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TAX FLASH NEWS

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Loans given to a shareholder from an open current account are taxable as ‘deemed dividend’ under Section 2(22)(e) of the Income-tax Act

Recently, the Amritsar Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of G.G. Oil & Fats Pvt Ltd[1] (the taxpayer) held that loan given to a shareholder from ‘open current account’ is taxable as ‘deemed dividend’ under the provisions of Section 2(22)(e) of the Income-tax Act, 1961 (the Act).

Facts of the case

The taxpayer is a dealer in edible/non-edible oils. During the financial year (FY) 2013-14, the taxpayer received unsecured loan/s from another company (GAPL) in which it held shares with 34.40 per cent voting power. The loan, which was interest-bearing, was not for any particular amount, but in the form of an open current account with regular debits and credits during the year. During the FY 2013-14, the opening balance as on 1 April 2013 at a debit (i.e. receivable) of INR 279.48 lacs, was liquidated by 15 April 2013, turning into a credit (payable) balance of INR 304.91 lacs on that date. The peak balance for the year was at INR3266.12 lacs on 6 November 2013. GAPL was a company in which public are not substantially interested.

The Assessing Officer (AO) held that to the extent of its accumulated profit, the loan or advance made by GAPL to the taxpayer was liable to be assessed as ‘deemed dividend’ under Section 2(22)(e) of the Act. The accumulated profit up to 31 March 2013, i.e., immediately prior to the current year, was of INR 67.36 lacs. The profit for the year, as per the audited accounts, was at INR150 lacs. Pro-rata basis profit (i.e., up to 6 November 2013), worked to INR49.81 lacs. Accordingly, the total accumulated profit up to that date, i.e., INR 117.17 lacs was brought to tax by the AO under Section 2(22)(e) read with Section 56 of the Act. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

[1] G.G. Oil & Fats Pvt Ltd v. DCIT (ITA No. 508/Asr/2017) – Taxsutra.com

The taxpayer contended that the transfer of funds from one company to another was on need basis. While the taxpayer was the beneficiary of the sums received from GAPL, the payer company, was also the beneficiary of the sums paid by the taxpayer thereto. The same therefore could not be regarded as either a loan or an advance, for the purpose of Section 2(22)(e) of the Act. The taxpayer contended that credit obtained only for a period of 82 days during the relevant year. Distinguishing various decisions[2] of the Supreme Court, it was contended that in those cases there were only one-way transactions i.e. the payment by the payer-company to the taxpayer-shareholder. However, in the instant case there were transactions in both ways. The taxpayer was also making payment to the payer-company (GAPL).

Tribunal’s decision

Relevance of subsequent repayment of loan/advance for the purpose of Section 2(22)(e) of the Act

The Supreme Court in various cases[3] observed that the withdrawals made by the taxpayer from the company amounted to grant of loan or advance by the company to the shareholder. The Tribunal relied on the decision of the Supreme Court in the case of Tarulata Shyam[4] where the Supreme Court has held that when loans are advanced to a shareholder in a private limited company having accumulated profits, the advance should be deemed to be dividend income of such shareholder. It was held that the repayment of a loan/s or advance/s was inconsequential for the purpose of application of the fiction of the provision of deemed divided. The Tribunal observed that the length of the time for which

[2] Tarulata Shyam v. CIT [1997] 108 ITR 345 (SC), Sarada (P.) v. CIT [1998] 229 ITR 444 (SC)
[3] Navnit Lal C. Jhaveri v. AAC [1965] 56 ITR 198 (SC), Punjab Distilling Industries Limited v. CIT [1965] 57 ITR 1 (SC), Tarulata Shyam v. CIT [1997] 108 ITR 345 (SC)
[4] Tarulata Shyam v. CIT [1997] 108 ITR 345 (SC)

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the loan or advance obtained would be of no significance for taxation purposes. The taxpayer's argument of having retained the credit (sum borrowed), which is on interest, for only 82 days during the year, would not be relevant consideration. The subsequent discharge of the credit, as by repayment, where it was described as a loan or advance, was ofno relevance. Accordingly, temporary loan/advance(s) were held as falling within the mischief of Section 2(22)(e) of the Act. Further, the Tribunal relied on the decision of Walchand & Co. Ltd.[5] wherein the Court approved the decision of the Supreme Court in the case of Tarulata Shyam. Accordingly, the Tribunal held that the relevance of the retention period does not arise.

