IN THE INCOME TAX APPELLATE TRIBUNAL
LUCKNOW BENCH "B", LUCKNOW

BEFORE SHRI. A. D. JAIN, VICE PRESIDENT
AND SHRI T. S. KAPOOR, ACCOUNTANT MEMBER

ITA No.86/LKW/2017
Assessment Year: 2012-13

Dy. CIT-2 Kanpur	v.	Shri Krishna Mohan Agarwal 111/230, Harsh Nagar Kanpur
		TAN/PAN:ACF[A1341,
(Appellant)		(Respondent)

Appellant by:	Shri S. K. Madhuk, CIT (DR)		
Respondent by:	Shri Swarn Singh, FCA		
Date of hearing:	23	07	2019
Date of pronouncement:	22	08	2019

O R D E R

PER A. D. JAIN, V.P.:

This is Revenue's appeal against the order of the ld. CIT(A)-I, Kanpur, dated 28/11/2016 for assessment year 2013-14, taking the following grounds:

1. The Ld. Commissioner of Income Tax (Appeals)-I,- Kanpur has erred in law by deleting the addition of Rs.10,45,07,000/- made on account of deemed dividend as per Section 2(22)(e) of I.T. Act, 1961.

2. The Ld. Commissioner of income Tax (Appeals)-I, Kanpur has erred in law by not considering the correct voting power of Shri K.M. Agarwal as registered shareholder and beneficial owner of shares both in individual and Karta/member of HUF capacity.

3. The order of the Ld. Commissioner of Income Tax (Appeals)-I, Kanpur had not taken into account the fact that as individual he had voting power of 8.84% and as Karta /member of HUF his share is 25% of Income in HUF and has voting rights in the company M/s Sumit chemicals Pvt. Ltd. to that extent. As per

explanation 3 to the section 2(22)(e) of the I.T. Act 1961, the member/Karta is having substantial interest in the concern K. M Agarwal HUF. The HUF is having 9.54% share in the company. That is each member is having 2.38% of voting right. Shri K M Agarwal has voting right of 8.84% in individual capacity and 2.38% as member of HUF. Thereby it is necessary to club the share holding of Shri K. M Agarwal both as an individual and as Karta Member of HUF. As that is above 10% the deemed dividend section is rightly applied by the AO.

4. The Ld. Commissioner of Income Tax (Appeals)-I, Kanpur has erred in law by deleting the addition made on account of deemed dividend when the loan/advance was given to the Director in his saving bank account in his individual capacity and moneys were siphoned from company to share holder to the tune of 10.47 crores.

5. The Ld. CIT(A) has relied heavily on distribution of income but has not considered the voting power requirement of section 2(22)(e) of the I.T. Act, 1961 for the purpose as per Hon'ble Supreme Court order of 4.01.2017, the Hon'ble Court has held as per para 17-

"Judgment in C P Mudalir, relied upon by the Ld. Counsel for the appellant will have no application. That was a judgment rendered in the context of section 2(6-A)(e) of Income Tax Act, 1922, wherein there was no provision like explanation 3". Inspite of this the Ld. CIT(A) had relied on the orders prior to this period.

6. The Ld. Commissioner of income Tax (Appeals)-1, Kanpur has erred in law by deleting the addition of Rs.1,04,86,510/- on account of unaccounted sales when the assessee had not proved beyond doubt the reason for difference in sale/purchase after giving credit of VAT/Excise duty. The difference in Audit Report and ledgers were not reconciled to the extent that why no addition is called for omission on part of assessee to disclose the entries in Audit Report.

7. The Ld. Commissioner of Income Tax (Appeals)-1, Kanpur has erred in law by deleting the disallowance amounting Rs.49,96,712/- on account of interest expenses on unsecured loans without appreciating the facts that the assessee had made

investments when he had such huge interest bearing unsecured loans.

8. That the order of Ld. Commissioner of Income Tax(Appeals)-1, Kanpur being erroneous in law and on facts, be vacated, and the order of the Assessing Officer dated 05.03.2015 of the Income Tax Act, 1961 be restored.

2. Ground Nos.1 to 5, challenge the action of the ld. CIT(A) in deleting the addition of Rs.10,45,07,000/-, made to the income of the assessee by the A.O on account of deemed dividend, invoking the provisions of section 2(22)(e) of the Act.

3. Concerning this issue, the ld. D.R. has contended that the ld. CIT(A) has erred in law by deleting the addition of Rs.10,45,07,000/- made on account of deemed dividend, as per section 2(22)(e) of the Act; that he has erred in law by not considering the correct voting power of Shri K.M. Agarwal, as registered shareholder and beneficial owner of shares, both in individual and Karta/member of HUF capacity; that the ld. CIT(A) had not taken into account the fact that as an individual, Shri K.M. Agarwal had the voting power of 8.84% and as Karta/member of the HUF, his share was 25% of the income in HUF and he has the voting rights in the company, M/s Sumit chemicals Pvt. Ltd. to that extent; that as per Explanation 3 to section 2(22)(e) of the Act, the member/Karta is having substantial interest in the concern, K. M Agarwal HUF; that the HUF is having 9.54% share in the company, which means each member is having 2.38% of voting right, therefore, Shri K. M Agarwal was having voting right of 8.84% in individual capacity and 2.38% as member of the HUF; that thereby it is necessary to club the shareholding of Shri K. M Agarwal, both as an individual and as Karta/member of HUF; that the ld. CIT(A) has erred in law by deleting the addition made on account of deemed dividend when the loan/advance was given to the Director in

