www.taxguru.in

REPORTABLE

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ITA No.462 of 2009 with ITA Nos. 2087/2010, 901/2010, 902/2010, 903/2010, 960/2010, 1327/2010, 1436/2010, 1502/2010, 1865/2010, 461/2010, 998/2009, 1421/2009, 1618/2010, 1758/2010, 1978/2010, 622/2011, 623/2011, 270/20111588/2010, 211/2010, 352/2010 & 2014/2010.

Reserved On: April 27, 2011.

% *Pronounced On: May 11, 2011.*

1) **ITA No.462 of 2009**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

ANKITECH PVT LTD. . . .RESPONDENT

2) **ITA No.2087 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

ANKITECH PVT LTD. . . .RESPONDENT

3) **ITA No.901 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

M/s MUKUL INTERNATIONAL LTD. . . .RESPONDENT

4) **ITA No.902 of 2010**

www.taxguru.in

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

M/s MUKUL INTERNATIONAL LTD. . . .RESPONDENT

5) **ITA No.903 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

M/s MUKUL INTERNATIONAL LTD. . . .RESPONDENT

6) **ITA No.960 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

M/s R.C. ENERGY METERING PVT. LTD. . . .RESPONDENT

7) **ITA No.1327 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

ACTIVE SECURITIES PVT. LTD. . . .RESPONDENT

8) **ITA No.1436 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

www.taxguru.in

VERSUS

P AND A ESTATES PVT. LTD. . . .RESPONDENT

9) **ITA No.1502 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

MEHRA STORE . . .RESPONDENT

10) **ITA No.1865 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

MOKUL INTERNATIONAL LTD. . . .RESPONDENT

11) **ITA No.461 of 2011**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

COSMOTECH COMMUNICATIONS PRODUCTS PVT. LTD. . . .RESPONDENT

12) **ITA No.998 of 2009**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

MAGIC INTERNATIONAL PVT. LTD., New Delhi

www.taxguru.in

. . .RESPONDENT

13) **ITA No.1421 of 2009**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

R.C. ENERGY MATERING PVT. LTD. . . .RESPONDENT

14) **ITA No.1618 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

KAISER EXPORT PVT LTD . . .RESPONDENT

15) **ITA No.1758 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

PEARL INDIA PUBLISHING HOUSE PVT. LTD.
. . .RESPONDENT

16) **ITA No.1978 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

STELCO INDIA P. LTD. . . .RESPONDENT

17) **ITA No.622 of 2011**

www.taxguru.in

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

CAPARO INDIA DEVELOPMENT PVT. LTD. . . .RESPONDENT

18) **ITA No.623 of 2011**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

CAPARO INDIA PVT. LTD. . . .RESPONDENT

19) **ITA No.270 of 2011**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

SHIVA COMMODITIES AND DERIVATIVES . . .RESPONDENT

Reserved On: April 29, 2011
Pronounced On: May 11, 2011

20) **ITA No.1588 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

TIMELESS FASHIONS PVT. LTD. . . .RESPONDENT

21) **ITA No.211 of 2010**

www.taxguru.in

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

NANDLALA SECURITIES PVT. LTD. . . .RESPONDENT

22) **ITA No.352 of 2011**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

INDIAN TECHNOCRAFT LTD. . . .RESPONDENT

Reserved On: May 02, 2011
Pronounced On: May 11, 2011

23) **ITA No.2014 of 2010**

COMMISSIONER OF INCOME TAX . . . APPELLANT

VERSUS

ROXY INVESTMENT . . .RESPONDENT

Counsels for the Revenue:

Ms. Prem Lata Bansal, Sr. Advocate with Mr. Deepak Anand.

Mr. Sanjeev Sabharwal, Sr. Standing Counsel.

Mr. N.P. Sahni, Sr. Standing Counsel.

Mr. Kamal Sawhney, Sr. Standing Counsel.

Ms. Rashmi Chopra, Sr. Standing Counsel.

www.taxguru.in

Counsels for the Assessee:

Mr. Ajay Vohra with Ms. Kavita Jha, Advocates.

Mr. Salil Kapoor, Advocate.

Dr. Rakesh Kapoor with Ms. Poonam Ahuja, Advocates.

Mr. Satyen Sethi with Mr. A.T. Panda, Advocates.
Mr. Rajat Navet, Advocate.

Mr. Sandeep Sapra, Advocate.

CORAM :-

HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MR. JUSTICE M.L. MEHTA

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?

2. To be referred to the Reporter or not?

3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. In all these appeals, same questions of law touching the interpretation that is to be accorded to the provisions of Section 2(22)(e) of the amount received by the Income Tax Act (hereinafter referred to as 'the Act'), arise for consideration. Our purpose would be served by taking note of the questions of law framed in ITA No.462 of 2009, as concededly answer thereto shall cover the outcome of all these appeals. The

www.taxguru.in

substantial questions of law on which this appeal was admitted are as under:

> "a) Whether ITAT was correct in law in deleting the addition of ₹6,32,72,265/- made by the Assessing Officer in the hands of assessee company under Section 2(22)(e) of the Act?
>
> b) Whether ITAT was correct in law in holding that the addition could not have been made by the Assessing Officer in the assessee company as it was not the shareholder of M/s Jackson?
>
> c) Whether ITAT has correctly interpreted the provisions of Section 2(22)(e) of the Act?
>
> d) Whether order passed by ITAT is perverse in law and on facts when it deleted the addition holding that though the amount received by the assessee by way of book entry falls within the ambit of Section 2(22)(e) of the Act but the same cannot be assessed in the hands of Assessee?"

2. Though as many as four questions are framed, it is with singular focus, viz., whether the assessee who was not the shareholders of M/s. Jackson Generators (P) Ltd. (JGPL) could be treated as covered by the definition of 'dividend' as contained in Section 2(22)(e) of the Income Tax Act (hereinafter referred to as 'the Act'). This issue has arisen under the following circumstances.

