

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH 'A', HYDERABAD**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER**

ITA No. 763/Hyd/2017
Assessment Year: 2011-12

Dy. Commissioner of Income-tax, Circle – 16(2) Hyd. vs. M/s Margadarsi Marketing Pvt. Ltd., Hyderabad.

PAN – AABCM4752F

Appellant

Respondent

Revenue by: Smt. Suman Malik
Assessee by: Shri K. Gopal Choudary

Date of hearing: 16/01/2018
Date of pronouncement: 24/01/2018

ORDER

PER S. RIFAUR RAHMAN, AM:

This appeal is filed by the revenue against the order of CIT(A) - 4, Hyderabad, dated 16/2/2017 relates to the AY 2011-12.

2. Briefly the facts of the case are, assessee company is engaged in the business of marketing of magazines, textiles and handicrafts. For the AY 2011-12, it files its return of income on 30/09/2011 admitting income of Rs. Nil. Subsequently, the case was selected for scrutiny under CASS and notices u/s 143(2) and 142(1) were issued and served on the assessee. In response to the notices, the AR of the assessee appeared and produced the details/information called for.

2.1 During the course of assessment proceedings, the Assessing Officer observed that the assessee company is providing services to M/s. Ushodaya Enterprises Limited and for rendering such services, the assessee company is receiving advances from Ushodaya Enterprises which are subsequently adjusted against the bills raised for the services rendered. The Assessing Officer further observed that since M/s. Ushodaya Enterprises is having accumulated profits, the excess advances received by the assessee company against the services rendered comes under the purview of deemed dividend u/s 2(22)(e) of the Act. The Assessing Officer rejected the assessee's submission that the company had never borrowed any advance or loan as such and had only sought advances on account for enabling it to render services from time to time and the advances received were regularly adjusted in the bills raised month to month. The Assessing Officer further stated that it fulfils the conditions specified under section 2(22)(e) of the I.T. Act, 1961. Thus, the Assessing Officer treated the 'outstanding advance' received by M/s. Margadarsi Marketing (P) Ltd. from M/s. Ushodaya Enterprises Ltd. as deemed dividend in the hands of the assessee company as per the provisions of Section 2(22)(e) of the I.T. Act, 1961.

3. Aggrieved by the order of AO, the assessee preferred an appeal before the CIT(A) and the CIT(A) following the decision of the ITAT, Hyderabad in assessee's own case for AY 2010-11 in ITA No. 282/Hyd/2014, order dated 13/06/2014, deleted the addition made by the AO u/s 2(22)(e) of the Act.

4. Aggrieved by the order of the CIT(A), the revenue is in appeal before us raising the following grounds of appeal:

1. On the facts and in the circumstances of the case and in law, the CIT(A) erred in deleting the Addition made u/s 2(22)(e).

2. On the facts and in the circumstances of the case and in law, the CIT(A) erred in holding that the advances received by the assessee company, not being a shareholder of M/s Ushodaya Enterprises Pvt. Ltd. cannot be considered as deemed dividend as per the provisions of Sec. 2(22)(e), without appreciating that the shareholders of the assessee-company are having substantial interest in M/s Ushodaya Enterprises Pvt. Ltd.

3. The appellant prays that the order of the CIT(A) on the above grounds be set aside and that of the Assessing Officer be restored.

4. The appellant craves leave to amend or alter any grounds or add a new ground, which may be necessary."

5. Considered the rival submissions and perused the material on record. We find that the issue in dispute is squarely covered by the decision of the coordinate benches of Hyderabad in assessee's own case for earlier years. In AY 2010-11, the coordinate bench following its decision in assessee's own case for earlier AYs 2005-06 to 2008-09 & 2009-10 upheld the order of the CIT(A) in deleting the addition made by the AO towards deemed dividend u/s 2(22)(e) by observing as under:

"8. After considering the rival submissions and perusing the record, we find that similar issue came up for consideration before the coordinate bench in assessee's own case for AYs 2005-06 to 2008-09 (supra), wherein the Bench held as follows:

"7. Having heard the submissions of the parties and perused the orders of the revenue authorities as well as other materials on record, we do not find any infirmity in the order of the CIT(A). The fact that the assessee is not a shareholder of M/s Ushodaya Enterprises Ltd. has not been controverted by the department. Therefore, as per the provision contained u/s 2(22)(e) of the Act the advances cannot be considered as deemed dividend in the hands of the assessee. The Hon'ble Delhi High Court in case of CIT Vs. Ankitech P. Ltd. 340 ITR 14, while considering identical issue

approved the decision of the ITAT, Mumbai Special Bench in case of Bhaumic Colours (P) Ltd., 313 ITR (AT) 146 and held as under:

“22. Insofar as the provisions of Section 2(22)(e) are concerned, we have already extracted this provision and taken note of the conditions/requisites which are to be established for making provision applicable. In Commissioner of Income Tax Vs. C.P. Sarathy Mudaliar[1972] 83 ITR 170, the Supreme Court had traced out the assessee of this provision in the following manner:

—Any payment by a company, not being a company in which the public are substantially interest, of any sum (whether as representing a part of the assets of the company or otherwise) made after 31.05.19987 by way of advance or loan.