his saving bank account in his individual capacity and moneys were siphoned from company to the shareholder to the tune of Rs.10.47 crores; that the Ld. CIT(A) has relied heavily on the distribution of income, but has not considered the voting power requirement of section 2(22)(e) of the Act; and that the reliance placed by the assessee on the decision of the Hon'ble Supreme Court, order dated 4.01.2017 in C.P. Mudalir was not considered by the ld. CIT(A), whereas he has placed reliance on the orders prior to this period.

4. The ld. counsel for the assessee, on the other hand, has placed reliance on the impugned order.

5. Heard. We find that the assessee is a shareholder in M/s Sumit Chemical Pvt. Ltd., a closely held company. During the year under consideration, the Assessing Officer found that the assessee had shown transaction of Rs.1045.07 lakhs with the related company, i.e., M/s Sumit Chemical Pvt. Ltd., in which he was a shareholder. The assessee was asked to explain the applicability of section 2(22)(e) of the Act, on the transactions entered into by him with the closely held private company, M/s Sumit Chemicals Pvt. Ltd. In response to that, the assessee contended that the voting rights of the assessee in M/s Sumit Chemicals Pvt. Ltd. is only 8.82% which is less than the requirement of 10% of section 2(22)(e) of the Act. However, on a perusal of the balance sheet filed by the assessee for assessment year 2012-13 of M/s Sumit Chemicals Pvt. Ltd, it was revealed that the assessee was also Karta of K.M Agarwal, HUF, having shareholding of 9.54% and the combined shareholding in both the capacities of Sri K.M Agarwal was more than 10% which qualifies for the requirement of section 2(22)(2) of the Act. The Assessing Officer clubbed the shareholding of Krishna Mohan Agarwal (individual) and K.M. Agarwal (HUF). The clubbed shareholding exceeded 10% of the share capital of M/s Sumit Chemicals

Pvt. Ltd. Thereafter, the Assessing Officer invoked the provisions of section 2(22)(e) of the Act and the loan of Rs.10,45,07,000/- given by M/s Sumit Chemicals Pvt. Ltd. to the assessee was treated as deemed dividend, holding (the relevant paras of the assessment order) as follows:

> *"4.2 Sec 2(22) (e) of the I.T Act, 1961 requires the shareholder to have at least 10% voting right for establishment of the fact that the shareholder has command in the company to derive the individual benefit and there is nexus between the company and the shareholder for individual benefit of the shareholder without paying any tax by both the parties. The purpose being that persons who manage such closely held companies arrange their affairs in a manner that they assist the shareholder in avoiding the tax payment by having the company pay or distribute, what would legitimately be dividend in the hands of the shareholder i.e. money in the form of loans/advances.*
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> *The section says that the shareholder i.e. in this case assessee Sri K.M Agarwal should be the shareholder of not less than 10% of voting rights .The section does not bar to club the individual capacity of the shareholder with his capacity as 'Karta' in HUF. Section only states that the shareholder should have 10% voting rights in the company to be receiver of deemed dividend .Sri K.M Agarwal is a registered and beneficial shareholder of shares in M/s Sumit Chemicals Pvt. Ltd having more than 10% of voting rights. However, to get the version of assessee, a show cause dated 30/01/2015 was issued to the assessee along with notice u/s 142(1) of the I.T Act, 1961.*
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> *4.3 Vide reply dated 06/02/2015 assessee submitted the reply on above issue. Assessee has replied, "As regards to the applicability of provisions of sec 2(22)(e)of the I.T Act, it is submitted that the assessee is neither a director nor having shareholding /voting power holding more than 10% of total shares in this company. The assessee is holding 25911 equity shares in the income, representing 8.82% shares."*

Further assessee has submitted, "In Point No.4 of the show cause notice, your honour has asked to show cause as to why the shareholding of K M Agarwal HUF be not clubbed together with individual as Karta of HUF is representing before the company for voting, ACM and all practical purposes is the same person.

The contention of your honour in this regard is erroneous and is not sustainable in law as KM Agarwal HUF is separate entity and is assessed to tax separately. It is HUF of KM Agarwal and have separate sources of income and ha ve separate funds in its capital account which belongs to Hindu Undivided Family of the assessee. The income of the HUF is separate and it is assessed to tax separately. M/s K. M Agarwal HUF is assessed to tax vide PAN-AAFHK8324J. Copy of ITR for A.Y 2011-12 & 2012-13 are enclosed. M/s K.M Agarwal HUF had made investment in the shares of M/s Sumit Chemicals Pvt Ltd out of family funds of HUF and is holding 28000 shares of Sumit Chemicals Pvt. Ltd. It is a long term investment of HUF and was made with a view to earn dividend Income and in order to have capital growth of funds of Hindu Undivided Family. The Hindu Undivided Family of K.M Agarwal is consisting of Himself, his wife Rama Agarwal, son Sumit Agarwal and daughter Mohini Agarwal. Though Sri K.M Agarwal is Karta of this HUF, however, he cannot take any decision/any benefit without the consent of all the members. Sri K.M Agarwal in capacity of Karta is only executing the transactions/representing the HUF before any authority or company for voting, AGM etc. in the capacity of Karta for and on behalf of Hindu Undivided Family and any decisions taken by him in the capacity of Karta is wholly and exclusively belongs to Hindu Undivided Family. By any stretch of imagination, the decision taken by Karta on behalf of its HUF cannot be treated as taken by him in his individual capacity or for the benefit of K.M Agarwal (Individual).