3. The assessee filed the return declaring income at 'Nil' under normal provisions but at ₹1.45 Crores under Section 115JB of the Act. During the assessment proceedings, the Assessing Officer (AO) noticed that the assessee company had received

www.taxguru.in

advances of ₹6,32,72,265/- by way of book entry from JGPL and the shareholders having substantial interest in the assessee company were also having 10% of the voting power in JGPL. The AO specifically took note of the share-holding pattern in the assessee company as well as in JGPL, which was as following:

> "The share holding pattern of the assessee company (hereinafter referred as APL) as on 31.03.2003 is as follows:
>
> | | Percentage holding |
> |---|---|
> | 1. Mahesh Kumar Gupta | 45.1% |
> | 2. Rukmani Gupta | 45.1% |
> | 3. Manmohan Gupta | 9.8% |
>
> The share holding pattern of a company M/s Jakson Generators P. Ltd. (hereinafter referred as JGPL) is as under:-
>
> | | Percentage holding |
> |---|---|
> | 1. Mahesh Kumar Gupta | 43.19% |
> | 2. Rukmani Gupta | 26.46% |
> | Others | 30.35%" |

4. The AO was of the view that as the two Guptas were the members holding substantial interests in JGPL which had provided loans and advances to the assessee company and these very Guptas had substantial interest even in the assessee company, for the purpose of Section 2(22)(e) of the Act the amount received by the assessee from JGPL which constituted 'advances and loans' would be treated as deemed dividend within the meaning of Section 2(22)(e) of the Act and added the aforesaid amount to the income of the assessee.

www.taxguru.in

The assessee had specifically pleaded that the provisions of Section 2(22)(e) of the Act would not be attracted as the assessee was not a shareholder in JGPL. According to the assessee, for the purposes of application of Section 2(22)(e) of the Act, one of the essential conditions was that the concern receiving the said money has to be that income is to be assessed at the hands of shareholder. The AO rejected this contention.

5. CIT (A) affirmed the aforesaid view taken by the AO.

6. However, in further appeal before the Tribunal, the appeal of the assessee has been allotted vide impugned order dated 06.06.2008 thereby deleting the addition made by the AO on account of deemed dividend under Section 2(22)(e) of the Act. The Income Tax Appellate Tribunal (for brevity 'the Tribunal') held that though the amount received by the assessee by way of book entry is a deemed dividend within the meaning of Section 2(22)(e) of the Act, the same cannot be assessed in the hands of assessee company, as it was not the shareholder in the company JGPL. A dividend cannot be paid to a non-shareholder. It would have to be taxed, if at all, in the hands of the shareholders who have a substantial interest in the assessee concern and also holding not less than 10% of the voting power in JGPL.

www.taxguru.in

7. We may point out at this stage that the Tribunal has relied upon the decision of the Special Bench, Mumbai in the case of ***ACIT Vs. Bhaumik Colour (P) Ltd.* 118 ITD 1 (Mum.) (SB)**. The said decision of the Special Bench has been affirmed by the Bombay High Court in the case of ***Commissioner of Income Tax Vs. Universal Medicare (P) Ltd.* 190 Taxman 144 (Bom.)**

8. Before we discuss the aforesaid decision, it would be prudent to take note of the provision of Section 2(22)(e) of the Act. It reads as under:

> "(a) xxx xxx xxx
> (b) xxx xxx xxx
> (c) xxx xxx xxx
> (d) xxx xxx xxx
> (*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 31st day of May, 1987, by way of advance or loan to a, 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;
>
> but "dividend" does not include—
>
> (*i*) a distribution made in accordance with sub-clause (*c*) or sub-clause (*d*) in respect of any share issued for full cash consideration, where the holder of the share is not

www.taxguru.in

> entitled in the event of liquidation to participate in the surplus assets ;
>
> [(*ia*) a distribution made in accordance with sub-clause (*c*) or sub-clause (*d*) in so far as such distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders after the 31st day of March, 1964, [and before the 1st day of April, 1965] ;]
>
> (*ii*) any advance or loan made to a shareholder [or the said concern] by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company ;
>
> (*iii*) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (*e*), to the extent to which it is so set off;
>
> [(*iv*) any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956 (1 of 1956);
>
> (*v*) any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).]"

9. It was not in dispute before us that all other conditions stipulated in this provision stands satisfied in the present case. There is a payment by a company (i.e. JGPL) of a sum which is in the nature of 'advance or loans' and the payment is within the limits of accumulated profits possessed by JPGL. The payment is not made to the Guptas directly, who are the shareholders, but to the assessee which is admittedly a concern in which such shareholders, i.e., Guptas are also members/shareholders and they have substantial interest in the assessee as is clear from the share pattern disclosed above

www.taxguru.in

as per Section 2(32) of the Act, in order to have substantial interest in the company such shareholders i.e. (Guptas) in the present case who carry no less than 20% of the voting power. In the instant case, the share holding of Guptas is much more than prescribed 20%. It is for this reason whether all the conditions stipulated in Clause (e) of Section 2(22) of the Act stand satisfied. As a fortiori, the payment of 'advance or loans' made by JGPL to the concern, i.e., the assessee would be treated as dividend within the meaning of Section 2(22)(e) of the Act. The dispute which has arisen, in the scenario is to whether this is to be treated as dividend income in the form of dividend advance of the shareholders or advance of the said concern (i.e. the assessees herein). Whereas the Department has taken it as income at the hands of the assessee, as per the assessee it cannot be treated as dividend income to their account. The Tribunal has accepted this plea of the assessee holding that such dividend income is to be taxed at the hands of shareholders.

10. In ***Bhaumik Colour (P) Ltd. (supra)***, the Special Bench, Mumbai took note of the historical background of Section 2(22)(e) of the Act. There cannot be any dispute that the historical background narrated by the Special Bench is flawless and therefore, we can reproduce the same:

www.taxguru.in

(a) Section 2(6A)(e) of the IT Act, 1922, as introduced by the Finance Act, 1955 corresponding to Section 2(22)(e) of the IT Act, 1961 was as follows:
Any payment by a company, not being a company in which the public are substantially interested within the meaning of Section 23A, 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, or any payment by any such company on behalf, or for the individual benefit, of a shareholder to the extent to which the company in either case possesses accumulated profits.

(b) Section 2(22) of the IT Act, 1961, defines dividend. Section 2(22)(e) of the Act, which is equivalent to Section 2(6A)(e) of the 1922 Act, as it existed originally in the IT Act, 1961, read 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, of 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 w.e.f. 1st April, 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 the 31st 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

www.taxguru.in

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 an HUF, or a firm or an AOP or a BOI 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.