First limb

a) to a shareholder, being a person who is the beneficial 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 percent of the voting power,

Second limb

b) or to my 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, or any such shareholder, to the extent to which the company in either case possesses accumulated profits.

23. It is rightly pointed out by the Bombay High Court in Universal Medicare (P) Ltd.(supra)that Section 2(22)(e) of the Act is not artistically worded. Be as it may, we may reiterate that as per this provision, the following conditions are to be satisfied:

(1) The payer company must be a closely held company.

(2) It applies to any sum paid by way of loan or advance during the year to the following persons:

(a) A shareholder holding at least 10 of voting power in the payer company.

(b) A company in which such shareholder has at least 20% of the voting power.

(c) A concern (other than company) in which such shareholder has at least 20% interest.

(3) The payer company has accumulated profits on the date of any such payment and the payment is out of accumulated profits.

(4) The payment of loan or advance is not in course of ordinary business activities.

24. The intention behind enacting provisions of Section 2(22)(e) is 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) of the Act is to tax dividend in the hands of shareholders. The deeming provisions 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.

25. Further, it is an admitted case that under normal circumstances, such a loan or advance given to the shareholders or to a concern, would not qualify as dividend. It has been made so by legal fiction created under Section 2(22)(e) of the Act. We have to keep in mind that this legal provision relates to 'dividend'. Thus, by a deeming provision, it is the definition of dividend which is enlarged. Legal fiction does not extend to 'shareholder'. When we keep in mind this aspect, the conclusion would be obvious, viz., loan or advance given under the conditions specified under Section 2(22)(e) of the Act would also be treated as dividend. The fiction has to stop here and is not to be extended further for broadening the concept of shareholders by way of legal fiction. It is a common case that any company is supposed to distribute the

profits in the form of dividend to its shareholders/members and such dividend cannot be given to non-members. The second category specified under Section 2(22)(e) of the Act, viz., a concern (like the assessee herein), which is given the loan or advance is admittedly not a shareholder/member of the payer company. Therefore, under no circumstance, it could be treated as shareholder/member receiving dividend. If the intention of the Legislature was to tax such loan or advance as deemed dividend at the hands of "deeming shareholder", then the Legislature would have inserted deeming provision in respect of shareholder as well, that has not happened. Most of the arguments of the learned counsels for the Revenue would stand answered, once we look into the matter from this perspective.

26. In a case like this, the recipient would be a shareholder by way of deeming provision. It is not correct on the part of the Revenue to argue that if this position is taken, then the income "is not taxed at the hands of the recipient". Such an argument based on the scheme of the Act as projected by the learned counsels for the Revenue on the basis of Sections 4, 5, 8, 14 and 56 of the Act would be of no avail. Simple answer to this argument is that such loan or advance, in the first place, is not an income. Such a loan or advance has to be returned by the recipient to the company, which has given the loan or advance.

27. Precisely, for this very reason, the Courts have held that if the amounts advanced are for business transactions between the parties, such payment would not fall within the deeming dividend under Section 2(22)(e) of the Act.

28. Insofar as reliance upon Circular No. 495 dated 22.09.1997 issued by Central Board of Direct Taxes is concerned, we are inclined to agree with the observations of the Mumbai Bench decision in Bhaumik Colour (P) Ltd. (supra) that such observations are not binding on the Courts. Once it is found that such loan or advance cannot be treated as deemed dividend at the hands of such a concern which is not a shareholder, and that according to us is the correct legal position, such a circular would be of no avail.

29. No doubt, the legal fiction/deemed provision created by the Legislature has to be taken to 'magical conclusion' as held in Andaleeb Sehgal (supra). The Revenue wants the deeming provision to be extended which is illogical and attempt is to create a real legal fiction, which is not created by the Legislature. We say at the cost of repetition that the definition of shareholder is not enlarged by any fiction.

30. Before we part with, some comments are to be necessarily made by us. As pointed out above, it is not in dispute that the conditions stipulated in Section 2(22)(e) of the Act treating the loan and advance as deemed dividend are established in these cases. Therefore, it would always be open to the Revenue to take corrective measure by treating this dividend income at the hands of the shareholders and tax them accordingly. As otherwise, it would amount to escapement of income at the hands of those shareholders.”

8. The same view has also been expressed by the Hon'ble Delhi High Court again in case of CIT Vs. Navyug Promoters P. Ltd. (203 Taxman 618) and Hon'ble Bombay High Court in case of CIT Vs. Universal Medicare (P) Ltd., (324 ITR 263).

