

**IN THE INCOME TAX APPELLATE TRIBUNAL  
“A” BENCH : BANGALORE**

**BEFORE SHRI N. V. VASUDEVAN, VICE PRESIDENT AND  
SHRI JASON P BOAZ, ACCOUNTANT MEMBER**

IT(IT)A No.1449/Bang/2015
Assessment year : 2011-12

M/s. Microfinish Valves Private Limited, B-161/162, Industrial Estate, Gokul Road, Hubli. <b>PAN : AABCM 2527 Q</b>	Vs.	Asst. Commissioner of Income Tax Circle – 2(1), Hubli
APPELLANT		RESPONDENT

Assessee by	:	Shri. Ravishankar, Advocate
Revenue by	:	Dr. Shankar Prasad, Addl. CIT

Date of hearing	:	14.02.2019
Date of Pronouncement	:	12.04.2019

**ORDER**

*Per Jason P Boaz, Accountant Member*

This appeal by the assessee is directed against the order of the CIT(A), Hubli, dated 10.09.2015 for Assessment Year 2011-12.

2. Briefly stated, the facts of the case are as under:

2.1 The assessee, a company, engaged in the business of manufacture of valves, filed its return of income for Assessment Year 2011-12 on 30.10.2011 declaring income of Rs.21,08,87,466/-. The return was processed under section 143(1) of the Income Tax Act, 1961 (in short 'the Act') and the case was subsequently selected for scrutiny for this Assessment Year. The assessment was concluded under section 143(3) of the Act vide order dated 24.03.2014 wherein the assessee's income was determined at Rs.24,66,57,560/-; in view of the following additions / disallowances:

(i) Deemed Dividend under section 2(22)(e)	-	Rs.3,30,00,000/-
(ii) Disallowance under section 40(a)(i)	-	Rs. 8,18,734/-
(iii) Disallowance under section 43B	-	Rs. 25,461/-
(iv) Capitalisation of Expenditure claimed as repairs	-	Rs. 14,20,430/-
(v) Disallowance of interest relating to WIP	-	Rs. 4,97,738/-
(vi) Difference in receipts as per 26AS	-	Rs. 7,263/-
(vii) Foreign exchange fluctuation	-	Rs. 468/-

2.2 Aggrieved by the order of assessment dated 24.03.2014 for Assessment Year 2011-12, the assessee preferred an appeal before CIT(A)-Hubli; which was dismissed vide the impugned order dated 10.09.2015.

3. The assessee, being aggrieved by the order of the CIT(A)-Hubli dated 10.09.2015 for Assessment Year 2011-12, has filed this appeal before the Tribunal wherein it has raised the following grounds:

1. *Ld. CIT(A). on the facts and in law, erred in confirming addition of Rs. 3,30,00,000/- made by the Assessing Officer u/s 2(22)(e) of the Act. CIT(A) ought to have appreciated that provisions of section*

*2(22)(e) could not have been invoked, among others, for the reason that:-*

*(a) Said sum of Rs. 330 lacs was received by the Appellant Company as "Inter Corporate Deposit" (ICD) and not as "Advance or Loan";*

*(b) Appellant Company is not a Legal Registered Shareholder and Beneficial Shareholder of M/s Microfinish Trading Pvt Ltd. (MTPL) which had placed the ICD with the Appellant Company;*

*(c) At the beginning of the relevant previous year, MTPL did not have accumulated profits;*

*(d) Without prejudice, lending of money is substantial part of the business of MTPL.*

*2. Ld. CIT(A) erred in confirming and not deleting disallowance of Rs. 8,18,734/-u/s 40(a)(i) of the Act.*

*3. Ld. CIT(A) erred in confirming disallowance of Rs. 14,95,189/- out of Expenditure incurred by the Appellant Company on Repairs to Building, holding it as Capital Repairs, though depreciation is allowed at Rs. 74,759/-*

*4 Ld. CIT(A) erred in confirming disallowance of Rs. 4.97.738/- out interest expenditure. considered as part of cost of New Project being set up by the Appellant Company even when interest of Rs. 85,753/- was already allocated by the Appellant itself.*

*5. Ld. CIT(A) further erred in confirming addition of Rs. 7.263/- made by AO based on reconciliation difference between books and report in 26AS.*

*The Appellant craves leave to add to, alter or amend any of the grounds of appeal.*

