) to assess the loan of RS.-10.20 crores as dividend income in the hands of the assessee. The Ld AR has contended that section 2(22)(e) was not applicable in the case of the assessee company as it was holding only 1.7% of the voting power in the lending company M/s Mega Resources Ltd. I find merit in the contention that the AO has erred in law as well as on facts in adding-up the share holding of the subsidiary company for computing the voting power of the assessee. I find no basis or justification (in fact, the AO has not given any in his assessment order) for considering the combined share-holding of the assessee company and its subsidiary company to conclude that the assessee was holding more than 10% voting power in the lending company. I am of the opinion that the AO has misconstrued the provisions of section 2(22)(e). The requirement of section 2(22)(e) is that the assessee should be holding not less than 10% voting power. The provisions of section 2(22)(e) is applicable only to a person who is the beneficial holder of shares having not less than 10% of the voting power. But, in the present case, the assessee is not holding shares in excess of the prescribed limit; and consequently, the provisions of section 2(22)(e) are not applicable in the case of the assessee. In the case of Bhaumik Colour (P) Ltd 313 ITR (AT) 146, the Hon'ble Special Bench has held that section 2(22)(e) has created a fiction whereby the definition of "dividend" has been enlarged to include even loans and advances; and so, the legal provision has to be given a strict interpretation. Secondly, the definition of "dividend" as given in section 2(22)(e) is an .inclusive definition and the AO was not competent to en1arge the same by importing things which do not form part of such legal fiction. In view of the above, the AO was not justified in including the share-holding of the subsidiary company also for the purposes of invoking section

2(22)(e). The AO has not disputed the fact that the assessee company was having 1.7% share-holding in the lending company. As the assessee company was holding less than 10% of the voting power in the lending company, the provisions of section 2(22)(e) was not attracted in its case. I am of the considered view that the action of the AO in assessing the loan of Rs.10.20 crores as dividend income by invoking section 2(22)(e) is neither sustainable in law nor on facts. Ground No.4 is allowed."

6. Aggrieved by the order of CIT(A) the revenue has raised ground no.1 before the Tribunal.

7. The ld. DR submitted that the CIT(A) failed in not considering the combined voting power of the assessee and the assessee's subsidiary M/s. Hooghly Mills Projects Ltd in M/s. Mega Resources Ltd and in this regard placed reliance on the decision of the Hon'ble Supreme Court in the case of Gopal & Sons (HUF) vs CIT 391 ITR 1(SC). We have perused the above decision. In the aforesaid decision the question that was considered by the Hon'ble Supreme Court was as to whether when a karta of the HUF is a shareholder in the lending company and when the lending company has given loans to HUF whether the holding of shares by the karta has to be considered as holding of shares by the HUF. The Hon'ble Supreme Court held that the karta is a member of the HUF and therefore the shareholding of the karta should be held to be on behalf of the HUF. Therefore the conditions for applicability of provision of section 2(22)(e) of the Act were attracted. We are of the view that the aforesaid decision has no application to the facts of the present case as the share holding of the assessee and share holding by its subsidiaries cannot be equated as to a case of shares held by Karta of a HUF in his capacity as Karta of HUF. The ld. DR also brought to our notice that the Hon'ble Supreme Court in the case of CIT vs Namdhari Seeds [2017] 79 taxmann.,com 124(SC) has admitted SLP of the Revenue and has framed the following question of law for consideration:

" whether High Court was justified in holding that it is only when payments are made by a company by way of advance or loan to a shareholder or payment to a concern in which shareholder is a member or partner and in which he has substantial interest, said amount of loan would be regarded as deemed dividend within meaning of section 2(22)(e)."

8. In our view the aforesaid circumstance viz., SLP being admitted on a question of law has no bearing whatsoever in the present case. In this case the AO has applied the first limb. For applicability of the first limb what has to be considered is only the voting power held by the assessee in M/s. Mega Resources Ltd and controversy surrounding the second limb, which is the subject matter of the SLP filed before the Hon'ble Supreme Court would be of no relevance to the present case.

9. In the case of ACIT Vs. Bhaumik Color Labs Pvt.Ltd., 118 ITD 1 (SB) (Mumbai), the Special Bench Mumbai had to deal with the following question:

> "Whether the words "such shareholder" occurring in section 2(*22*)(*e*) refer to a shareholder who is both the 'registered' shareholder and the beneficial shareholder ?"

It was held by the Special Bench as follows:

> "In view of the judgments of the Supreme Court in the cases of CIT v. C.P. Sarathy Mudalian [1972] 83 ITR 170 and Rameshwarlal Sanwarlal v. CIT [1980] 122 ITR 1/3 Taxman 1 (AP), it is clear that to attract the first limb of the provisions of section 2(22)(e) the payment must be to a person who is a registered holder of shares. As already mentioned the condition under the 1922 Act and the 1961 Act regarding the payee being a shareholder remains the same and it is the condition that such shareholder should be beneficial owner of the shares and the percentage of voting power that such shareholder should hold has been prescribed as an additional condition under the 1961 Act. The word 'Shareholder' alone existed in the definition of dividend in the 1922 Act. The expression 'Shareholder' has been interpreted under the 1922 Act to mean a registered shareholder. This expression 'Shareholder' found in the 1961 Act has to be, therefore, construed as applying only to registered shareholder. [Para 22]

