

IN THE INCOME TAX APPELLATE TRIBUNAL
AGRA BENCH, AGRA

BEFORE SHRI BHAVNESH SAINI, JUDICIAL MEMBER AND
SHRI A.L. GEHLOT, ACCOUNTANT MEMBER

ITA No.82/Agr/2012
Assessment Year: 2008-09

Shri Krishna Gopal Maheswari, vs. Addl. Commissioner of Income Tax,
539, Arya Nagar, Range-5, Firozabad.
Jalesar Road,
Firozabad.
(PAN: ACSPM 2205 R).
(Appellant) (Respondent)

Appellant by : Shri Mahesh Agarwal, C.A.
Respondent by : Shri K.K. Mishra, Jr. D.R.

Date of Hearing : 17.10.2012
Date of Pronouncement of order : 23.10.2012

ORDER

PER A.L. GEHLOT, ACCOUNTANT MEMBER:

This is an appeal filed by the assessee against the order dated 04.10.2011 passed by the Id. CIT(A)-II, Agra for the Assessment Year 2008-09.

2. The assessee has raised the following grounds of appeal:-

“1. That the Ld. CIT(A) has erred in law and on facts in confirming the addition of Rs.37,28,059/- made by the assessing officer u/s 2(22)(e) of the Act in relation to the loan taken from M/s Krishna Bead Industries Pvt. Ltd.

2. *That while confirming the addition aforesaid Ld. CIT(A) has erred in law and on facts to hold that money lending was not substantial part of business of the lending company and as such the impugned loan was not covered by the exclusion as provided in Clause (ii) of Sec. 2(22)(e).*
 3. *That the Ld. CIT(A) has erred in law while so upholding simply on the basis of presentation of accounts in the Balance Sheet and Profit & Loss account of the company without appreciating the true nature and character of such accounts.*
 4. *That under the facts and in law ld. CIT(A) ought to have deleted the addition made by the AO u/s 2(22)(e).”*
3. The brief facts of the case are that the assessee enjoys income from house property, share from firm and trading of shares of companies. During the assessment proceedings, the A.O. noticed that the assessee has taken unsecured loan from Krishna Beads Industries Private Limited of Rs.37,28,059/-. The assessee is a Director and having substantial interest in the company Krishna Beads Industries Private Limited. The assessee was holding not less than 10% of the voting power in the said Company. The A.O. asked the assessee why the amount of Rs.37,28,659/- be not treated as deemed dividend as per the provisions of section 2(22)(e) of the Income Tax Act, 1961 ('the Act' hereinafter). Before the A.O. it was submitted by the assessee that clause (3) of object clause of the Company was to carry on the business of financing enterprises and to finance whether by way of making loans or advances to or subscribing to the capital etc. The said object clause has been reproduced by the A.O. in his order at page no.3.

The A.O. after considering the assessee's submission noticed that the object clause of the company nowhere shows that the company's main business was of money lending. The A.O. examined the Balance Sheet of the company and noticed that the total loans and advance are only Rs.47,90,339/-, out of which loan to the extent of Rs.37,28,029/- was given to the assessee. The A.O. has also examined the Profit & Loss Account of the company and noticed that interest received from the assessee of Rs.62,280/- has been shown as indirect income. The company also have no license of money lending business. The A.O. made addition of Rs.37,28,059/- under section 2(22)(e) of the Act.

4. The Order of the A.O. has been confirmed by the CIT(A) as under :- (Page nos.5, 6, 7 & 8)

“2.1 After going through the records and carefully considering the submission of Ld. AR, I am, of the opinion that provisions of sec. 2(22)(e) are clearly applicable in the appellant's case. Before I discuss the facts of the case of the appellant it is considered necessary to refer provisions of sec. 2(22)(e). As per these provisions any loan or advance to a share holder or a concern is treated as dividend in certain cases to the extent of accumulated profits. The applicability of sec. 2(22)(e) depends on fulfillment of following conditions -

- (i) The company should be one in which the public are not substantially interested.*
- (ii) The equity shareholder, who is beneficial owner of shares holding not less than ten percent of voting power, or*

- (iii) Any concern in which share holder (holding not less 10% voting power) is a member or partner and in which he has a substantial interest, or
- (iv) Any person, on behalf, or for the individual benefit of such shareholder. Such shareholder here means a shareholder who is beneficial owner of shares holding not less than 10% voting power.

