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INCOME TAX APPEAL NO.223 OF 2011

Commissioner of Income Tax, Agra

Vs.

M/s Atul Engineering Udyog, Nunihai, Agra

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Hon'ble Tarun Agarwala, J.
Hon'ble Dr. Satish Chandra, J

(Per: Tarun Agarwala,J.)

The present appeal has been filed by the Department under Section 260-A of the Income Tax Act (hereinafter referred to as the "Act") against the order of the Tribunal for the Assessment Year 2006-07.

The facts leading to the filing of the appeal is, that the assessee is a partnership firm and also has a sister concern, which is a Private Limited Company known as M/s Atul Generators Pvt. Ltd.

The assessee was incurring heavy losses. On the other hand, the sister concern was unable to utilise the natural gas that was being supplied by M/s Gas Authority of India Limited (hereinafter referred to as "GAIL") under a contract wherein the sister concern was under an obligation to obtain 80% of the quantity

of gas as a minimum guarantee. The assessee had generators worth Rs.93 lacs for the purpose of generating power, but had no gas. Accordingly, an agreement was executed between the assessee and its sister concern whereby generators were supplied by the assessee for which a floating security deposit of Rs.80 lacs was given by the sister concern. In this agreement, the sister concern was to use the generators and generate electricity on the basis of the gas supplied by the GAIL. In return, the sister concern would supply electricity to the assessee at concessional rate. The deposit was made by the sister concern to the assessee in the ordinary course of business. The assessee firm is not a shareholder in the Company though its partners are shareholders in the Company. The payment received by the assessee was utilised for payment to the creditors from whom the assessee had purchased the raw material for manufacture of its products and other statutory liabilities.

The assessing officer did not agree with the contention of the assessee that the amount received by the assessee from its sister concern was a security deposit for the loan of the generator. The assessing officer held, that even though the relationship between

the assessee firm and its sister concern was symbiotic and not unilateral since both the concern were taking advantage by way of this business transaction, the amount given by the sister concern was not a floating deposit, but was a deemed dividend in the hands of the assessee under Section 2(22)(e) of the Act. The assessing Officer consequently added the said amount in the income of the assessee. The assessee, being aggrieved, filed an appeal, which was allowed and the addition was deleted. The Department thereafter filed a second appeal before the Tribunal, which was dismissed. The Department has now filed the present appeal, urging that a substantial question of law arises for consideration, namely-

(I) "Whether Hon'ble Tribunal was justified in law holding that the security deposit of Rs.80,00,000/- received through mutual agreement by the assessee with its sister concern cannot be assessed u/s 2(22)(e) of the Act, ignoring that the said agreement is nothing but a colourable device adopted to avoid the incidence of tax ?"

(II) Whether Hon'ble Tribunal was justified in law in differentiating the security deposit from loan/advance ?"

The Tribunal held, that the amount given by the sister concern to the assessee was not a loan or an advance, but was a security deposit. Further, the amount given by the sister concern to the assessee was given in the course of business and was not given to a shareholder and, consequently, the provision of Section 2(22)(e) was not applicable.

In this backdrop we have heard Sri Dhananjai Awasthi, the learned counsel for the appellant and Sri Rahul Agarwal, the learned counsel for the assessee.

The short point involved is, whether the amount of Rs.80 lacs given by the sister concern to the assessee is a deemed dividend under Section 2(22)(2) of the Act. For facility, the said provision is extracted hereunder:

"2 (22) **"dividend"** includes–

(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;

(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;

From a perusal of the aforesaid provision "dividend" includes any payment by a Company by way of advance or loan to a shareholder or to any concern in which such holder is a member or a partner and in which he has a substantial interest would be a deemed dividend, but such dividend would not include any advance or loan made to a shareholder by a Company in the ordinary course of its business.

The essential ingredient is a "loan" or an "advance" to a shareholder or to a concern in which such shareholder has a substantial interest. Under this provision a deemed fiction is created whereby the scope and ambit of dividend has been enlarged to cover "loan" and "advance" granted by closely held Companies to their shareholders.

From a reading of Section 2(22)(e) of the Act, it is apparent that it has the effect of bringing to tax as dividend where any payment of any sum is made by way of advance or loan to a shareholder in which a shareholder holds a substantial interest or any payment

is made on behalf of a shareholder or any payment is made for the individual benefit of a shareholder. Any of the above three conditions would be taxed if the "advance" or "loan" is made to a shareholder and the Company possesses a cumulative profit at the time it makes the payment and, therefore, such payment would be deemed to be a dividend only to the extent of such profits.