Attention of your honour is drawn to the following judgements wherein it was held that income of HUF cannot be clubbed with that of individual or vice versa:

a) In case of Lachman Das Bhatia & Sons vs. Commissioner of Income -tax (2007)162 Taxman 118(Delhi)

b) D.N Bhandarkar v CIT 158 ITR 724 Kar. (1986)

c) CIT vs. Om Prakash (1996)217 ITR 785 (SC)

d) Pratap H. Desai (HUF) vs. ACIT (2009)118 ITD 29(Pat)

Had it be the intention of Law, there was no need of forming an HUF or the income of the HUF be clubbed with that of individual and taxed accordingly. By proposing to club the shareholding of HUF with that of individual, your honour is trying to do something which is not permissible under the law".

4.4 To ascertain the exact facts of the case, a copy of audit report alongwith annexures and ROC return in Form 20B were procured from website and Circle-6 assessment record of company for M/s Sumit Chemicals Pvt. Ltd. for the A.Y 2012-13. Also the sales tax detail of the company were procured from the Sales Tax Site. The following facts have emerged from perusal of the above documents-

- *M/s Sumit Chemicals Pvt. Ltd. was a closely held company in which the directors and relatives of directors were shareholders. The company had not allotted shares to any outside members. There were two HUFs K.M Agarwal (HUF) and Ram Kumar Agarwal (HUF) which were also in the list of shareholders. Again, the family members were only allottees of shares in both the HUFs and were registered and beneficial owner of the shares. As per the ROC return filed in Form 20B by M/s Sumit Chemicals Pvt. Ltd on 31/08/2012, the company had inducted an outside member Sri Jay Narain Yadav as one of the directors. He was appointed on 30/11/2011. No shares were allotted to him though and had no voting power. The previous director was Sri K.M Agarwal who was director since 1988 and had resigned on 30/11/2011.Form 32 filed with ROC dated 24/01/2012 is on record. His shareholding however, in individual capacity had remained intact.*

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- *Shri K.M. Agarwal was director during the financial year 2011-12 for almost the whole year and was the key*

person. The question arises what was need to change the director when the company had no intention to allot any shares to new Director Sri Jay Narain Yadav and call for his interference in the closely held company where all the affairs are managed by the same group of family members. The only intention which had come out from this arrangement is to hide the fact that Sri K.M Agarwal had been the key person managing the affairs of the company.

- *The assessee was the key person in M/s Sumit Chemicals Pvt. Ltd is also clear from the Sales tax department record of the company .Here the registered dealer for the company is reported as Sri K.M Agarwal and he is reflected as director of the company along with Sri Sumit AgarwaI.(Scanned copy attached).*
- *The shareholding pattern of this company is such that the registered shareholders belong to same family i.e. grandfather, father, mother, daughter, son. The money is siphoned to the registered/beneficial shareholder to escape the liability of dividend distribution tax u/s 115O of the I.T Act, 1961. The shareholding pattern is a mask to show the total voting right of each individual below 10%. No dividends were ever declared by the company as per record and HUF or individual shareholder had not shown any dividend income.*
- *On the contrary, the money is floated between the company, assessee and other family members in the form of unsecured loans and advances.*
- *It is pertinent to mention that the assessee company had tried to hide the fact that Sri K.M Agarwal was the director of M/s Sumit Chemicals Pvt Ltd during the A.Y 2012-13. The assessee was the director for large period of the financial year but the authorized representatives had given false version of the position of the assessee during the year. Portion of reply of assessee dated 20/01/2015 is reproduced for reference, "As regard to the applicability of provisions of section 2(22)(e) of the*

I.T Act, it is submitted that the assessee is neither the director in the company nor having shareholding/voting power holding more than 10% of total shares in the company SCPL.

Wherein in the audit report of the assessee the auditor had himself stated him to be the director of the company.

.....

