

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Reserved on : 27.08.2019

Pronounced on : 24.09.2019

CORAM

THE HONOURABLE MR. JUSTICE M.S.RAMESH

W.P.No.34786 of 2015

and

M.P.No.1 of 2015

R.Chitra ... Petitioner

Vs.

1.The Vice Chairman,
Income Tax Settlement Commission,
Additional Bench,
640 Anna Salai, Nandanam,
Chennai-600 035.

2.The Principal Commissioner of Income Tax,
Central 2, Chennai-34.

3.The Deputy Commissioner of Income Tax,
Central Circle 2,
Coimbatore.

... Respondents

PRAYER: Writ Petition is filed under Article 226 of the Constitution of India, praying for a Writ of Certiorari, calling for the records comprised in File No.TN/N-53/2013-14/45/IT dated 14.09.2015 on the file of the first respondent and to quash the same insofar as it relates to determination of deemed dividend as the income of the petitioner for the assessment years 2009-10 to 2013-14.

For Petitioner : Mr.Jehangir D.J.Mistri, Sr. Counsel
for Mr.R.Sivaraman

For Respondents : Mr.ANR. Jaya Prathap, JSC
& Mr.A.P.Srinivas
1 to 3 Senior Standing Counsel

O R D E R

The order of the Income Tax Settlement Commission dated 14.09.2015, insofar as it includes the deemed dividend for the purpose of determining the total income of the petitioner for

the assessment years 2009-10 to 2013-14 is concerned, is under challenge in the present Writ Petition.

2. Heard Mr. Jehangir D.J. Mistri, learned Senior counsel for the petitioner and Mr. ANR. Jaya Prathap, JSC & Mr. A.P. Srinivas, learned Senior Standing Counsel appearing on behalf of the respondents.

3. The brief facts of the case are as follows:

a) M/s. Rasi Seeds Private Limited and Rasi Tex Private Limited are two Private Limited Companies in both of which, Mrs. Chitra, the petitioner herein, is a shareholder. On 10.01.2013, search and seizure operations were carried out in the residential and business premises of the petitioner, by the Income Tax Department under Section 132 of the Income Tax Act (hereinafter referred to as 'the Act'). During the course of the search, the Department seized cash to the extent of Rs.35 lakhs from the residential premises of the petitioner. In pursuance to the search, the jurisdictional Assessing Officer issued a notice dated 30.09.2013 to the petitioner under Section 153A, r/w. Section 153 C of the Act, for the assessment years 2007-2008 to 2012-2013. The petitioner had responded to the said notices by filing the Returns of Income for each of these years on 28.02.2014. The petitioner had also filed the Returns of Income for the assessment years 2013-2014 under Section 139 of the Act on 30.09.2013.

b) Pending the assessment of her income for the assessment years 2007-2008 to 2012-2013 under Section 153 C and for the assessment year 2013-2014 under Section 143 of the Act, the petitioner had made an application under Section 245 C of the Act for settlement of her cases. The petitioner offered the income of Rs.35 lakhs seized from her residence as additional income for the assessment year 2013-2014 and also disclosed that the said income was derived out of the sale of Silver Oak trees which were felled at her agricultural lands. The application for settlement was claimed to have been made since the petitioner was not able to prove that the seized cash is out of the sale of such trees.

c) In the application before the Income Tax Settlement Commission (hereafter referred to as 'Commission'), the petitioner had disclosed that she was a shareholder, holding more than 20% of equity share capital in each of the two Companies namely, M/s. Rasi seeds Private Limited (RSPL) and M/s. Rasi Tex India Private Limited (RTPL) and that RSPL had advanced monies in the ordinary course of its business as inter corporate loans to RTPL.

d) The second respondent submitted a report under Rule 9 of the Income Tax Settlement Commission Procedure Rules, requesting the Commission to hold that the petitioner is liable to be taxed on the deemed dividend under Section 2 (22) (e) of the Act and alternatively to treat the application is invalid.

e) The Commission, through the impugned order dated 14.09.2015 held that the sum of Rs.137,19,75,000/- advanced by RSPL to RTPL is to be assessed as deemed dividend in the hands of the petitioner, along with the income returned in each of the years and the additional income offered in the application. This order is put under challenge in the present Writ Petition.

4. Mr.Jehangir D.J.Mistri, learned Senior Counsel for the petitioner assailed the impugned order on the following grounds:

a. While Circular No. 19 of 2017 directs that deemed dividend under Section 2(22) (e) of the Act cannot apply where transactions entered are in the nature of commercial transactions, Circular No. 495 of 1987 directs that deemed dividend will be taxable in the hands of the concern where loan/advances is made by a company to concern with common shareholder. These circulars of the CBDT are binding in nature and are required to be followed, even where they mitigate rigors of the act.

b. There is no dispute that the current account transactions between RSPL and RTPL are in the normal/ordinary course of business and thus, deemed dividend should not apply.

c. Even assuming that assessment of dividend under Section 2 (22)(e) can be made in the hands of the shareholders, even then, dividend is not taxable as per the provisions of Section 10 (34).

d. Since there were more than two shareholders in the assessment years 2012-2013 and 2013-2014 namely, the petitioner and M. Ramasamy, the provisions of Section 2(22)(e) cannot be applied for those years as the computation mechanism fails.

e. Even assuming that the amount advanced for the first time by RSPL to RTPL is treated as deemed dividend, any transfer of money by RTPL to RSPL and subsequent repayment by RSPL to RTPL thereafter should not be taxed as deemed dividend. As such by adjusting such payments by RTPL to RSPL, deemed dividend ought to have been limited to Rs.35,47,20,422/- as against Rs.137,19,75, 000/-.

f. No incriminating material was found during search in relation to the deemed dividend and thus the proceedings under Section 153 A r/w. 153 C are not valid. Though this argument

was advanced before the Commission, the issue was not adjudicated.

5. In support of all the aforesaid contentions, the learned Senior counsel for the petitioner relied on various decisions, which I shall address while discussing such contentions.

6. Substantiating the findings of the Commission in the impugned order, Mr.A.P. Srinivas, learned Senior Standing counsel for the Department countered the aforesaid submissions of the petitioner, in the following manner:

a. The Circulars of the CBDT will not bind the Courts, especially, when it is against the provisions of law. Even otherwise, without explaining how the transactions between the two Companies constitute ordinary commercial transactions, the petitioner cannot rely on the circulars.

b. The case of the petitioner does not fall within the exclusion as defined in Section 2(22)(e)(ii) of the Act. There is a factual finding of fact by the Commission in the impugned order that lending of money was not a substantial part of the business of RSPL. According to the Department, the word ordinary course of business is qualified by the words "where the lending of money is substantial part of the business".

c. The exemption under Section 10 (34) will apply only when dividend distribution tax is paid under Section 115-O. Further, the definition of Income under Section 2 (24) includes dividend and Section 2(22)(e) applies to deemed dividend. Section 8 is the basis of the charge and Section 115-O is relating to special provisions of tax on distributed profits of domestic Companies.

d. The other shareholder, Mr. Ramasamy, was not the petitioner before the Settlement Commission. Initially, it was projected by the petitioner as if she was the only one having more than 20% shareholding. The argument raised by the petitioner of failure of the computation mechanism is hypothetical since Mr.Ramasamy is not taxed on the same income.

e. Even when an advance of loan is subsequently repaid in its entirety during the relevant years, still deemed dividend is applicable.

f. The plea of lack of incriminating material will not arise since the petitioner himself had filed an application before the Settlement Commission to adjudicate the issue of deemed dividend. During the course of search, a specific question in relation to applicability of deemed dividend was put to Senthil Nathan.

7. By distinguishing the decisions relied upon by the learned Senior counsel for the petitioner, the learned Standing counsel for the Department also relied upon a various decisions,

which I shall deal with later.

8. I have given careful consideration to the submissions made by the respective counsels and have carefully perused all the materials placed before me.

MAINTAINABILITY OF WRIT PETITION AGAINST ORDER OF SETTLEMENT COMMISSION

9. Before addressing the various submissions put forth by the petitioner, it would be necessary to address a preliminary objection raised by the learned Standing counsel for the respondent on the jurisdiction of this Court under Article 226 of the Constitution of India to deal with an order passed by the Settlement Commission under Section 245 D (4) of the Act.

10. By relying on the decisions of the Hon'ble Apex Court in the case of Jyotendrasinhji Versus S.I. Tripathi and others reported in (1993) 201 ITR 611 (SC); C.A. Abraham V. ACIT in 255 ITR 340; and Mathurbhai Bhimjbhai Rudani V. ITSC in 37 Taxman.com 333 Gujarat High Court, the learned Standing counsel submitted that the decision making process alone can be challenged and not the decision itself. Even otherwise, piecemeal acceptance of the Settlement Commission's order and a challenge to the remaining portion is impermissible.

11. The various arguments advanced by the learned Senior counsel for the petitioner, which have been extracted above, are to the effect that the impugned order of the Commission is not in accordance with the provisions of the Act. Among the various grounds raised by the petitioner, two primary grounds are to the effect that advances in the nature of commercial transactions would not fall within the ambit of Section 2 (22) (e) and that dividend is not taxable as per the provisions of Section 10 (34) of the Act. These grounds are predominantly to the effect that the findings rendered by the Settlement Commission in the impugned order are not in accordance with the provisions of the Act.

12. In Jyotendrasinhji (supra), the Hon'ble Apex Court had held that the only ground upon which the Court could interfere against the order of the Commission is that when such order is contrary to the provisions of the Act and that such contravention had prejudiced the appellant. This proposition has been reiterated in various other subsequent decisions of various High Courts. In the said decision, the Hon'ble Apex Court had also referred to the decision of the Hon'ble Supreme Court in R.B. Shreeram Durga Prasad & Fatechand Nursing Das Vs Settlement Commission [(1989) 176 ITR 169], wherein it was held that judicial review is permissible, not with the decision, but with the decision making process. Nevertheless, it was ultimately held that the order of the Settlement Commission could be interfered with, if it is in contrary to the provisions of the

Act. The relevant portion in Jyotendrasinhji's case reads as follows:

"Indeed, it would be difficult to predicate the reasons and considerations which induce the commission to make a particular order, unless of course the commission itself chooses to, give reasons for its order. Even if it gives reasons in a given case, the scope of enquiry in the appeal remains the same as indicated above viz., whether it is, contrary to any of the provisions of the Act. In this context, it is relevant to note that the principle of natural justice (and alteram partem) has been incorporated in Section 245-D itself. The sole overall limitation upon the Commission thus appears, to be that it should act in accordance with the provisions of the Act. The scope of enquiry, whether by High Court under Article 226 or by this Court under Article 136 is also the same whether the order of the Commission is contrary to any of the provisions of the Act and if so, has it prejudiced the petitioner/appellant apart from ground of bias, fraud & malice which, of course, constitute a separate and independent category. Reference in this behalf may be had to the decision of this Court in Sri Ram Durga Prasad v. Settlement Commission 176 I.T.R. 169, which too was an appeal against the orders of the Settlement Commission. Sabyasachi Mukharji J., speaking for the Bench comprising himself and S.R. Pandian, J. observed that in such a case this Court is "concerned with the legality of procedure followed and not with the validity of the order." The learned Judge added 'judicial review is concerned not with the decision but with the decision-making process.' Reliance was placed upon the decision of the House of Lords in Chief Constable of the N.W. Police v. Evans, [1982] 1 W.L.R.1155. Thus, the appellate power under Article 136 was equated to power of judicial review, where the appeal is directed against the orders' of the Settlement Commission. For all the above reasons, we are of the opinion that the only ground upon which this Court can interfere in these appeals is that order of the Commission is contrary to the provisions of the Act and

that such contravention has prejudiced the appellant. The main controversy in these appeals relates to the interpretation of the settlement deeds though it is true, some contentions of law are also raised. The commission has interpreted the trust deeds in a particular manner. Even if the interpretation placed by the commission the said deeds is not correct, it would not be a ground for interference in these appeals, since a wrong interpretation of a deed of trust cannot be said to be a violation of the provisions of the Income Tax Act. It is equally clear that the interpretation placed upon the said deeds by the Commission does not bind the authorities under the Act in proceedings relating to other assessment years."

