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Income Tax Appeal No.224 of 2015
Ravi Agarwal
Vs.
Assistant Commissioner of Income Tax, Circle-II, Bareilly
****

Hon'ble Tarun Agarwala,J.
Hon'ble Surya Prakash Kesarwani,J.

(Per: Tarun Agarwala,J.)

1. The present appeal relates to the assessment year 2003-04. The appellant took a loan of Rs.21.20 lacs from a Company known as Sarnath Finance Limited, in which the appellant is a share holder to the extent of 15%. In assessment proceedings the appellant was required to explain as to why the loans and advances taken from Sarnath Finance Ltd. should not be treated as a deemed dividend in view of the provision of Section 2(22)(e) of the Income Tax Act (hereinafter referred to as the "Act"). The assessing authority, after considering the explanation held, that the alleged loan taken by the appellant was a deemed dividend and, therefore an income from other sources. The assessing authority held that the Finance Company, namely, Sarnath Finance Limited was mainly engaged in advancing hire purchase of transport vehicle and that the said Finance Company had only made 10.79% investment in loans and advances which cannot be termed as a substantial part of business of the Company. The assessee, being aggrieved, filed an appeal which was dismissed and thereafter filed an

appeal before the Tribunal.

2. During the pendency of the appeal the appellant filled an application seeking permission to add an additional ground, which was rejected. Thereafter an application under Section 254 of the Act was filed which was also rejected. The appellant thereafter preferred an appeal before the High Court under Section 260A of the Act, being Income Tax Appeal No.190 of 2014, in which it was held that the Tribunal had not considered the nature of the transaction of the Company before determining as to whether the exclusionary clause (ii) of Section 2(22)(e) of the Act was attracted or not and, accordingly, remanded the matter to the Tribunal for a decision afresh. The Tribunal thereafter decided the matter and again rejected the appeal of the assessee holding that the alleged loan given by the Sarnath Finance Ltd. to the assessee was in the ordinary course of business and was not covered by the exclusionary Class (ii) of Section 2(22)(e) of the Act.

3. The Tribunal found that the object as per the memorandum of association of the Finance Company is business of lending money, but, contended that as per the balance sheet, the loans and advances shown by the Finance Company had been grouped under different heads, namely, “loans and advances” and “stock on hire including hire purchase”. The Tribunal further found that the balance sheet showed Rs.426.32 lacs under the heading stocks on hire and Rs.56.23 lacs under the heading “loans and advances” and, therefore, concluded that a substantial business of the

Finance Company was for hire purchase transactions and not for “loans and advances” and, therefore, the loan taken by the appellant was not covered under the exclusionary clause (ii) of Section 2(22)(e) of the Act.

4. In this back drop, we have heard Sri Abhinav Mehrotra, the learned counsel for the assessee and Sri Krishna Agarwal, the learned counsel for the Department.

5. We find that the following question of law arises for consideration, namely:-

> “Whether the loan/advance given by the Finance Company to the assessee, who is a share holder in the Finance Company was made in the ordinary course of its business, hence outside the scope of Section 2(22) (e) of the Act.”

6. In order to appreciate the submission of the learned counsel for the parties, it would be appropriate to consider the provision of Section 2(22)(e) of the Act.

> “2(22) “dividend” includes—
>
> (a) .....
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> (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 ;
>
> but “dividend” does not include—

> (i) .....
> (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 ;

7. The necessary ingredients as contemplated under Section 2(22)(e) of the Act are not disputed by the Department and the admitted fact is, that the appellant is a share holder of 15% in Sarnath Finance Ltd. who gave a loan. This Finance Company as per the memorandum and articles of association is engaged in the business of loans and advances. It has also come on record that the nature of transaction given by the Finance Company to the appellant is a simpliciter loan which was subsequently returned by the appellant to the Finance Company. According to the appellant he had received the loan as a share holder from the Finance Company in its ordinary course of business and that the lending of money constitutes a substantial part of the business of the Finance Company and, therefore, the said loan could not be treated as a deemed dividend in view of the provision of sub Section (ii) of Section 2(22)(e) of the Act. On the other hand, the Department has urged that lending of money was not a substantial part of the business of the Company and that the substantial part was hire purchase transaction, hence the lending of money was not in its ordinary course of business and the same was, therefore, not covered by the exclusionary clause (ii) of Section 2(22)(e) of the Act.

8. The provision of Section 2(22)(e) of the Act states,

that any payment by a Company not being a Company in which the public are substantially interested of any sum by way of advance or loan to a shareholder, who has a holding of not less than 10% of the voting powers, such advance or loan made to a shareholder in the ordinary course of its business will not be treated as a dividend where the lending of money by the Company is a substantial part of the business of the Company. The words “substantial part of the business” has not been defined under the Act.

9. The Bombay High Court in **Commissioner of Income Tax, Panaji, Goa vs. Parle Plastics Ltd., 2011 (196) Taxman 62** explained as to what would constitute a “substantial part of the business”. The Bombay High Court after considering the meaning of the word “substantial” in various dictionaries concluded:-