It was only after confrontation to the assessee of the return filed with ROC, the assessee had submitted to the correct facts. The assessee tried to put up a case where he was a passive shareholder during the relevant period. Wherein, all the key affairs of the company were managed by Sri Sumit Agarwal and Sri Jay Narain Yadav as directors of the company Regarding the issue of clubbing of shareholding, assessee had relied upon the case law: regarding 'clubbing of income', which had no relevance with the present facts of the case. The assessee's shareholding as individual and Karta of HUF needs to be clubbed as he was the director, registered shareholder of the shares and beneficial owner of the shares during the relevant previous year in the company. The section requires that the total shareholding of a particular shareholder needs to be seen in all the capacities in the company which should not be less than 10%. The judgement of Hon'ble Delhi High Court in the case of CIT vs. National Travel Services is important to mention here. In this case the court has held that it is accepted that firm not being a legal entity cannot become a shareholder of a company and in case loan has been advanced to a firm whose partners are shareholders, then it would frustrate the provisions of section 2(22)(e), and will lead to absurd results. Therefore loan received by a firm, whose partners are registered shareholders of the company which advanced the loan, would fall within the ambit of sec 2(22)(e) of the I.T Act, 1961. The reverse corollary

is fit in the case of assessee. Here the loan was taken by the shareholder who was the Karta of HUF which was also a shareholder. Likewise, the Companies Act does not prohibit the membership of the HUF but the shares are always registered in the name of Karta of the HUF. The HUF has no legal capacity to become member of the company or to keep shares in its name. It is the Karta who keep the shares and is the registered owner of shares. The company has never declared any dividend in the present case and it is not the HUF but the individual shareholder (Karta of HUF) who has benefited from the shareholding of HUF and is the beneficial owner of Shares in HUF. Therefore, based on above facts, Sri K.M Agarwal is held to be the shareholder having ownership of shares and voting rights of more than 10% in the company M/s Sumit Chemicals Pvt. Ltd."

6. Thus, the Assessing Officer clubbed the shareholding of Krishna Mohan Agarwal (individual) and K.M. Agarwal (HUF) and such clubbed shareholding exceeded 10% of share capital of M/s Sumit Chemicals Pvt. Ltd. and, thereafter, he invoked the provisions of section 2(22)(e) of the Act. Accordingly, the loan of Rs.10,45,07,000/- given by M/s Sumit Chemicals Pvt. Ltd. to the respondent assessee was treated as deemed dividend.

7. The ld. CIT(A) has deleted the addition, holding that the intention behind enacting the provisions of Section 2(22) (e) of the Act 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; that instead of distributing accumulated profits as dividend, the companies distribute them as loans or advances to shareholders or to the concern in which

such shareholders have substantial interest, or make any payment on behalf of, or for the individual benefit of, such shareholder; that in such an event, by the deeming provisions, such payment by the company is treated as dividend; that the intention behind the provisions of section 2(22) (e) of the Act is to tax dividend in the hands of the shareholders; and that 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 loans or advances would ultimately be made available to the shareholders of the company giving the loans or advances.

8. The ld. CIT(A) discussed the following case laws:

(1) ACIT vs. Bhaumik Colour (P) Ltd., 119 ITD 1 (Mum.) (SB).

(2) CIT vs. Krupeshbhai N Patel, 34 Taxmann.com 245 (Gujrat).

(3) CIT vs. Navibhai N Patel, 35 Taxmann.com 354 (Gujrat).

(4) CIT vs. C. P. Sarathy Mudaliar, order dated 12/10/1971 of Hon'ble Apex Court.

(5) CIT vs. C.P. Sarathy Mudaliar, 83 ITR 170 (SC).

(6) Rameshwarlal Sanwarmal vs. CIT, 122 ITR 1 (SC).

(7) CIT vs. Hotel Hilltop, 313 ITR 116 (Raj.)

From the above decisions, the ld. CIT(A) concluded that section 2(22)(e) of the Act is a deeming section; that it creates the fiction of treating loans to shareholders as deemed dividend; that to be covered in its ambit, the shareholder has to be registered as a shareholder; that he/she has to have a 10% voting right; that he/she has to be a beneficial owner of the shares; that having registered ownership or beneficial ownership separately excludes one from the provisions; that since an HUF acquires shares through its Karta, an HUF is not a

registered shareholder; and that the members of the HUF are beneficial shareholders, but not registered shareholders.

9. The ld. CIT(A) further observed, as below:

> "Let us examine the shareholding of K.K. Aarwal in individual capacity as well as Karta of K.M. Agarwal, HUF as under
>
> The shareholding of assessee, KM Agarwal and KM Agarwal HUF, in M/s Sumit Chemicals Pvt. Ltd. (SCPL), on 31/03/2011 & 31/03/2012 is as follows:

	31/03/2011		31/03/2012	
	(No. of equity shares of Rs.100/- each)	% of shareholding	No. of equity shares of Rs.100/- each)	% of shareholding
KM Agarwal	25,911	8.82%	25,911	8.82%
KM Agarwal HUF	28000	9.54%	28000	9.54%
		18.36		18.36

> Thus in the light of the discussion supra the shareholding of K.M Agarwal and K.M. Agarwal (HUF), in M/s Sumit Chemicals Pvt. Ltd. (SCPL) cannot be taken together. Individually the shareholding is below 10% in both cases."