11. It is clear from the above that Under the 1922 Act, two categories of payments were considered as dividend viz., (a) any payment by way of advance or loan to a shareholder was considered as dividend paid to shareholder; or (b) any payment by any such company on behalf of or for the individual benefit of a shareholder was considered as dividend. In the 1961 Act, the very same two categories of payments were considered as dividend but an additional condition that payment should be to a shareholder being a person who is the beneficial owner of shares and who has a substantial interest in the company viz., shareholding which carries not less than twenty per cent of the voting power, was introduced. By the

www.taxguru.in

1987 amendment w.e.f. 1st April, 1988, the condition that payment should be to a shareholder 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 was substituted. Thus, the percentage of voting power was reduced from twenty per cent to ten per cent. By the very same amendment, a new category of payment was also considered as dividend viz., payment to any concern in which such shareholder is a member or a partner and in which he has a substantial interest. Substantial interest has been defined to mean holding of shares carrying 20 per cent of voting power.

12. The controversy in the present case relates to this new category introduced by way of Amendment, viz., payment to any concern in which such shareholder is a member or a partner or in which he has a substantial interest. The Special Bench analyzed the language implied in creating this new category and spelt out the conditions which are required to be satisfied for attracting this category in Para 26 of its order, which reads as under:

> "19. The provisions of Section 2(22)(e) create a fiction bringing in amounts paid otherwise than as dividend into the net of dividends. Therefore, this clause must be given a strict interpretation as held by the Hon'ble Supreme Court

www.taxguru.in

in the case of CIT v. C.P. Sarathy Mudaliar. In the case of the assessee as well as the intervener there is no dispute that the companies which gave the loan or advance were one in which public are not substantially interested. Nor is there any dispute that these companies possess accumulated profits to the extent of the loan or advance. The three limbs of Section 2(22)(e) 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 31st May, 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.

20. In the case of CIT v. C.P. Sarathy Mudaliar (supra), provisions of Section 2(6A)(e) of the Act, 1922, which was synonymous to Section 2(22)(e) of the IT Act, 1961 came up for consideration. In the said case, members of HUF acquired shares in a company with the fund of the family. Loans were granted to HUF and the question was whether the loans could be treated as dividend income of the family falling within Section 2(6A)(e) of the Act, 1922. The apex Court held that only loans advanced to shareholders could be deemed to be dividends under Section 2(6A)(e) of the Act; the HUF could not be considered to be a 'shareholder' under Section 2(6A)(e) of the Act and hence, loans given to

www.taxguru.in

the HUF will not be considered as loans advanced to "shareholder" of the company and could not, therefore, be deemed to be its income. The apex Court further held that when the Act speaks of shareholder it refers to the registered shareholder.

21. The aforesaid decision of the apex Court in the case of C.P. Sarathy Mudaliar (supra) has been followed by the apex Court in the case of Rameshwarlal Sanwarmal v. CIT (supra). In this case, the company advanced the loans to the assessee HUF who was the beneficial owners of the shares in the company, but the shares were registered in the name of the individual Karta, who held the shares for and on behalf of the HUF. On the above facts, the question before the Supreme Court was whether the loans advanced to the HUF-beneficial owner of the shares-would be taxed as deemed dividend in the hands of the HUF. The Supreme Court held that the HUF being only the beneficial shareholder and not a registered shareholder would not fall within the purview of Section 2(6A)(e) of the 1922 Act. The apex Court observed as follows:

...What Section 2(6A)(e) is designed to strike at is advance or loan to a 'shareholder' and the word 'shareholder' can mean only a registered shareholder. It is difficult to see how a beneficial owner of shares whose name does not appear in the register of shareholders of the company can be said to be a 'shareholder'. He may be beneficially entitled to the share but he is certainly not a 'shareholder'. It is only the person whose name is entered in the register of the shareholders of the company as the holder of the shares who can be said to be a shareholder qua the company and not the person beneficially entitled to the shares. It is the former who is a 'shareholder' within the matrix and scheme of the company law and not the latter. We are, therefore, of the view that it is only where a loan is advanced by the company to a registered shareholder and the other conditions set out in Section 2(6A)(e) are satisfied that the amount of the loan would be liable to be regarded as 'deemed dividend' within the meaning of Section 2(6A)(e).

22. It is thus clear from the aforesaid pronouncement of the Hon'ble Supreme Court 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

www.taxguru.in

be beneficial owner of the shares and the percentage of voting power that such shareholder should hold that 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. It is a principle of interpretation of statutes that where once certain words in an Act have received a judicial construction in one of the superior Courts, and the legislature has repeated them in a subsequent statute, the legislature must be taken to have used them according to the meaning which a Court of competent jurisdiction has given them.

23. 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 w.e.f. 1st April, 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 described 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) of the Act. 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. It is not possible to accept the contention of the learned Departmental Representative that under the 1961 Act there is no requirement of a shareholder being a registered holder and that even a beneficial ownership of shares would be sufficient.

24. The expression "shareholder being a person who is the beneficial owner of shares" referred to in the first limb of Section 2(22)(e) refers to both a registered shareholder and beneficial shareholder. If a person is a registered shareholder but not the beneficial then the provision of

www.taxguru.in

Section 2(22)(e) will not apply. Similarly if a person is a beneficial shareholder but not a registered shareholder then also the first limb of provisions of Section 2(22)(e) will not apply.

25. The new category of payment which was considered as dividend introduced by the Finance Act, 1987 w.e.f. 1st April, 1988 by the second limb of Section 2(22)(e) is payment "to any concern in which such shareholder is a member or a partner and in which he has a substantial interest. It is this category of payment with which we are concerned in this reference.

26. 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 a 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 Section 2(22)(e) viz., a registered and a beneficial holder of shares holding 10 per cent voting power. The Hon'ble Rajasthan High Court in the case of Union of India us. Wazir Singh, while dealing with an expression "no such application" in the context of Rule 97 of the Rajasthan High Court Rules, 1952 has held as follows:

Generally the word 'such' refers only to previously indicated, characterized or specified. 'Such' is an adjective meaning, the one previously indicated or refers only to something which has been said before.

The Hon'ble Allahabad High Court in the case of Mohan Lal and Anr. v. Grain Chambers Ltd. AIR 1959 All 279 has held as follows:

In fact, it appears to us that the word 'such' is used before a noun in a latter part of a sentence, the proper construction in the English language is to hold that the same noun is being used after the word 'such' with all its

www.taxguru.in

characteristics which might have been indicated earlier in the same sentence.

(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 per cent 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 per cent of the voting power.

