Court No. - 32

Case :- INCOME TAX APPEAL No. - 695 of 2012

Petitioner :- Commissioner Of Income Tax -Ii
Respondent :- M/S Khandelwal Associates
Petitioner Counsel :- Shambhu Chopra

Hon'ble Sunil Ambwani,J.
Hon'ble Aditya Nath Mittal,J.

1. We have heard Shri Shambhu Chopra, learned counsel for the income tax department.

2. In this income tax appeal under Section 260A of the Income Tax Act, the revenue is aggrieved by the order of the Income Tax Appellate Tribunal (ITAT) dated 02.03.2012 by which the Tribunal has affirmed the order of CIT (A), allowing the appeal to the effect that the loan totalling Rs.48,20,549/- was treated by the A.O. as deemed dividend under Section 2 (22) (e) read with Section 56 (2) (i) of the Act.

3. The findings recorded by CIT (A) summarised by the ITAT are as follows:-

"As to whether section 2 (22) (e) of the Act is applicable to the appellant's case is a finding of fact. it is seen that admittedly the two partners of the firm namely Shri Kailash Chand Gupta and Mithlesh Khandelwal have profit sharing ratio of 80:20 and are registered and beneficial shareholders of M/s Khandelwal Cables Limited with share4holding of 11.57% and 13.05% respectively. Hence, 2 out of 3 conditions of section 2 (22) (e) are undisputedly fulfilled in the appellant's case. Thus, only the nature of the receipts aggregating to Rs.48,20,549/- is in dispute insomuch that the Assessing Officer has treated these as advances/ loans as envisaged in section 2 (22) (e) of the Act, whereas the appellant has claimed that both the partners had substantial credit balances with M/s Khandelwal Cables Limited and that at no point of time was any amount received from Khandelwal Cables Limited which exceeded the deposits of the partners with Khandelwal Cables Limited. The combined cop-y of account of the appellant firm and its 2 partners in the books of Khandelwal Cables Limited was furnished by the appellant during ass4essment proceedings (Annexure to this order) and has been discussed in detail in the assessment order. The Assessing Officer has refuted the above claim of the appellant referring to the appellant's individual account independent of its partners' accounts with M/s Khandelwal Cables Limited. However, this view of the Assessing Officer is not justified for the reasons that-

-As argued by the appellant, a partnership firm is a compendious name of all the partners. Hence, the transactions of the firm cannot be considered in isolation from the transactions of the partners on behalf of and in their capacity as partners of the firm.

- The advances by Khandelwal Cables Limited to the appellant firm are not advances in the absolute as (i) Khandelwal Cables Limited was in possession of the funds of the partners and owned job work charges payable and (ii) the advances to the appellant firm did not exceed the credit balances of the partners with and job work charges receivable from Khandelwal Cables Limited. Hence, the impugned advance by Khandelwal Cables Limited to the appellant are effectively repayment of the loans of the appellant's partners though ostensibly to the appellant firm. Thus, though, in form, the amounts drawn by the appellant from Khandelwal Cables

Limited appear as advances/ loans, in substance the appellant firm has received the impugned amounts of and from its own partners, though through Khandelwal Cables Limited. This is no different from repayment by Khandelwal Cables Limited of the deposits of the appellant's partners and introduction thereof by the partners in the appellant firm.

The A.O. is of the view that the account of the appellant in the books of Khandelwal Cables Limited deserves to be considered in isolation from the partner's accounts in the books of Khandelwal Cables Limited and job work charges for the purpose of section 2 (22) (e). However, this view does not appear to be tenable for the reason that section 2 (22) (e) envisages integrated consideration of transactions between the creditor company and the debtor concern linked through the common shareholder. Bay this rationale, all the transactions fo the appellant firm and its partners with M/s Khandelwal Cables Limited warrant consideration in a composite manner.

4.6 Thus, since the consolidated balance in all the accounts of the appellant and its partners in Khandelwal Cables Limited (refer Annexure) is adequate to cover the appellant's withdrawals receipts from Khandelwal Cables Limited, no deemed dividend as per section 2 (22) (e) of the Act arises in the appellant's hands. Hence, the addition of Rs.48,20,549/- is not sustainable and accordingly deleted."

4. We do not find that any discussion in the judgment of ITAT in which finding of fact recorded by CIT (A) were challenged to the effect that though, in form, the amounts drawn by the appellant from Khandelwal Cables Limited appear as advances/ loans, in substance the appellant firm has received the impugned amounts of and from its own partners, though through Khandelwal Cables Limited. This was no different from repayment by Khandelwal Cables Limited of the deposits of the appellant's partners and introduction thereof by the partners in the appellant firm.

5. Shri Shambhu Chopra submits that the A.O. had recorded finding that the amount could not be treated as repayment as in the books of account of the company the payments were made for the job work and that the outstanding amount was not reduced by the amount of loans advance by the company to the assesse firm on respective dates.

6. The appeal has been preferred on the following questions of law:-

"1. Whether the Hon'ble ITAT is justified in law in holding that the addition on account of deemed dividend, under section 2 (22) (e) of the IT Act, 1961, could only be made in the hands of the registered/ beneficial shareholder, ignoring the fact that the S.2 (22) (e) does not contain any such specific provision or restriction and nowhere provides as to who is to be taxed in respect of such income, and also ignoring the explanation given in CBDT's circular no.495 dated 22.9.1987, which was issued in respect of the amending provisions of the Finance Act, 1987, to the effect that deemed dividend would be taxed in the hands of a concern where all the following conditions are satisfied:

(i) where the company makes the payment by way of loans or advances to a concern.