10. The ld. CIT(A) called for a remand from the Assessing Officer. This remand report has been reproduced by the ld. CIT(A) in his order (impugned, pages 11 to 12), as follows:-

> *"The AO was called by me to discuss the issue the shareholding of K.M. Agarwal individual and K.M. Agarwal as Karta of HUF on 10.10.2016 and subsequently remand report dated 18.01.2016 was received on the same issue whether the share of Karta of*

HUF and Individual can be clubbed together for the purposes of section 2(22)(e) as under:-

"However, I would like to rely on some additional facts and case laws in this regard. A book named "A Step Ahead" is published by the committee of departmental officers headed by CCIT(CCA), Gujrat in Gujrat region on controversial issues in assessment. The interpretation of section 2(22)(e) with regard to clubbing of shareholding rights was taken from there. Moreover, Delhi High Court in the case of National Travels Services (supra) elaborately analyzed this issue and concluded that in case it is accepted that firm not being a legal entity cannot become a shareholder of a company and in case loan has been advanced to a firm whose partners are shareholders, then it would frustrate the provisions of Section 2(22)(e), and will lead to absurd results. Therefore, loan received by a firm, whose partners are registered shareholders of the company which advanced the loan, would fall within the ambit of Section 2(22)(e). Likewise, as per company law HUF is represented by its Karta. The loan taken by Karta from company would fall in ambit of deemed dividend. The Companies Act does not prohibit membership of Hindu Undivided Family. In case of HUF, the shares are registered in the name of 'A' as Karta of HUF. The assessee was asked to provide the register of members and shareholders maintained as per companies act. But, assessee had not provided any detail. The HUF consists of assessee and his family members and other shareholders alongwith the HUF are same family members. The case of assessee is the example of colorable device where assessee had tried to split the shareholding to avoid the consequences of 10% or 20% shareholding with each of the shareholders. The copy of article written by Sri 'Rajneesh S.Vohra, JCIT, TDS(Ahmedabad) on understanding of deemed dividend in the departmental publication "A Step Ahead" is attached for ready reference".

11. Further, the ld. CIT(A) referred to and relied on 'CIT vs. National Travel Service', 347 ITR 305 (Delhi), and in accordance therewith, it was held as follows:

"In the case of the assesse Shri K.M. Agarwal holds, both as registered and beneficial owner, shares aggregating to 8.82% only.

The HUF of K.M. Agarwal (through K.M. Aggarwal Karta) holds separately registered and beneficial ownership of shares aggregating to 9.39%.

As the requirement is that the shareholder needs to be a beneficial shareholder irrespective of the person in whose name the shares are registered therefore the shareholding of HUF cannot be taken to be that of the Karta for purpose of section 2(22)(e) as the Karta is not the beneficial owner thereof. Therefore for loan taken by K.M Agarwal in individual capacity is to be considered for the purposes of section 2(22) (e).

This is supported by the decision of Hon'ble Delhi High Court in the case of National Travel Service Supra on which the AO is relying heavily.

In view of the historical background of section 2(22)(e) and decision of higher judicial authorities it is clear that the Assessing Officer's contention that for purposes of applicability of section 2(22)(e) shareholding of individual & HUF can be clubbed is not valid and therefore this stand cannot be upheld.

The Assessing Officer in her order has carried an elaborate and a detailed description of calculating accumulated profits as well as calculating the amount given as loan.

However as the primary condition of 10% beneficial shareholding of Mr. K.M Aggarwal is not established the remaining amount/ part of the addition becomes an exercise in futility because nothing can be added under section 2(22)(e). Therefore no comments are offered on the same.

As Shri K.M. Agarwal holds 8.82% shares in closely held private company M/s Sumit Chemicals Pvt. Ltd., both as registered and beneficial owner, he is not covered by the provisions of section 2(22)(e). Addition made is deleted on this ground as not sustainable.

Result:

Addition made is deleted on this ground as not sustainable. Appeal is allowed."

12. Having considered the rival contentions in the light of the material placed on record, we find no error whatsoever in the order under appeal. In 'CIT vs. National Travel Service' (supra), as noted by the ld. CIT(A), the concerned partnership firm consisted of three partners, namely, Mr. Naresh Goyal, Mr Surinder Goyal and M/s Jet Enterprises Private Limited. The three partners had profit sharing ratio of 35%, 15% and 50%, respectively. NTS was a shareholder of M/s. Jetair Private Limited (Jetair), holding about 48 percent shares. However, the shares were purchased in the names of two partners, namely Mr. Naresh Goyal and Mr. Surinder Goyal. Thus, the firm was the beneficial owner of 48 percent stake in Jetair, whereas the partners were the registered shareholders. NTS had taken a loan of INR 28.52 crores from Jetair.

13. The issue before the Hon'ble High Court in the case of 'CIT vs. National Travel Service' (supra), therefore, was whether the loan taken from M/s Jet Enterprises Pvt. Ltd. would be taxable as deemed dividend in the hands of MTS inspite of the fact that MTS was not a shareholder of M/s Jet Enterprises Pvt. Ltd. as per its Register of members. The Hon'ble High Court held, as follows:

"According to us the outcome of this appeal depends on the following two questions:

(1) To attract the first limb of Section 2(22)(e) of the Act, is it necessary that the person who has received the advance or loan is a shareholder and also beneficial owner.

To put it otherwise, whether both the conditions are required to be satisfied will depend upon the interpretation to be given to the words "being a person who is a beneficial owner of shares...." Which was inserted by amendment in the aforesaid provision carried out by the Finance Act, 1987 w.e.f. 1st April, 1988.