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

13. The Special Bench held that the intention behind this provision is to tax dividend in the hands of the shareholders.

14. The Bombay High Court while confirming the aforesaid decision of the Special Bench in the case of ***Universal Medicare (P.) Ltd.*** made the analysis this provision in the following manner:

> "8. Clause (e) of section 2(22) is not artistically worded. For facility of exposition, the contents can be broken down for analysis: (i) Clause (e) applies to any payment by a company not being a company in which the public is substantially interested of any sum, whether as representing a part of the assets of the company or otherwise made after the 31 May, 1987; (ii) Clause (e) covers a payment made by way of a loan or advance to (a) a shareholder, being a 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 (b) any concern in which such shareholder is a member or a partner and in which he has a substantial interest; (iii) Clause (e) also includes in its purview any payment made by a company on behalf of or for the individual benefit, of any such shareholder; (iv) Clause (e) will apply to the extent to which the company, in either case, possesses accumulated profits. The remaining part f the provision is not material for the purposes of this appeal.

www.taxguru.in

9. In order that the first part of Clause (e) of Section 2(22) is attracted, the payment by a company has to be by way of an advance or loan. The advance or loan has to be made, as the case may be, either to a shareholder, being a beneficial owner holding not less than ten per cent of the voting power or to any concern to which such a shareholder is a member or a partner and in which he has a substantial interest. The Tribunal in the present case has found that as a matter of fact no loan or advance was granted to the assessee, since the amount in question had actually been defalcated and was not reflected in the books of account of the assessee. The fact that there was a defalcation seems to have been accepted since this amount was allowed as a business loss during the course of assessment year 2006-2007. Consequently, according to the Tribunal the first requirement of there being an advance or loan was not fulfilled. In our view, the finding that there was no advance or loan is a pure finding of fact which does not give rise to any substantial question of law. However, even on the second aspect which has weighed with the Tribunal, we are of the view that the construction which has been placed on the provisions of Section 2(22)(e) is correct. Section 2(22)(e) defines the ambit of the expression 'dividend'. All payments by way of dividend have to be taxed in the hands of the recipient of the dividend namely the shareholder. The effect of Section 2(22) is to provide an inclusive definition of the expression dividend. Clause (e) expands the nature of payments which can be classified as a dividend. Clause (e) of Section 2(22) includes a payment made by the company in which the public is not substantially interested by way of an advance or loan to a shareholder or to any concern to which such shareholder is a member or partner, subject to the fulfillment of the requirements which are spelt out in the provision. Similarly, a payment made by a company on behalf, of for the individual benefit, of any such shareholder is treated by Clause (e) to be included in the expression 'dividend'. Consequently, the effect of Clause (e) of Section 2(22) is to broaden the ambit of the expression 'dividend' by including certain payments which the company has made by way of a loan or advance or payments made on behalf of or for the individual benefit of a shareholder. The definition does not alter the legal position that dividend has to be taxed in the hands of the shareholder. Consequently in the present case the payment, even assuming that it was a dividend, would have to be taxed not in the hands of the assessee but in the hands of the shareholder. The Tribunal was, in the circumstances, justified in coming to the conclusion that, in any event, the payment could not be taxed in the hands of

www.taxguru.in

> the assessee. We may in concluding note that the basis on which the assessee is sought to be taxed in the present case in respect of the amount of Rs. 32,00,000/- is that there was a dividend under Section 2(22)(e) and no other basis has been suggested in the order of the Assessing Officer."

15. At this stage, it will be useful to point out that even the Rajasthan High Court in the case of ***Commissioner of Income Tax Vs. Hotel Hilltop* 217 CTR (Raj.) 527** had interpreted the provision in identical manner. It would be apt to quote Para 7 of the said judgment which contains the relevant discussion:

> "The more 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 concern firm. In which event, it would fall within the expression "deemed dividend". Obviously, income from dividend, is taxable as income from other sources, under Section 56 of the Act, 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 Roop Kumar and Devendra Kumar, are the common persons, holding more than requisite amount of share holding, 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,

www.taxguru.in

> or on whose individual benefit, being such shareholder, the amount is paid by the company to the concern."

16. Notwithstanding the aforesaid judgments of Bombay High Court and Rajasthan High Courts, learned counsel appearing for the Revenue made a frantic effort to persuade us to take a contrary view. Ms. P.L. Bansal, learned Senior Counsel appearing for the Revenue, leading from the front, made a fervent plea that some of the significant aspects were not noticed and discussed by the two High Courts in the aforesaid judgments which could have altered the course of action. She, thus, started her comments on first principle and citing various provisions of the Act as well as the deeming fiction which the concerned provisions of Section 2(22)(e) of the Act had created, her endeavour was to demonstrate that by this deeming provision fictionally the concern which receives such payment would be treated shareholder for the purposes of this provision and such a payment in the form of advance or loan has to be treated as dividend in the hands of a recipient, i.e., a kind of concern stipulated in the second category and logically, it is this concern (which is the assessee in the instant case) who should be taxed for such dividend income. The genesis of her submission runs as follows:

www.taxguru.in

Normally, a company incorporated under the Indian Companies Act would distribute the income/profits to its shareholders by declaring dividend. Therefore, dividends represent the profits earned by a company which are given to the shareholders who are treated as owners of the company to the extent of their shareholding. However, in those companies where public does not have major stake and are closely held companies, there can always be an apprehension that the profits are given away to the shareholders, who have controlling/substantial interest, in the form of loans and advances so that those very profits are not transmitted to the shareholders in the form of dividends resulting into evading of tax advance of recipients, viz., the shareholders who would have otherwise received that very amount as dividends. It was pointed out that under Section 8 of the Act, dividend income of the interest specified therein is to be included in the total income of the assessee. Section 14 of the Act stipulates various heads of income, one of them being "Income from Other Sources". As per Section 56 of the Act, dividend income is to be included under this head, viz., "Income from Other Sources". Thus, the amount of dividend received by the shareholders is to be treated as income which is to be taxed under head "Income from Other Sources". She referred to the

www.taxguru.in

Supreme Court judgment in the case of ***Kantilal Manilal and Ors. v. The Commissioner of Income-Tax*** **41 ITR 275** where the nature of this kind of income is explained in the following manner:

> "...............Dividend" is defined in section 2(6A) as inclusive of various items and exclusive of certain others which it is not necessary to set out for the purpose of this appeal. "Dividend" in its ordinary meaning is a distributive share of the profits or income of a company given to its shareholders. When the Legislature by section 2(6A) sought to define the expression "dividend" it added to the normal meaning of the expression several other categories of receipts which may not otherwise be included therein. By the definition in section 2(6A), "dividend" means dividend as normally understood and includes in its connotation several other receipts set out in the definition.............."