13. In *C A Abraham*, (supra) the Madras High Court had observed in paragraph 16 that it cannot be said that the Settlement Commission has followed any legal procedure so as to enable this Court to interfere with the order of the Commission. Likewise, in *Mathurbhai Bhimjbhai Rudani* (supra), the Gujarat High Court had relied upon *Jyotendrasinhji* (supra) and concurred that interference can be made to the order of the Settlement Commission, if the order is contrary to the provisions of the Act and such contravention prejudices the appellant. As stated earlier, the various legal propositions put forth before this Court, assailing the orders of the Settlement Commission, are to the effect that the impugned order of the Commission is not in conformity with the provisions of the Act and by applying the ratio laid down in *Jyotendrasinhji's* case (supra), it can be said that the present Writ Petition is maintainable.

14. Likewise, this is not a case where the petitioner had accepted a portion of the impugned order and challenged the rest. As stated earlier, the petitioner offered the income of Rs.35 lakhs seized as additional income for the assessment year 2013-2014 and also disclosed that the said income was derived out of the sale of Silver Oak trees which were felled at her agricultural lands. The application for settlement was made since the petitioner was not able to prove that the seized cash was out of the sale of such trees. Apprehending that the amounts advanced by RSPL to RTPL may be assessed as deemed dividend is in the hands of the petitioner, a mention was made in the application that the petitioner is a shareholder, holding more than 20% of equity share capital in both the Companies and that RSPL had advanced the money in the ordinary course of its business as corporate loans to RTPL. It is nobody's case that

the petitioner claimed a portion of the sum of Rs.35 lakhs offered as income, to be taxable. Hence the contention of the learned Standing counsel for the Department that a piecemeal challenge to the Settlement Commission's order is not maintainable, cannot be sustained. As such, this Court is of the view that the challenge to the impugned order of the Settlement Commission by invoking Article 226 of the Constitution of India in this Writ Petition, is maintainable.

15. I shall now address the various grounds raised and deliberated by the respective counsels.

RELEVANCE AND VALIDITY OF CDBT CIRCULARS:

16. The learned Senior counsel for the petitioner, would place reliance on two Circulars issued by the Central Board of Direct Taxes (CBDT). While Circular No. 119 of 2017 directs that advances in nature of commercial transaction would not fall within the ambit of Section 2(22)(e) and that no appeals be filed by the Department on this ground and those already filed shall be withdrawn or not pressed upon, Circular No. 495 of 1987 directs that deemed dividend will be taxable in the hands of the concern where loan/advances are made by a Company to concern with common shareholder. Reliance was placed on the decisions in UCO Bank V. CIT [(1999) 237 ITR 889 (SC)]; Navnit Lal C. Javeri Vs ACIT [(1965) 56 ITR 198 (SC)]; KP Verghese V. ITO [(1981) 131 ITR 597 (SC)]; and Keshavji Ravji and Company V. CIT [(1990) 183 ITR 1 (SC)] in this regard.

17. The learned Standing counsel for the Department would oppose this proposition stating that without explaining how the transactions between the two Companies constitute ordinary commercial transaction, the petitioner cannot rely on the Circulars. The learned counsel also contended that the Circulars will not bind the Courts, especially when it is against the provisions of law. According to the learned counsel, proceedings under Section 245 L of the Act before the Settlement Commission is deemed to be judicial proceedings and therefore, these Circulars will have no binding effect. For such a proposition, the learned Standing counsel relied upon the decisions in Hindustan Aeronautics Limited V. CIT reported in (2000) 243 ITR 808 (SC) and CEEE V. Rattan Melting and Wire Industries reported in (2008) 231 ELT 22 (SC) and submitted that the Hon'ble Supreme Court had distinguished the applicability of the decision in KP Verghese and Navnit Lal relied upon by the petitioner.

18. Two issues that arise for consideration at this juncture are as to whether the Circulars of the CBDT are binding on the Settlement Commission and if so, whether the contents of these two Circulars would allure to the benefit of the petitioner?

19. Three Hon'ble Judges of the Hon'ble Supreme Court had dealt with the relevance and binding nature of the CBDT's circulars in UCO Bank (supra) and held that these Circulars are legally binding on the revenue, even if they be found not in accordance with the correct interpretation of the Section and they depart or deviate from such construction. The following are the relevant portions of the judgment:

"... there is really little probability of the loans being repaid. It is considered desirable to extend this principle to banks which, instead of transferring the doubtful debts to a suspense account, credit the interest on such debts to that account provided the Income-tax Officer is satisfied that recovery is practically improbable." This circular was in force till 20th of June, 1978 when the Central Board of Direct Taxes issued a circular dated 20th of June, 1978 withdrawing with immediate effect the earlier circular of 6th of October, 1952. The reason for the withdrawal of the circular of 1952 is set out in the circular of 20th of June, 1978. The reason is stated thus: "the Board has been advised that where accounts are kept on mercantile basis, interest thereon is taxable irrespective of whether the interest is credited to suspense account or to interest account. The Kerala High Court has also expressed the same view in the case of State Bank of Travancore v. Commissioner of Income-tax, Kerala [110 ITR 336]. The amount of such interest is, therefore, includible in the taxable income." The withdrawal of the circular of 6th of October, 1952 which had been in force for thirty six years was on account of the decision of the Kerala High Court in State Bank of Travancore v. Commissioner of Income-tax, Kerala (Supra). The Central Board of Direct Taxes, however, issued another circular of 9th of October, 1984 under which the Central Board of Direct Taxes decided that "interest in respect of doubtful debts credited to suspense account by the banking companies will be subjected to tax but interest charged in an account where there has been no recovery for three consecutive accounting years will not be subjected to tax in the fourth year and onwards. However, if there is any recovery in the fourth year or

later the actual amount recovered only will be subjected to tax in the respective years. This procedure will apply to assessment year 1979-80 and onwards. The Board's Instruction No.1186 dated 20.6.78 is modified to this extent." The same circular has also further clarified that upto assessment year 1978-79 the taxability of interest on doubtful debts credited to suspense account will be decided in the light of the Board's earlier circular dated 6.10.1952 as the said circular was withdrawn only in June, 1978. The new procedure under the circular of 9th of October, 1984 will be applicable for and from the assessment year 1979-80. All pending disputes on the issue should be settled in the light of these instructions. Therefore, upto the assessment year 1978-79, the Central Board of Direct Taxes' circular of 6th October, 1952 would be applicable; while from the assessment year 1979-80, the Central Board of Direct Taxes' circular of 9th of October, 1984 is made applicable. In the present case, the assessment was made on the basis of the Central Board of Direct Taxes circular of 9th of October, 1984, since the assessment pertains to assessment year 1981-82 to which the circular of 6th October, 1984 is applicable.

What is the status of these circulars? Section 119(1) of the Income-tax Act, 1961 provides that, "The Central Board of Direct Taxes may, from time to time, issue such orders, instructions and directions to other income-tax authorities as it may deem fit for the proper administration of this Act and such authorities and all other persons employed in the execution of this Act shall observe and follow such orders, instructions and directions of the Board. Provided that no such orders, instructions or directions shall be issued (a) so as to require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner; or (b) so as to interfere with the discretion of the Appellate Assistant Commissioner in the exercise of his appellate functions". Under sub-section (2) of Section 119, without prejudice to the generality of

the Board's power set out in sub-section (1), a specific power is given to the Board for the purpose of proper and efficient management of the work of assessment and collection of revenue to issue from time to time general or special orders in respect of any class of incomes or class of cases setting forth directions or instructions, not being prejudicial to assessees, as the guidelines, principles or procedures to be followed in the work relating to assessment. Such instructions may be by way of relaxation of any of the provisions of the sections specified there or otherwise. The Board thus has power, inter alia, to tone down the rigour of the law and ensure a fair enforcement of its provisions, by issuing circulars in exercise of its statutory powers under Section 119 of the Income-tax Act which are binding on the authorities in the administration of the Act. Under Section 119(2)(a), however, the circulars as contemplated therein cannot be adverse to the assessee. Thus, the authority which wields the power for its own advantage under the Act is given the right to forego the advantage when required to wield it in a manner it considers just by relaxing the rigour of the law or in other permissible manners as laid down in Section 119. The power is given for the purpose of just, proper and efficient management of the work of assessment and in public interest. It is a beneficial power given to the Board for proper administration of fiscal law so that undue hardship may not be caused to the assessee and the fiscal laws may be correctly applied. Hard cases which can be properly categorised as belonging to a class, can thus be given the benefit of relaxation of law by issuing circulars binding on the taxing authorities.

The question whether interest earned, on what have come to be known as "sticky" loans, can be considered as income or not until actual realization, is a question which may arise before several income tax officers exercising jurisdiction in different parts of the country. Under the accounting practice, interest which is transferred to the suspense account and not brought to the profit and loss

account of the company is not treated as income. The question whether in a given case such "accrual" of interest is doubtful or not, may also be problematic. If, therefore, the Board has considered it necessary to lay down a general test for deciding what is a doubtful debt, and directed that all income tax officers should treat such amounts as not forming part of the income of the assessee until realized, this direction by way of a circular cannot be considered as travelling beyond the powers of the Board under Section 119 of the Income Tax Act. Such a circular is binding under Section 119. The circular of 9th of October, 1984, therefore, provides a test for recognising whether a claim for interest can be treated as a doubtful claim unlikely to be recovered or not. The test provided by the said circular is to see whether, at the end of three years, the amount of interest has, in fact, been recovered by the bank or not. If it is not recovered for a period of three years, then in the fourth year and onwards the claim for interest has to be treated as a doubtful claim which need not be included in the income of the assessee until it is actually recovered.