The loan and advance given to such person shall be deemed to be dividend only to the extent to which it is shown that the company possesses accumulated profits on the date of loan etc. There are certain exceptions also provided in the subsection one of which is that any advance or loan to a share holder or specified 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 will not attract the provisions of sec.2(22)(e) – This exception shall apply only when two cumulative conditions are fulfilled – first, the loan should have been made by the company in the ordinary course of business and secondly, money lending should be substantial part of the company's business. Thus, the effect of sub-clause(e) of sub section (22) of sec.2 is to create a fiction and treat the loans or advances to a shareholder who is the beneficial owner of shares holding 10% or amore of voting power of the company as dividend. It also includes payments made by the company on behalf or for the individual benefit of such share holder. It further includes advances or loans made to any concern in which such share holder is a member or partner and in which he has a substantial interest. Now, coming to the facts of the case in hand it is seen that the total income as per P&L account as on 31.3.08 shown by M/s Krishna Beads (P) Ltd. on account of sales and other income is Rs.2657609/-. The break up of which as per Schedule 9 is as under :-

| | | |
|---------------------|---------|-----------|
| Sales (Net) | 46465 | 118143939 |
| Exchange difference | 21763 | 1195445 |
| Other income | 2589381 | 1157186 |
| | 2657609 | 120496570 |

The break up of other income of Rs.2589381/- as given in annexures to the accounts is as under –

| | | |
|---------------------------------------|---------|--------|
| <i>Interest accrued on investment</i> | 420000 | 420000 |
| <i>Interest on FDR</i> | 472591 | |
| <i>Interest on FD</i> | 0 | 267776 |
| <i>Balance written off</i> | 1219725 | |
| <i>Vat refund</i> | 343340 | |
| <i>Duty drawback red</i> | 71445 | 469410 |
| <i>Indirect income</i> | 62280 | |

Whereas breakup as given by Ld. AR during the appellate proceedings vide his written submissions is as under-

| | |
|----------------------------|-----------|
| <i>Sales</i> | 46,465 |
| <i>Exchange Difference</i> | 21,763 |
| <i>Balance Written off</i> | 12,19,725 |
| <i>Vat Refund</i> | 3,43,340 |
| <i>Duty Draw Back</i> | 71,445 |
| <i>Interest on FDRs</i> | 4,72,591 |
| <i>Interest on Loans</i> | 4,82,280 |

A comparison of figures as given in annexures to the audited accounts and as given during the appellate proceedings throws some interesting facts what has been stated to interest on loans amounting to Rs.482280/- by the Ld. AR is in fact composed of two items as per audited accounts as under -

| | | |
|---|---|--------|
| (i) <i>Interest accrued on investment</i> | - | 420000 |
| (ii) <i>Indirect incomes</i> | - | 62280 |

Other items of income as per the annexures are -

| | |
|-----------------------------|---------|
| <i>Balances written off</i> | 1219725 |
| <i>Interest on FDR</i> | 472591 |
| <i>Balances written off</i> | 1219725 |
| <i>Vat refund</i> | 343340 |

Thus the above analysis shows that not a single rupee income has been shown from money lending activity. The interest earned on

FDRs and interest accrued on investment can by no stretch of imagination can be said to have been earned from money lending business. What is now being claimed as interest earned of Rs.62280/- from the appellant on the advances given to him is in fact shown as 'indirect income' in the annexures. If the money lending was a dominant business activity of the company then how the income earned from such activity can be 'indirect income' is beyond ones comprehension. The explanation being offered is contrary to facts on record and utterly misleading. The explanation is a blatant subterfuge. There was hardly any money lending business carried out by the company i.e. M/s Krishna Beads Ind. (P) Ltd. is also borne out from the fact that total loans and advances as per the balance sheet of the company are to the extent of Rs.4790339/- out of which Rs.3728029/- has been given to the appellant, that also interest free in view of the discussion above that sum of Rs.62280/- has been shown as indirect income in the audited accounts. On these facts it is oxymoron to claim that major part of the activity of the company M/s Krishna Beads Ind. (P) Ltd. was money lending. Thus, I am of the considered opinion that the case of the appellant is far removed from the exception as provided in sub clause (ii) of clause (e) sub section (22) of sec.2 (i.e. 2(22)(e)(ii). The AO has rightly made the addition and the same is upheld. Grounds raised are dismissed."