17. She, thus, argued that in order to ensure that the income which is normally to be distributed as dividend by the company is not frittered away in the form of advance and loans to the same very shareholders escaping the clutches of tax, provisions of Section 2(22)(e) of the Act were enacted. By this provision, a fiction is created and certain receipts which would not be dividend in common parlance are qualified and treated as dividend for the purpose of exigible to taxation under this Act. Her submission was that when this legal fiction is created in respect of dividend income, it was to be taken to its logical conclusion. Thus, any concern which had received the amount should be taxed, was the submission. Ms. Bansal bolstered her

www.taxguru.in

submission by referring to Section 4 of the Act which is a charging section and stipulates that the tax is to be paid at the rates specified in respect of 'the total income of the previous year of every person'. From this, she argued that it is the income in the hands of the person which was liable to be taxed, which would mean that the recipient of the dividend would be such a person who has earned this income. She also relied upon the provisions of Section 5 of the Act, which deals with 'scope of total income' and puts the income in the hands of recipient, as the person who is to be taxed in this behalf. Thus, her submission was that the provisions of 2(22)(e) of the Act pertaining to the aforesaid category were to be interpreted having regard to the aforesaid provisions. As per the deemed provision, income would be of a person who receives 'loans and advances'. She also referred to Explanation 3 to Section 2(22)(e) of the Act, which reads as under:

> "Explanation 3 – For the purposes of this Clause,-"
>
> (a) "concern" means a Hindu undivided family, or a firm or an associate 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;"

www.taxguru.in

18. She also took umbrage under Circular No.495 dated 22.09.1997 issued by Central Board of Direct Taxes, which reproduced in **168 ITR (Statues) 91** and reads as under:

> "(i) Where the company makes the payment by way of loans or advances to a concern;
>
> (ii) Where a member or a partner of the concern holds 10 per cent of the voting power in the company; and
>
> (iii) Where the member or partner of the concern is also beneficially entitled to 20 per cent of the income of such concern."

19. Her main thrust was on the words "further deemed dividend would be taxable in the hands of the concern, where all the following conditions are satisfied……………………". She, thus, argued that when the aforesaid category was introduced by way of Amendment by Finance Act 1987 making the said category effective from 13.04.1988, this Circular issued by CBDT would clearly show that what was intented was that the amount in the form of advance or loans deemed as dividend is taxable by the concern, viz., the recipient which is the assessee in the instant case. According to her, such a deemed provision and a fiction created by the Legislature had to be taken to its logical conclusion, as highlighted by a Full Bench of this Court as well in ***Andaleeb Sehgal vs. Union of India (UOI) and Anr.*** **173 (2010) DLT 296** in the following terms:

www.taxguru.in

"21. From the aforesaid pronouncements, the principle that can be culled out is that it is the bounden duty of the court to ascertain for what purpose the legal fiction has been created. It is also the duty of the court to imagine the fiction with all real consequences and instances unless prohibited from doing so. That apart, the use of the term 'deemed' has to be read in its context and further the fullest logical purpose and import are to be understood. It is because in modern legislation, the term 'deemed' has been used for manifold purposes. The object of the legislature has to be kept in mind. On a scanning of the language employed in Section 11 of the Act, it is clear as day that once the notification comes into existence in respect of an Authority, it becomes a Commission under Section 3 for the purposes of the Act because of the use of the term 'deemed'. At the same time, the government has been conferred the power, a significant and a pregnant one, to form an opinion whether all or any of the provisions of the Act should be made applicable to that Authority and direct that only those provisions of the Act shall be applied to that Authority. To elaborate, the appropriate government has been bestowed with the power to exclude the applicability of certain provisions of the Act while appointing an Authority other than a Commission under Section 3 of the Act and at that point of time it can exclude certain provisions not to be made applicable. Thus, though the authority becomes a deemed Commission appointed under Section 3 for the purposes of the Act, it has to be read in the context keeping in view the intendment of the legislature. It has to be construed that the term 'deemed' does not clothe the said authority, to be a Commission under the Act which has all the powers as the competent government has the power/authority to exercise the exclusion for certain provisions while issuing a notification."

20. She also referred to the judgment of the Supreme Court in the case of ***Builders Association of India and Ors. v. Union of India (UOI) and Ors*** **73 STC 370**: (pg.400)

"36. Even after the decision of this Court in the State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd. [1959]1SCR379 (supra) it was quite possible that where a contract entered into in connection with the construction of a building consisted of two parts, namley, one part relating to the sale of materials used in the construction of the

www.taxguru.in

building by the contractor to the person who had assigned the contract and another part dealing with the supply of labour and services, sales tax was leviable on the goods which were agreed to be sold under the first part. But sales tax could not be levied when the contract in question was a single and indivisible works contract. After the 46th Amendment the works contract which was an indivisible one is by a legal fiction altered into a contract which is divisible into one for sale of goods and the other for supply of labour and services. After the 46th Amendment, it has become possible for the States to levy sales tax on the value of goods involved in a works contract in the same way in which the sales tax was leviable on the price of the goods and materials supplied in a building contract which had been entered into in two distinct and separate parts as stated above. It could not have been the contention of the revenue prior to the 46th Amendment that when the goods and materials had been supplied under a distinct and separate contract by the contractor for the purpose of construction of a building the assessment of sales tax could be made ignoring the restrictions and conditions incorporated in Article 286 of the Constitution. If that was the position can the States contended after the 6th Amendment under which by a legal [fiction the transfer of property in goods involved in a works contract was made liable to payment of sales tax that they are not governed by Article 286 while levying sales tax in sale of goods involved in a works contract? they cannot do so. When the law creates a legal fiction such fiction should be carried to its logical end. There should not be any hesitation in giving full effect to it. If the power to lax a sale in an ordinary sense is subject to certain conditions and restrictions imposed by the Constitution, the power to tax a transaction which is deemed to be a sale under Article 366(29A) of the Constitution should also be subject to the same restrictions and conditions. Ordinarily unless there is a contract to the contrary in the case of a works contract the property in the goods used in the construction of a building passes to the owner of the land on which the building is constructed, when the goods or materials used are incorporated in the building. The contractor becomes liable to pay the sales tax ordinarily when the goods or materials are so used in the construction of the building and it is not necessary to wait till the final bill is prepared for the entire work. In Hudson's Building Contracts (8th edition) at page 362 it is stated thus:

> "The well-known rule is that the property in all materials and fittings, once incorporated in or

www.taxguru.in

> affixed to a building, will pass to the free holder - quicquid plantatur solo, solo cedit. The employer under a building contract may not necessarily be the free holder, but may be a lessee or licensee, or even have no interest in the land at all, as in the case of a subcontract. But once the builder has affixed materials, the property in them passes from him, and at least as against him they become the absolute property of his employer, whatever the latter's tenure of or title to the land. The builder has no right to detach them from the soil or building, even though the building owner may himself be entitled to sever them as against some other person - e.g., as tenant's fixtures. Nor can the builder reclaim (hem if they have been subsequently severed from the soil by the building owner or anyone else. The principle was shortly and clearly stated by Blackburn J. in Appleby v. Myers (1867) LR 2 CP 651 :'Materials worked by one into the property of another become part of that property. This is equally true whet her it be fixed or movable properly. Bricks built into a wall become part of the house, thread stitched into a coat which is under repair, or planks and nails and pitch worked into a ship under repair, become part of the coat or the ship."

