



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 Company¹ upheld the decision of the Delhi High Court in the case of Ankitech Private Limited². 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.³. The decision of the Special Bench has been affirmed by the Bombay High Court in the case of Universal Medicare (P) Ltd.⁴.

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

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

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

⁴ 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.



www.kpmg.com/in

Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Pralhad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh – 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

KRM Tower, Ground Floor,
No 1, Harrington Road
Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana – 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

Salarpuria Knowledge City,
ORWELL, 6th Floor, Unit 3, Phase
III, Sy No. 83/1, Plot No 2,
Serilingampally Mandal, Raidurg
Ranga Reddy District,
Hyderabad, Telangana – 500081
Tel: +91 40 6111 6000
Fax: +91 40 6111 6799

Jaipur

Regus Radiant Centres Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur, Rajasthan, 302018.
Tel: +91 141 - 7103224

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai – 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park
Tower-B, Plot# 7, Sector 142,
Expressway Noida, Gautam Budh Nagar,
Noida – 201305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara

iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri, Vadodara – 390 007
Tel: +91 0265 235 1085/232 2607/232 2672

[Privacy](#) | [Legal](#)

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

This document is meant for e-communication only