5. The Id. Authorised Representative reiterated the submissions made before the A.O. and submitted that the dispute is only whether loan and advance received by the assessee is covered under the exceptional circumstances provided in section 2(22)(e) of the Act, as provided under clause (ii) of section 2(22)(e) of the Act that any advance or loan made to a share holder by a company in the ordinary course of its business, where the lending of money is substantial part of the company. The Id. Authorised Representative submitted that the assessee received the loans and advances from company in the course of its business as the substantial part of business of the company is lending of money. Ld. Authorised Representative tried

to demonstrate referring items of Balance Sheet and Profit & Loss account that in the year under consideration interest income has been increased. Ld. Authorised Representative further submitted that the CIT(A) failed to appreciate the true nature of transaction. The CIT(A) wrongly came to the conclusion on this basis and it is appearing in the Profit & Loss account and Balance Sheet. The Id. Authorised Representative submitted that for examining the true nature of the transaction the entries in the books of account are not relevant. The Id. Authorised Representative in support of his contention relied upon the judgement of Hon'ble Supreme Court in the case of Sulej Cotton Mills Limited vs. CIT, 116 ITR 1 (SC) and CIT vs. Laxmi Sugar & Oil Mills Limited, 161 ITR 168 (SC). The Id. Authorised Representative has also relied upon the decision of Amritsar Bench of I.T.A.T. in the case of DCIT vs. Taj Nedou Hotel (P) Ltd., 77 TTJ (Asr) 673. The Id. Authorised Representative submitted that since the money lending is substantial business of the assessee, therefore, provisions of section 2(22)(e) of the Act is not applicable. Ld. Authorised Representative in support of his contention relied upon the judgement of Hon'ble Mumbai High Court in the case of CIT vs. Parle Plastics Limited & Another, 332 ITR 63 (Bom.)

6. The Id. Departmental Representative, on the other hand, relied upon the order of CIT(A).

7. We have heard the Id. Representatives of the parties and records perused. The issue to be examined in the case under consideration is that whether loans and advances received by the assessee from the Company in the ordinary course of its business where the lending of money is a substantial part of business of the assessee Company. To examine the issue, we would like to see section 2(22)(e) of the Act which reads as under :-

“2(22) dividend includes—

(a)

(b)

(c)

(d)

(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 shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern)] or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits ;

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 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).]

Explanation 1.—The expression "accumulated profits", wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956.

Explanation 2.—The expression "accumulated profits" in sub-clauses (a), (b), (d) and (e), shall include all profits of the company up to the date of distribution or payment referred to in those sub-clauses, and in sub-clause (c) shall include all profits of the company up to the date of liquidation, ³[but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place].

[Explanation 3.—For the purposes of this clause,—

(a) "concern" means a Hindu undivided family, or a firm or an association of persons or a body of individuals or a company ;

(b) a person shall be deemed to have a substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the income of such concern ;]”

8. If we consider the object of introduction of sub-clause (e), we notice that a company in which public are not substantially interested may not declare dividends or adequate dividends and may merely give loans to shareholders and such loans, not being dividends under the general law, would not be taxable as income in the hands of shareholders. As the public would not have substantial interest in such company, those substantially interested in the company may not recover the loans or allow them to be that barred by time. The result would be that the amounts which were ostensibly received as loans or advances become the income of shareholders and yet they would not be required to pay any tax on said income under the general law. It is to avoid the evil of this nature that sub-clause (e) of section 2(22) has been enacted.

9. On a plain reading of section 2(22)(e), we find that the section is applicable for any payment by a company, not being a company in which the public are substantially interested, of any sum by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than the 10% of the voting power but this deemed dividend does not include any advance or loan made to shareholder by a company in the ordinary course of its business, where the lending of money is substantial part of business of the

company. On consideration of the facts of the case, we noticed that there is no dispute about the facts that all the conditions laid down under section 2(22)(e) are satisfied for application of section 2(22)(e) except condition laid down under clause (ii) of section 2(22)(e) of the Act. Only argument of the assessee was that the case of the assessee falls under clause (ii) of section 2(22)(e) of the Act. The crux of the argument of the Id. Authorised Representative that loans and advances received by the assessee from the company is during the ordinary course of business as substantial part of the business of the assessee company is lending money. In other words, money lending is a substantial part of company from whom the loan was taken by the assessee and the loan received to the assessee was in the ordinary course of this money lending business. To examine whether the said company was having substantial part of money lending business or not ? Before that it is relevant to mention that the Id. Authorised Representative submitted that the accounting entries are not relevant for examining the issue but, in this regard, we are of the considered view that the books of account maintained on the basis of principle of accountancy and same is certified by technical person like Auditor, the figures reported in financial audited statements can be considered for the purpose of income tax Act unless some contrary material facts have been brought on record, or any material brought on record showing that the books of account maintained by the assessee was not in accordance with the accounting standard and principle of accountancy. This view is supported by section 145 of