#### **4. Ground No.1 – Deemed Dividend under section 2(22)(e) of the Act**

4.1 In this ground (supra), the assessee contends that the authorities below erred in making / confirming the addition of Rs.3.30 Crores under section 2(22)(e) of the Act. According to the assessee, the CIT(A) ought to have appreciated that the provisions of section 2(22)(e) of the Act could not have been invoked, *inter alia*, for the reasons that (i) the said amount of Rs.3.30 Crores was received by the assessee as an ‘inter corporate deposit’ (ICD) and not as an ‘advance on loan’; (ii) that the assessee is not a shareholder of M/s. Microfinish Trading Pvt. Ltd., (MTPL), which had placed the ICD with the assessee and (iii) that at the beginning of the relevant previous year, MTPL did not have accumulated profits. The learned AR for the assessee submitted that this issue is covered in favour of the decision of the Co-ordinate Bench of this Tribunal in the assessee’s own case for Assessment Year 2012-13 in ITA No. 1706/Bang/2017 dated 16.11.2018.

4.2 Per contra, the learned DR for Revenue supported the orders of the authorities below.

4.3.1 The issue for consideration before us, as raised in this ground (supra) is with regard to the action of the authorities below in bringing to tax a sum of Rs.3.30 Crores as deemed dividend under section 2(22)(e) of the Act. We find that the facts and circumstances of the case on hand are similar to the similar issue considered by the Co-ordinate Bench of this Tribunal in the assessee’s own case in Assessment Year 2012-13 (supra). In its order in ITA No.1706/Bang/2017 dated 16.11.2018, the Co-ordinate Bench, following, *inter alia*, the decision of the Special Bench of ITAT, Mumbai, in the case of Bhoumik Color Labs (ITA No.5030/M/04, 118 ITD 1 (SB) (Mum)), at paras 11 to 15 thereof, has held as under:

*"11. In the present appeal we are concerned with the second limb of Sec.2(22)(e) of the Act, viz., "to any concern in which such shareholder is a member or a partner and in which he has a substantial interest". The following conditions are required to be satisfied for application of the above category of payment to be regarded as Dividend. They are:-*

- (a) There must be a payment to a concern by a company.*
- (b) A person must be Shareholder of the company being a registered holder and 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. This is because of the expression "Such Shareholder" found in the relevant provision. This expression only refers to the shareholder referred to in the earlier part of Sec.2(22)(e) viz., a registered and a beneficial holder of shares holding 10% voting power.*
- (c) The very same person referred to in (b) above must also be a member or a partner in the concern holding substantial interest in the concern viz., when the concern is not a company, he must at any time during the previous year, be beneficially entitled to not less than twenty percent of the income of such concern; and where the concern is a company he must be the owner of shares, not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits, carrying not less than twenty percent of the voting power*
- (d) If the above conditions are satisfied then the payment by the company to the concern will be dividend.*

*12. The Special Bench of ITAT, Mumbai, in the case of Bhaumik Color Labs 1TA 50301M/04, 118 ITD 1 (SB) (Mum), considered the question Whether deemed dividend u/s. 2(22)(e) of the Income Tax Act, 1961 can be assessed in the hands of a person other than a shareholder of the lender? The Special Bench held that deemed dividend can be assessed only in the hands of a person who is a shareholder of the lender company and not in the hands of a person other than a shareholder. The Special Bench on the above issue has observed as follows:-*

*"30. At the outset it has to be mentioned that provisions of Sec.2(22)(e) which brought in a new category of payment which was to be considered as dividend as introduced by the Finance Act 1987 w.e.f.1-4-88 viz.,*

*payment by a company "to any concern in which such shareholder is a member or a partner and in which he has a substantial interest" do not say as to in whose hands the dividend has to be brought to tax, whether in the hands of the "concern" or the "shareholder". We have already seen the divergent views on this issue which have been referred to in the earlier part of this order.*

*31. The above provisions were subject matter of consideration before the Hon'ble Rajasthan High Court in the case of CIT Vs. Hotel Hilltop. 217 CTR 527(Raj). The facts of the case before the Hon'ble Court were as follows. The Assessee was one M/S.Hotel Hilltop a partnership firm. This firm received an advance of Rs.10 lacs from a company M/S.Hilltop palace Hotels (P) Ltd. The shareholding pattern of M/S.Hilltop Palace Hotels (P) Ltd., was as follows:*

- 1. Shri Roop Kumar Khurana 23.33%*
- 2. Smt.Saroj Khurana 4.67%*
- 3. Vikas Khurana 22%*
- 4. Deshbandhu Khurana 25%*
- 5. Shri Rajiv Khurana 25%*