> "In the 1961 Act the word 'Shareholder' is followed by the following words 'being a person who is the beneficial owner of shares'. This expression used in section 2(22)(e) both in the 1961 Act and in the amended provisions with effect from 1-4-1988 only qualifies the word 'Shareholder' and does not in any way alter the position that the shareholder has to be a registered shareholder. These provisions also do not substitute the aforesaid requirement to a requirement of merely holding a beneficial interest in the shares without being a registered holder of shares. The expression 'being' is a present participle. A

participle is a word which is partly a verb and partly an adjective. In section 2(22)(e), the present participle 'being' is used to describe the noun shareholder like an adjective. The expression 'being a person who is the beneficial owner of shares' is, therefore, a further requirement before a shareholder can be said to fall within the parameters of section 2(22)(e). In the 1961 Act, section 2(22)(e) imposes a further condition that the shareholder has also to be 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. Thus, it was not possible to accept the contention of the revenue that under the 1961 Act there was no requirement of a shareholder being a registered holder and that even a beneficial ownership of shares would be sufficient."

10. In view of the aforesaid decision, we are of the view that the Assessee was a registered and beneficial shareholder of shares of M/S.Mega Resources Ltd., that conferred voting rights of only 1.7%. It is only this share holding that has to be considered for applying the first limb of Section 2(22)(e) of the Act and the shareholding of the Assessee's subsidiary M/S.Hooghly Mills Projects Ltd., should not be considered and it is irrelevant. The question in the present case is not even as to whether the Assessee is a beneficial shareholder of the shares held by M/S.Hoogly Mills Projects Ltd. We therefore uphold the order of CIT(A) and dismiss ground no.1 raised by the revenue.

11. Ground no.2 raised by the revenue reads as follows :-

" 2. That, on the facts and in the circumstances of the case, the CIT(A) is not justified in law in directing the A.O. to compute the disallowance under Rule 8D(iii) by restricting to those investments that have yielded tax free dividend income during the year."

12. The issue raised in ground no.2 is with regard to disallowance of expenses incurred in earning exempt income u/s 14A of the Act. The issue is only with regard to disallowance of other expenses which is covered by Rule 8D(2)(iii) of the Rules. According to the Assessee only other expenses of Rs.20,000/- can be considered as one incurred in earning dividend income and only to that extent other expenses should be disallowed. The Assessee pointed out that while computing its total income it has already reduced expenses by Rs.20,000/- in this regard and therefore no further

disallowance of expenses u/s.14A of the Act should be made. The AO applied the provision of Rule 8D(2)(iii) of the Rules and made a disallowance of Rs.11,08,667/- as expenses incurred in earning the dividend income. This was worked out @ 0.5% of the average investments.

13. On appeal by the assessee the CIT(A) directed the AO to consider only the investment which yielded dividend income for the purpose of working of the value of investment. In do so placed reliance on the decision of Hon'ble TAT Kolkata in the case of REI Agro Ltd. In ITA No.1331/Kol/2011. The following were the relevant observations of CIT(A) :-

> " 10. I have perused the assessment order and considered the submissions made on behalf of the assessee. I find substance in the argument that the AO has mechanically applied rule 8D in the present case. I am also reminded of a recent order dated 19-06-2013 of the jurisdictional ITAT 'A' Bench, Kolkata in the case of REI Agro Ltd in ITA No. 1331/Kol/2011 wherein it was held that the disallowance under rule 8D(iii) should be restricted to V2 % of only those investments which yielded tax free income during the relevant previous year. In other words, the AO while computing the disallowance under rule 8D(iii) should consider only those investments that have yielded tax free dividend income during the year. I find from the assessment order that the assessee has earned dividend income of Rs.4,00,200/- during the relevant year. Following the above decision of the jurisdictional ITAT, the AO is directed to compute the disallowance under rule 8D(iii) by restricting to those investments that have yielded tax free dividend income during the year. Ground no 5 is decided accordingly."

14. Aggrieved by the order of CIT(A) the revenue has raised ground no.2 before the Tribunal.

15. We have considered the rival submissions. As far as the disallowance u/r 8D(2)(iii) is concerned, we are of the view that the CIT(A)'s direction to direct the AO to consider, while working out the average value of investments, only investments that yielded tax free income is correct and is line with the decision of the ITAT, Kolkata Benches in the case of REI Agro Ltd. Vs DCIT in ITA No.1331/Kol/2011 order dated 19.06.2013 which has since been approved by the

Hon'ble Calcutta High Court. We therefore confirm the order of the CIT(A) and dismiss Gr.No.2 raised by the revenue.

16. In the result the appeal by the revenue is dismissed.

Order pronounced in the Court on 02.06.2017.

Sd/-	Sd/-
[Waseem Ahmed]	[N.V.Vasudevan]
Accountant Member	Judicial Member

Dated : 02.06.2017.
[RG PS]

Copy of the order forwarded to:

1. M/s. The Hooghly Mills Co.Ltd., 10, Clive Row, Kolkata-700001.
2. D.C.I.T., Circle-1, Kolkata.
3. CIT(A)-I, Kolkata. 4. C.I.T.-ICentral-I, Kolkata.
5. CIT(DR), Kolkata Benches, Kolkata.

True copy

By order

Senior Private Secretary
Head of Office/ D.D.O., ITAT, Kolkata Benches