the Act itself. The judgement cited by the Id. Authorised Representative in the case of Sutej Cotton Mills Limited vs. CIT (supra) and CIT vs. Laxmi Sugar & Oil Mills Limited (supra) does not help to the assessee as the CIT(A) did not accept the figures reported in financial statement blindly. But certainly he has taken the help of determining the nature of transaction. The Courts held in those cases that Balance Sheet and financial statement prepared on the basis of books of account are not conclusive for determining the nature of transaction. The Court did not hold that one cannot take the help of those figures for determining the nature of business or transaction in determining the issue under the Income Tax Act. The issue whether the business of the company was a business of money lending or not, to examine this aspect one has to see various aspect of evidences including procedural aspect which are required to be taken under Company's Act and report to controlling Officers including Registrar of Companies, SEBI and others. For doing money lending business one has to obtain necessary permission from competent authority. We may state here that the assessee has failed to furnish any single evidence to support that the company has followed such procedure based on which it can be said that the substantial part of the business of the company was money lending. If we examine this aspect from business activities, we noticed that there are accepted principles that the business activities and transaction are recorded in the books of account. In the case under consideration, the total loan and advances as on 31.03.2008 are only in respect of three parties, Krishna Gopal

Maheswary i.e. the assessee and other two parties Abhishek Enterprises & Gaurav Luminaries Pvt. Ltd. The details of loans and advances are reproduced from page no.22 of the Paper Book as under :-

| Name of the Party | Balance as on 31.03.2008 | Interest earned | Rate of Interest | Shown in the Balance Sheet as |
|-----------------------------|--------------------------|-----------------|------------------|-------------------------------|
| Krishna Gopal Maheswari | 3790339 | 62280 | 12% | Deposits, Loans & Advances |
| Abhishek Enterprises | 3500000 | 420000 | 12% | Investments |
| Gaurav Luminaries Pvt. Ltd. | 1000000 | | | Deposits, Loans & Advances |

10. Further in respect of loan and advances to Abhishek Enterprises of Rs.35 lacs, this amount has been shown as investment in the balance sheet and not under the loans and advances. We may also mention that the assessee did not take interest bearing loans and advances from different parties. The auditor has also in his report clarified that the company has not granted but taken unsecured loans, interest free, from other parties covered in the register maintained under Section 301 of the Companies Act, 1956. In money lending business, the transactions are taking and giving money on finance. This is a fundamental characteristic of money lending business. The Apex Court in the case of State of Gujrat vs. Raipur Manufacturing Company Limited, 19 STC (1) SC while defining the word business in taxing statute the Courts held that the word “business” used in the sense of an occupation or profession are which occupies time, attention and labour of a person, normally with the object of making profit. To regard an activity as business there must be a course of dealing either only continued or contemplated to

be continued with a profit motive and not for support or pleasure. Whether or not a person carries on business in a particular commodity must depend upon volume, frequency continuity and regularity of transaction of purchase and sale in a class of goods and transaction must ordinary be included into that profit motive. To carry on business ordinarily the characteristic of volume, frequency, continuity and regularity indicate and intension to continue the activity of carrying on transaction must exist. This decision which was recorded in the context of Sales Tax law was relied upon and referred to in the context of Income Tax law in a decision of the Hon'ble Supreme Court in the case of Sole Trustee, Loka Shikshana Trust vs. CIT, 101 ITR 234 (SC).

11. In the light of above discussion, we find that the assessee has failed to establish that the substantial part of business of the company is money lending and the loans and advances received to the assessee is the in the ordinary course of money lending business. Unless the assessee establishes that money lending business was the substantial part of the business of the company and the loans and advances received during the course of money lending business, the assessee will not fall under the exceptional circumstances provided in section 2(22)(e)(ii) for the purpose not to include the calculation of deemed dividend. Further, merely stating in the object clause that the business of the assessee company was money lending cannot be held that the case of assessee falls under exceptional

circumstances not to treat the deemed dividend. On the basis of above discussions, we do not find any infirmity in the order of CIT(A). Order of CIT(A) is accordingly confirmed.

12. In the result, appeal filed by the assessee is dismissed.

(Order pronounced in the open Court)

Sd/-
(BHAVNESH SAINI)
Judicial Member

Sd/-
(A.L. GEHLOT)
Accountant Member

PBN/*

Copy of the order forwarded to:

1. Appellant
2. Respondent
3. CIT (Appeals) concerned
4. CIT concerned
5. D.R., ITAT, Agra Bench, Agra
6. Guard File.

By Order

Sr. Private Secretary
Income-tax Appellate Tribunal, Agra
True Copy