

**IN THE HIGH COURT OF PUNJAB AND HARYANAAT
CHANDIGARH**

**ITA No.132 of 2012 (O&M)
Date of decision:11.9.2012**

Commissioner of Income Tax I, Ludhiana

...Appellant

Versus

M/s Octave Apparels, GT Road, Ludhiana

.....Respondent

**CORAM: HON'BLE MR.JUSTICE AJAY KUMAR MITTAL
HON'BLE MR. JUSTICE GURMEET SINGH SANDHAWALIA**

Present: Mr. Rajesh Katoch, Advocate for the appellant.

Ajay Kumar Mittal,J.

1. This appeal has been preferred by the revenue under Section 260A of the Income Tax Act, 1961 (in short, “the Act”) against the order dated 27.1.2012, Annexure A.III passed by the Income Tax Appellate Tribunal, Chandigarh Bench 'B', Chandigarh (for brevity, “the Tribunal”) in ITA No.31/CHD/2011, for the assessing year 2007-08, claiming following substantial question of law:-

“Whether on the facts and circumstances of the case, the Hon'ble Income Tax Appellate Tribunal confirming the deletion of addition by the Commissioner of Income (A) is correct by ignoring that the firm alongwith its partners possessed more than 10% (Shri Balbir Kumar, Partner –

6.64% + Shri Harsh Kumar, partner – 6.00% + the assessee i.e. M/s Octave Apparels 1.07% = 13.71%) to the voting power in the company thus making it liable to attract the provisions of Section 2(22) (e)?”

2. Briefly, the facts as narrated in the appeal may be noticed. The respondent-assessee is a firm deriving income from manufacturing and trading of garments and clothes. It filed its return of income on 29.10.2007 declaring income of ₹ 2,06,70,940/-. Assessment under section 143(3) of the Act was completed on 11.12.2009. The Assessing Officer made an addition of ₹2,30,86,070/- on account of deemed dividend income under section 2(22)(e) of the Act by observing that partners had collectively more than 10% voting power and majority of the shares belonged to the mother of the two individual partners and balance to other family members who were specified persons under Section 40A(2) of the Act and provisions under Section 40A(2) of the Act were applicable. The Assessing officer also made an addition of ₹ 4,49,967/- on account of disallowance of 20% on expenditure of bonus and wages observing that at some places there was variation in the signatures of the workers and language of the signatures was also different. Aggrieved by the order, the assessee filed an appeal before the Commissioner of Income Tax (Appeals), [CIT(A)] who vide order dated 8.10.2010 deleted the total addition of ₹ 2,30,86,070/- on account of deemed dividend income and disallowance of wages and bonus for ₹4,49,967/-. The revenue filed appeal against the order before the Tribunal. Vide order dated 27.1.2012, Annexure A.III impugned

herein, the appeal was dismissed by the Tribunal Hence this appeal by the revenue.

3. The issue herein is whether any loan amount advanced by M/s Octave Apparels Private Limited to the respondent-assessee would fall under Section 2(22) (e) of the Act as deemed dividend.

4. The Tribunal noticed that the assessee was holding 1.07% shares of sister concern whereas the partners of the assessee firm Shri Balbir Kumar and Shri Harsh Kumar were holding 6.64% and 6% shareholding respectively. It was, thus, concluded that the assessee firm was holding less than 10% shareholding of the voting power and any amount advanced by closely held company to the assessee firm was not to be treated as deemed dividend under the provisions of section 2(22) (e) of the Act.

5. In order to adjudicate the controversy raised herein, it would be advantageous to quote the provision of Section 2 (22) (e) of the Act, 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.”

6. The aforesaid provision came up for consideration before the Rajasthan High Court in *Commissioner of Income Tax v. Hotel Hilltop*, (2009) 313 ITR 116. It was held that following four conditions are *sine qua non* for attracting provisions of Section 2(22) (e) of the Act:-

- “(i) the assessee should be a shareholder of the company;
- (ii) the company should be a closely held company in which the public are not substantially interested;
- (iii) there must be payment by way of advance or loan to a shareholder or any payment by the company on behalf of or for the individual benefit of the shareholder; and
- (iv) there must be sufficient accumulated profits in the hands of the company up to the date of such payment.”