(ii) where a member or a partner of the concern holds 10 per cent of the voting power in the company; and

(iii) where the member or partner of the concern is also beneficially entitled to 20 percent of the income of such concern.

2. Whether the Ld ITAT is justified in holding that under provisions of S.2 (22) (e), where the payment by way of loan or advance is made to the firm in which the shareholder is partner, the dividend should be assessed in the hands of the shareholder and not the recipient firm, even though such interpretation negates the provisions of Ss 4 and 5 of the Income Tax Act, 1961 under which tax is chargeable only from the person who receives the income or to whom the income accrues, i.e., the assessee firm in the present case.

3. Whether the Hon'ble ITAT is thus justified in holding that the basic condition for invoking section 2 (22) (e) was not satisfied since the assessee firm itself was not a shareholder in the Company from which it had received loan/ advance, and thereby confirming the CIT (Appeal)'s action in deleting the addition of Rs.48,20,549/- despite the fact that CIT (Appeals) in his order had confirmed that the impugned addition was covered as deemed dividend U/s 2 (22) (e), although he had deleted the addition purely on the basis of facts of the case.

4. Whether the Hon'ble ITAT is justified in thus deciding the legal issue in favour of the assessee and dismissing the revenue's appeal without adjudicating the finding given by the CIT (A) on merit, which had been specifically challenged before it by the Department."

7. We have gone through the orders of the A.O., CIT (A) and ITAT and find that the question as to whether amount was advanced as loans or by way of repayment for job work is question of fact, which has been considered by CIT (A) and with which ITAT did not interfere.

8. The object of Section 2 (22) (e) was considered by the Supreme Court in **Commissioner of Income Tax, Kolkata v. Mukundray K. Shah, (2007) 4 SCC 327**. The Supreme Court observed in para 11 as follows:-

"11. We find merit in this civil appeal. The companies having accumulated profits and the companies in which substantial voting power lies in the hands of the person other than the public (controlled companies) are required to distribute accumulated profits as dividends to the share-holders. In such companies, the controlling group can do what it likes with the management of the company, its affairs and its profits. It is for this group to decide whether the profits should be distributed as dividends or not. The declaration of dividend is entirely within the discretion of this group. Therefore, the Legislature realized that though funds were available with the company in the form of profits, the controlling group refused to distribute accumulated profits as dividends to the shareholders but adopted the device of advancing the said profits by way of loan to one of its shareholders so as to avoid payment of tax on accumulated profits. This was the main reason for enacting section 2(22)(e) of the Act."

9. The question as to whether deeming provision and dividend under Section 2 (22) (e) is attracted in the present case has to be seen in the light of the finding of fact recorded by CIT (A) with which ITAT did not interfere.

10. The deeming provision under Section 2 (22) (e) of the Act by which loans and advance have to be added back as income of the company was subject matter of consideration in **ACIT v. Bhaumik Colour P. Ltd., (2009) 313 ITR (AT) 146 (Mumbai)** and **Exide Industries Ltd. v. Union of India, (2007) 292 ITR**

470 (Cal).

11. The aforesaid two decisions were considered by the **Bombay High Court in CIT v. Universal Medicare Private Ltd., (2010) 324 ITR 263 (Bom).** The Bombay High Court held that all payments by way of dividend have to be taxed in the hands of the recipient of the dividend namely the shareholder. The effect of section 2 (22) is to provide an inclusive definition of the expression "dividend". Clause (e) expands the nature of payments which can be classified as a dividend. Clause (e) of section 2 (22) includes a payment made by the company in which the public are not substantially interested by way of an advance or loan to a shareholder or to any concern of which such shareholder is a member or partner, subject to the fulfillment of the requirements which are spelt out in the provision. Similarly, a payment made by a company on behalf, or for the individual benefit, of any such shareholder is treated by clause (e) to be included in the expression "dividend". The effect of clause (e) of section 2 (22) is to broaden the ambit of the expression "dividend" by including certain payments which the company has made by way of a loan or advance or payments made on behalf of or for the individual benefit of a shareholder. The definition does not alter the legal position that dividend has to be taxed in the hands of the shareholder.

12. In the present case also even assuming requirement of the first part of the Section has been complied with, and that advance could be treated as dividend, it had to be taxed not in the hands of the assessee but in the hands of the shareholder.

13. In the present case a clear finding of fact has been recorded by CIT (A), that in the facts and circumstances as given in the order of A.O., the amount was not paid by way of as loan in advance, but for the job work, which was done by the partnership firm for the company and for which the amount was outstanding.

14. The fact that the amounts paid were not reduced as found by A.O., is only circumstance, which does not affect the finding of CIT (A).

15. For the aforesaid reasons, we agree with the judgment of Bombay High Court in CIT v. Universal Medicare P. Ltd. (Supra), which has followed Asstt. CIT v. Bhaumik Colour P. Ltd. (Supra) and Exide Industries Ltd. v. Union of India (Supra) that the effect of Section 2 (22) (e) of the Act has to be seen in the light of the facts and circumstances of the case. A deeming provision can also

be subject to rebuttal. In the present case from the finding of fact such deeming provision was rebutted by the assessee and that findings to that effect have been accepted by the ITAT, which we do not find to be either illegal, arbitrary or perverse. The questions of law as framed by the revenue do not arise for consideration in the appeal, which is concluded by findings of fact.

16. The income tax appeal is **dismissed.**

Order Date :- 13.8.2012
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