In the case of Navnitlal C. Javeri v. K.K. Sen, Appellate Assistant Commissioner of Income-Tax, 'D' Range, Bombay (1965 (1) SCR 909), the legal effect of such circulars is, inter alia, considered by a Bench of five judges of this Court. Section 2(6A) (e) and Section 12(1B) were introduced in the Income-tax Act by the Finance Act 15 of 1955 which came into force on 1st of April, 1955. The Government, however, realised that the operation of Section 12(1B) would lead to extreme hardship because it would have covered the aggregate of all outstanding loans of past years and would impose an unreasonably high liability on the shareholders to whom the loans might have been advanced. The Minister, therefore, gave an assurance in Parliament that outstanding loans and advances which are otherwise liable to be taxed as dividends in the assessment years 1955-56 will not be subjected to tax if it is shown that they had been genuinely refunded to the respective

companies before 30th of June, 1955. Accordingly, a circular was issued by the Central Board of Revenue on 10th of May, 1955 pointing out to all income tax officers that it was likely that some of the companies might have advanced loans to their shareholders as a result of genuine transactions of loans, and the idea was not to affect such transactions and not bring them within the mischief of the new provision. The officers, therefore, were asked to intimate to all the companies that if the loans were repaid before 30th of June, 1955 in a genuine manner, they would not be taken into account in determining the tax liability of the shareholders to whom they may have been advanced despite the new section. This circular was held by this court as binding on the Revenue, though limiting the operation of Section 12(1B) or excluding certain transactions from the ambit of Section 12(1B). It was so held because the circular was considered as issued for the purpose of proper administration of the provisions of Section 12(1B) and the court did not look upon this circular as being in conflict with Section 12(1B).

A similar view of CBDT circulars has been taken in the case of K.P. Varghese v. Income Tax Officer, Ernakulam and Ors. (1981 (4) SCC 173 [at page 188]), by a Bench of two judges consisting of P.N. Bhagwati and E.S. Venkataramiah, JJ. The Bench has held that circulars of Central Board of Direct Taxes are legally binding on the Revenue and this binding character attaches to the circulars even if they be found not in accordance with the correct interpretation of the section and they depart or deviate from such construction. Citing the decision of Navnitlal C. Javeri v. K.K. Sen (Supra), this Court observed that circulars issued by the Central Board of Direct Taxes under Section 119 of the Act are binding on all officers and persons employed in the execution of the Act even if they deviate from the provisions of the Act. In Keshavji Ravji and Co. v. Commissioner of Income-Tax (1990 [183] ITR 1) a Bench of three judges of this Court has also taken the view that circulars beneficial to the assessee

which tone down the rigour of the law and are issued in exercise of the statutory powers under Section 119 are binding on the authorities in the administration of the Act. The benefit of such circulars is admissible to the assessee even though the circulars might have departed from the strict tenor of the statutory provision and mitigated the rigour of the law. This Court, however, clarified that the Board cannot pre-empt a judicial interpretation of the scope and ambit of a provision of the Act. Also a circular cannot impose on the tax-payer a burden higher than what the Act itself, on a true interpretation, envisages. The task of interpretation of the laws is the exclusive domain of the courts. However, the Board has the statutory power under Section 119 to tone down the rigour of the law for the benefit of the assessee by issuing circulars to ensure a proper administration of the fiscal statute and such circulars would be binding on the authorities administering the Act.

In the case of C.B. Gautam v. Union of India and Ors. (1993 (199) ITR 530 at page 546) a Bench of five judges of this Court considered as enforceable, Instruction No.1A88 issued by the Central Board of Direct Taxes relating to the enforcement of the provisions of Chapter XX-C of the Income-tax Act. The Central Board pointed out in the said instruction that in administering the provisions of the said Chapter, it has to be ensured that no harassment is caused to bona fide and honest purchasers or sellers of immovable property and that the power of pre-emptive purchase has to be exercised by the appropriate authority only when it has good reason to believe that the property has been sold at an undervalue and there is payment of black money in the transaction. The instruction that when the property is put up for sale by the appropriate authority, the reserve price should be fixed at a minimum of 15% above the purchase price shown as the apparent consideration under the agreement between the parties, was held to be binding on the authority. The Constitution Bench in the above case also approved of the

decision of this Court in K.P. Varghese v. Income Tax Officer (Supra).

There are, however, two decisions of this Court which have been strongly relied upon by the respondents in the present case. The first decision is the majority judgment in The State Bank of Travancore v. Commissioner of Income-Tax, Kerala (1986 (158) ITR 102) decided by a Bench of three Judges of this court by a majority of two to one. This judgment directly deals with interest on "sticky advances" which have been debited to the customer but taken to the interest suspense account by a banking company. The majority judgment has referred to the circular of 6th of October, 1952 and its withdrawal by the second circular of 20th of June, 1978. The majority appears to have proceeded on the basis that by the second circular of 20th of June, 1978 the Central Board had directed that interest in the suspense account on "sticky" advances should be includible in the taxable income of the assessee and all pending cases should be disposed of keeping these instructions in view. The subsequent circular of 9th of October, 1984 by which, from the assessment year 1979-80 the banking companies were given the benefit of the circular of 9th of October, 1984, does not appear to have been pointed out to the Court. What was submitted before the Court was, that since such interest had been allowed to be exempted for more than half a century, the practice had transformed itself into law and this position should not have been deviated from. Negating this contention, the Court said that the question of how far the concept of real income enters into the question of taxability in the facts and circumstances of the case, and how far and to what extent the concept of real income should intermingle with the accrual of income, will have to be judged "in the light of the provisions of the Act, the principles of accountancy recognised and followed, and feasibility". The Court said that the earlier circulars being executive in character cannot alter the provisions of the Act. These were in the nature of concessions which could always be prospectively withdrawn. The Court also

observed that the circulars cannot detract from the Act. The decision of the Constitution Bench of this Court in Navnitlal C. Javeri v. K.K. Sen (Supra), or the subsequent decision in K.P. Varghese v. Income Tax Officer (supra) also do not appear to have been pointed out to the Court. Since the later circular of 9.10.1984 was not pointed out to the Court, the Court naturally proceeded on the assumption that the benefit granted under the earlier circular was no longer available to the assessee and those circulars could not be resorted to for the purpose of overcoming the provisions of the Act. Interestingly, the concurring judgment of the second judge has not dealt with this question at all but has decided the matter on the basis of other provisions of law.

The said circulars under Section 119 of the Income-tax Act were not placed before the Court in the correct perspective because the later circular continuing certain benefits to the assessee was overlooked and the withdrawn circular was looked upon as in conflict with law. Such circulars, however, are not meant for contradicting or nullifying any provision of the statute. They are meant for ensuring proper administration of the statute, they are designed to mitigate the rigours of the application of a particular provision of the statute in certain situations by applying a beneficial interpretation to the provision in question so as to benefit the assessee and make the application of the fiscal provision, in the present case, in consonance with the concept of income and in particular, notional income as also the treatment of such notional income under accounting practice.

In the premises the majority decision in the State Bank of Travancore v. Commissioner of Income-Tax (Supra) cannot be looked upon as laying down that a circular which is properly issued under Section 119 of the Income-tax Act for proper administration of the Act and for relieving the rigour of too literal a construction of the law for the benefit of the assessee in certain situations would not be binding on the departmental authorities. This

would be contrary to the ratio laid down by the Bench of five judges in Navnitlal C. Javeri v. K.K. Sen (Supra). In fact, State Bank of Travancore v. Commissioner of Income-Tax (Supra) has already been distinguished in the case of Keshavji Ravji and Co. v. Commissioner of Income-Tax (Supra) by a Bench of three judges in a similar fashion. It is held only as laying down that a circular cannot alter the provisions of the Act. It being in the nature of a concession, could always be prospectively withdrawn. In the present case, the circulars which have been in force are meant to ensure that while assessing the income accrued by way of interest on a "sticky" loan, the notional interest which is transferred to a suspense account pertaining to doubtful loans would not be included in the income of the assessee, if for three years such interest is not actually received. The very fact that the assessee, although generally using a mercantile system of accounting, keeps such interest amounts in a suspense account and does not bring these amounts to the profit and loss account, goes to show that the assessee is following a mixed system of accounting by which such interest is included in its income only when it is actually received. Looking to the method of accounting so adopted by the assessee in such cases, the circulars which have been issued are consistent with the provisions of Section 145 and are meant to ensure that assessee's of the kind specified who have to account for all such amounts of interest on doubtful loans are uniformly given the benefit under the circular and such interest amounts are not included in the income of the assessee until actually received if the conditions of the circular are satisfied. The circular of 9.10.1984 also serves another practical purpose of laying down a uniform test for the assessing authority to decide whether the interest income which is transferred to the suspense account is, in fact, arising in respect of a doubtful or "sticky" loan. This is done by providing that non-receipt of interest for the first three years will not be treated as interest on a doubtful loan. But if after three years the payment of interest is not

received, from the fourth year onwards it will be treated as interest on a doubtful loan and will be added to the income only when it is actually received.

We do not see any inconsistency or contradiction between the circular so issued and Section 145 of the Income-tax Act. In fact, the circular clarifies the way in which these amounts are to be treated under the accounting practice followed by the lender. The circular, therefore, cannot be treated as contrary to Section 145 of the Income-tax Act or illegal in any form. It is meant for a uniform administration of law by all the income tax authorities in a specific situation and, therefore, validly issued under Section 119 of the Income-tax Act. As such, the circular would be binding on the Department.

The other judgment on which reliance was placed by the Department was a judgment of a Bench of two judges of this Court in Kerala Financial Corporation V. Commissioner of Income-Tax (1994 (4) SCC 375) where this Court, following the majority view in State Bank of Travancore v. Commissioner of Income-Tax (Supra) held that interest which had accrued on a "sticky" advance has to be treated as income of the assessee and taxable as such. It is said that ultimately, if the advance takes the shape of a bad debt, refund of the tax paid on the interest would become due and the same can be claimed by the assessee in accordance with law. For reasons set out above, we are not in agreement with the said judgment. The relevant circulars of C.B.D.T. cannot be ignored. The question is not whether a circular can override or detract from the provisions of the Act; the question is whether the circular seeks to mitigate the rigour of a particular section for the benefit of the assessee in certain specified circumstances. So long as such a circular is in force it would be binding on the departmental authorities in view of the provisions of Section 119 to ensure a uniform and proper administration and application of the Income-tax Act."

The aforesaid observations are self-explanatory. The Hon'ble Apex Court, while delivering the decision in UCO bank (supra) had also taken note of the findings in Navnit Lal C. Javeri, KP Verghese and Keshavji Ravji (supra).

20. To circumvent the proposition laid in UCO Bank (supra), the learned Standing counsel placed reliance on Hindustan Aeronautics Ltd (supra) and submitted that the Circulars will not bind the Courts. It is also his submission that the Hon'ble Apex Court in Hindustan Aeronautics Ltd has already distinguished the applicability of the decisions of Navnit Lal C. Javeri and KP Verghese (supra), which were relied upon by the petitioner.

21. Hindustan Aeronautics Ltd (supra) dealt with the scope of Section 264 of the Act and observed that there is no doubt that the instructions given by the CBDT are binding on the authorities under the Act but when the Hon'ble Supreme Court or the High Court has declared a law on question arising for consideration, it will not be open to a Court to direct that the Circulars should be given effect to and not the view expressed in a decision of the Hon'ble Supreme Court or the High Court. The ratio that the instructions given by the CBDT are binding on the authorities had been reiterated in Hindustan Aeronautics Ltd (supra). What has been clarified in the said case is that such instructions cannot supersede the law declared by the Hon'ble Supreme Court or the High Court. It is in this background that reference was made to the decisions in Navnit Lal C. Javeri and KP Verghese (supra) and a perusal of the observations made in this regard may not be considered of having been distinguished from the position laid down in Hindustan Aeronautics Ltd. Similar findings were rendered in Rattan Melting and Wire Industries.