Whether receipt of loan/advance from GAPL are only in the nature of loan/ advance

The repayment was in excess, constituting a loan/advance by the shareholder to the payee company, would carry no special significance. The plea of a mutual, open and current account was adopted by the Supreme Court in the case of P.K. Badiani[6]. Neither, therefore, the fact of subsequent repayment, nor of the payment finding reflection in a current account, was considered. The Supreme Court clarified that the nature shall have to be examined with reference to each individual payment, i.e., whether it creates a debt or is in discharge of an earlier one. The Tribunal observed that the transactions between the two companies in the present case were purely financial transactions, i.e., receipt and payment of money, either directly or indirectly (i.e., where the amount is paid – which is by the payer-company, to another for and on behalf of the payee and, accordingly, debited to its account or, correspondingly, credited to the account of GAPL by the taxpayer in its' books of account). No business purpose of GAPL, which was not in the business of money lending, was shown. The amounts paid and received in the instant case were clearly in the nature of a loan/s, i.e., sums borrowed, which though was not at a fixed amount or for a fixed period of time. A reduction or even a closure of liability (on account of loan/advance) by the year-end was not relevant.

Relevance of length of the period over which the credit obtained

It was contended that the loan amounting to INR3266.12 lacs was of temporary in nature, having been paid in full by 29 November 2013, i.e. within 45 days. However, subsequent repayment or the length of period over which it obtained was of no consequence for the purpose of applicability of the provision of Section 2(22)(e) of the Act. The repayment depends on the availability of surplus funds with the taxpayer, being deployed in its business. There could be no certainty as to the length of the retention period and, thus, the nature of a loan as a 'temporary' loan, is, in the facts and circumstances of the case, suspect.

The argument of the taxpayer that the retention period being 'low' was of no relevance in the context of the provision. The repayment being a function of the business needs. A repayment in disregard thereof may hurt the borrowers' business interest. The extension of a loan/advance carries with it an obligation to repay, with or without interest. This extension, which could be both ways does not create any mutual obligation. The two companies in the instant case were not in the business of money lending. A company would give funds to another only when they were for the time being surplus with it. Similarly, the payer-company would borrow only when it requires money for its purposes, and being at a cost, would retain it only for the period as was necessary.

The purpose for which the payee may deploy the funds received, i.e., business or otherwise, was of no relevance as far as the deeming fiction of the provision was concerned. The repayment of the whole of it (which is by 29 November 2013), i.e., before the year-end, itself proves it to be nothing but financial transactions. It is for this reason that loan transactions, where the lender-company was in the business of money lending, were exempted from the purview of Section 2(22)(e) of the Act.

The provision of Section 2(22)(e) of the Act would apply even if the shareholder does not, as is usually the case for an individual shareholder, maintain books of account, and which was so in the present case only because of it being a corporate entity. The provision was applicable qua any payment and, therefore, would (or would not) apply with reference to each specific sum. It was immaterial whether such payment/s was recorded in the books of account or not, and the only thing relevant is if it is in the nature of a loan/s or advance/s.

Taxability of the dividend under Section 2(22)(e) of the Act as 'income from other sources' under Section 56 of the Act

In the case of Poona Electric Supply Co. Ltd.[7], the Supreme Court observed that the concept of 'real income' was subject to the provisions of the Act. The loan or advance being both ways would not carry any special significance in the context of the provision inasmuch as both qualify, independently, to be a loan or advance. The payments which are purely financial transactions, i.e., loan/advance(s) simpliciter, squarely covered within the ambit of the provision of Section 2(22)(e) of the Act.

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[5] Walchand & Co. Ltd. v. CIT [1975] 100 ITR 598 (Bom)

[6] CIT v. P.K. Badiani [1970] 76 ITR 369 (Bom)

[7] Poona Electric Supply Co. Ltd. v. CIT [1965] 57 ITR 521 (SC)

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The dividend in Section 56 of the Act refers to the dividend as defined under Section 2(22) of the Act. It would qualify as dividend under Section 2(22)(e) of the Act.

