



## Deemed dividend is not taxable in the hands of a loan recipient concern if such concern is not a shareholder of the lender company – Supreme Court

### Background

Recently, the Supreme Court in the case of Madhur Housing and Development Company<sup>1</sup> upheld the decision of the Delhi High Court in the case of Ankitech Private Limited<sup>2</sup>. The Delhi High Court had held that deemed dividend would not be taxable in the hands of loan recipient concern if such concern is not shareholder of the lender company. It is taxable in the hands of common shareholders having substantial interest in both the entities.

### Delhi High Court decision in the case of Ankitech Private Limited

#### Facts of the case

- The taxpayer, a private limited company, filed the return declaring income of INR1.45 crore under Section 115JB of the Income-tax Act, 1961 (the Act).
- During the assessment proceedings, the Assessing Officer (AO) noticed that the taxpayer had received advances of INR6.32 crore by way of book entry from Jackson Generators Private Limited (JGPL) and the shareholders having substantial interest in the taxpayer were also having 10 per cent of the voting power in JGPL.
- The AO observed that the two shareholders were holding substantial interests in JGPL which had provided loans and advances to the taxpayer and these shareholders had

substantial interest even in the taxpayer. Therefore, under Section 2(22)(e) of the Act the amount received by the taxpayer 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 taxpayer.

- The Commissioner of Income-tax (Appeal) [CIT(A)] affirmed the order of the AO.
- The Tribunal deleted the addition made by the AO on account of deemed dividend under Section 2(22)(e) of the Act. The Tribunal held that though the amount received by the taxpayer 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 taxpayer, 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 taxpayer and also holding not less than 10 per cent of the voting power in JGPL.
- The Tribunal relied on the decision of the Special Bench of the Mumbai Tribunal in the case of Bhaumik Colour (P) Ltd.<sup>3</sup>. The decision of the Special Bench has been affirmed by the Bombay High Court in the case of Universal Medicare (P) Ltd.<sup>4</sup>.

<sup>1</sup> CIT v. Madhur Housing and Development Company (Civil Appeal No. 3961 of 2013) – Taxsutra.com

<sup>2</sup> CIT v. Ankitech Private Limited [ITA No. 462 of 2009] (Del)

<sup>3</sup> ACIT v. Bhaumik Colour (P) Ltd. [2009] 118 ITD 1 (Mum) (SB)

<sup>4</sup> CIT v. Universal Medicare (P) Ltd. [2010] 190 Taxman 144 (Bom)

## Delhi High Court decision

- The Delhi High Court held that the intention behind the provisions of Section 2(22)(e) of the Act is to tax dividend 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.
- 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. It is to be kept 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. 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.
- The second category specified under Section 2(22)(e) of the Act, i.e., a concern (like the taxpayer 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.
- It would always be open to the tax department to 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.

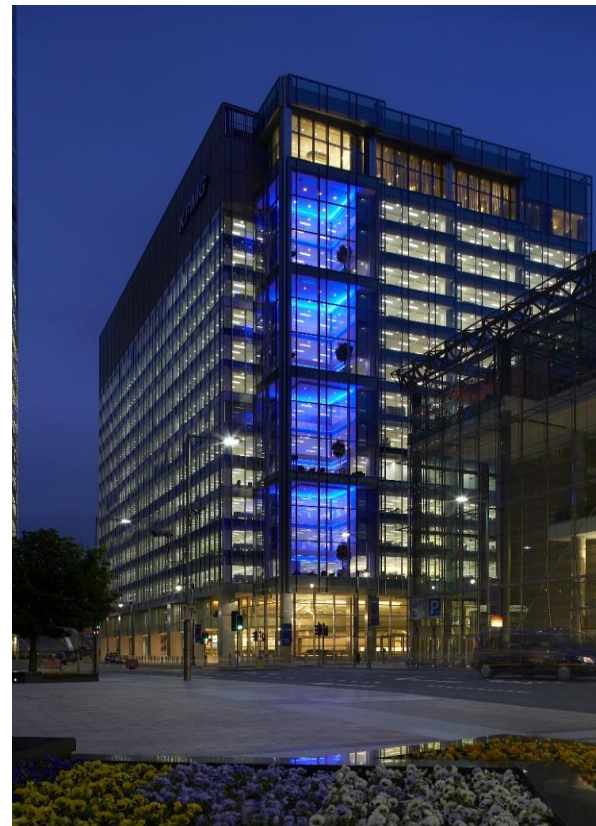
## Supreme Court decision

- The Delhi High Court decision in the case of Ankitech Private Limited is a detailed judgment going into Section 2(22)(e) of the Act which arises at the correct construction of the said Section. The Supreme Court does not wish to add anything to the judgment except to say that it is agreed therewith.

## Our comments

The issue whether deemed dividend is taxable in the hands of the concern in which the shareholders of the lender company has substantial interest or in the hands of such common shareholder has been a matter of debate before the courts. The Special Bench of the Mumbai Tribunal in the case of Bhaumik Colour (P) Ltd. held that in the absence of indication in Section 2(22)(e) of the Act to extend the legal fiction to a case of loan or advance to a non-shareholder, loan or advance cannot be taxed as deemed dividend in the hands of such non-shareholder. The decision of the Special Bench has been affirmed by the Bombay High Court in the case of Universal Medicare (P) Ltd. and the Delhi High Court in the case of Ankitech Private Limited.

The Supreme Court put at rest this controversy and held that deemed dividend is not taxable in the hands of a loan recipient concern if such concern is not a shareholder of the lender company. It is taxable in the hands of common shareholders having substantial interest in both the entities. The Supreme Court decision has provided clarity on the issue and it may help the taxpayers who are facing same issue under Section 2(22)(e) of the Act.



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