21. We have seriously deliberated on the aforesaid arguments advanced by the counsels for the Revenue.

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:

www.taxguru.in

> "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.

www.taxguru.in

(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

www.taxguru.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

www.taxguru.in

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

www.taxguru.in

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 'logical 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

www.taxguru.in

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.

31. We may also point out here that when these appeals along with other appeals were heard, some appeals were listed and the tax effect of which was less than ₹10 lacs and those were dismissed on that ground. Had those appeals been decided on merits, still the assessees would have succeeded. At the same time, in those cases, we would not like the shareholders to go scot free and therefore, even in those cases, it would be permissible for the Revenue to take remedial steps by roping in the shareholder(s) and tax the deemed dividend at their hands.

32. We, thus, answer the questions in favour of the assessee and against the Revenue, as a result, these appeals are dismissed.

ITA No.1588 of 2011

33. In this appeal, we find that the addition is deleted on two counts:

(i) The assessee who was recipient of the amount was not the shareholder in the payer company and therefore, provisions of Section 2(22)(e) of the Act were not applicable.

www.taxguru.in

(ii) Even the money which was paid was not in the nature of loan or advance simplicitor, but the amounts were advanced for business transaction.

34. Though the appeal of the Revenue is to fail on the first question, which is answered while deciding this appeal above, answer to second question is also necessary for the simple reason that if the assessee succeeds on this issue, then even the shareholder cannot be fastened with any tax liability as conditions stipulated under Section 2(22)(e) of the Act would not be treated as satisfied.

35. From the orders of the Authorities below, we find that an amount of ₹4,25,08,497/- was given by M/s. Golden Strands Private Limited (hereinafter referred to as 'M/s Golden') to the assessee company. Two shareholders in M/s Golden, viz. Shri Ranjeet Bhatia and Smt. Nenu Bhatia, who hold 50% share each, are also the Directors of the company. These two shareholders hold 10.67% and 16.66% shares in the assessee company as well. Thus, other conditions contained in Section 2(22)(e) of the Act are satisfied. However, the CIT (A) as well as the Tribunal have found that the assessee having a trading relationship with M/s Golden with whom during the year, job work of ₹1,98,66,179/- was done. The audited accounts were submitted. The submission of the assessee is that the

www.taxguru.in

transactions carried during the year had been carried on the normal course of business and as such, there was no advance of money to invoke provisions of deemed dividend. The AO, in fact, did not even go into this assessee and simply going by the interest of the two shareholders (two Bhatias) in M/s Golden and in the assessee, he taxed the assessee. Finding of facts found by the CIT (A) and the Tribunal are that the transaction in question was a business transaction which had benefitted both the assessees and M/s Golden, and that the transaction did not represent giving any loan or advance simplicitor by M/s Golden to the assessee.

36. We are of the opinion that under no circumstances, the provisions of Section 2(22)(e) of the Act could be invoked. This appeal is accordingly dismissed.

ITA No.211 of 2011

37. In this case also, we find the amount in question given by the payer to the assessee was not loan or advance and detailed finding of facts are arrived at by the CIT (A) and the Tribunal that the money in question was trading receipt and result of business transactions between the parties. The findings recorded by the two Authorities below are that the assessee does buy and sell shares through M/s. O.J. Financial Services

www.taxguru.in

Ltd. and for that, it had given a margin money to the said broker in the immediate preceding year. It is this amount, which was treated deemed dividend by the AO, though the same was refund of margin money by M/s. O.J. Financial Services Ltd. (payer) to the assessee company and not a loan or advance as alleged by the AO in the assessment order.

38. The observations/findings of the CIT(A) in this behalf are as under, which have been confirmed by the Tribunal also:

> "In view of the above, it is settled law that for attracting provision of section 2(22)(e), there must be a loan or advance and such loan and advance should be for the benefit of the beneficial shareholder. In the instant case, there is no loan or advance to the shareholder of the appellant company and the appellant company is not the shareholder in M/s O.J. Financial Services Ltd. Therefore, deemed dividend cannot be taxed in the hands of the person other than a shareholder in the present case. Since, appellant company is not a shareholder in M/s O.J. Financial Services Ltd., the provisions of section 2(22)(e) do not apply in the hands of the appellant company."

39. In fact, even the AO has observed that there was trading relations between the parties, but formed a wrong opinion that "the trading liabilities as such are not examined from the scope of deemed dividend". This was rightly repelled by the CIT (A) in the following manner:

> "Without prejudice to this, even the allegation of the AO that trading transaction like refund of margin money and buying and selling of shares as in the instant case are covered in the mischief of section 2(22)(e) of the Act is not tenable in the eyes of law. First of all, the question whether trading advance or trading transaction constitute loan or advance, an essential ingredient to cover a

www.taxguru.in

> transaction within section 2(22)(e) of the IT Act, was considered by the Hon'ble High Court, Delhi in the case of CIT Vs. Raj Kumar ITA No.1130/2007 judgment delivered on 14.05.2009 and CIT Vs. Ambassador Travels (P) Ltd. (ITA No.337/2008) dated 23.04.2008. In both these case the Court while affirming of the judgment of Hon'ble High Court of Bombay in the case of Nagindas M. Kapadia has held that trading advances are not covered within the mischief of section 2(22)(e) of the IT Act.
>
> In view of the above discussion, it is clear that trading transaction/or refund of margin money by M/s O.J. Financial Services Ltd. to the appellant company are not covered under the mischief of section 2(22)(e) of the IT Act."