(2) Whether the assessee who is a partnership firm can be treated as "shareholder" because of the reason that it has purchased the shares in the name of the two partners.

In so far as first question formulated above is concerned, answer to that can be found in Rameshwarlal Sanwarmal Vs. CIT, 122 ITR 1 (SC), which followed the judgment in the case of Commissioner of Income Tax Vs. C.P. Sarathy Mudaliar Page 22 of 28 [1972] 83 ITR 170.

That was a case where the assessee was HUF which had obtained certain loans of a company whose shares it beneficially owned. However, these shares stood in the name of S.M. Sharia (Karta) of the said HUF in the register of shareholders of the company. The loans were advanced by the company to three concerns which were owned by the assessee/HUF.

The Court held that conditions stipulated in Section 2 (6A) (e) of the Income Tax Act, 1922 (which is akin to Section 2 (22)(e) of the present mischief of this Section as the HUF was not the shareholder even when it was beneficial owner of the shares. It is dear there from that both the conditions have to be satisfied.

This view has been followed by the Rajasthan High Court in the case of Harish Chand Golecha Vs. CIT, 132 LTR 30 while dealing with the present provision contained in the Income Tax Act, 1961.

The expression — being a person as a beneficial owner of shares, qualifies the word "shareholder'. Thus to attract the provisions of Section 2(22)(e) of the Act, the person to whom the loan or advance is made should be a shareholder as well as beneficial owner.

This brings us to the more important issue viz. whether the 'assessee firm' can be treated as a shareholder having purchased shares through its partners in the company which has paid the loans or is it necessary that a shareholder has to be a 'registered shareholder'.

If the contention of the assessee is accepted, in no case a partnership firm can come within the mischief of Section 2(22)(e) of the Act because of the reason that shares would be purchased by the firm in the name of its partners as the firm is not having

any separate entity of its own. With the name of the partner entering into the register of members of the company as shareholder, the said partner shall be the shareholder in the records of the company but not the beneficial owner as beneficial owner is the partnership firm.

This would mean that the loan or advance given by the company would never be treated as deemed dividend either in the hands of the partners or in the hands of partnership firm.

In this way the very purpose for which this provision was enacted would get defeated.

We are, therefore, of the opinion that for the purpose of Section 2(22)(e) of the Act, partnership firm is to be treated as the shareholder and it is not necessary that is has to be "registered shareholder".”

14. In this regard, the ld. CIT(A) has held as follows:

"In the case of the assesse Shri K.M. Agarwal holds, both as registered and beneficial owner, shares aggregating to 8.82% only.

The HUF of K.M. Agarwal (through K.M. Aggarwal Karta) holds separately registered and beneficial ownership of shares aggregating to 9.39%.

As the requirement is that the shareholder needs to be a beneficial shareholder irrespective of the person in whose name the shares are registered therefore the shareholding of HUF cannot be taken to be that of the Karta for purpose of section 2(22)(e) as the Karta is not the beneficial owner thereof. Therefore for loan taken by K.M Agarwal in individual capacity is to be considered for the purposes of section 2(22) (e).

This is supported by the decision of Hon'ble Delhi High Court in the case of National Travel Service Supra on which the AO is relying heavily.

In view of the historical background of section 2(22)(e) and decision of higher judicial authorities it is clear that the Assessing Officer's contention that for purposes of applicability of section

2(22) (e) shareholding of individual & HUF can be clubbed is not valid and therefore this stand cannot be upheld.

The Assessing Officer in her order has carried an elaborate and a detailed description of calculating accumulated profits as well as calculating the amount given as loan.

However as the primary condition of 10% beneficial shareholding of Mr. K.M Aggarwal is not established the remaining amount/ part of the addition becomes an exercise in futility because nothing can be added under section 2(22)(e). Therefore no comments are offered on the same.

As Shri K.M. Agarwal holds 8.82% shares in closely held private company M/s Sumit Chemicals Pvt. Ltd., both as registered and beneficial owner, He is not covered by the provisions of section 2(22)(e). Addition made Is deleted on this ground as not sustainable.

Result:

Addition made is deleted on this ground as not sustainable. Appeal is allowed."

15. No decision contrary to 'CIT vs. National Travel Service' (supra) has been cited before us. There is also no contra decision to the following decisions, as relied upon by the assessee:

(1) Order of ITAT Indore Bench in the case of Manish Karwa Vs. ACIT [2014] 45 Taxmann.com 351.

(2) Order of Ahmedabad Bench of ITAT in the case of JCIT Vs. Kunal Organics (P) Limited [2007] 164 Taxman 169 (Ahmedabad).

(3) Judgment of Hon'ble Delhi High Court in the case of CIT Vs. Ankitech (P) Limited [2011] 11 Taxraann.com 100 (Delhi).

(4) Judgment of the Hon'ble Supreme Court of India in the case of CIT Delhi Vs. Madhur Housing and development Company approving the judgment of the Hon'ble Delhi High Court in the case of Ankitech Private Limited (supra) [2018] 401 ITR 152 (SC).

16. In view of the above, finding no error therein, the decision of the ld. CIT(A) on this issue is confirmed, rejecting ground nos. 1 to 5.