*The constitution of the firm Motel Hill Top was as follows:*

- 1. Shri Roop Kuma Khurana: 45%*
- 2. Shri.Deshbandhu Khurana: 55%*

*The AO assessed the sum of Rs.10 lacs as deemed dividend u/s.2(22)(e) of the Act in the hands of the firm because the two partners of M/s.Hotel Hill Top were holding shares by which they had 100% voting power in M/S.Hill Top Palace Hotels (P) Ltd. They were also entitled to 20% of the income of the firm M/S.Hotel Hill Top. Therefore the loan by M/S.Hill Top Palace Hotels (P) Ltd. To the firm M/S.Hotel Hill Top was treated as deemed dividend in the hands of M/S.Hotel Hill Top, the firm under the Second limb of Sec.2(22)(e) of the Act. The CIT(A) held that since the firm was not the shareholder of the company the assessment as deemed dividend in the hands of the firm was not correct. The order of the CIT(A) was confirmed by the Tribunal.*

*On Revenue's appeal before the Hon'ble High Court, the following question of law was framed for consideration:-*

*"Whether on the facts and in the circumstances of the case and in law the learned Tribunal was justified in upholding the order of learned CIT(A) deleting the addition of Rs.10 lacs as deemed dividend under Section 2(22)(e) of the IT Act? "*

*The Hon'ble Court held as follows:-*

*"The important aspect, being the requirement of section 2(22)(e) is, that the payment may be made to any concern, in which such shareholder is a member, or the partner, and in which he has substantial interest, or any payment by any such company, on behalf or for the individual benefit of any such shareholder ....."* Thus, the substance of the requirement is that the payment should be made on behalf of or for the individual benefit of any such shareholder, obviously, the provision is intended to attract the liability of tax on the person, on whose behalf, or for whose individual benefit, the amount is paid by the company, whether to the shareholder, or to the concerned firm. In which event, it would fall within the expression 'deemed dividend'. Obviously, income from dividend, is taxable as income from the other sources under section 56, and in the very nature of things the income has to be of the person earning the income. The assessee in the present case is not shown to be one of the persons, being shareholder. Of course, the two individuals being R and D. are the common persons, holding more than requisite amount of shareholding and are having requisite interest, in the firm, but then, thereby the deemed dividend would not be deemed dividend in the hands of the firm, rather it would obviously be deemed dividend in the hands of the individuals, on whose behalf, or on whose individual benefit, being such shareholder, the amount is paid by the company to the concern. Thus, the significant requirement of section 2(22)(e) is not shown to exist. The liability of tax, as deemed dividend, could be attracted in the hands of the individuals, being the shareholders, and not in the hands of the firm."

*32. The aforesaid decision of the Hon'ble Rajasthan High Court which is the only decision of High Court, should be sufficient to answer question No.2 which has been referred to the Special Bench by holding that deemed dividend can be assessed only in the hands of a person who is a shareholder of the lender company and not in the hands of a person other than a shareholder. The argument of the learned D.R. that the Hon'ble Rajasthan High Court did not deal with the second limb of Sec.2(22)(e) of the Act is not correct."*

13. *The Special Bench further held as follows:-*

*"34. We are of the view that the provisions of Sec.2(22)(e) does not spell out as to whether the income has to be taxed in the hands of the shareholder or the concern(non-shareholder). The provisions are ambiguous. It is therefore necessary to examine the intention behind enacting the provisions of Sec.2(22)(e) of the Act.*

*35. The intention behind enacting provisions of section 2(22)(e) are that closely held companies (i.e. companies in which public are not substantially interested), which are controlled by a group of members, even though the company has accumulated profits would not distribute such profit as dividend because if so distributed the dividend income would become taxable in the hands of the shareholders. Instead of distributing accumulated profits as dividend, companies distribute them as loan or advances to shareholders or to concern in' which such shareholders have substantial interest or make any payment on behalf of or for the individual benefit of such shareholder. In such an event, by the deeming provisions such payment by the company is treated as dividend. The intention behind the provisions of section 2(22)(e) is to tax dividend in the hands of shareholder. The deeming provisions as it applies to the case of loans or advances by a company to a concern in which its shareholder has substantial interest, is based on the presumption that the loan or advances would ultimately be made available to the shareholders of the company giving the loan or advance. The intention of the legislature is therefore to tax dividend only in the hands of the shareholder and not in the hands of the concern.*