The Tribunal, after considering the matter in detail found that the assessee firm was having a business dealing with its sister concern, which was apparent from the books of account of the assessee, which showed various job works being carried out by the sister concern. The Tribunal also found that the sister concern was bound to make payment to M/s Gas Authority of India Ltd. of the minimum contracted quantity to the extent of 80% of the natural gas irrespective of its use. The Tribunal further found that a commercial transaction had taken place between the assessee and its sister concern whereby the assessee was getting in return concessional rate of electricity @ Rs.2/- per unit and, for such business expediency, the sister concern had furnished a refundable interest free security deposit to the assessee. The Tribunal found, that on account of this commercial transaction the

sister concern had paid Rs.80 lacs to the assessee as interest free refundable security deposit, which was subsequently refunded by the assessee to the sister concern and, consequently, held that the said amount given by the sister concern was a security deposit and not a loan or an advance. The finding arrived at by the Tribunal is a finding of fact based on appreciation of evidence, which has not been doubted by the appellant.

The only ground urged that since the partners of the assessee firm had worked as shareholders in the Company and had a substantial interest, such deposit of loan was by way of diversion of the profits of the Company and, therefore, such deposit has to be treated as a deemed dividend under Section 2(22)(e) of the Act, in view of the ratio laid down in **Commissioner of Income Tax vs. Sunil Chopra,** (2011)201 Taxman 316(Delhi), **Commissioner of Income Tax vs. National Travel Services,** (2011)202 Taxman 327(Delhi), **P.K.Badiani vs. Commissioner of Income Tax,** I.T.R. 105 (SC)642, **Sadhana Textiles Mills Pvt. Ltd. vs. Commissioner of Income Tax,** I.T.R.188 (Bombay High Court) 318, **M.D.Jindal vs. Commissioner of Income Tax, I.T.R.** 164(Calcutta High Court)28, **Commissioner of Income Tax vs.**

P.K.Abubucker, I.T.R. 259 (Madras High Court)507, **Commissioner of Income Tax, Andhara Pradesh vs. C.P. Sarathy Mudaliar,** I.T.R. 83 (S.C.)170**.**

We find that the aforesaid decisions are distinguishable and not applicable as in these cases the advance was made to a shareholder and, therefore, a finding was given that it was a deemed dividend.

In **Commissioner of Income Tax vs. Creative Dyeing and Printing Pvt. Ltd.,** 318 ITR 476, an advance was given to the said assessee by the sister concern, which held 50% of the share holding in the assessee concern for mordenisation project. The advance so given was adjusted against the dues for job work to be done by the assessee. The Delhi High Court held that it was a business transaction and the advance was not assessable as a deemed dividend under Section 2(22)(e) of the Act. The said decision was affirmed by the Supreme Court when the appeal of the Department in S.L.P. No.8558 of 2010 was dismissed by the Supreme Court on 7.7.2010. The said decision is squarely applicable in the instant case.

Apart from the aforesaid, the word "loan" means anything lent, especially money on interest. On the other hand, "deposit" means something which is deposited or put down, namely, a sum of money paid

to secure an article, service, etc. The legislature has made a conscious distinction between the expression "loan' and "deposit". The two are not identical in meaning.

In the case of a deposit the delivery of money is usually at the instance of the giver and it is for the benefit of the person who deposits the money. The benefit normally being earning of interest from the party who accepts the deposit. The deposit could also be for safe keeping or as a security for the performance of an obligation undertaken by the depositor. On the other hand, in the case of a loan, it is the borrower at whose instance and for whose needs the money is advanced. The borrowing is primarily for the benefit of the borrower although the person, who lends the money, may also stand to gain by earning interest on the amount lent. Another distinction is the obligation to return the money so received. In the case of a deposit, the deposit becomes payable when a demand is made and, in the case of the "loan", the obligation to repay the amount arises immediately on receipt of the loan.

In the light of the aforesaid, we find that the deposit made by the sister concern was a business transaction arising in the normal course of business

between the two concerns. This is a finding of fact, which is based on the appreciation of evidence.

Consequently, we find that the order of the Tribunal does not suffer from any manifest error of law. No substantial question of law arises for consideration.

The appeal fails and is dismissed.

Dated:26.9.2014.
AKJ.

(Dr. Satish Chandra, J.) **(Tarun Agarwala, J.)**