17. Ground No. 6 relates to the deletion of addition of Rs.1,04,86,510/- on account of unaccounted sales.

18. The brief facts are that from the ledgers submitted by Shri K.M. Agarwal vide reply dated 13/11/2014, the Assessing Officer noted the sales transaction of the assessee with M/s Sumit Chemicals, for the year under consideration, as below:

Sr No	Prop. Concern	Total Sales As per audit report of Sumit Chemicals P Ltd (A)	Total Sales As per Ledger Submitted To JCIT Rg-2 vide reply 04/02/201 5 By Sumit Chemicals(C)	Difference C-A (Concealed Income)
1	Synthetic Silica Products	7889200	17843655	9954455
2	Chhavi Microfine Ltd.	2919875	3451929	532054
			Total	10486509

19. The Assessing Officer observed that as per sales to M/s Sumit Chemicals Pvt. Ltd., there was unaccounted purchase by the assessee-company; and that similarly, the same amount of difference was found as unexplained sales in the hands of Shri K.M. Agarwal. Accordingly, the Assessing Officer applied the gross profit rate of 16.25% on the amount of Rs.1,04,86,509/-, being the difference amount of concealed income, which comes to Rs.17,04,060/-, and the same was treated as concealed income of the assessee. The Assessing Officer further observed that the sales and purchase were out of books; that the assessee had failed to give the correct position of sales and purchases, despite providing to

him various opportunities. By applying the formula of cost price = sale price – gross profit, the amount of purchase was calculated by the Assessing Officer at Rs.87,82,450/- and this amount was treated as unaccounted investment made by the assessee in purchase of raw material. He accordingly, added Rs.1,04,86,510/- (Rs.17,04,060 + 87,82,450), to the total income of the assessee as unaccounted sales.

20. Aggrieved, the assessee preferred an appeal before the ld. CIT(A), who, after considering the remand report of the Assessing Officer, deleted the addition, observing as under:

> *"It is settled accounting practice that in a customer's account, amount of sale is debited inclusive of amount of VAT & excise however the customer accounts for purchase net of excise & VAT as the aforesaid taxes are available to the customer as Cenvat/ Input Vat" against Excise duty payable/ output Vat payable.*
>
> *The reconciled account statements filed during before me both in books of SCPL and M/s Synthetic Silica Products & M/s Chhavi Microfine together with Tax Audit report of SCPL & assessee established that there are no difference in the books of the two accounts.*
>
> *It appears that there was no reason to add all the debits entries (sale or interbank transaction) in the account of SCPL as appearing in books of Synthetic Silica Products & Chhavi Microfine Products to arrive at total sales made by assessee to SCPL.*
>
> *If this is followed the aggregation of entries relating to sales appearing in the customer's ledger, as appearing in supplier's books, would exceed the purchase recorded by the customer in its purchase account.*
>
> *The AO was called by me to discuss the issue the on 10.10.2016 and subsequently remand report dated 18.01.2016 was received on the same issue*
>
> *The A.O. has stated in the remand report as under:*
>
> *"The ledgers submitted by the assessee on various dates and the submission in this regard was made the part of the assessment*

order. From the perusal of the assessment order it can be seen that the assessee was unable to substantiate that why such huge difference had arisen. The claim of the assessee that the difference is due to Excise duty/VAT is totally incorrect and assessee should give some proof to reconcile the difference. The addition was made on real fact basis and not on hypothetical basis".

In my opinion and understanding of the accounts, the above reconciliation explains the entire difference and in the light of the same.

Addition made is not sustainable and the same is therefore dismissed.

Result:

Addition made is deleted and appeal allowed on this ground."

21. Before us, the ld. D.R. has submitted that the ld. CIT(A) has erred in law by deleting the addition of Rs.1,04,86,510/- on account of unaccounted sales, when the assessee had not proved beyond doubt the reason for the difference in sale/purchase after giving credit of VAT/Excise duty; and that the differences in the Audit Report and ledgers were not reconciled by explaining as to why no addition he made for the omission on the part of assessee to disclose the entries in the Audit Report.

22. The ld. counsel for the assessee, on the other hand, has placed reliance on the order of the ld. CIT(A).

23. Heard. As observed by the ld. CIT(A), it is a settled accounting practice that in a customer's account, the amount of sale is debited inclusive of the amount of VAT & Excise. However, for purchase, the customer's account is the net of excise & VAT, as the aforesaid taxes are available to the customer as Cenvat/ Input Vat against Excise duty payable/output Vat payable. Through the reconciled account statements filed befoe the ld. CIT(A), both in the books of SCPL

and M/s Synthetic Silica Products & M/s Chhavi Microfine together with Tax Audit report of SCPL, the assessee established that there were no difference in the books of the two accounts. Therefore, we find that the ld. CIT(A) has decided the issue in correct perspective and no interference is called for in his order on this issue. Accordingly, ground No.6 of the Revenue is rejected.

24. Ground No.7 relates to the deletion of disallowance amounting to Rs.49,96,712/- on account of interest expenses on unsecured loans.

