IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

R/TAX APPEAL NO. 811 of 2019

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THE PRINCIPAL COMMISSIONER OF INCOME TAX 4

Versus

MOHAN BHAGWATPRASAD AGRAWAL

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Appearance:
MRS MAUNA M BHATT(174) for the Appellant(s) No. 1
for the Opponent(s) No. 1

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CORAM: **HONOURABLE MR.JUSTICE J.B.PARDIWALA**
and
HONOURABLE MR. JUSTICE BHARGAV D. KARIA

Date : 20/01/2020

ORAL ORDER

(PER : HONOURABLE MR. JUSTICE BHARGAV D. KARIA)

1. This tax appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as "the Act, 1961") is at the instance of the Revenue and is directed against the order dated 12th April, 2019 passed by the Income Tax Appellate Tribunal, Bench "A", Ahmedabad (for short "the Tribunal") in the ITA No.29/Ahd/2019 for the A.Y.2015-16.

2. The Revenue has proposed the following questions as the substantial questions of law;

> *"(A) Whether on facts of the case and in law, the Appellate Tribunal is correct to hold that assessee has received the sum of Rs.2,50,80,923/- from M/s.Shreem Design Infrastructure Pvt. Ltd and Rs.76,53,711/- from M/s. Aatrey Infrastructure Pvt. Ltd in the ordinary course of business of creditor companies?*

(B) Whether on facts of the case and in law, the Appellate Tribunal is correct to hold that provision of section 2(22)(e) of the Act are not attracted in this case?

(C) Whether on facts of the case and in law, the Appellate Tribunal is correct to hold that the creditor companies in this case i.e. M/s. Shreem Design Infrastructure Pvt. Ltd and M/s. Aatrey Infrastructure Pvt. Ltd are also into the business of money lending?"

3. The Assessing Officer made a disallowance as deemed dividend under Section 2(22)(e) of the Act, 1961 as the assessee was having 11.61% of share holding in M/s. Shreem Design & Infrastructure Pvt. Ltd. (for short SDIPL") and 22.81% share holding in M/s. Aatrey Infrastrucutre Pvt. Ltd. (for short "AIPL").,the companies in which public are not substantially interested. The Assessing Officer, therefore, held that the provisions of Section 2(22)(e) of the Act, 1961 are applicable in the case of the present assessee as the assessee has obtained loan and advances from the aforesaid companies.

4. In response to the same, the assessee filed its reply in writing stating that SDIPL and AIPL are covered by the specific exemption given in sub-clause (ii) of Section 2(22)(e) of the Act which provides that any advances 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 company would be excluded. It was further submitted by the assessee that at Page No. 2 Para-6 and at Page No.4, Para-20 of the Memorandum of Association of both the Companies, money lending was authorized. However, as the main object of both the Companies was to carry on business of builder,

masons and general construction, industrial construction etc., and to carry out the construction business of property lands, flats, houses, shops, offices, industrial estate etc., the Assessing Officer made addition of Rs.2,50,80,923/- in respect of SDIPL and Rs.76,53,711/- in respect of AIPL to the extent of accumulated profit treating the same to be the deemed divided. Thereafter the same was added to the total income of both the assessee. The appeal filed by the respondent-assessee before the CIT (A) was dismissed.

5. Being dissatisfied, the assessee preferred an appeal before the Income Tax Appellate Tribunal. The Tribunal, after taking into consideration various decisions relied upon by the assessee, arrived at following findings;

> '*12. We have heard the rival submissions and perused the material available on record. We find that the AO has made addition on account of loans and advances taken from M/s. SDIPL and M/s. AIPL being Rs.2,50,80,923 and Rs. 76,53,711 respectively being accumulated profit as the conditions laid down u/s. 2(22)(e) are satisfied. The claim of the assessee that the loans and advances were obtained in ordinary course of business of money lending on which interest was paid at market rate @9% and Moneylender Company's substantial part of money lending business was not accepted on the ground that the main object of the lender companies was not carrying on money lending business. The perusal audit report for assessment year 2014-15 shows that SDIPL has done money lending business which constitutes substantial part of its business as the percentage ratio of loan and advances to total funds available comes to 79.37% and percentage of loan and advances to total assets of the company comes to 69.71%. The ratio of loans and advances given to unsecured loan was at 105.25%. Similarly, AIPL percentage ratio of loan and advances to total funds available comes to 35.66% and percentage of loan and advances to total assets of the company comes*