22. The observations made in Hindustan Aeronautics Ltd are as follows:

"However, the learned counsel for the appellant relied on the decisions in Navnitlal C. Javeri v. K.K.Sen, AAC of Income Tax, 56 ITR 198, Ellerman Lines Ltd. vs. C.I.T, 82 ITR 913 and K.P.Varghese vs. ITO, 131 ITR 597, to contend that the circular issued by the Board under Section 119 of the Act is binding on the Commissioner in terms of which he was bound to examine the revision of the appellant on merits and the order of the learned Single Judge merely gives effect to such a course. Dr. Gauri Shankar, learned senior advocate for the Revenue, however, pointed out by referring to several decisions of this Court to the effect that the circulars or instructions given by the

Board are no doubt binding in law on the authorities under the Act but when the Supreme Court or the High Court has declared the law on the question arising for consideration it will not be open to a Court to direct that a circular should be given effect to and not the view expressed in a decision of the Supreme Court or the High Court. We find great force in this submission made by the learned senior advocate for the Revenue and find absolutely no merit in this appeal and the same stands dismissed, but in the circumstances of the case, there shall be no orders as to costs."

23. In *Rattan Melting and Wire Industries (supra)*, the Constitutional Bench of the Hon'ble Apex Court held thus:

" 6. Circulars and instructions issued by the Board are no doubt binding in law on the authorities under the respective statutes, but when the Supreme Court or the High Court declares the law on the question arising for consideration, it would not be appropriate for the Court to direct that the circular should be given effect to and not the view expressed in a decision of this Court or the High Court. So far as the clarifications/circulars issued by the Central Government and of the State Government are concerned they represent merely their understanding of the statutory provisions. They are not binding upon the court. It is for the Court to declare what the particular provision of statute says and it is not for the Executive. Looked at from another angle, a circular which is contrary to the statutory provisions has really no existence in law."

7. As noted in the order of reference the correct position vis-à-vis the observations in para 11 of *Dhiren Chemical's case (supra)* has been stated in *Kalyani's case (supra)*. If the submissions of learned counsel for the assessee are accepted, it would mean that there is no scope for filing an appeal. In that case, there is no question of a decision of this Court on the point being rendered. Obviously, the assessee will not file an appeal questioning the view expressed vis-à-vis the circular. It has to be the revenue authority who has to question that. To lay content with the circular would mean that the

valuable right of challenge would be denied to him and there would be no scope for adjudication by the High Court or the Supreme Court. That would be against very concept of majesty of law declared by this Court and the binding effect in terms of Article 141 of the Constitution."

24. Useful reference could be made to the decision of a Division Bench of the Bombay High Court in the case of Commissioner of Income Tax V. Income Tax Settlement Commission and another [(2014) 364 ITR 410 (Bom)] wherein most of the decisions discussed above were considered and ultimately held that the Circulars of the CBDT have a binding force.

25. Now that, it is found that the Circulars of the CBDT are binding in nature, the consequent issue as to whether the contents of the circulars would allure to the benefit of the petitioner herein, requires consideration. For a proper appraisal, the (relevant) portions of these two Circulars are extracted hereunder:

Circular No. 19/2017

"F.No.279/Misc./140/2015/ITJ

Government of India

Ministry of Finance

Central Board of Direct Taxes

New Delhi, Dated 12th June, 2017

Sub: Settled View on section 2 (22) (e) of the Income Tax Act, trade advances-reg.

Section 2(22) clause (e) of the Income Tax Act, 1961 (the Act) provides that "dividend" includes 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, being a person who is the beneficial owner of share (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.

2. The Board has observed that some Courts in the recent past have held that trade advances in the nature of commercial transactions would not fall within the ambit of

the provisions of Section 2(22)(e) of the Act. Such views have attained finality.

2.1 Some illustrations/examples of trade advances/commercial transactions held to be not covered under Section 2(22)(e) of the Act are as follows:

i) Advances were made by a company to a sister concern and adjusted against the dues for job work done by the sister concern. It was held that amounts advanced for business transactions do not fall within the definition of deemed dividend under Section 2(22)(e) of the Act. (CIT V. Creative Dyeing & Printing Pvt. Ltd., Delhi High Court).

ii) Advance was made by a company to its shareholder to install plant and machinery at the shareholder's premises to enable him to do job work for the company so that the company could fulfill an export order. It was held that as the assessee proved business expediency, the advance was not covered by Section 2(22)(e) of the Act. (CIT V. Amrik Singh, P & H, High Court).

iii) A floating security deposit was given by a company to its sister concern against the use of electricity generators belonging to the sister concern. The company utilised gas available to it from GAIL to generate electricity and supplied it to the sister concern at concessional rates. It was held that the security deposit made by the company to its sister concern was a business transaction arising in the normal course of business between two concerns and the transaction arising in the normal course of business between two concerns and the transaction did not attract section 2(22)(e) of the Act. (CIT, Agra V. Atul Engineering Udyog, Allahabad High Court).

3. In view of the above it is, a settled position that trade advances, which are in the nature of commercial transactions would not fall within the ambit of the word 'advance' in Section 2(22)(e) of the Act. Accordingly, henceforth, appeals may not be filed on this ground by officers of the Department and those already filed, in Courts/Tribunals may be withdrawn/not pressed upon.

4. The above may be brought to the notice of all concerned.

5. Hindi version follows.

(Neetika Basal)

Deputy Secretary to Government of India"

Circular No. 495 of 1987:

"C.B.D.T. Circulars

Subject: The Finance Act, 1987-Explanatory Notes on the provisions relating to direct taxes

...

Definition of dividend-Section 2(22) (e):

10.1 Sections 104 to 109 relate to levy of additional tax on certain closely-held companies (other than those in which the public are substantially interested) if they fail to distribute a specified percentage of their distributable profits as dividends. These provisions had lost much of their relevance with the reduction of the maximum marginal rate of personal tax to 50 per cent, which is lower than the rate for corporation tax on closely-held companies. Sections 104 to 109 have, therefore, been omitted by the Finance Act, 1987.

10.2 With the deletion of sections 104 to 109 there was a likelihood of closely held companies not distributing their profits to shareholders by way of dividends but by way of loans or advances so that these are not taxed in the hands of the shareholders. To forestall this manipulation, sub-clause (e) of clause (22) of Section 2 has been suitably amended. Under the existing provisions, payments by way of loans or advances to shareholders having substantial interest in a company to the extent to which the company possesses accumulated profits is treated as dividend. The shareholders having substantial interest are those who have a shareholding carrying not less than 20 per cent, voting power as per the provisions of clause (32) of Section 2. The amendment of the definition extends its application to payments made (i) to a shareholder holding not less than 10 percent of the voting power, or (ii) to a concern in which the shareholder has substantial interest. "Concern" as per the newly inserted Explanation 3(a) to section 2(22) means a HUF or a firm or an association of persons or a body of individuals or a company. A shareholder having a substantial interest in a concern as per part (b) of Explanation 3 is deemed to be one who is beneficially entitled to not less than 20 per cent of the income of such concern.

10.3 The new provision would, therefore, be applicable in a case where a shareholder has 10 per cent or more of the equity capital. Further, 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 per cent of the income of such concern.

With a view to avoid the hardship in cases where advances or loans have already been given, the new provisions have been made applicable only in cases where loans or advances are given after 31st May, 1987.

These amendments will apply in relation to assessment year 1988-89 and subsequent years. ..."

26. Circular No. 19 of 2017 directs that advances in the nature of commercial transaction would not fall within the ambit of Section 2 (22)(e) of the Act. Accordingly, it was directed therein that appeals may not be filed on this ground by officers of the Department and those appeals already filed may be withdrawn or not pressed. If the directions of the Circular is pressed into service, the transaction between RSPL and RTPL, being in the nature of commercial transaction, would not fall within the ambit of Section 2 (22) (e) of the Act. Likewise, Circular No. 494 of 1987 directs that deemed dividend will be taxable in the hands of the concern where loan or advances are made by a Company to concern with common shareholder. The learned Standing counsel for the respondent had contended that without explaining as to how the transaction between the two Companies constitute ordinary commercial transaction, the petitioner cannot rely on the Circular.

27. In the application before the Settlement Commission, the petitioner herein had specifically stated that RSPL had advanced money to RTPL in the ordinary course of business. The money so received was utilized for its working capital requirements and no part of the same was diverted as loan or advance for direct or indirect benefit of any of the Directors, including the petitioner. It was further stated therein that these funds were given as inter corporate loans on which interest was charged at market rates. The interest charged by RSPL have been assessed as business income by the same Assessing Officer, who is also the Assessing Officer of the petitioner. The authorized representative of the petitioner had reiterated these aspects and stated before the Settlement Commission that the money advanced by RSPL was in the ordinary course of business. The Settlement Commission had extracted the statement of the authorised representative in the impugned order and had not disputed the fact that the loan granted was in the ordinary course of business. The only finding by the Settlement Commission in this regard was that the lending of money does not form a substantial part of the business of RSPL. When the fact

which was specifically referred to in the application and contended before the Settlement Commission has not been disputed, it cannot be said that the petitioner had failed to explain before the Commission that the transactions were during the ordinary course of business. In this context, the objections raised by the learned Standing counsel for the respondents, cannot be sustained.

28. The learned Senior counsel for the petitioner relied upon the decision of CIT V. Creative Dyeing and Printing Private Limited reported in (2009) 318 ITR 476 (Delhi) for the aforesaid proposition and the relevant portions of the said judgment reads as below:

"The Tribunal has also referred to the judgment of the Bombay High Court in the case of C.I.T. Vs. Nagin Das M. Kapadia 177 ITR 393 (Bom) in which it was held that business transactions are outside the purview of Section 2(22)(e) of the Act. In the said case, the company in which Kapadia was having substantial interest had paid various amount to Kapadia. The Tribunal had ITA 250/2009 Page 6 found that Kapadia had business transactions with the company and on verification of the accounts, the Tribunal deleted the amounts which were relating to the business transactions and which finding was upheld by the High Court.

9. In the present case the Tribunal on considering decisions in various cases held as under:

" From the ratio laid down in above cases and on the basis of judicial interpretation of words, „Loans" or „Advances", it can be held that section 2(22)(e) can be applied to „Loans" or „Advances" simplicitor and not to those transactions carried out in course of business as such. In the course of carrying on business transaction between a company and a stockholder, the company may be required to give advance in mutual interest. There is no legal bar in having such transaction. What is to be ascertained is what is the purpose of such advance. If the amount is given as advance simplicitor or as such per se without any further obligation behind receiving such advances, may be treated is „deemed dividend", but if it is otherwise, the amount given cannot be branded as „advances" within the meaning of

deemed dividend under section 2(22)(e). Just as per clause (ii) of section 2(22)(e), dividend is not to include advance or loan made by a company in the ordinary course of business where the lending of money is a substantial part of the business of the company advance in the ordinary course of carrying on business cannot be considered as „dividend" within the meaning of section 2(22)(c). By granting advance if the business purpose of the company is served and which is not the sum, which it otherwise would have distributed as dividend, cannot be brought within the deeming provision of treating such „Advance" as deemed dividend"

10. We agree with the aforesaid observations. The finding of facts, arrived at by the Tribunal in the present case is that the transaction in question was a ITA 250/2009 Page 7 business transaction and which transaction would have benefited both the assessee company and M/s. Pee Empro Exports Pvt. Ltd. In fact, as stated above, the counsel for the appellant has conceded that the amount is in fact not a loan but only an advance because the amount paid to the assessee company would be adjusted against the entitlement of moneys of the assessee company payable by M/s. Pee Empro Exports Pvt. Ltd. in the subsequent years.