9. The ITAT, Hyderabad Bench in case of MARC Manufacturers Pvt. Ltd. Vs. ACIT in ITA No. 555/Hyd/2008 dt. 31/08/2009 while considering identical issue of advancement of loan to one company, which is not a shareholder of the lender company following the decision of ITAT Mumbai Special Bench in case of Bhaumik Colour P. Ltd. (supra) and other decisions held as under:

“5. It can be seen from the circular that the provisions of amended section 2(22)(e) are to be applied only to the payments made to the shareholders and not to any other person or concern other than the shareholders. The Allahabad High Court in the case of CIT vs. H.K. Mittal reported in 219 ITR 420 held that the chief ingredient of dividend as defined in sub clause (e) of clause (22) of section 2 of the I T Act is that the recipient should a shareholder on the day the loan was advanced. If that fact is not established, there cannot be a deemed dividend. Therefore, the provisions of sec. 2(22)(e) cannot be applied to MARC as it is not a shareholder in MTAR Technologies Pvt. Ltd. (Hereinafter called as MTAR). In this regard, the assessee relies on the declslon of the ITAT Mumbai Bench "G" in the case of Seamist Properties Pvt. Ltd. vs. ITO reported in (2005) 1 SOT page 142. The assessee further submits that the provisions of sec. 2(22)(e) mention as under:

"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 day of 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"

6. *The intention of the legislature is clarified in circular issued by the CBIT as at the time of amendment of clause (e) of sub section (22) of sec. 2 is further fortified by the fact that for deduction of tax at source. Sec. 194 provide that such deduction of tax has to be made in the case of the payments of the nature mentioned in clauses (a), (b), (c), (d) and (e) of sub section (22) of Section 2 only in a case where such payments were made to a shareholder. Section 199 also indicates that adjustment of TOS would be provided in the assessment of shareholder only. The very fact that the provision for deduction of tax at source and adjustment of tax is only in respect of the payments to the' shareholder would clearly indicate that even after the amendment, the effect of clause (e) of sub section (22) of Sec. 2 would apply only when the payment is made to shareholder. Wherever, the tax is to be deducted at source from a dividend or deemed dividend and the consequential effect of giving effect to such deduction of tax at source, etc., reference was made only to the payments to the shareholder. This would indicate clearly that clause (e) would apply only in case of payments to the shareholder and not to others."*

Therefore, considered in the light of the ratios laid down as aforesaid the advances cannot be treated as deemed dividend coming within the ambit of section 2(22)(e) of the Act.

10. *Even otherwise also the amounts received by the assessee from M/s Ushodaya Enterprises P. Ltd. cannot be treated as deemed dividend under section 2(22)(e) of the Act. On a perusal of the order passed by the CIT(A) for the assessment year 2006-07, which is also in appeal before us, it is very much evident that the CIT(A) has elaborately and exhaustively dealt with the issue by examining all the relevant facts and materials and thereafter has come to the conclusion that the amounts received by the assessee from M/s Ushodaya Enterprises is in regular course of trade, hence, outside the purview of section 2(22)(e) of the Act. On the contrary, the Assessing Officer neither in course of the assessment proceeding nor in his remand report has brought any materials to establish the fact that the amount received was not in regular course of trade but in the nature of loan and advance as envisaged u/s 2(22)(e) of the Act. In aforesaid view of the matter, we find no reason to interfere with the order passed by the CIT(A) in all the assessment years under consideration and uphold the same. The grounds raised by the department being devoid of merit are therefore dismissed in all the appeals under consideration.*

11. *In the result, all the appeals filed by the Department are dismissed."*

9. *Since the issue under consideration is materially identical to that of the case decided by the coordinate bench in assessee's*

own case for AY 2005-06 to 2008-09 & 2009-10, respectfully following the same, we uphold the order of the CIT(A) in deleting the addition made by the AO towards deemed dividend u/s 2(22)(e) of the IT Act and dismiss the grounds raised by the revenue in this regard.

As the issue under consideration is materially identical to that of earlier AYs, following the decision therein, we uphold the order of the CIT(A) in deleting the addition made u/s 2(22)(e) and dismiss the grounds raised by the revenue.

6. In the result, appeal of the revenue is dismissed.

Pronounced in the open court on 24th January, 2018.

Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMBER

Sd/-
(S. RIFAUR RAHMAN)
ACCOUNTANT MEMBER

Hyderabad, dated 24th January, 2018

kv

Copy forwarded to:

1. DCIT, Circle – 16(2), 2nd Floor, B Block, IT Towers, AC Guards, Masab Tank, Hyd.
2. M/s Margadarsi Marketing Pvt. Ltd., 6-3-570, Eenadu Complex, Somajiguda, Hyd – 500 082
3. CIT(A) - 4, Hyderabad
4. Pr. CIT - 4, Hyderabad
5. The DR, ITAT, Hyderabad
6. Guard File