No deemed dividend if transaction of advance was made between companies for business expediency

Summary – The Mumbai ITAT in a recent case of Chandrasekhar Maruti, (the Assessee) held that where assessee-company was a major shareholder in three companies, since said companies were having various business transactions and running accounts with each other, loans given by those companies to each other in course of inter-se business transactions could not be regarded as deemed dividend in hands of assessee

Facts

- The assessee was an individual deriving income from salary, house property and other sources. He was having major shareholding in three companies namely, 'AI', 'SE' and 'M'.
- During assessment proceedings, the Assessing Officer noticed that 'AI' had advanced an amount of Rs. 31 lakhs to 'SE' and 'SE' had also advanced an amount of Rs. 35 lakhs to 'M'.
- The Assessing Officer also noticed that the assessee was having more than 50 per cent shareholdings in all these companies.
- The assessee had also not brought anything on record to prove that there was no profit available to the said companies as on the date of advancing of loans. In the facts and circumstances, the Assessing Officer held that the loan of Rs. 66 lakhs was deemed dividend in the hands of the assessee under section 2(22)(e).
- On second appeal:

Held

- If one compares the definition of dividend as provided under the old Act of 1922 with the present Act of 1961 it is apparent that the definition of dividend under the relevant provisions of both the Acts is almost identical. Under the old Act (*i.e.*, Act of 1922), any payment by company in which the public is not sunstantially interested, any sum by way of advance or loan to a shareholder or any payment by any such company on behalf of or for the benefit of the shareholder to the extent to which such company possesses accumulative profits, is to be deemed as dividend at the hands of such shareholder.
- However, under the new Act (*i.e.,* Act of 1961), the shareholder of such a company must be having a substantial interest or holding which should be not less than 10 per cent of the voting power. The another condition that has been added is that the payment by such a company to any concern in which such shareholder is a member or a partner in which he has a substantial interest has been added which find place between the words '…. Advance or loan to a shareholder….' and the word '….or for the individual benefit, of any such shareholder…….' The words to any concern in which such shareholder is a member or a partner…… are sandwiched between the first condition of payment of such a shareholder directly and the second condition of payment made to any company on behalf,

or for the individual benefit, of any such shareholder. A perusal of the definitions as provided under the old Act (*i.e.,* the Act of 1922) and the New Act (*i.e.,* the Act of 1961) and even a careful perusal of the definition provided under the new Act alone, would reveal that the phrase by way of advance or loan appearing in sub-cause (e), must be construed to mean those advances or loans which a shareholder enjoys for simply on account of being a person who is the beneficial owner of shares.

- The purpose is to bring within the tax net accumulated profits which were distributed by closely held companies to its shareholders in the form of loans to avoid payment of dividend distribution tax under section 115-O of the Act, 1961. Thus, the gratuitous loan or advance given by a company to its shareholders would come within the purview of section 2(22) but not to the cases where the loan or advance is given in course of business or out of business expediency or in return to an advantage conferred upon the company by such shareholder.
- Admittedly, the assessee is a director in three closely held companies. It is also undisputed fact that the company 'AI' paid Rs. 31 lakhs to 'SE' which in turn paid a sum of Rs. 35 lakhs to 'M'. The assessee explained that 'SE' is a parent company, which is an Indian representative of foreign manufacturer of analytical instruments, which are usually supplied to industries like Cement, Chemical, Petroleum, University, Educational Institutions, Hospitals, Government Laboratories, etc. After imports of the machinery and equipments, the company does the installation and commissioning of instruments. The company either directly or through its agents provides maintenance services of instruments. For getting the orders, company has to provide demonstration of equipment at user's site and prove feasibility of instrument to the intended buyer. For that purpose, buyers usually provide their samples and parameters to satisfy their requirement and confirm specifications.
- The other company, namely 'M' provides scientific and technical services to 'SE' at the rate of Rs. 3 lakhs per month. 'M' provides services such as demonstration of instrument to prospective customers of 'SE' and carried out analysis of samples provided by customers and providers information required by the customers. 'SE' is having a well equipped laboratory with analytical equipments with qualified staff in this respect. The nature of business of 'AI' is the sale of instruments and after-sale service. It is mainly dealing with and rendering of services of installation, commissioning and after-sale services of analytical instruments supplied by 'SE', such as installation of instrument, providing onsite training to the users of instruments, providing annual maintenance services.
- For these services 'AI' raises its bills on 'SE'. It has been further explained in the statement of facts that during the financial year 2008-09, 'AI' received the outstanding amount from 'SE' amounting to Rs. 39,95,907. Since the said amount was not immediately required by 'AI' a sum of Rs. 31 lakhs was kept as inter-corporate deposit on 16-12-2008 with 'SE' and interest was credited in account amount to Rs. 96,450. So far as transaction of Rs. 35 lakhs as advance by 'SE' is concerned, it has been explained that during the year 'M' raised bills totalling to Rs. 39,70,8000 on 'SE'. A sum was deducted by the said 'SE' towards tax, thus, a sum of Rs. 35,61,808 was outstanding. A sum of Rs. 35

lakhs was received by 'M' which the company treated as inter-corporate deposits instead of treating the same as payment against the bills outstanding.

- The assessee in this respect has relied upon the balance sheet of 'SE' and 'AI'. The assessee has further relied upon the paper book to show that there were other transactions also and that the 'SE' had a running account in the books of 'AI'. There is a running ledger account of 'SE' in the books of 'AI', wherein there is continuous exchange of transactions. There are almost more than 40 entries of debit and credit of the amounts. The assessee has further relied upon the paper book and submitted that the 'M' has raised bills in the year ending 31-3-2009 in respect of sales made to 'SE'. The assessee had a running account with these companies as these companies owed money to the assessee as narrated in the earlier paras of this order.
- The assessee has further invited attention to the impugned order of the Commissioner (Appeals), wherein the Commissioner (Appeals) has himself observed that the assessee himself had not received any loan/advance from these companies. The Commissioner (Appeals) has also discussed that during the year these companies were having various business transactions and having running accounts with each other. The facts itself reveal that these companies were carrying on *inter se* transactions and were having running accounts, the amounts were paid and returned also and that no part of the said amount was attributed to the shareholders. The nature of business of the three companies is connected with each other and that are depending upon each other for their business and there are mutual transactions which these companies use to do for the financial help of each other for the purpose of business expediency. All the more, the most important fact is that the assessee had to receive amounts from 'SE' and 'M' but, in fact, no amount has been received by the assessee.
- Even otherwise, if the assessee had to receive certain amount from the said company, then under such circumstances, any payment which is not more than that such company owes to the assessee, made by the said company to the assessee will not constitute deemed dividend under section 2(22)(e). The other important issue is that the payments were not gratuitous or for the benefit of the shareholder. There is also merit in the contention of the assessee that same amount was routed in the chain of transactions, *i.e.,* amount of Rs. 31 lakhs by 'AI' to 'SE' and in turn 'SE' paid the amount of Rs. 35 lakhs to parent company. Under such circumstances it cannot in any manner be held that the assessee had received the benefit of Rs. 66 lakhs, *i.e.,* the total amount of transaction. Under the circumstances, there is merit also in the alternate contentions raised by the assessee.
- As discussed above, payments made thorugh inter se transactions between companies could not be termed as any gratuitous payment to the assessee shareholder, and, thus, the provisions of section 2(22)(e) were not applicable in this case. In view of this, the appeal of the assessee is allowed and the additions made by the lower authorities under section 2(220(e) in the hands of the assessee are hereby deleted.