7. Interpreting Section 2(22) (e) of the Act, the Bombay High Court in *CIT v. Universal Medicare (P) Limited*, (2010) 324 ITR 263 noted as under:-

“Clause (e) of Section 2(22) is not artistically worded. For facility of exposition, the contents can be broken down for analysis: (i) Clause (e) applies to any payment by a company not being a company in which the public is substantially interested of any sum, whether as representing a part of the assets of the company or otherwise made after the 31 May

1987; (ii) Clause (e) covers a payment made by way of a loan or advance to (a) a shareholder, being a 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 (b) any concern in which such shareholder is a member or a partner and in which he has a substantial interest; (iii) Clause (e) also includes in its purview any payment made by a company on behalf of or for the individual benefit, of any such shareholder; (iv) Clause (e) will apply to the extent to which the company, in either case, possesses accumulated profits. The remaining part of the provision is not material for the purposes of this Appeal.

By providing an inclusive definition of the expression 'dividend', clause 2(22) brings within its purview items which may not ordinarily constitute the payment of dividend. Parliament has expanded the ambit of the expression 'dividend' by providing an inclusive definition.

In order that the first part of clause (e) of Section 2 (22) is attracted, the payment by a company has to be by way of an advance or loan. The advance or loan has to be made, as the case may be, either to a shareholder, being a beneficial owner holding not less than ten per cent of the voting power or to any concern to which such a shareholder is a member or a partner and in which he has a substantial interest. The Tribunal in the present case has found that as a matter of fact no loan or advance was granted to the assessee, since the amount in question had actually

been defalcated and was not reflected in the books of account of the assessee. The fact that there was a defalcation seems to have been accepted since this amount was allowed as a business loss during the course of assessment year 2006 2007. Consequently, according to the Tribunal the first requirement of there being an advance or loan was not fulfilled. In our view, the finding that there was no advance or loan is a pure finding of fact which does not give rise to any substantial question of law. However, even on the second aspect which has weighed with the Tribunal, we are of the view that the construction which has been placed on the provisions of Section 2(22)(e) is correct. Section 2(22)(e) defines the ambit of the expression 'dividend'. 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 is not substantially interested by way of an advance or loan to a shareholder or to any concern to 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'. Consequently, 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 . Consequently in the present case the payment, even assuming that it was a dividend, would have to be taxed not in the hands of the assessee but in the hands of the shareholder. The Tribunal was, in the circumstances, justified in coming to the conclusion that, in any event, the payment could not be taxed in the hands of the assessee. We may in concluding note that the basis on which the assessee is sought to be taxed in the present case in respect of the amount of Rs.32,00,000/- is that there was a dividend under Section 2(22)(e) and no other basis has been suggested in the order of the Assessing Officer.”

8. Following the decisions in *Universal Medicare (P) Limited's* case and *Hotel Hilltop's* case (supra), this Court in ITA No.14 of 2012 (*Commissioner of Income Tax I, Ludhiana v. M/s Arora Knit Fab Pvt. Limited, Ludhiana*) decided on 19.4.2012 recorded that the shareholders of different holdings cannot be clubbed to decide the issue of fulfilment of the conditions laid down in Section 2(22) (e) of the Act. It was further observed that only the shareholder can be assessed on account of deemed dividend and not the company under the aforesaid provision.

9. Examining the factual matrix herein, as noticed earlier, Shri Balbir Kumar, partner possessed 6.64% of the shareholding whereas Shri Harsh Kumar, partner had 6% only. The share of the

assessee i.e. M/s Octave Apparels was 1.07% and in such circumstances, the provisions of Section 2(22)(e) of the Act could not be resorted to. The Tribunal was, thus, right in concluding in favour of the assessee.

10. No question of law much less substantial question of law arises in this appeal.

11. Finding no merit in the appeal, the same is dismissed.

(Ajay Kumar Mittal)
Judge

September 11, 2012
'gs'

(Gurmeet Singh Sandhawalia)
Judge