

Tax Insights

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Deemed dividend is taxable only in hands of a registered and beneficial owner holding prescribed threshold of shares as on date on which loans were advanced – Chennai bench of the Tribunal

In brief

The Chennai bench of the Income-tax Appellate Tribunal¹ (Tribunal) dismissed Revenue's appeal in a batch of appeals filed in the case of five related group companies on a similar fact pattern dealing with taxability of deemed dividend under section 2(22)(e) of the Income-tax Act, 1961 (the Act). The Tribunal reiterates the following cardinal principles to be construed while taxing the deemed dividend –

- The shareholder referred to in section 2(22)(e) of the Act must be a registered as well as a beneficial shareholder.
- The date relevant to determine the shareholding to invoke this deeming provision is the date on which loans were advanced or payments were made.
- The deemed dividend must be taxed only in the hands of the shareholder having substantial interest and not in the hands of the company receiving the loan.

Based on the facts of the case and applying the above principles, the Tribunal upheld the deletion of deemed dividend by the lower appellate authorities.

In detail

Facts

- A search was conducted in the premises of company X, its shareholder and three other individuals of a family group, who are said to be the ultimate shareholders of taxpayer companies and exercising substantial interest in company X.
- Upon perusal of seized materials and sworn statements, a substantial increase in the capital work-in-progress (CWIP) was noted in the books of company X. While the said CWIP was said to be work performed by the taxpayer companies for company X, the same was not substantiated by any supporting documents. Also, the tax officer (TO) identified that the taxpayer companies are related to each other and are group companies of company X.

¹ ITA No. 642/Chny/2023

- Accordingly, the TO believed that such CWIP represented loans and advances by company X to the taxpayer companies. Hence, he concluded that such advances were taxable in the hands of taxpayer companies as deemed dividend under section 2(22)(e) of the Act, as the same were received on behalf of and for the benefit of the ultimate shareholders.
- The TO also noted a change in the shareholding of the taxpayer companies just three days prior to the date of advancing of loans by company X, which the TO believed to be a means to avoid the application of deemed dividend provisions.

Tribunal's ruling

- The Tribunal relied on the Delhi High Court's decision in the case of Ankitech² (affirmed by the Supreme Court in the case of Madhur Housing³) and concluded that the deemed dividend provisions under section 2(22)(e) of the Act apply only if the shareholder is both a registered and a beneficial shareholder.
- The Tribunal noted that, though the Delhi High Court in National Travel Services⁴ took a contrary view, there was no Supreme Court decision upon appeal⁵ as it was dismissed as withdrawn given that the taxpayer therein opted for the Vivad se Vishwas scheme. Thus, the Tribunal was of the view that the Delhi High Court decision in the case of Ankitech², affirmed by the Supreme Court, continues to be binding.
- On the issue of relevant date of shareholding for applicability of deemed dividend provisions, the Tribunal relied upon the Allahabad High Court judgment in the case of H.K. Mittal⁶ and the Mumbai bench of the Tribunal's ruling in the case of KIIC Investment⁷ to observe that the relevant date for determining the shareholding is the date of advancing the loans.
- Reverting to the facts of the case, the Tribunal categorically observed the following undisputed factual aspects:
 - Neither the taxpayer companies nor its shareholders are the shareholders of company X, i.e. the lender company.
 - There are no common registered and beneficial shareholders between company X (lender) and the taxpayer companies holding equity shares with 10% voting power or more, both prior to and post the change in shareholding pattern.
 - None of the three individuals is registered and a beneficial shareholder in company X with equity shareholding of 10% or more.
- Given the facts of the case, the Tribunal was of the view that deemed dividend provisions under section 2(22)(e) of the Act would not be applicable. It also remarked that whether the family running the businesses benefited from the loans is immaterial, as the primary conditions are not fulfilled.
- The Tribunal went one step ahead to conclude that, while there is no applicability of section 2(22)(e) of the Act in the said fact pattern, the deemed dividend is required to be taxed only in the hands of the shareholder and not in the hands of the company, in which such shareholder has substantial interest, which received the loans.
- The Tribunal relied upon the previous judicial precedents⁸ rendered by various High Courts and the Tribunal to arrive at the above conclusion.

The takeaways

This Tribunal ruling reaffirms the established principles of taxability of deemed dividend. It heavily relies upon the previous judicial precedents rendered by the Supreme Court and High Courts and other benches of the Tribunal, thus reinforcing the law of Judicial Discipline.

² CIT v. Ankitech P. Limited [2012] 340 ITR 14 (Delhi)

³ CIT v. Madhur Housing and Development Co. [2018] 401 ITR 152 (SC)

⁴ CIT v. National Travel Services [2012] 347 ITR 305 (Del)

⁵ National Travel Services v. CIT [2018] 401 ITR 154 (SC)

⁶ CIT v. H.K. Mittal [1996] 219 ITR 420 (All)

⁷ KIIC Investment Company v. DCIT [2019] 101 taxmann.com 19 (Mum-ITAT)

⁸ CIT v. Universal Medicare Private Limited [2010] 324 ITR 263 (Bombay); CIT v. Hotel Hilltop [2008] 217 CTR 527 (Rajasthan); CIT v. Ankitech P. Limited [2012] 340 ITR 14 (Delhi); and others

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