25. The Assessing Officer, on perusal of the HUDFC Savings Bank account of the assessee and the details submitted by the assessee during the assessment proceedings, noted that assessee had invested Rs.50 lakhs on 30/3/2012 out of balance in his Savings Bank account; and that in the computation of income filed by the assessee, the assessee stood shown to have reduced the total profit of Rs.1,07,03,181.74 from both the proprietary concerns by the interest paid on borrowed funds of Rs.65,22,404/-. The Assessing Officer asked the assessee, vide query letters dated 30/1/2015 and 11/2/2015, to explain the nature and allowability of this expenditure. In response to that, the assessee submitted that the amount of interest was paid on borrowed funds which were of unsecured nature; that the amount was used for business purpose and was in accordance with section 37 of the Act; and that the immediate source of this FDR was the amounts taken from family members, on which no interest was paid. The Assessing Officer did not accept the contentions of the assessee and disallowed the interest amount of Rs.50 lakhs and added to the income of the assessee.

26. The ld. CIT(A) has discussed this issue at pages 22 to 25 of his order. The relevant portion of the order is reproduced, as below:

"This issue has to examined as per the provisions of section 36 (1) (iii)

Let us examine the provisions of section 36(1) (iii)

(iii) The phrase "for the purpose of business" - The expression "for the purpose of business" occurs In Section 36(1)(iii).

For allowance of a claim for deduction of interest under this provision in Section 36(1)(iii) following three conditions are there (Supreme Court in Madhav Prasad Jatia Vs. CIT, (1979) 118 ITR 200 (SC)

(i) The money, that is capital, must have been borrowed by the assessee

(ii) It must have been borrowed for the purpose of business.

(iii)The assessee must have paid interest on the borrowed amount i.e. he has shown the same as an item of expenditure.

While explaining the meaning of this phrase the Hon'ble Supreme Court in the case of S. A. Builders Ltd. Vs. CIT(A), Chandigarh reported in 288 ITR 1 has used the word "commercial expediency".

By using this phrase Hon'ble Supreme Court has given a new dimension and clarified the concept further. In the judgment the Supreme Court has defined commercial expediency as

"an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as a business expenditure, if it was incurred on grounds of commercial expediency".

The burden of proving, that the moneys borrowed has not been utilized for non-business purpose and the lending has all' ingredients of "commercial expediency", is on the assessee.

There are various case laws which supports this contention viz.

CIT Vs. Coimbatore Salem Transport P. Ltd. 61 ITR 480 (Mad)

Indian Metals & Ferro Alloys Ltd. Vs. CIT, 193 ITR 344 (Ori)

CIT Vs. Abhishek Ind (P&H) 286 ITR 1.

In the case of R. Dalmia Vs. CIT 133 ITR 169 (Del.) the Hon'ble High Court decided that

"Where the interest paid concerns the borrowed money for business as well as non-business purposes, the claim may be disallowed in its entirety if no adequate material is adduced by the assessee to determine that portion of interest which pertains to business purposes".

Assesse has invested Rs.50,00,000/- out of interest free loans, whereas he is incurring interest on the bank loans.

We have to examine if business funds have been used for these investments. Here it is has to be established/ proved if the borrowings were utilized for non-business purposes, if yes then hence disallowance u/s 36(1)(iii) is to be made for utilization of borrowed funds for on business purposes.

As is borne by several judicial pronouncements that it is not the job of the revenue to step into the shoes of the assesse and to decide how he should run his business. It is true and the present case also.

It is also matter of commercial judgment as to how the assessee makes his investments and how he utilizes his funds.

But when the assessee starts claiming interest expenses from his income for the funds which are not deployed in the business then it becomes the out of the revenue to investigate and made disallowances of expenses which are bogusly claimed as having incurred for the purposes of business.

Assesse has stated:

"May note that the appellant had taken unsecured loans in preceding years for the purpose of his business which were utilized in proprietary concerns

M/s Synthetic Silica Products and M/s Chhavi Micro fine Products. expenditure allowable expenditure under section 37(1) of the I.T. Act, 1961.

As is clear assesse has not brought any credible evidence on record to establish that the moneys borrowed was utilized for

business purpose and the borrowing was for "commercial expediency".

The question as to the extent of disallowance when it is proved that the borrowings were utilized for non-business purposes.

Since the FDR of Rs.50 lacs on 30/03/2012 disallowance @12% will be made for this time period u/s 36(1)(iii).

Addition made is partly sustained on this ground."

27. Heard. We find that the ld. CIT(A) has decided the issue, placing reliance on various case laws and partly sustained the addition made by the Assessing Officer. No cogent material or case law was brought to our notice by the ld. D.R., contrary to that brought on record by the ld. CIT(A). We, therefore, confirm the order of the ld. CIT(A) on this issue and reject ground No.7 taken by the Revenue.

28. Ground No.8 is general in nature, which requires no specific adjudication.

29. In the result, the appeal of the Revenue stands dismissed.

Order pronounced in the open Court on 22/08/2019.

Sd/-	Sd/-
[T. S. KAPOOR]	[A. D. JAIN]
ACCOUNTANT MEMBER	VICE PRESIDENT

DATED:22/08/2019
JJ:2607

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT(A)
4. CIT
5. DR

By order

Assistant Registrar