11. The counsel for the appellant has very strenuously urged that neither the Tribunal nor the judgment of this Court in Rajkumar's case (supra) deals with that part of the definition of deemed dividend under Section 2(22)(e) which states that deemed dividend does not include an advance or loan made to a shareholder 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 [Section 2(22)(e)(ii)] i.e. there is no deemed dividend only if the lending of moneys is by a company which is engaged in the business of money lending. Dilating further the counsel for the appellant contended that since M/s. Pee Empro Exports Pvt. Ltd. is not into the business of lending of money, the payments made by it to the assessee company would therefore be covered by Section 2(22)(e)(ii) and consequently payments even for business transactions would

be a deemed dividend. We do not agree. The Tribunal has dealt with this aspect as reproduced in para (9) above. The provision of Section 2(22)(e)(ii) is basically in the nature of an explanation. That cannot however, have bearing on interpretation of the main provision of Section 2(22)(e) and once it is held that ITA 250/2009 Page 8 the business transactions does not fall within Section 2(22)(e), we need not to go further to Section 2(22)(e)(ii). The provision of Section 2(22)(e)(ii) gives an example only of one of the situations where the loan/advance will not be treated as a deemed dividend, but that's all. The same cannot be expanded further to take away the basic meaning, intent and purport of the main part of Section 2(22)(e). We feel that this interpretation of ours is in accordance with the legislative intention of introducing Section 2(22)(e) and which has been extensively dealt with by this Court in the judgment in Raj Kumar's case (supra). This Court in Raj Kumar's case (supra) extensively referred to the report of the Taxation Enquiry Commission and the speech of the Finance Minister in the Budget while introducing the Finance Bill. Ultimately, this Court in the said judgment held as under:

"10.3 A bare reading of the recommendations of the Commission and the Speech of the then Finance Minister would show that the purpose of insertion of clause (e) to section 2(6A) in the 1922 Act was to bring within the tax net monies paid by closely held companies to their principal shareholders in the guise of loans and advances to avoid payment of tax.

10.4 Therefore, if the said background is kept in mind, it is clear that sub-clause (e) of section 2(22) of the Act, which is pari material with clause (e) of section 2(6A) of the 1922 Act, plainly seeks to bring within the tax net accumulated profits which are distributed by closely held companies to its shareholders in the form of loans. The purpose being that persons who manage such closely held companies should not arrange their affairs in a manner that they assist the shareholders in

avoiding the payment of taxes by having these companies pay or distribute, what would legitimately be dividend in the hands of the shareholders, money in the form of an advance or loan.

10.5 If this purpose is kept in mind then, in our view, the ITA 250/2009 Page 9 word „advance" has to be read in conjunction with the word „loan". Usually attributes of a loan are that it involves positive act of lending coupled with acceptance by the other side of the money as loan: it generally carries an interest and there is an obligation of repayment. On the other hand, in its widest meaning the term „advance" may or may not include lending. The word „advance" if not found in the company of or in conjunction with a word „loan" may or may not include the obligation of repayment. If it does then it would be a loan. Thus, arises the conundrum as to what meaning one would attribute to the term „advance". The rule of construction to our minds which answers this conundrum is noscitur a sociis. The said rule has been explained both by the Privy Council in the of Angus Robertson v. George Day (1879) 5 AC 63 by observing "it is a legitimate rule of construction to construe words in an Act of Parliament with reference to words found in immediate connection with them" and our Supreme Court in the case of Rohit Pulp & Paper Mills Ltd. v. Collector of Central Excise, AIR 1991 SC 754 and State of Bombay v. Hospital Mazdoor Sabha AIR 1960 SC 610."

12. Therefore, we hold that the Tribunal was correct in holding that the amounts advanced for business transaction between the parties, namely, the assessee company and M/s. Pee Empro Exports Pvt. Ltd. was not such to fall within the definition of deemed dividend under Section 2(22)(e). The present appeal is therefore dismissed."

The aforesaid decision in Creative Dyeing and Printing Private Limited was upheld by the Hon'ble Supreme Court in an order dated 22.09.2009 in a special leave to appeal.

29. In CIT V. C. Subba Reddy, (2017) 77 Taxmann. com 320 (Madras High Court), a Hon'ble Division Bench of this Court held

thus:

"3. The decision of the Calcutta High Court in the case of M.D.Jindal vs. Commissioner of Income Tax (164 ITR 28) was relied upon to counter the objection of the Assessee to the effect that the credit arose out of a business transaction to which the provisions of section 2(22)(e) would not stand attracted. The officer pressed into service clause (ii) of the exclusion to section 2(22)(e) of the Act to state that only ordinary business transactions carried on by companies engaged substantially in the business of money lending would stand excluded from the mischief of section 2(22)(e) of the Act.

4. The Assessee's appeal before the Commissioner of Income Tax (Appeals) (CIT(A)) was allowed by order dated 31.08.2004. The account copy of CHPL for the period from 01.04.1997 to 31.03.2002 was examined. It was found that for the period from 01.04.1996 to 30.03.2001, the funds of the Assessee were, in fact, lying with the company and not vice-versa. The Commissioner notes that during 01.04.1996 to 31.03.2000, the quantum of funds of the assessee with the company ranged between 1.5 crores to 6.92 crores and during the previous year relevant to AY 2001-02, i.e. between 01.04.2000 to 31.03.2001, it ranged between 6.92 crores to 7.19 crores. CHPL raised an invoice for an amount of Rs.8.43 crores and after giving credit to the assessee's monies available with CHIL, a debit balance of Rs.1.61 crores as on 31.03.2001 was arrived at. The credit balance thus arose solely on account of the construction work carried on by CHIL as subcontractor of CPD. The Commissioner (Appeals) also finds as a fact that the account copy for the period 01.04.2001 to 31.03.2002 revealed that the amount had been settled the next year and the 4 balance squared off. Thus there was no benefit derived by the assessee by reason of the credit of Rs.1.61 crores.

5. The order of the CIT(A) was carried in appeal before the Income Tax Appellate Tribunal ('Tribunal') which confirmed the aforesaid factual findings, dismissing the appeal of the Revenue by order dated 09.02.2007, assailed in appeal before us. The appeal raises the

following Substantial Question of Law for our consideration: 'i)Whether on the facts and circumstances of the case, the Tribunal was right in holding that the provisions of Section 2(22)(e) treating a loan or advance as a deemed dividend does not apply if the loan is given as part of a contractual obligation? ii)Whether on the facts and circumstances of the case, the Tribunal was right in interpreting the Section on the basis of intention of the legislature, when the words of the Section are clear and unambiguous? iii)Whether on the facts and circumstances of the case, the Tribunal was right in looking at the transaction between the two companies in other years to arrive at the conclusion that the loan granted in the relevant financial year does not amount to deemed dividend under Section 2(22)(e) of the Act?'

6. We have heard the submissions of Mr.T.Ravikumar, learned counsel appearing for the Revenue and Mr.S.Sri Mr.S.Sridhar, learned counsel appearing for the Assessee.

7. The provisions of Section 2(22)(e) impose a deeming fiction and the conditions imposed therein call for strict and concurrent satisfaction being - (i) payment by closely held company, (ii) of the nature of an advance or loan, (iii) to a share holder or beneficial owners of shares, (iv) with more than 10% voting power, (v) for his individual benefit.

8. In the present case, the credit arises by virtue of a contractual obligation and a business transaction and has been settled the very next year. There is no individual benefit derived by the Assessee. Moreover, the credit does not satisfy the definition of 'advance' or 'loan'. The fiction thus fails on several counts. The Revenue relies upon the judgment of the Supreme Court in the case of Miss P.Sarada vs. Commissioner of Income Tax (229 ITR 444) and the decision of the Calcutta High Court in M.D.Jindal vs. Commissioner of Income Tax (164 ITR 28).

9. In the first case, the assessee had made withdrawals from out of accumulated profits that were deemed to be dividend u/s 2(22)(e) of the Act. The defence taken was that the

withdrawals 6 could be taken to have been paid from out of monies lying to the credit of another shareholder. This was negatived by the Supreme Court. In the present case, there are no withdrawals and as the findings of fact by the lower authorities reveal, the frequency of advances by the Assessee to the company was more than in the reverse. The Calcutta High Court, in the case of M.D.Jindal, dealt with a transaction that was found to be colourable. The concurrent finding of fact in that case was to the effect that the transaction was a device designed to circumvent the provisions of Section 2(22)(e) of the Act. The veil was thus lifted and the true facts brought to light. In the present case, there is no such allegation and on the contrary, the concurrent finding is to the effect that no benefit has accrued to the assessee, the credit is the result of a business transaction and is neither in the nature of a loan or a deposit. The decisions relied upon by the revenue do not advance its case, being distinguishable on facts.

10. Various case laws have been cited by the counsel appearing for the Assessee but we do not consider it necessary to advert to the same in view of our conclusion on the facts of the present case, that the provisions of Sections 2 (22)(e) of the Act do not stand attracted."

30. Likewise, in CIT V. Gayatri Chakroborty reported in (2018) 407 IT 730 (Calcutta), it was held as follows:

"The submission of Mr.Khaitan, learned Senior counsel, appearing for the assessee is that the transactions between the assessee and the company bore the character of mutual running or current account. He points out that there was a concurrent finding on this count by the two statutory appellate for a upon appreciation of evidence and in exercise of our jurisdiction under Section 260A of the Act, we ought not to enter into fresh exercise of appreciation of evidence. He has drawn our attention to that part of the decision of the Tribunal in which analysis has been made of ledger of the assessee in the books of the company. We shall revert to the finding of the Tribunal on this count later in this judgment.

Law on this point is clear. In the event of transactions between a shareholder and a company in

which the public are not substantially interested and the former has substantial stake, create mutual benefits and obligations, then the provision of treating any sum received by the shareholder out of accumulated profits as deemed dividend would not apply. The company in the instant case fits the description conceived in the aforesaid provision to come within the ambit of Section 2(22)(e) of the Act. The controversy which falls for determination is whether the sum received by the assessee formed part of running current account giving rise to mutual obligations or the payment formed one-way traffic, assuming the character of loan or advance out of accumulated profit. A Co-ordinate Bench of this Court in the case of Pradip Kumar Malhotra V. CIT 2001 (338) ITR 538 (Cal) has laid down the factors for testing the transactions between a company and its shareholder in the light of the aforesaid provision (page 545 of 338 ITR):

"... We are of the opinion that the phrase by way of advance or loan' appearing in sub-clause (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 share (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; 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 a shareholder, in such case, such advance or loan cannot be said to be a deemed dividend within the meaning of the Act. Thus, for gratuitous loan or advance given by a company to those classes of shareholders would come within the purview of section 2 (22) but not to the cases where the loan or advance is given in return to an advantage conferred upon the company by such shareholder."