> “11. The expression used under clause (ii) of Section 2(22) is `substantial part of the business'. We would, therefore, have to ascertain the meaning of the word “substantial”, appearing in the expression “substantial part of the business”. Stroud's Judicial Dictionary, Fifth Edition, gives the first meaning of word “substantial” as “A word of no fixed meaning, it is an unsatisfactory medium for carrying the idea of some ascertainable proportion of the whole”. The decision of *Terry's Motors Ltd. v. Rinder* [1948] S.A.S.R. 167 (South Australiyan Court) is given in support of this meaning. In the meaning No.8, while considering 'substantial amount', it is stated that out of a rent of £80 p.a.., £13 p.a. attributable to the amount paid for furniture, was a substantial amount, on the basis of the decision in Maclay v. Dixon 170 L.T. 49. In meaning No.15, relying upon the decision of *Ladbrooke (Football) v. William Hill (Football)* [1964] 1 W.L.R. 273, it is said that in deciding whether the reproduced part of copyright material is a “substantial” part of the whole, it is the quality rather than the quantity of the part that should be considered. Black's Law Dictionary, Sixth Edition defines the word substantial as of real worth and importance; of considerable value; valuable; belonging to substance; actually

existing; real; not seeming or imaginary; not illusive; solid; true; veritable. Something worthwhile as distinguished from something without value or merely nominal. No decision was cited before us wherein a view has been taken that in order to show that a part of the whole to be treated as “substantial part”, the part must exceed 50% of the whole. In our view, the expression “substantial part” does not connote an idea of being the “major part” or the part that constitutes majority of the whole. If the legislature really intended that more than 50% of the business of the lending company must come from the business of lending, nothing prevented the legislature from using the expression “majority of business”. If the legislature at all intended that a particular minimum percentage of the business of a lending company should come from the business of lending, the legislature could have specifically provided for that percentage while drafting clause (ii) of Section 2(22) of the Act. The legislature had deliberately used the word “substantial” instead of using the word “major” and/or specifying any percentage of the business or profit to be coming from the lending business of the lending company for the purpose of clause (ii) of Section 2(22) of the Act. We would give an illustration to ascertain the meaning of the expression “substantial business” or “substantial income” of a company. In the modern days, large number of companies do not restrict to one or two businesses. They carry on numerous activities and carry on numerous businesses and have numerous business divisions. Let us take a case of a first company which has 3 divisions of works consisting of three different types of business. Turn over as well as the profit of the first division is 40%; turn over and profit of second division is 30% and the turn over and profit of the third line of business is 30%. In the case of this company no part of the business has turn over exceeding 50% and no part of the business company generates profit of more than 50% of the total. In such a case can it be said that none of the businesses of the said company is a substantial business of the company. In our view not. The first business which constitutes 40% of the turn over and contributes 40% to the profit would be the single largest part of the business of the company, the second and third divisions of the business, each of which contributes 30% of the turn over as well as profit of the company, though not the major and not even single largest part of the business of the company, would still be a substantial part of the business of the company, because if any part of the three divisions of the business of the company was to be closed down, that would result in loss of turn over and/or business of 30%, ordinarily no company would regard such part of the business as insignificant. As rightly observed

> in Stroud's Judicial Dictionary, it is not possible to give any fixed definition of the word “substantial” in relation to “a substantial business of a company”. Any business of a company which the company does not regard as small, trivial, or inconsequential as compared to the whole of the business is substantial business. Various factors and circumstances would be required to be looked into while considering whether a part of the business of a company is its substantial business. Sometimes a portion which contributes substantial part of the turn over, though it contributes a relatively small portion of the profit, would be substantial part of the business. Similarly, a portion which relatively a small as compared to the total turnover, but generates a large, say more than 50% of the total profit of the company would also be substantial part of its business. Percentage of turn over in relation to the whole as also the percentage of the profit in relation to the whole and sometimes even percentage of a manpower used for a particular part of business in relation to the total man power or working force of the company would be required to be taken into consideration. Employees of a company are now called its “human resources” and, therefore, the percentage of “human resources” used by the company for carrying on a particular division of business may also be required to be taken into consideration while considering whether a particular business forms substantial part of its business. Undisputedly, the capital employed by a company for carrying on a particular division of its business as compared to the total capital employed by it would also be relevant while considering whether the part of the business of the company constitutes “substantial part of the business” of the company.”

10. We are in respectful agreement with the said decision on the question of “substantial part of business”.

11. We are of the opinion that it is not possible to give a fixed definition of the word “substantial” in relation to a substantial business of a Company. We are of the opinion that any business of a Company which is not trivial or inconsequential as compared to the whole of the business would be termed as substantial part of the business. In the instant case, the assessing officer has held that the business

of giving loans and advances by Sarnath Finance Company constituted less than 20% of the total investment and, therefore, the same is not a substantial part of the business of the Company. In our view, such reasoning is per se misconceived.

12. We find from a perusal of the order of the Tribunal that Sarnath Finance Co. is admittedly engaged in the business of loans and advances, as is clear from the memorandum of association. The Tribunal picks holes from the balance sheet of the Sarnath Finance Co. contending that under the heading “Loans and Advances” the Company had made sub groups, namely, “Loans and Advances” and “stocks on hire including hire purchase”. The Tribunal, therefore, concluded that a substantial part of the business of the said Finance Company was hire purchase. In our view, the Tribunal has side tracked the issue without realising that “stocks on hire” was also shown under the heading of “Loans and Advances” in the balance sheet of the Finance Company. The break up of different kinds of loans and advances indicated by the said Finance Company in its balance sheet was for its convenience. The fact remains that the Finance Company was substantially carrying on the business of lending money which was its main business.

13. In the light of the aforesaid, we are of the view that the Tribunal and the authorities below committed a manifest error in holding that the loan and advance given by the Sarnath Finance Company to the appellant was a

deemed dividend. In fact, it was covered by the exclusionary clause (ii) of Section 2(22)(e) of the Act.

14. In the light of the aforesaid, the appeal is allowed. The question of law is answered in favour of the assessee and against the Department.

Dated : 8.10.2015
AKJ

(Surya Prakash Kesarwani,J.) **(Tarun Agarwala,J.)**