Bombay High Court The Commissioner Of Income Tax - 10 vs Universal Medicare Private ... on 22 March, 2010 Bench: Dr. D.Y. Chandrachud, J.P. Devadhar 1

IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.2264 OF 2009

The Commissioner of Income Tax - 10, Mumbai ..Appellant.

Versus

Universal Medicare Private Limited ..Respondent.

Mr.B.M. Chatterjee with Ms.Padma Divakar for the appellant.

Mr.J.D. Mistry with Mr.Atul K Jasani for the respondent.

CORAM : Dr.D.Y. Chandrachud &
J.P. Devadhar, JJ.

DATE : 22nd March 2010. ORAL JUDGMENT (Per Dr.D.Y. Chandrachud, J.) 1. The appeal by the revenue under Section 260A of the Income Tax Act, 1961 arising out of an order of the Tribunal pertaining to assessment year 2003-2004, raises the following three questions of law : 1. Whether, on the facts and in the circumstances of the case, the ITAT, in law, was right in deleting the addition of Rs.35 lac treated as deemed dividend u/s.2(22)(e) of the Income Tax Act, 1961, by stating that since the transactions are not reflected in the books of accounts, it cannot be treated as deemed dividend ? 2. Whether, on the facts and in

the circumstances of the case, the Tribunal in law, was right in holding that the AO has not established that the money was advanced for the benefit of any shareholder and the same has to be taxed in the hands of such shareholder who obtained the benefit and not in the hands of the assessee company, following the ratio of decision in the case of ACIT Vs. Bhaumik Colour P. Limited [(27 SOT 270 (SB)] ? 3. Whether on the facts and in the circumstances of the case, the ITAT in law was right in directing the AO to allow the amount of provision for leave encashment without appreciating the fact that the dis-allowance was made as there was no proof of payment furnished to the effect that the same was paid before the due date of filing the return u/s.139 (1) of the Income Tax Act ? 2. For convenience of reference, it would be appropriate to take up the third question initially. The Tribunal has relied upon the judgment of the Calcutta High Court in the case of Exide Industries Limited V/s. Union of India, 292 ITR 470, in which the provisions of Section 43B(f) have been struck down. The Tribunal directed the Assessing Officer to allow the amount as claimed towards leave encashment. The issue as regards the correctness of the judgment of the Calcutta High Court in Exide Industries Limited (supra) is pending in appeal before the Supreme Court and interim orders have been passed. The Appeal, insofar as the issue of leave encashment is concerned is admitted on the following question of law : "Whether the Tribunal was justified in directing the Assessing Officer to allow the amount claimed by way of provision for leave encashment in view of the provisions of Section 43B(f) of the Income Tax Act, 1961 ? 3. The first and second questions are now taken up. Briefly stated, the admitted facts are that an amount of Rs.32,00,000/- was transferred from the bank account of a company by the name of Capsulation Services Private Limited (CSPL) to the account of the assessee maintained in the Chembur Branch of the State Bank of India. Mr.Vikram Tannan was a Director of CSPL. He held over 10 % of the equity capital of CSPL and over 20% of the equity capital of the assessee. The Assessing Officer, in the course of the order of assessment, relied on the provisions of Section 2(22)(e) and treated the amount of Rs.35,00,000/- as deemed dividend in the hands of the assessee and directed that the amount be added back to its total income. The assessee contended that one Mr.Teredesai, Vice President (Finance) had misappropriated large sums of money by opening bank accounts and the transaction by which an amount of Rs.32,00,000/- was transferred from CSPL was part of the misappropriation. According to the assessee, the amount was not reflected in the books of the assessee since it had been misappropriated by the Vice President (Finance). The fact that the amount has been defalcated could not, according to the assessee, be disputed in view of the fact it has been allowed by the Assessing Officer as a business loss during the assessment year 2006-2007. Hence, the contention of the assessee was two-fold. First, according to the assessee, for Section 2(22)(e) to apply the amount ought to have been received as an advance or loan from a company to a concern in which the shareholder had substantial interest. This condition, according to the assessee, was not met since the amount was neither an advance nor a loan to the assessee but represented misappropriation of funds by the Vice President (Finance). Consequently, even if the amount is treated as deemed