to 32.45%. The ratio of loans and advances given to unsecured loan was at 56.29%.We further observe that though the memorandum of article of the Association of the company does not authorized money lending business as main object, but page 2 paragraphs 6 and at page 4 para 20 authorized the lending of surplus money by these companies. The perusal of sub clause (ii) of section 2 (22) (e) shows that it does not envisaged such a condition of authorization. In order to appreciate that there is no requirement of main object as of money lending business, it would be relevant to reproduced the sub clause (ii) of section 2(22)(e) which read as under:- "Any advance or loan made to shareholder (or the said concern) by a company in the ordinary course of its business, where the lending of money is substantial part of business of the company." (bold letter emphasized by us). Thus, the provision makes it clear that there is no specific requirement that MOA of company specifically mention in main object as money lending business and it is not necessary for license. Now coming to term substantial part of the company business, which has not been defined specifically, but same can be understood from Explanation 3 (b) to section 2(22)(e) which is as follows: "Explanation 3(b)- a person shall be deemed to have substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty percent of the income of such concern." Similar, definition is given in section 2(32) of the Act which read as under:-"A person who has substantial interest in the company" in relation to a company, means 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, carrying not less than twenty percent of the voting power." Thus, as per definition as given in above sections, the word used as "substantial" would mean where the assessee company has carried on money lending business of more than 20% or more of the total income of closely held company and turnover of loans funds to total fund of the company is above 20% , then any loan or advances made by the said company to its shareholders cannot be deemed dividend asper exclusion clause (ii) to section 2(22)(e) of the Act. The learned counsel for the assessee supported his view by placing reliance on the decision of Hon'ble Supreme Court in the case K. N. Guruswamy vs. State of Mysore

AIR 1954 SC 592 (PP1-7) and contended that the word appearing in the section and rules must be given the same meaning unless there is nothing to indicate the contrary. Since, SDIPL has carried out money lending business in the percentage ratio of loan and advances to total funds available comes to 79.37% and percentage of loan and advances and M/s. AIPL has carried out its money lending business in the percentage ratio of 35.65% of loans and advances of total available, which is more than twenty percent as mentioned in Explain (b) to section 2(22)(e) and section 2(32) of the Act. Further, the Hon`ble Bombay High Court in the case of CIT v. Parley Plastics Ltd. [2011] 332 ITR 63 (Bombay) held as follows

"12. Applying these tests to the present case, we do not find that the ITAT has committed any error in coming to the conclusion that lending of money was a substantial part of the business of AMPL. The ITAT has noted that 42% of the total assets of AMPL as on 31.3.1996 and 39% of the total assets of AMPL as on 31.3.1997 were deployed by it by way of total loans and advances. By no means, the deployment of about 40% of the total assets into the business of lending could be regarded as an insignificant part of the business of AMPL. The ITAT has also held that the income AMPL had received by way of interest of Rs.1,08,18,036/- while it's total profit was Rs.67,56,335. Excluding the income earned by AMPL by way of interest, the other business had resulted into net loss. In our view, the ITAT has taken into consideration the relevant factors and has applied the correct tests to come to the conclusion that lending of money was substantial part of the business of the AMPL. Since lending of money was a substantial part of the business of AMPL, the money given by it by way of advance or loan to the assessee could not be regarded as a dividend, as it has to be excluded from the definition of "dividend" by virtue of clause (ii) of Section 2(22) of the Act. Hence, question No.2 is answered in favour of the assessee and against the Revenue."

13. *In the present case, we observe that 69.71% of the total assets of SDPL as on 31.3.2015 and 32.45% of the total assets of AIPL as on 31.3.2015 were deployed by the above lender companies by way of total loans and advances. By no means, the deployment of about 69.71% and 32.45% of the total assets into the business*

of lending could be regarded as an insignificant part of the business of SDPL and AIPL. We find that find that the SDPL had received by way of interest of Rs.1,67,16,067 while its total profit was Rs. 50,48,266 excluding interest income earned by SDPL by way of interest, Similarly AIPL has earned interest income of Rs. 17,68,467 and other business had resulted into insignificant income. Therefore, we are of the considered opinion that considering the relevant factors and as ratio laid down by Hon`ble Bombay High Court in above cited decision, the lending of money was substantial part of the business of the both lender companies under consideration from whom the assessee has received loans and advances. The learned counsel for the assessee has relied on the decision of Hon`ble Delhi High Court in the case of CIT v. Bharat Hotels Ltd. [2019] 103 taxmann.com 295 (Delhi) wherein it was held that where assessee received loan from two companies which were substantially involved in money lending business, Tribunal rightly concluded that proviso (ii) to section 2(22)(e) would apply to assessee1s case and addition of deemed dividend made to assessee`s income was to be deleted. Since lending of money was a substantial part of the business of SDIPL and AIPL, the money given by it by way of advance or loan to the assessee could not be regarded as a dividend, as it has to be excluded from the definition of "dividend" by virtue of clause (ii) of Section 2(22) of the Act. We therefore, hold accordingly.

