

(2009) 09 DEL CK 0379

Delhi High Court

Case No: ITA No. 250 of 2009

Commissioner of Income Tax

APPELLANT

Vs

Creative Dyeing and Printing Pvt.
Ltd.

RESPONDENT

Date of Decision: Sept. 22, 2009

Acts Referred:

- Income Tax Act, 1922 - Section 2(6A)
- Income Tax Act, 1961 - Section 12(1B), 2(22), 23A, 260A

Citation: (2010) 229 CTR 250 : (2009) 318 ITR 476 : (2009) 184 TAXMAN 483

Hon'ble Judges: Valmiki J Mehta, J; A.K. Sikri, J

Bench: Division Bench

Advocate: Suruchi Aggarwal, for the Appellant; M.P. Rastogi and K.N. Ahuja, for the Respondent

Final Decision: Dismissed

Judgement

Valmiki J. Mehta, J.

This appeal u/s 260A of the Income Tax Act, 1961 (hereinafter referred to as the Act) is preferred by the revenue against the order dated 9.5.2008 of the Income Tax Appellate Tribunal (hereinafter referred to as the I.T.A.T.) whereby the Tribunal has held that the payment of an advance for a commercial purpose to the assessee company by its sister concern M/s Pee Empro Exports Pvt. Ltd. is not deemed dividend u/s 2(22)(e) of the Act.

2. The facts of the case are that the respondent is engaged in the business of dyeing and printing of cloth and was acting as an ancillary unit of M/s. Pee Empro Exports Pvt. Ltd. for the last several years. Both the assessee company and M/s. Pee Empro Exports Pvt. Ltd. have common shareholders/directors Mr. P.S. Uppal, Mr. P.M.S. Uppal, Mr. Surinder Uppal and so on. M/s. Pee Empro Exports Pvt. Ltd. also has a 50% shareholding in the assessee company. The said M/s. Pee Empro Exports Pvt.

Ltd. in order to increase its export business and to compete with the international standards in garment exports had suggested modernization and expansion of the plant and machinery of the assessee company for which M/s. Pee Empro Exports Pvt. Ltd. made available a project report for such expansion on 28.7.2000 to the assessee company. The assessee company in turn vide its letter dated 30.9.2000 informed M/s. Pee Empro Exports that for increasing such capacity as desired by M/s. Pee Empro Exports a huge investment is required and showed its inability to invest such large amount out of the present available funds. M/s. Pee Empro agreed then to make available funds to the extent of 50% cost because it was not only in the interest of M/s. Pee Empro Exports but also on account of fact that M/s. Pee Empro itself owns 50% shares in the assessee company. The rest of the 50% project cost was to be made available by the directors Mr. P.S. Uppal and Mr. P.M.S. Uppal.

3. The Assessing Officer for this amount paid to the assessee company by M/s Pee Empro Exports Pvt. Ltd. made an addition of Rs. 3,60,18,885/- in terms of Section 2(22)(e) of the Act as deemed dividend for the reason that the two directors of the assessee company, namely, Mr. P.S. Uppal and Mr. P.M.S. Uppal having more than 20% share in the assessee company and who also held 27.42% and 29.71% share respectively in M/s. Pee Empro Exports i.e. two directors have interest in the company from whom the amount has been received.

4. The relevant part of Section 2(22)(e) is extracted as under:

Any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) [made after the 31st day of May, 1986, by way of advance or loan to a shareholder, being a person who is the, beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this Clause referred to as the said concern)] or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits. But "dividend" does not include

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(ii) any advance or loan made to a shareholder [or the said concern] by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.

5. Before us, the learned Counsel for the appellant/revenue has contended that the present case is a case of deemed dividend in as much as M/s. Pee Empro Exports Pvt. Ltd. has given a loan to the assessee company but the lending company, namely, M/s. Pee Empro Exports Pvt. Ltd. is not into the business of money lending as required by Section 2(22)(e)(ii). The Counsel for the respondent, on the other

hand, has referred to two recent Division Bench judgments of this Court reported as C.I.T. v. Raj Kumar 2009(181) Taxman 155 and CIT v. Ambassador Travels (Pvt.) Ltd. 2008(173) Taxman 407 to contend that merely because a loan is given by M/s. Pee Empro Exports Pvt. Ltd. to the assessee company would not mean that the same would become a deemed dividend in as much as moneys are paid for transactions which are business transactions/commercial transactions and therefore such transactions cannot fall under the expression "deemed dividend" within the provision of Section 2(22)(e).