31. There is yet another aspect to the applicability of Circular No. 19 of 2017. The Circular was issued on the basis of various judicial precedents, which has been referred to in the Circular itself. References were made in the said Circular to Creative Dyeing and Printing Private Limited (supra), wherein it was held that amounts advanced for business transactions do not fall within the definition of deemed dividend under Section 2 (22) (e) of the Act. Likewise, the CBDT Circular had placed reliance on the decisions in CIT V. Amrik Singh, Punjab and Haryana High Court reported in 2015-LL-0429-5, ITA No. 347 of

2013 and CIT, Agra V. Atul engineering Udyog, Allahabad High Court reported in 2014-LL-0926-121, wherein advances and security deposits made were held to be transactions which did not attract Section 2 (22) (e). Thus, it is clear that even prior to the issue of this 2017 Circular, the position in law was clear that deemed dividend would not apply to normal commercial transactions. Viewing from this angle also, the petitioner would be entitled to succeed on this ground.

WHETHER DEEMED DIVIDEND IS TAXABLE IN THE HANDS OF THE SHAREHOLDERS OR CONCERN?

32. The learned Senior counsel for the petitioner would submit that, even assuming that deemed dividend will be taxable, in view of Circular No. 494 of 1987, such deemed dividend will be taxable in the hands of the concern only and there is no justification for casting the liability on the shareholder. Attention of this Court was brought to diverging views of the Hon'ble Apex Court in the case of Madhur Housing (TS-462-SC-2017), wherein the decision of the Delhi High Court in the case of Ankitech Private Limited [(2012) 340 ITR 14 (Delhi)] was relied on and held that deemed dividend is taxable in the hands of shareholder, while in the case of Gopal and sons (HUF) [391 ITR 1], it was held that deemed dividend is taxable in the hands of the concern. When the issue came up for consideration in National Travel Services (Appeal No. 837), the Hon'ble Apex Court had referred the matter to a larger Bench to have a relook into the controversy.

33. While the petitioner contends that deemed dividend is not taxable in the hands of shareholders, the learned Standing counsel for the Department would contend that it is taxable in the hands of the shareholder. To substantiate such a submission, the learned counsel for the Department would attempt to justify that Circular No. 495 of 1987 runs contrary to the provisions. The learned Counsel also submitted that the reference to a larger Bench in the case of National Travel Services (supra) will not have any inference on this case. It will not be out of place to point out that in National Travel Services one of the learned Judges in the quorum had held that the decision in the case of Ankitech, as upheld by Madhur Housing, was wrongly decided. Nevertheless, since the matter has now been referred to a larger Bench for reconsideration, this Court does not intend to fix the liability of taxation either in the hands of the concern or in the hands of the shareholder, on an assumption that deemed dividend is taxable. In any view of the matter, now that this Court has held that the Circulars of the CBDT have a binding effect, it can be safely held that deemed dividend is not taxable in the hands of the shareholders, without reference

to the issue which has been referred to the larger Bench.

WHETHER DIVIDEND IS TAXABLE UNDER SECTION 10 (34) OF THE ACT?

34. The definition of the term "dividend" under Section 2 (22) envisages various situations under which a payment made by a Company to its shareholders would amount to distribution of dividend. However, Section 10 (34) of the Act exempts from payment of tax, any income by way of dividend referred to in Section 115-0.

35. Section 10 (34), as inserted by the Finance Act, 2003 with effect from 01.04.2004, reads thus:

INCOMES NOT INCLUDED IN TOTAL INCOME:

Section 10: In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included -

(34) any income by way of dividends referred to in Section 115-0.

Provided that nothing in this clause shall apply to any income by way of dividend chargeable to tax in accordance with the provisions of Section 115BBDDA;

Section 115-0 of the Income Tax Act reads as follows:

115-0. (1) Notwithstanding anything contained in any other provision of this Act and subject to the provisions of this section, in addition to the income tax chargeable in respect of the total income of domestic company for any assessment year, any amount declared, distributed or paid by such company by way of dividends (whether interim or otherwise) on or after the first day of April 2003, whether out of current or accumulated profits shall be charged two additional income tax (hereafter referred to as tax on distributed profits) at the rate of 15%.

36. Section 115-0, which falls under Chapter XII-D of the Act, does not define the term 'dividend'. However, the explanation to Section 115-Q, which also falls under Chapter XII-D, makes it clear that 'dividend' referred to in Section 115-0 also includes 'deemed dividend' as defined in Section 2 (22) (e) of the Act. The "explanation" to Section 115Q reads thus:

115Q. If any principal officer of domestic company and the company does not pay tax on distributed profits in accordance with the provisions of section 115-0, then, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of this act for the collection and recovery of income tax shall

apply.

Explanation - For the purposes of this chapter, the expression "dividends" shall have the same meaning as is given to "dividend" in clause (22) of section 2 but shall not include sub-clause (e) thereof.

37. The phrase "for the purposes of this Chapter" in the explanation above refers to the term 'dividend' mentioned in Section 115-O which also falls under Chapter XII-D. The explanation to Section 115-Q was not required if 'deemed dividend' under Section 2 (22) (e) was not referred to in Chapter XII-D. The provision makes a specific reference to unpaid distribution tax by a Company. The explanation to Section 115-Q which existed at the relevant time but was omitted by the Finance Act, 2018 provided that for the purposes of the said Chapter namely, Chapter XIID, which contains Sections 115-O and 115-Q, the expression "dividend" shall have the same meaning, as is given to dividend under Sub Section (22) of Section 2, but shall not include sub-clause (e). Thus, there was no need to omit the explanation to Section 115Q with effect from 01.04.2018, whereby deemed dividend is now payable even on dividend referred to in Section 2 (22) (e) of the Act.

38. On a comprehensive reading of Section 10 (34), 115-O and the explanation to 115Q, it is explicit that dividend is not taxable under Section 10 (34) of the Act, since such dividend would be exempted from tax in the hands of the receiver in terms of Section 10 (34). If Section 10 (34) stipulates that dividend is not taxable, the Settlement Commission cannot tax the same. In view of this, the order passed by the Settlement Commission can only be deemed to be contrary to the provisions of the Act namely, Section 10 (34) r/w. Section 115-O of the Act.

39. The proviso to Section 10 (34) stipulates that the income by way of dividends referred to in Section 115-O shall not apply to any income by way of dividend chargeable to tax in accordance with the provisions of Section 115 BBDA. In Section 115BBDA, a specific explanation has been inserted to exclude deemed dividend as referred to in Section 2 (22) (e) from the scope of dividend as referred to in Section 115BBDA. In Section 115BBDA, exclusion is not for the entire Chapter but has been generally excluded. Therefore, it is quite evident that, wherever the term 'dividend' is used in Section 115BBDA, Section 2(22)(e) is not covered.

40. It is not in dispute that Section 2 (24) includes dividend income also. What is pertinent is that such dividend, including the deemed dividend under Section 2(22)(e) of the Act, is exempted under Section 10 (34) of the Act, in the hands of the petitioner. Section 10 (34) of the Act does not provide to say that the dividend will be exempted in the hands of the shareholders only when dividend distribution tax is paid. On the

other hand, it only refers to say that as long as the dividend is referred to in Section 115-O of the Act, it will be exempted from tax under Section 10 (34) of the Act.

41. The Bombay High Court, in a decision in the case of PCIT V. Smt. Kayan Jamshid Pandole reported in (2018) 100 Taxmann.com 284 had held as follows:

"2. Following questions are presented for our consideration:

"(a) Whether on the facts and in the circumstances of the case and in law, the Hon'ble Income-tax Appellate Tribunal was justified in holding that the amount of Rs.2,78,46,000/- received by the assessee from Spirax Marshall (P) Ltd on sale of its shares to the said company under the Scheme of Arrangement, which is treated as deemed dividend under section 2(22)(d) of the Act, is exempt under Section 10(34) of the Act?

(b) Whether on the facts and in the circumstances of the case and in law, in this peculiar case, the assessee can claim exemption under section 10(34) of the Act when the company Priya Soparkar 2 7 itxa 387-16-o M/s Spirax Marshall (P) Ltd has not paid additional income-tax under section 115-O of the Act?"

6. On the other hand, learned counsel Mr.Porus Kaka appearing for the assessee submitted that the income generated by way of buy back of shares by the company was in the nature of capital gain. Assessee had offered the same to tax accordingly. If the Revenue contends that the income is in the nature of deemed dividend, the effect of Section 10 (34) of the Act would automatically follow. He further submitted that all other assesseees who were shareholders of the same company and who formed a common group had made declaration in the income tax returns declaring the gain as a capital gain. The Revenue has not opposed these claims in their cases. The Revenue has isolated the cases of only two assesseees for a differential treatment. He 1 (2018) 400 ITR 1 (SC) Priya Soparkar 5 7 itxa 387-16-o further pointed out that case of Kamal Imran Panju also arose out of the same arrangement. In

said case, the revenue chose not to pursue the issue beyond the level of the Tribunal. On the question of consistency, therefore, he argued that the revenue would be precluded from pursuing the present appeal.

8. Section 2(22) of the Act as is well known includes range of situations under which payment by company to its shareholders would amount to distribution of dividend. Clause

(d) of Section 2(22) provides that any distribution to its shareholders by the company on reduction of capital to the extent to which the company possesses the accumulated profit which arose after end of previous year, under certain circumstances would be included in the term "dividend".

9. Section 10(34) in turn exempts from payment of tax, any income by way of dividend referred to Section 115-O. As per Sub-section (1) of Section 115-O notwithstanding anything contained in the provisions of Act and subject to the provisions of the said section in addition to the income tax chargeable in respect of the total income of the domestic company, any amount declared, distributed or paid by such company by way of dividend on or after 1st April, 2003 would be chargeable to additional income tax referred to as tax on distributed profits.

10. The question would be whether the deemed dividend under Section 2(22)(d) would fall within the purview of Sub-Section 1 of Section 115-O of the Act. However, the legislature has advisedly cleared this position by providing an explanation to Section 115-Q of the Act. Before we refer to the explanation, Priya Soparkar 7 7 itxa 387-16-o we may note that Section 115-Q provides that if any Principal Officer of domestic company and a company does not pay tax on distributed profits in accordance with the provisions of Section 115-O then he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of the Act for collection and recovery of the income tax

shall apply. This provision thus makes a specific reference to unpaid distribution tax by a company. An explanation to Section 115-Q which existed at the relevant time but which was omitted by the Finance Act, 2018 and provided that for the purposes of the said Chapter (Chapter XIID) which contains Section 115-O and 115-Q, the expression "dividend" shall have the same meaning as it given to dividend under Sub-Section (22) of Section 2, but shall not include sub-clause (e) thereof.

11. The plain effect of the explanation, therefore, would be that even the deemed dividend under Section 2(22)(d) of the Act would be covered from the purpose of Chapter XIID. In turn, therefore, such deemed dividend would be one which is referred to Section 115-O of the Act. Inescapable conclusion, therefore, Priya Soparkar 8 7 itxa 387-16-o would be that such dividend also would be exempt from tax in the hands of the receiver in terms of Section 10(34) of the Act.