14. *We further find that the loan taken from the SDIPL and AIPL were compensated by way of interest @9% being market rate paid by the assessee on loan, therefore, the assessee in real sense did not derive any benefit of the company so as to the provisions (ii) of sec. 2(22)(2) of the Act. The learned counsel for the assessee relied in the case of ACIT vs. M/s. Zenon (India) Pvt. Ltd. ITA No. 1124/Kol/2012 (Paper Book 38 to 43 and Smt. Sangita Jain vs. ITO ITA No. 1817/Kol/2009 (Paper Book 44 to 51) which supports his contentions. The learned counsel for the assessee placed reliance in the case of Shri Pradip Kumar Malhotra v. CIT [I.T.A.No. 219 of 2013 dated 02.08.2011 of Hon`ble Calcutta High Court] [PB-24-37]. Wherein it was held by the Honourable Calcutta High Court that phrase " by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans, which is shareholder enjoys for*

simply on account of being a Partner, who is the beneficial owner of shares, but if such loan or advance is given to such shareholder as a consequence of any further consideration, which is beneficial to the Company, received from such shareholder, in such a case, such advance or loan cannot be said to be deemed dividend within the meaning of the Act. It was held that gratuitous loan or advance given by a company to those classes of shareholders thus, would come within the purview of section 2(22)(e) but not the cases where the loan or advance is given in return to an advantage conferred upon the company by such shareholder. Since, the assessee has paid interest on loans and advances taken from SDIPL and AIPL, hence, he has compensated and no benefit has been derived. Therefore, applying the ratio of Hon`ble Calcutta High Court as quoted above, and Co-ordinate Bench decisions ACIT vs. M/s. Zenon (India) Pvt. Ltd. ITA No. 1124/Kol/2012 (Paper Book 38 to 43 and Smt. Sangita Jain vs. ITO ITA No. 1817/Kol/2009 (Paper Book 44 to 51), the loans and advances taken by the assessee are not covered by the provisions of section 2(22)(e) of the Act. Thus, considering the totality of facts and judicial decision as discussed above , we hold that the AO was not justified in making addition on account of deemed dividend of Rs. 2,50,80.923 from SDIPL and Rs. 76,53,711 from AIPL. Hence, same are directed to be deleted. Accordingly, grounds of appeal raised by the assessee are allowed."

6. Thus, the Tribunal has arrived at a finding of fact that 69.71% of the total assets of SDPL as on 31.3.2015 and 32.45% of the total assets of AIPL as on 31.3.2015 were deployed by both the companies by way of loan and advances which could not be regarded as an insignificant part of the business. The Tribunal found that SDPL had received, by way of interest, a sum of Rs.1,67,16,067/- against its total profit of Rs.50,48,266/- excluding the income earned by SDPL by way of interest, Similarly AIPL has earned an amount of Rs. 17,68,467/- by way of interest and other business which resulted into insignificant income. The Tribunal also recorded

that both the companies were paid the interest on the loan and advances obtained by them at the market rate of 9%. The Tribunal, has also taken into consideration the decision of the Calcutta High Court in the case of **Shri Pradip Kumar Malhotra v. CIT,** *[I.T.A.No. 219 of 2013 dated 02.08.2011,* which was relied upon by the assessee, wherein it has been held that the phrase " by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans, which shareholder enjoys for simply on account of being a Partner, who is the beneficial owner of shares, but if such loan or advance is given to such shareholder as a consequence of any further consideration, which is beneficial to the Company, received from such shareholder, in such a case, such advance or loan cannot be said to be deemed dividend within the meaning of Section 2(22)(e) the Act.

7. It would be, therefore, germane to refer to the provisions of Section 2922)(e) of the Act, 1961, which reads thus;

> *"2(22)(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) a distribution made in accordance with sub- clause*

(c) or sub- clause (d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets;

(ia) a distribution made in accordance with sub- clause (c) or sub- clause (d) in so far as such distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders after the 31st day of March, 1964 , [2] and before the 1st day of April, 1965];]

(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;

(iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub- clause (e), to the extent to which it is so set off.

Explanation 1-The expression" accumulated profits", wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946 , or after the 31st day of March, 1948 , and before the 1st day of April, 1956 .

Explanation 2.-- The expression" accumulated profits" in sub- clauses (a), (b), (d) and (e), shall include all profits of the company up to the date of distribution or payment referred to in those sub- clauses, and in subclause (c) shall include all profits of the company up to the. date of liquidation, but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place].

Explanation 3.- For the purposes of this clause,-

(a) " *concern*" *means a Hindu undivided family, or a firm or an association of persons or a body of individuals or a company;*
(b) a person shall be deemed to have a substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the income of such concern;]"

8. On perusal of the above provision, it is clear that as the assessee was holding more than 10% of the shares in both the companies, the provisions of Section 2(22)(e) of the Act would come into play. However, the section further provides that the dividend does not include any advances or loan made to a share holder by the Company in the ordinary course of business where lending of money is a substantial part of the business of the Company.. In the case on hand, it is not in dispute that both the companies were having money lending as the substantial part of their business. Therefore, the Tribunal has rightly hold that no addition can be made by way of deemed dividend in the case of the assessee.

9. In view of the above, no question of law, much less any substantial question of law would arise for the determination of this Court. The appeal stands dismissed accordingly.

(J. B. PARDIWALA, J)

(BHARGAV D. KARIA, J)

Vahid