6. Before we refer to the rival contentions of the parties, we would like to reproduce the following finding of facts arrived at by the Tribunal:

7.5 In the present case the amount paid by M/s Pee Empro Exports to the appellant-company does not bear the characteristic of loans and advances. The amount has been paid by M/s Pee Empro Exports in its own interest and that too for the purpose of business because the ultimate beneficiary of the proposed expansion of plant and machinery is M/s. Pee Empro Exports itself. M/s. Pee Empro Exports has not made the payment to the appellant-company for the individual benefit of Mr. R.S.Uppal and Mr. P.M.S. Uppal and on the contrary these two Directors have also provided funds to the appellant-company as owners of the company as also made by M/s Pee Empro Exports.

The assessee undertook expansion of its capacity, which was in mutual interest of assessee as well Pee Empro Exports. If the assessee has not undertaken such expansion, no advance could have been made to it or that Pee Empro Exports would not have distributed as dividend to its shareholders. This but for the advances, the amount of advances could not have reached assessee at all. We therefore, delete the additions as made by the Assessing Officer as the amount received by assessee is not deemed dividend within the meaning of Section 2(22)(e) of the Act.

The Counsel for the revenue has also further stated that it is not in dispute that the monies which have been advanced to the assessee company by M/s. Pee Empro Exports Pvt. Ltd. have not to be repaid but have to be adjusted against the dues payable by M/s. Pee Empro Exports Pvt. Ltd. to the assessee company in the subsequent years for the job work of printing and dyeing which is done by the assessee company for M/s. Pee Empro Exports Pvt. Ltd.

7. We find that the Tribunal in the present case has very extensively dealt with legislative intention of introducing Section 2(22)(e) and has referred to such legislative intention by reference to Supreme Court judgment in the case of [Navnitlal C. Javeri Vs. K.K. Sen, Appellate Assistant Commissioner of Income Tax, "D" Range, Bombay](#), where a similar provision of the Income Tax Act, 1922 i.e. Section 2(6A)(e) was in issue by reproducing the relevant para in Navneet Lal's case as under:

In dealing with Mr. Pathak's argument in the present case, let us recall the relevant facts. The companies to which the impugned Section applies are companies in which at least 75 per cent of the voting power lies in the hands of other than the public, and that means that the companies are controlled by a group of persons allied together and having the same interest. In the case of such companies, the controlling group can do what it likes with the management of the company, its affairs and its profits within the limits of the Companies Act. It is for this group to determine whether the profits made by the company should be distributed as dividends or not. The declaration of dividend is entirely within the discretion of this group. When the legislature realized that though money was reasonably available with the company in the form of profits, those in charge of the company deliberately refused to distribute it as dividends to the shareholders, but adopted the device of advancing the said accumulated profits by way of loan or advance to one of its shareholders, it was plain that the object of such a loan or advance was to evade the payment of tax on accumulated profits u/s 23A. It will be remembered that an advance or loan which falls within the mischief of the impugned Section is advance or loan made by a company which does not normally deal in money-lending, and it is made with the full knowledge of the provisions contained in the impugned section. The object of keeping accumulated profits without distributing them obviously is to take the benefit of the lower rate of super-tax prescribed for companies. This object was defeated by Section 23A which provides that in the case of undistributed profits, tax would be levied on the shareholders on the basis that the accumulated profits will be deemed to have been distributed against them. Similarly, Section 12(1B) provides that if a controlled company adopts the device of making a loan or advance to one of its shareholders, such shareholders will 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 has received the said loan by way of dividend. It is clear that, when such a device is adopted by a controlled company, the controlling group consisting of shareholders have deliberately decided to adopt the device of making a loan or advance. Such an arrangement is intended to evade the application of Section 23A. The loan may carry interest and the said interest may be received by the company; but the main object underlying the loan is to avoid payment of tax.

8. The Tribunal has also referred to the judgment of the Bombay High Court in the case of [Commissioner of Income Tax Vs. Nagindas M. Kapadia](#), 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 amounts to Kapadia. The Tribunal had 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 as "deemed dividend", but if it is otherwise, the amount given cannot be branded as "advances" within the meaning of deemed dividend u/s 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)(e). 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 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 u/s 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 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 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 [M/s. Rohit Pulp and Paper Mills Ltd. Vs. Collector of](#)

[Central Excise, Baroda,](#) and [The State of Bombay and Others Vs. The Hospital Mazdoor Sabha and Others,](#)

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 u/s 2(22)(e). The present appeal is therefore dismissed.