dividend within the meaning of Section 2(22)(e) it is taxable in the hands of the shareholder and not in the hands of the assessee. Secondly, even on the assumption that this was an amount advanced to the assessee by the CSPL, for the purposes of taxation a deemed dividend would be taxable in the hands of the shareholder and not the assessee to whom the payment was advanced. 4. The Assessing Officer came to the conclusion that the provisions of Section 2(22)(e) are attracted the moment a loan or advance is made and the subsequent defalcation of funds was immaterial. The Assessing Officer held that the loan was received from the bank account of CSPL; the money was deposited in the bank account of the assessee and the subsequent defalcation of the funds after the receipt of moneys by the assessee was an extraneous circumstance which made no difference to the application of Section 2(22)(e). The Assessing Officer found that Mr.Vikram Tannan who was a Director of the Assessee held more than 20% of the equity capital of CSPL. The Assessing Officer came to the conclusion that all the conditions for the application of Section 2(22(e) were fulfilled and the loan of Rs. 35,00,000/- from CSPL would have to be treated as deemed dividend in the hands of the assessee. 5. In Appeal, the Commissioner of Income Tax (Appeals) affirmed the order of the Assessing Officer, save and except with a modification that the actual amount which has been received by the assessee was held to be Rs. 32,00,000/- and not Rs.35,00,000/- as determined by the Assessing Officer. 6. The Tribunal in Appeal has reversed the findings of the Commissioner of Income Tax (Appeals) on two counts. Firstly, the Tribunal held that the provisions of Section 2(22)(e) would be attracted if a loan was taken by the shareholder from any closely held company. In the present case, the Tribunal noted that the amount was part of a fraud committed on the assessee and the transaction was not reflected in its books of account. In the circumstances, Section 2(22)(e) was held not to apply. Secondly, the Tribunal held that even otherwise, the amount would have to be taxed in the hands of the shareholder who obtained the benefit and not in the hands of the assessee. 7. Under Section 56, income of every kind which is not to be excluded from the total income under the Act is chargeable to income tax under the head income from other sources, if it is not chargeable to income tax under any of the heads specified in items (a) to (e) of Section 14. Under clause (1) of sub-section (2), income by way of dividend is chargeable to income tax under the head income from other sources. Section 2(22) provides an inclusive definition of the expression 'dividend' for the purposes of the Act. Section 2(22)(e) is as follows : (22)"dividend" includes - (a) to (d) ....

(e) any payment by a company, not being a company in which

the public are substantially interested, or any sum (whether as representing a part of the assets of the company or otherwise) made after the 31st day of May, 1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than

ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern) or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits; 8. Clause (e) of Section 2(22) is not artistically worded. For facility of exposition, the contents can be broken down for analysis: (i) Clause (e) applies to any payment by a company not being a company in which the public is substantially interested of any sum, whether as representing a part of the assets of the company or otherwise made after the 31 May 1987; (ii) Clause (e) covers a payment made by way of a loan or advance to (a) a shareholder, being a beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power; or (b) any concern in which such shareholder is a member or a partner and in which he has a substantial interest; (iii) Clause (e) also includes in its purview any payment made by a company on behalf of or for the individual benefit, of any such shareholder; (iv) Clause (e) will apply to the extent to which the company, in either case, possesses accumulated profits. The remaining part of the provision is not material for the purposes of this Appeal. By providing an inclusive definition of the expression 'dividend', clause 2(22) brings within its purview items which may not ordinarily constitute the payment of dividend. Parliament has expanded the ambit of the expression 'dividend' by providing an inclusive definition. 9. In order that the first part of clause (e) of Section 2(22) is attracted, the payment by a company has to be by way of an advance or loan. The advance or loan has to be made, as the case may be, either to a shareholder, being a beneficial owner holding not less than ten per cent of the voting power or to any concern to which such a shareholder is a member or a partner and in which he has a substantial interest. The Tribunal in the present case has found that as a matter of fact no loan or advance was granted to the assessee, since the amount in question had actually been defalcated and was not reflected in the books of account of the assessee. The fact that there was a defalcation seems to have been accepted since this amount was allowed as a business loss during the course of assessment year 2006-2007. Consequently, according to the Tribunal the first requirement of there being an advance or loan was not fulfilled. In our view, the finding that there was no advance or loan is a pure finding of fact which does not give rise to any substantial question of law. However, even on the second aspect which has weighed with the Tribunal, we are of the view that the construction which has been placed on the provisions of Section 2(22)(e) is correct. Section 2(22)(e) defines the ambit of the expression 'dividend'. All payments by way of dividend have to be taxed in the hands of the recipient of the dividend namely the shareholder. The effect of Section 2(22) is to provide an inclusive definition of the expression dividend. Clause (e) expands the nature of payments which can be classified as a dividend. Clause (e) of Section 2(22) includes a payment made by the company in which the public is not substantially interested by way of an advance or loan to a shareholder or to any concern to which such shareholder is a member or partner, subject to the fulfillment of the

requirements which are spelt out in the provision. Similarly, a payment made by a company on behalf, of for the individual benefit, of any such shareholder is treated by clause (e) to be included in the expression 'dividend'. Consequently, the effect of clause (e) of Section 2(22) is to broaden the ambit of the expression 'dividend' by including certain payments which the company has made by way of a loan or advance or payments made on behalf of or for the individual benefit of a shareholder. The definition does not alter the legal position that dividend has to be taxed in the hands of the shareholder. Consequently in the present case the payment, even assuming that it was a dividend, would have to be taxed not in the hands of the assessee but in the hands of the shareholder. The Tribunal was, in the circumstances, justified in coming to the conclusion that, in any event, the payment could not be taxed in the hands of the assessee. We may in concluding note that the basis on which the assessee is sought to be taxed in the present case in respect of the amount of Rs.32,00,000/- is that there was a dividend under Section 2(22)(e) and no other basis has been suggested in the order of the Assessing Officer. 10. For the aforesaid reasons, the first and second questions will not give rise to any substantial questions of law. (J.P. Devadhar, J.) (Dr.D.Y. Chandrachud, J.)