40. There is another reason given by the CIT (A) as well as the Tribunal which touches the extent of share holding. What is found is that Shri Navin Gupta holds share in M/s. O.J. Financial Services Ltd. in his individual capacity. On the other hand, the shareholding in the assessee company is by HUF of which Shri Navin Gupta is the Karta. On that basis, the CIT (A) as well as the Tribunal held that there was no common shareholder in the two companies. Though at the bar, this approach of the Tribunal is questioned by the learned counsel for the Revenue on the plea that even in the assessee company, it is the HUF, which is holding the shares, for the purposes of Section 2(22)(e) of the Act, it should be treated as common shareholder inasmuch as Shri Navin Gupta as Karta in same position influences the decision of the assessee as he would be in his individual capacity. However, since the

www.taxguru.in

transaction itself is not treated as loan advanced to shareholder of the company, this aspect need not arise for consideration.

41. This appeal is accordingly dismissed on the aforesaid ground itself.

ITA No.352 of 2011

42. In this case, the respondent assessee is engaged in the business of procuring of contract work for various clients from Government departments. According to the AO, the assessee had taken loan from M/s Sweta Estate Pvt. Ltd. The share holding pattern of M/s Sweta Estates Pvt Ltd. for the year under consideration is as below:

Sl. No.	Name of the Shareholder	No. of Shares	%age of Shareholding
1.	Sh. Amarjit Singh Bakshi	52237	9.95
2.	Smt. Amrita Bakshi	52237	9.95
3.	Sh. Kanwaljit Singh	51975	9.90
4.	Smt. Minu Bakshi	51975	9.90
5.	M/s. Bombay Builders Pvt. Ltd.	2310	0.44
6.	Sh. K.S. Bakshi (HUF)	51975	9.90
7.	Sh. Sanjit Bakshi	51975	9.90
8.	Sh. S.S. Bakshi	52290	9.96
9.	Sh. A.S. Bakshi (HUF)	52238	9.95
10.	Smt. H.K. Bakshi	52290	9.96
11.	Skyrock Engineers Pvt. Ltd.	48248	9.19
12.	Safdarjung Estates Pvt. Ltd.	5250	1.00
		525000	100.00

www.taxguru.in

43. According to the AO, the shareholding of Kanwaljit Singh (9.9%) and Sh. Kanwaljit Singh, Karta of Sh. K.S. Bakshi (HUF), whose shareholding in M/s. Sweta Estates Pvt. Ltd., is 9.9%, together exceeds required 10%. On the above reasoning, it was concluded that the assessee was beneficial owner of shares holding not less than ten per cent of the voting power.

44. CIT (A), however, did not agree with the aforesaid opinion of the AO. He was of the view that shareholding of K.S. Bakshi (HUF) could not be clubbed with the shareholding of Kanwaljit Singh for the purposes of bringing the assessee within the tax net of Section 2(22)(e) of the Act. He was of the view that HUF of K.S. Bakshi is a separately recognized entity and separate from individual. Relying upon the judgment of the Mumbai Bench Tribunal in ***Bhaumik Colour (P) Ltd. (supra)***, the CIT held that Since Section 2(22)(e) refers to both the registered shareholder and beneficial shareholder, beneficial owner of the share in this case was HUF and not the Karta of HUF in his individual capacity. It cannot be disputed that ***Bhaumik Colour (P) Ltd. (supra)*** holds so. The said judgment is interpreted by the Tribunal in the impugned order in the following manner:

www.taxguru.in

> "6. We have heard both sides. We find ourselves in complete agreement with the ratio laid down by the Special Bench of the ITAT in the case of Bhaumik Colour Lab Pvt. Ltd. (supra). The Special Bench in the aforesaid case has opined that the provisions of Section 2(22)(e) of the I.T. Act create a fiction bringing in amounts paid as loans and advances otherwise than as divided into the net of dividends and such a provision must received strict interpretation. By applying the principle of strict interpretation the Special Bench observed that no (sic.) 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. The word "shareholder" alone existed in the definition of dividend in the 1922 Act and 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 shareholders. It is a principle of interpretation of statures that once certain words in an Act have received a judicial construction in one of the superior courts, and the legislature has repeated them in a subsequent statute, the legislature must be taken to have used them according to the meaning which a court of competent jurisdiction has given them.
>
> 6.1 In the 1961 Act, the word "shareholder" in section 2(22)(e) is followed by the following words "being a peson who is beneficial owner of shares". This expression only qualifies the word "shareholder" and does not in any way alter the position that the shareholder has to be a registered shareholder nor substitute the requirement to a requirement of merely holding a beneficial interest in the shares without being a registered holder of shares. If a person is a registered shareholder but not the beneficial shareholder then the provisions of section 2(22)(e) will not apply. Similarly if a person is a beneficial shareholder but not a registered shareholder also the first limb of the provisions of section 2(22)(e) will not apply."

45. The Tribunal while forming this opinion was guided by the judgment of the Supreme Court in ***C.P. Sarathy Mudaliar (supra)***. The said judgment is analyzed and made use of while interpreting the provisions of Section 2(22)(e) of the Act

www.taxguru.in

holding HUF and Karta thereof on individual capacity for the application of Section 2(22)(e) of the Act in the following terms:

> "20. In the case of CIT v. C.P. Sarathy Mudaliar (supra), provisions of Section 2(6A)(e) of the Act, 1922, which was synonymous to Section 2(22)(e) of the IT Act, 1961 came up for consideration. In the said case, members of HUF acquired shares in a company with the fund of the family. Loans were granted to HUF and the question was whether the loans could be treated as dividend income of the family falling within Section 2(6A)(e) of the Act, 1922. The apex Court held that only loans advanced to shareholders could be deemed to be dividends under Section 2(6A)(e) of the Act; the HUF could not be considered to be a 'shareholder' under Section 2(6A)(e) of the Act and hence, loans given to the HUF will not be considered as loans advanced to "shareholder" of the company and could not, therefore, be deemed to be its income. The apex Court further held that when the Act speaks of shareholder it refers to the registered shareholder.
>
> 21. The aforesaid decision of the apex Court in the case of C.P. Sarathy Mudaliar (supra) has been followed by the apex Court in the case of Rameshwarlal Sanwarmal v. CIT (supra). In this case, the company advanced the loans to the assessee HUF who was the beneficial owners of the shares in the company, but the shares were registered in the name of the individual Karta, who held the shares for and on behalf of the HUF. On the above facts, the question before the Supreme Court was whether the loans advanced to the HUF-beneficial owner of the shares-would be taxed as deemed dividend in the hands of the HUF. The Supreme Court held that the HUF being only the beneficial shareholder and not a registered shareholder would not fall within the purview of Section 2(6A)(e) of the 1922 Act. The apex Court observed as follows:
>
>> ...What Section 2(6A)(e) is designed to strike at is advance or loan to a 'shareholder' and the word 'shareholder' can mean only a registered shareholder. It is difficult to see how a beneficial owner of shares whose name does not appear in the register of shareholders of the company can be said to be a 'shareholder'. He may be