12. The contention of the counsel for the Revenue that the company having not paid such dividend distribution tax, exemption under Section 10(34) should be deprived to the assessee needs to be noted only for rejection. If a certain income is exempt at the hands of receiptant by virtue of statutory provision, unless a provision is made in the statute itself, such exemption cannot be withdrawn only because the payer has not paid tax. The statute has made specific provision for recovery or unpaid tax from the company. In the result, the tax appeal is dismissed."

In the aforesaid observations, the Bombay High Court has emphatically held that if certain income is exempted in the hands of the recipient by virtue of statutory provisions, such an exemption cannot be withdrawn only because the payer has not paid the tax, unless such provisions are made in the statute itself.

42. In the light of the aforesaid decision, it can be held that the Settlement Commission ought to have passed orders only in accordance with the provisions of the Act and the contrary findings in the impugned order of the Commission, cannot be sustained. As such, the conclusion which this Court is able to

arrive on this proposition is that "dividend is not taxable" as per the provisions of Section 10 (34) of the Act and the contrary findings in the impugned order of the Settlement Commission is deemed to be violative of the statutory provisions and therefore illegal.

43. The learned Standing counsel for the Department submitted that the decision of the Bombay High Court in *Kayan Jamshid Pandole* (supra) is distinguishable on facts. I am unable to endorse such a submission. A plain reading of paragraphs 8 to 11 of the said decision reveals that the Bombay High Court had laid down the proposition of law that dividend referred therein, is not taxable, without reference to the facts of that case. Hence it cannot be said that the findings therein could to be distinguished, by applying the facts of that case.

WHETHER THE PROVISIONS OF Section 2(22)(E) CAN BE APPLIED FOR THE ASSESSMENT YEARS WHERE THERE ARE MORE THAN TWO SHAREHOLDERS?

44. The learned Senior counsel for the petitioner had raised a further ground stating that when there are more than one shareholder having substantial interest in RTPL for the assessment years 2012-13 and 2013-14, the provisions of Section 2(22)(e) cannot be applied for those years as the computation mechanism fails. The Department had accepted that no addition can be made under Section 2(22)(e) in the case of the other shareholder namely, Mr. M.Ramasamy under Section 153A.

45. During the assessment years 2012-13 and 2013-14, Mr. Ramasamy held more than 20% shareholding in RSPL and RTPL. A specific contention was raised by the petitioner before the Settlement Commission that since there are more than two shareholders in the assessment years 2012-13 and 2013-14, the provisions of Section 2(22)(e) cannot be applied for those years as the computation mechanism fails. The Settlement Commission, had simply rejected this contention stating that Mr. M.Ramasamy was not an applicant before the Commission. The learned Standing counsel for the Department reiterated this finding of the Commission and further stated the argument of the petitioner that the computation mechanism would fail, is hypothetical.

46. It is not in dispute that during the assessment years 2012-13 and 2013-14, there were more than one shareholder holding substantial interest in RSPL and RTPL. The Settlement Commission was also appraised of this fact that there are two shareholders having substantial interest in RTPL. The loan from RSPL was not made directly to the specific shareholder and as more than one shareholder is to be treated as specified shareholder for the purposes of Section 2(22)(e) for the loan from RSPL to RTPL, the Section cannot be applied for the relevant assessment years for the reason that the computation of the Section fails since the Section does not provide making the amount of loan to be added in the hands of more than one

shareholder or dividing the amount of loan between specified shareholders in any ratio. Since the computation of the Section itself fails, it necessarily would follow that the charge of the Section for the assessment years 2012-13 and 2013-14 would also fail.

47. The Hon'ble Apex court in CIT Vs. B C Srinivasa Shetty reported in (1981) (128 ITR 294) (SC) had held as follows:

"Section 45 charges the profits or gains arising from the transfer of a capital asset to income tax. Thus it must be one which falls within the contemplation of the section. It must bear that quality which brings Section 45 into play. To determine whether the goodwill of a new business is such an asset, it is permissible, as we shall presently show, to refer to certain other sections of the head "capital gains". Section 45 is a charging section. For the purpose of imposing the charge, Parliament has enacted detailed provisions in order to compute the profits or gains under that head. No existing principle or provision at variance with them can be applied for determining the chargeable profits and gains. All transactions encompassed by Section 45 must fall under the governance of its computation provisions. A transaction to which those provisions cannot be applied must be regarded as never intended by Section 45 to be the subject of the charge. This inference flows from the general arrangement of the provisions in the Income Tax Act, where under each head of income, the charging provision is accompanied by a set of provisions for computing the income subject to the charge. The character of the computation provisions in each case bears the relationship to the nature of the charge. Thus, the charging Section and the computation provisions together constitute an integrated code. When there is a case to which the computation provisions cannot apply at all it is evident that such a case was not intended to fall within the charging section. Otherwise, one would be driven to conclude that while a certain income seems to fall within the charging Section there is no scheme of computation for quantifying it. The legislative pattern discernible in the Act is against such a conclusion. It must be borne in mind that the legislative intent is presumed to run uniformly

through the entire conspectus of provisions pertaining to each head of income."

48. It is the contention of the Department that the argument raised by the petitioner of failure of computation mechanism is hypothetical situation since Mr. Ramasamy is not taxed on the same income. Such a contention of the Department came to be diluted when the petitioner had produced a copy of the reassessment order under Section 147 of the Act, whereby the deemed dividend was taxed in the hands of Mr. Ramasamy also. As seen in the facts of the instant case, the whole amount was already taxed in the hands of the petitioner and the present reassessment order of Mr. Ramasamy amounted to double taxation. What was claimed to be a hypothetical situation has now been disproved in view of the reassessment order of Mr. Ramasamy. It is stated that the matter is now pending for adjudication before the ITAT, Chennai.

49. In *Govind Saran Ganga Saran V. Commissioner of Sales Tax and others* [(1985) 155 ITR 144 (SC)], the Hon'ble Supreme Court had held as hereunder:

"Where the turnover of goods declared under Section 14 of the central sales tax act, 1956, to be of special importance in interstate trade or commerce is subjected to tax under the sales tax law of the state, Section 15 of that act prescribes the maximum rate at which such tax may be imposed and requires that such tax shall not be levied at more than one point. If either of these two conditions, which are essential to the validity of an impost by the state on such goods, is not satisfied, the impost will be invalid.

In order that tax should not be levied at more than one stage, it is imperative that the sales tax law of the state should specify either expressly or by necessary implication the single point at which the tax may be levied. Alternatively, it may empower a statutory authority to prescribe such single point for the purpose. When such point is not prescribed, either by the statute or by the statutory delegate, no compliance is possible with Section 15. The single point at which the tax may be imposed must be definite ascertainable point so that both the dealer and the sales tax authorities may know clearly the point at which the tax is to be levied."

50. The learned Senior counsel for the petitioner contended that even assuming that the amount advanced for the first time

by RSPL to RTPL is treated as deemed dividend, any transfer of money by RTPL to RSPL and subsequent repayment by RSPL to RTPL thereafter should not be taxed as 'deemed dividend'. As such by adjusting such payments by RTPL to RSPL, the deemed dividend ought to have been limited to Rs.35,47,20,422/- as against Rs.137,19,75,000/-. Opposing such a contention, the learned Standing counsel for the respondent submitted that even when an advance of loan is subsequently repaid in its entirety during the relevant years, still deemed dividend is applicable. In support of such a contention, the learned counsel placed reliance of the decisions in Smt. Tarulata Shyam V. CIT [(1977) 108 IT 345(SC)] and P. Sarada V. CIT [(1998) 229 ITR 444 (SC)].

51. It is the case of the petitioner that if loans advanced first by RSPL to RTPL is considered as dividend, any payment made by RTPL to RSPL ought to be considered as loan by RTPL to RSPL. The Settlement Commission had not considered such a contention put forth before it but had relied upon the decisions in Tarulata Shyam and P Sarada (supra). The decisions may not be relevant since it is not the argument of the petitioner that tax closing balance of loan outstanding at the year end as deemed dividend, but that the amount repaid by the shareholder to the Company should be construed as a loan since the shareholder never repaid the dividend back to the Company.

52. The Settlement Commission was of the view that even if the advance of loan is subsequently repaid in its entirety during the relevant previous year, still deemed dividend is applicable, for which purpose reliance was placed on Tarulata Shyam and P. Sarada (supra). It is not the case of the petitioner that the tax closing balance of loan outstanding at the year-end should be the deemed dividend for that particular year and so on for the subsequent years. On the other hand, it is a submission that if loans advanced first by RSPL to RTPL is considered as dividend, any payment made by RTPL to RSPL ought to be considered as loan by RTPL to RSPL. This was made as a specific contention before the Settlement Commission which was ignored, by placing reliance on Tarulata Shyam and P. Sarada (supra).

53. In the decision of the Hon'ble Division Bench of the Madras High Court in the case of Sunil Kapoor V. CIT reported in 63 Taxmann.com 97, the decision of Tarulata Shyam (supra) was considered and ultimately held that the amounts advanced to the assessee during the relevant year, less the amount repaid by the assessee in the same year, would be treated as "deemed dividend" under Section 2(22)(e) of the Act. The relevant observations of the decision reads as follows:

"15. Following the view of the Supreme Court in Navnit Lal Javeri's case (supra), the Calcutta High Court, in the case of Smt.

Tarulata Shyam & Ors. Vs - Commissioner of Income Tax, West Bengal II, Calcutta (1971 (82) ITR 485 (Cal)), held that tax is attracted at the point when the loan is borrowed by the member/shareholder. For better clarity, the relevant portion of the order is quoted hereunder :-

It is clear from the above cited passage that if a controlled company adopted a device of making a loan or advance to one of its shareholders such a shareholder would be deemed to have received the said amount out of the accumulated profits and would be liable to pay tax on the basis that he had received the said loan by way of dividend. Whether the loan is ultimately repaid to the company or not is immaterial. This decision would seem to answer all the contentions raised by Mr. Choudhury against the assessment of the amount as dividend. Further, as pointed out by both the Accountant Member and the President of the Income-tax Appellate Tribunal, neither the Bombay High Court nor the Madras High Court, who had also an occasion to consider this question, had any doubts that the liability to tax attached as soon as the loan was taken from the company. For instance, in the Madras case of K. M. S. Lakshmana Aiyar v. Additional Income-tax Officer, it was observed that under section 2(6A)(e) a loan or advance by a controlled company to its shareholder would attract tax liability though such a loan might be repaid subsequently even during that year. Again, the Bombay High Court in Navnit Lal C. Javeri v. K. K. Sen, from which the aforesaid appeal was taken to the Supreme Court, has observed as follows :

"The tax is attracted at the point of time when the said loan is borrowed by the members."

We have, therefore, no hesitation in holding that the liability to be taxed attaches to any amount taken as a loan by a shareholder from the company at the moment the loan is borrowed and it is immaterial whether the loan is repaid before the end of the accounting year or not. The answer to the question referred

must, therefore, be in the affirmative and in favour of the department.