The Tribunal observed that the dividend declared, distributed or paid by a company, on which tax under Section 115-O of the Act has been suffered, would fall under Section 10(34) of the Act.

The question of the genuineness of the loan or advance was of no relevance. The decisions relied on by the taxpayer were distinguishable on facts. Further, being not a regular dividend, declared and paid by company, the same does not fall to be covered under Section 10(34) and, thus, was covered under Section 56 of the Act. Accordingly, the same has been rightly brought to tax under Section 2(22)(e) and 56 of the Act by the tax department.

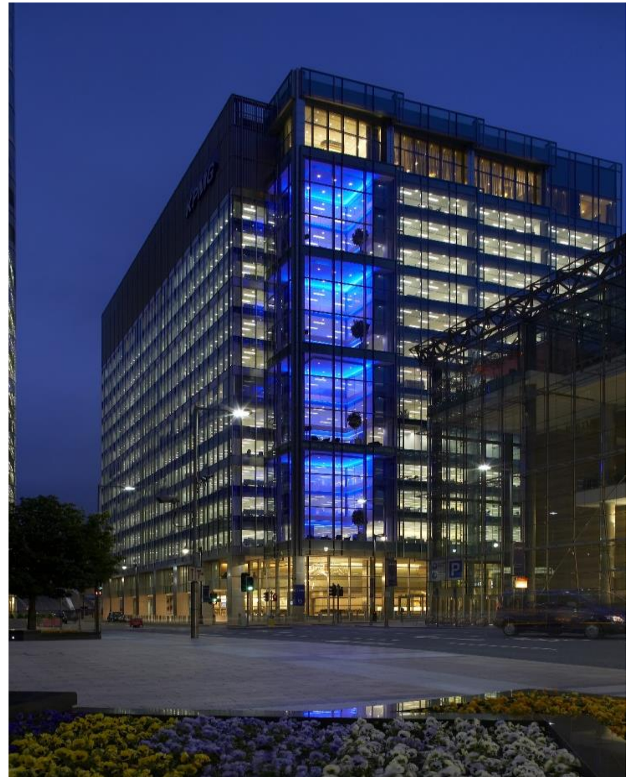
Our comments

Taxability of loan/advances given by a closely held company to its shareholders as deemed dividend has been a subject matter of debate before the Courts/Tribunal.

In some of the cases Courts/Tribunal[8] have held that loan given to a shareholder even if re-paid within a certain period is deemed dividend under Section 2(22)(e) of the Act. However, in few cases the Courts/Tribunal[9] have held that payments made by a company through a running account in discharge of its existing debts or against purchases or for availing services, such payments made in the ordinary course of business carried on by both the parties cannot not be treated as deemed dividend for the purpose of Section 2(22)(e) of the Act. Further, the trade advances which are in the nature of money transacted to give effect to a commercial transaction would not fall within the ambit of the provisions of Section 2(22)(e) of the Act.

However, the Tribunal in the present case has held that loan given to a shareholder from an 'open current account' was taxable as 'deemed dividend' under Section 2(22)(e) of the Act. The purpose for which the payee may deploy the funds received, i.e., business or otherwise, was of no relevance as far as the deeming fiction of the provision was concerned. The repayment of the whole amount proves that it was nothing but financial transactions.

It is pertinent to note that with effect from AY 2018-19, provisions of Dividend Distribution Tax (DDT)[10]. have been amended. Therefore, the company giving such loan or advances shall be liable to pay DDT @ of 30 per cent. However, the recipient of such loan or advances would not be liable to pay any tax on the same[11].



[8] Tarulata Shyam v. CIT [1997] 108 ITR 345 (SC), Sarada v. CIT 229 ITR 444 (SC), Rajesh P. Ved v. ACIT 1 ITR (Trib) 275 (Mum)
[9] Ishwar Chand Jindal v. ACIT (ITA No. 4967/Del/2012, dated 29 May 2015), DCIT v. Lakhra Brothers (2007) 106 TTJ (Chd)

[10] Section 115-O of the Act
[11] By virtue of Section 10(34) of the Act.

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