www.taxguru.in

> beneficially entitled to the share but he is certainly not a 'shareholder'. It is only the person whose name is entered in the register of the shareholders of the company as the holder of the shares who can be said to be a shareholder qua the company and not the person beneficially entitled to the shares. It is the former who is a 'shareholder' within the matrix and scheme of the company law and not the latter. We are, therefore, of the view that it is only where a loan is advanced by the company to a registered shareholder and the other conditions set out in Section 2(6A)(e) are satisfied that the amount of the loan would be liable to be regarded as 'deemed dividend' within the meaning of Section 2(6A)(e).

22. It is thus clear from the aforesaid pronouncement of the Hon'ble Supreme Court 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 that 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. It is a principle of interpretation of statutes that where once certain words in an Act have received a judicial construction in one of the superior Courts, and the legislature has repeated them in a subsequent statute, the legislature must be taken to have used them according to the meaning which a Court of competent jurisdiction has given them.

23. 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 w.e.f. 1st April, 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

www.taxguru.in

> 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 described 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) of the Act. 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. It is not possible to accept the contention of the learned Departmental Representative that under the 1961 Act there is no requirement of a shareholder being a registered holder and that even a beneficial ownership of shares would be sufficient.
>
> 24. The expression "shareholder being a person who is the beneficial owner of shares" referred to in the first limb of Section 2(22)(e) refers to both a registered shareholder and beneficial shareholder. If a person is a registered shareholder but not the beneficial then the provision of Section 2(22)(e) will not apply. Similarly if a person is a beneficial shareholder but not a registered shareholder then also the first limb of provisions of Section 2(22)(e) will not apply."

46. In view of the above, this appeal is also dismissed.

ITA No.2014 of 2010

47. In this case, apart from the fact that the assessee is not shareholder and therefore, the loan and advance given to the assessee is not treated as deemed dividend under Section 2(22)(e) of the Act, we find that the CIT (A) had given additional ground for non-applicability of the said provision. In this case, the assessee had taken a loan of ₹1.40 Crore from

www.taxguru.in

M/s. Teletube Electronics Ltd., which was treated as deemed dividend by the AO on the ground that the shareholders of M/s. Teletube Electronics Ltd. had a substantial interest in the assessee. Admittedly, the assessee is not a shareholder of M/s. Teletube Electronics Ltd. The shareholding pattern of the two companies as on 31.03.2002, which is concerned financial year, was as under:

Shareholders	**TEL (Lender Company)**	**Roxy (Borrower Company/ Appellant)**
Roxy Investment Pvt. Ltd.	1.8%	NIL
CEA Consultant Pvt. Ltd. (CEA)	22.08%	17.06%
SW Consultant Pvt. Ltd. (SW) (100% subsidiary of CEA)	NIL	24.58%
Kaura Properties Pvt. Ltd.	36.59%	11.28%
Others	39.53%	47.08%
Total	**100%**	**100%**

48. It is clear from the above that no shareholder individually holds more than 10% shares. The following observations of the CIT (A) are to be taken note of:

> "It is not disputed that Appellant holds only 1.8% shares in M/s. Teletube Electronics Ltd., the question is whether Appellant on the strength of shares of M/s. Teletube Electronics Ltd. held by M/s CEA Consultants P Ltd. can be said to be beneficial owner of 10% of the voting power. It is not in dispute those shares of Teletube Electronics Ltd. held by the Appellant and M/s. CEA Consultants P. Ltd. are registered in their respective names. It in turn implies that both the Appellant and M/s. CEA Consultants P. Ltd. are independently exercising their voting rights.
>
> > 13. Under the existing provisions of sec. 2(22)(e), payment made by way of advance or loan to a shareholder having "substantial interest" in the

www.taxguru.in

company was treated as deemed dividend. The shareholder having substantial interest as per provision of clause (32) of sec. 2 of the Act, was the one carrying not less than 20% voting power. In other words, earlier sec.2(22)(e) was applicable to shareholders having substantial interest in the company and the benchmark of the substantial interest was 20% of the voting power. By Finance Act, 1987, this benchmark of substantial interest was done away with. It is important to note here that section 2(32) defining the expression "person who has substantial interest in the company" was not amended. Therefore, to widen the scope of sec.2(22)(e), it was necessary to provide for the category of shareholders to whom the section would apply and it was provided by inserting the words "a shareholder, being a person who is beneficial owner of shares holding not less than 10% f the voting power". The concept of "voting power" was in built on the provisions of sec.2(22)(e) as it existed prior to 1987 amendment. The insertion of the words "beneficial owner of shares holding not less than 10% of the voting power" to "10% of voting power.

A beneficial owner of shares cannot exercise voting power because to exercise the right to vote his/her name must appear in the register of members. In this view of the matter, it will not be correct to say that the ratio laid down by Hon'ble Supreme Court in Rameshwarlal Sanwarmal Vs. CIT 122 ITR 1 that word "shareholder" in section 2(22)(e) is no more applicable.

Moreover, since the purpose of sec. 2(22)(e), as stated in Circular No.495 dated 22.09.1987, is to tax the distribution of profits to shareholders, where the same is distributed not by way of dividend but by way of loan or advances, therefore, the view that word "shareholder" has been used as "registered shareholder" cannot be found fault with. Any other view would be against the very spirit of sec. 2(22)(e) of IT Act. The condition of 10% of the voting power is to be seen qua the shareholder; otherwise, the condition would be of no relevance."

49. Though the appeal has to fail on the ground that the assessee cannot be taxed as it is not a shareholder in M/s. Teletube Electronics Ltd., even on the aforesaid ground, i.e., it was not

www.taxguru.in

having 10/20% shareholding in M/s. Teletube Electronics Ltd., non-applicability of Section 2(22)(e) of the Act is apparent.

50. This appeal, therefore, stands dismissed on this ground.

(A.K. SIKRI)
JUDGE

(M.L. MEHTA)
JUDGE

MAY 11, 2011
pmc