16. The Supreme Court in the case of Smt. Tarulata Shyam & Ors. Vs - Commissioner of Income Tax, West Bengal (1977 (108) ITR 345 (SC)), which appeal is a product of the above referred to decision from the Calcutta High Court, has culled out the situation in which the payments made to a shareholder are to be treated as taxable dividend, wherein five conditions have been laid down for the purpose of determination of the head on which the amount is to be taxed. For better clarity, the said portion of the order is extracted hereinbelow :-

From the above discussion it emerges clear that the fiction created by section 2 (6A)(e) read with section 12(1B) of the Act is inexorably attracted as soon as all the conditions necessary for its application exist in a case. In Navnit Lal's case [1965] 56 ITR 198, 202 (SC) this court, after an analysis of these provisions, listed these conditions, as follows " the combined effect of these two provisions is that three kinds of payments made to the shareholder of a company to which the said provisions apply, are treated as taxable dividend to the extent of the accumulated profits held by the company. There three kinds of payments are: (1) payments made to the shareholder by way of advance or loan; (2) payments made on his behalf; and (3) payments made for his individual benefit. There are five conditions which must be satisfied before section 12 (1B) can be invoked against a shareholder. The first condition is that the company in question must be one in which the public are not substantially interested within the meaning of section 23A as it stood in the year in which the loan was advanced. The second condition is that the borrower must be a shareholder at the date when the loan was advanced ; it is immaterial what the extent of his shareholding is. The third condition is that the loan advanced to a shareholder by such a company can be deemed to be dividend only to the extent to which it is shown that

the company possessed accumulated profit at the date of the loan. This is an important limit prescribed by the relevant section. The fourth condition is that the loan must not have been advanced by the company in the ordinary course of its business. In other words, this provision would not apply to cases where the company which advances a loan to its shareholder carries on the business of money lending itself ; and the last condition is that the loan must have remained outstanding at the commencement of the shareholder's previous year in relation to the assessment year 1955-56. (Emphasis supplied).

The first four conditions factually exist in the instant case. The last condition is not applicable because it was a transitory provision applicable to the assessment year 1955-56 only, while we are concerned with the assessment year 1957-58, and the previous year is the calendar year 1956.

I 17. Keeping the above guidelines, as postulated by the Supreme Court in mind, a cursory look into the facts of the present case would disclose that there is no dispute that the company is a controlled (private limited) company in which the public are not substantially interested. Further, the assessee is admittedly a shareholder and Director of KIPL. It is also beyond controversy that at all material times, the company possessed "accumulated profits" in excess of the amount which the assessee-shareholder was paid during the previous year. The Income-tax Officer found that surplus reserve of the company for the year ending 31.3.09 stood at Rs.10,26,62,126/=. The assessee drew money for the purpose of making payments, which were personal in nature, aggregating Rs. 76,86,829/=:, which amount was shown as loan or advance in the books of accounts of KIPL. The company's business is not money-lending and it could not be said that the loans had been advanced by the company in the ordinary course of its business. In such circumstances, in the instant case, all the amounts advanced to the assessee/appellant under the head loans and

advances fall squarely within the ambit of Section 2 (22) (e) of the Income Tax Act.

18. The object of the Legislature in enacting section 2 (22) (e) is to prevent the escapement of tax by some shareholders. Under section 2 (22) (e) of the Act, by a deeming provision, the Legislature has made payment of any advance or loan to a shareholder a deemed dividend so as to subject such payments to the levy of tax in the hands of the receiver of the said amount. It should be noted that pari materia provision, viz., clause (e) of section 2(6A) of the Act was substituted for the original provision by the Finance Act, 1955, with effect from 1st April, 1955. The object of the provision is to prevent avoidance of tax by the shareholders of a closely-held company. In such a company, a few shareholders, who effectively control it, can easily exploit its juristic personality, by restraining it from distributing its yearly dividends and thereby accumulating its profits, and thus saving themselves from a higher tax incidence resulting from the distribution of dividend.

19. In such a backdrop, the above provision came to be inserted so as to make any payment made by the company by way of advances and loans to shareholders, who satisfy certain conditions, as enumerated above, to fall under the head dividend as defined under Section 2 (22) (e) of the Income Tax Act. In the case on hand, the assessee/appellant having received the above amount from KIPL under the head loans and advances as shown in the books of accounts of KIPL, the five ingredients, as propounded by the Supreme Court in Tarulata Shyam's case (supra) to bring the said amount under the ambit of dividend are wholly satisfied in the present case and the four parameters, as enumerated by the Assessing Officer, are also squarely attracted to the case of the assessee herein. Therefore, any amount paid to the assessee by the company during the relevant year, less the amount repaid by the assessee in the same year, should be deemed to be construed as dividend for all purposes.

20. However, in the case on hand, the Assessing Officer has taken the entire amount of Rs.76,86,829/= received by the assessee from the company as dividend, while computing the income, but has lost sight of the payment made. In such circumstances, this Court is of the considered opinion that the CIT (Appeals) has rightly come to the conclusion that the position as regards each debit will have to be individually considered, because it may or may not be a loan. The AO is, therefore, directed to verify each debit entry on the aforesaid line and treat only the excess amount as deemed dividend u/s 2 (22) (e) of the Act. We find such a direction issued by the CIT (Appeals), as upheld by the Tribunal is in consonance with the provision of Section 2 (22) (e) of the Act, and only those amounts, which reflect in the debit side of the books of accounts of the company falling under the definition of loans and advances, with regard to the shareholder, in the relevant year will be entitled to be taken as deemed dividend.

21. For the foregoing reasons, it is ordered as follows :-

i) On the question of law raised, we are of the view that the Tribunal was justified in dismissing the appeal filed by the assessee/appellant and, consequently, the order of the Tribunal dated 25.6.2013 stands confirmed.

ii) Consequently, the issue as framed by this Court is answered in favour of the Revenue and against the assessee."

54. The final point raised by the learned Senior counsel for the petitioner is that no incriminating material was found during search in relation to the deemed dividend and thus, the proceedings under Section 153A r/w. 153C are not valid. Though this argument was advanced before the Commission, the issue was not adjudicated. To such a contention, the learned Standing counsel submitted that the plea of lack of incriminating material will not arise since the petitioner himself had filed an application before the Settlement Commission to adjudicate the issue of deemed dividend. During the course of search, a specific question in relation to applicability of deemed dividend was put to Senthil Nathan, the husband of the petitioner.

55. It is a fact that that the ground of absence of incriminating material in relation to deemed dividend, was placed before the Settlement Commission but not considered. The petitioner, by letter dated 31.08.2015, had submitted that there was no incriminating material in relation to deemed dividend found during the search and accordingly, no addition can be made under Section 2(22)(e). The said contention was taken note of by the Settlement Commission in paragraph 7.2 of its order but however, had failed to address the issue.

56. The Hon'ble Division Bench of the Bombay High Court in CIT V. Continental Warehousing Corporation Ltd [(2015) 374 ITR 645 (Bom)] held that the power under Section 153A cannot be routinely exercised in the absence of any incriminating material during the search. In CIT V. Kabul Chawla (2016) [380 ITR 0573 (Delhi)], it was held that since no incriminating material was unearthed during the search, no additions could have been made to the income already assessed. The jurisdiction of such assessment is to assess what is found during the search and thus, there has to be some incriminating material found during the course of search. As stated earlier, the petitioner had submitted before the Settlement Commission during the course of search under Section 132 of the Act that no fresh incriminating material with respect to the deemed dividend was found. Unfortunately, the Settlement Commission has not addressed this issue at all. Thus, the proceedings under Section 153A r/w. 153C of the Act are not valid.

57. For all the foregoing reasons, this Court is of the affirmed view that the order of the Settlement Commission is not in accordance with the provisions of the Act and therefore, this Court would be justified in invoking its extraordinary powers under Article 226 of the Constitution of India. Accordingly, the impugned order of the Income Tax Settlement Commission comprised in file number No. TN/CN-53/2013-14/45/IT dated 14.09.2015, insofar as it relates to determination of deemed dividend as the income of the petitioner for the assessment years 2009-2010 to 2013-2014 are concerned, is hereby quashed. The petitioner herein shall be entitled to claim refund of any tax paid, pursuant to the impugned order of the Settlement Commission. The Writ Petition stands allowed accordingly. Consequently, connected Miscellaneous Petition is closed. No costs.

Sd/-

Assistant Registrar (CJ Conf)

//True Copy//

Sub Assistant Registrar

DP

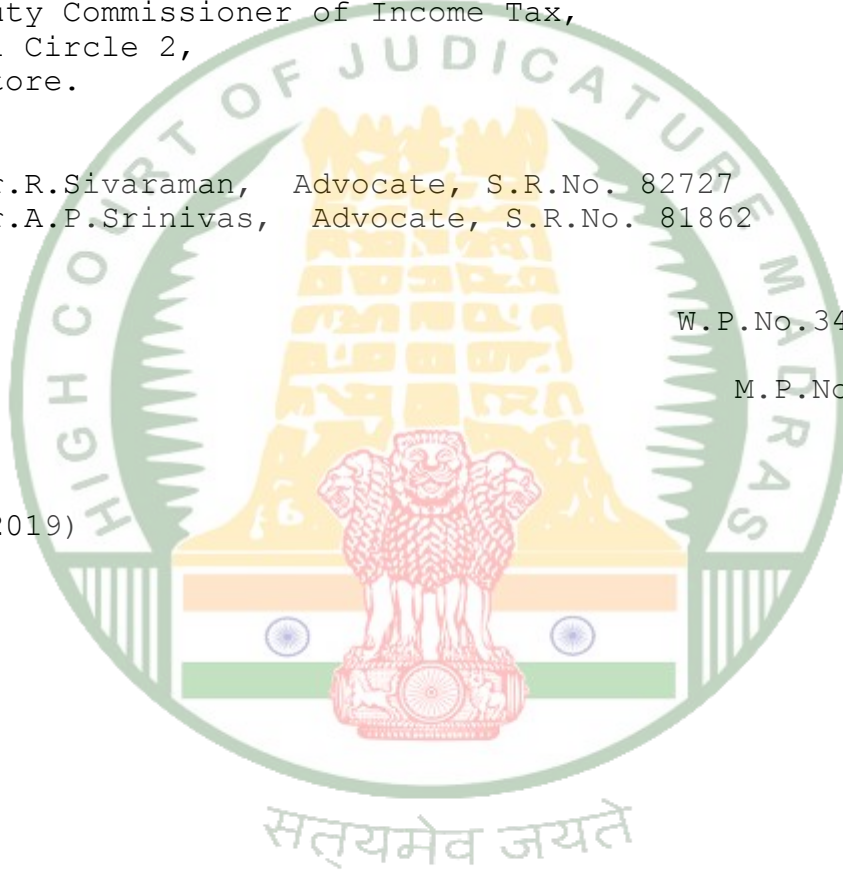
To

- 1.The Vice Chairman,
Income Tax Settlement Commission,
Additional Bench,
640 Anna Salai, Nandanam,
Chennai-600 035.
- 2.The Principal Commissioner of Income Tax,
Central 2, Chennai-34.
- 3.The Deputy Commissioner of Income Tax,
Central Circle 2,
Coimbatore.

+1cc to Mr.R.Sivaraman, Advocate, S.R.No. 82727
+1cc to Mr.A.P.Srinivas, Advocate, S.R.No. 81862

W.P.No.34786 of 2015
and
M.P.No.1 of 2015

SR(CO)
GN(04/11/2019)



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