*36. The basis of bringing in the amendment to Sec.2(22)(e) of the Act by the Finance Act, 1987 w.e.f 1-4-88 is to ensure that persons who control the affairs of a company as well as that of a firm can have the payment made to a concern from the company and the person who can control the affairs of the concern can draw the same from the concern instead of the company directly making payment to the shareholder as dividend. The source of power to control the affairs of the company and the concern is the basis on which these provisions have been made. It is therefore proper to construe those provisions as contemplating a charge to tax in the hands of the shareholder and not in the hands of a non-shareholder viz., concern. A loan or advance received by a concern is not in the nature of income. In other words there is a deemed accrual of income even u/s.5(1)(b) in the hands of the shareholder only and not in the hands of the payee viz., non-shareholder (Concern). Sec.5(1)(a) contemplates that the receipt or deemed receipt should be in the nature of income. Therefore the deeming fiction can be applied only in the hands of the shareholder and not the non-shareholder viz., the concern.*

37. *The definition of Dividend U/s.2(22)(e) of the Act is an inclusive definition. Such inclusive definition enlarges the . meaning of the term "Dividend" according to its ordinary and natural meaning to include even a loan or advance. Any loan or advance cannot be dividend according to its ordinary and natural meaning. The ordinary and natural meaning of the term dividend would be a share in profits to an investor in the share capital of a limited company. To the extent the meaning of the word "Dividend" is extended to loans and advances to a shareholder or to a concern in which a shareholder is substantially interested deeming them as Dividend in the hands of a shareholder the ordinary and natural meaning of the word "Dividend" is altered. To this extent the definition of the term "Dividend can be said to operate. If the definition of "Dividend" is extended to a loan or advance to a non shareholder the ordinary and natural meaning of word dividend is taken away. In the light of the intention behind the provisions of Sec.2(22)(e) and in the absence of indication in Sec.2(22)(e) to extend the legal fiction to a case of loan or advance to a non-shareholder also, we are of the view that loan or advance to a non-shareholder cannot be taxed as Deemed Dividend in the hands of a non-shareholder."*

14. *The aforesaid view has since been approved in several decisions rendered by Hon'ble High Court of Bombay and Delhi in the case of CIT Vs. Universal Medicare Pvt. Ltd., 324 ITR 263 (Born), CIT Vs. Ankitech Pvt.Ltd. & others 340 ITR 14 (Del.) National Travel Services (2012) 249 CTR (del) 540 and the Hon'ble Karnataka High Court in the case of CIT Vs. Sarva Equity (P) Ltd, (2014) 111 DTR 207 (Kam.) and the Hon'ble Supreme Court in the case of CIT Vs. Madhur Housing and Development Co. 401 ITR 152(SC) Since the Assessee in the present case is not a shareholder in the lender company, we are of the view that the above decision is squarely applicable to the facts of the Assessee's case.*

15. *In view of the aforesaid decision, we are of the view that the action of the revenue authorities in bring to tax a sum of Rs.4 Crores as deemed dividend u/s.2(22)(e) of the Act cannot be sustained and the said addition is directed to be deleted. The relevant ground of appeal of the Assessee is allowed."*

4.3.1 Respectfully following the aforesaid decision of the Co-ordinate Bench of this Tribunal in the assessee's own case for Assessment Year 2012-13

(supra), we are of the view that the action of the authorities below in bringing to tax a sum of Rs.3.30 Crores as deemed dividend under section 2(22)(e) of the Act is unsustainable and accordingly direct deletion of the said addition. Consequently, ground No.1 of assessee's appeal is allowed.

## **5. Ground No.3 – Repairs to Building**

5.1 In this ground (supra), the assessee assails the order of the learned CIT(A) in upholding the disallowance of Rs.14,95,189/- out of expenditure incurred by the assessee on repairs to building; holding them to be capital expenditure and allowing depreciation thereon. According to the learned AR, the said expenditure has been incurred on the assessee's own premises and was incurred towards supply of pipe columns and fabrication for extension of an existing parking shed and repairs and renovation of design department, involving expenses such as replacement of broken flooring tiles, false ceilings, plastering of walls, reducing the size of cabins and addition partitions. It is submitted that a perusal of the description of the items on which the repair expenses have been incurred would clearly establish that they do not by any stretch of imagination give rise to the creation of a new asset that gives an enduring benefit to the assessee. Detailed break up of the same was placed at pages 105-112 of Paper Book submitted.

5.2 Per contra, the learned DR supported the orders of the authorities below.

5.3 We have considered the rival contentions and carefully perused the material on record. We have perused the items of expenditure incurred by the assessee on extension of parking shed, as laid out in the order of assessment; i.e., towards supply of pipe columns and fabrication, replacing of broken flooring, falling ceilings, painting plastering of walls, reducing of cabin sizes and adding partitions, etc., and the break up of the expenditure incurred on repairs and

maintenance placed at pages 105 to 112 of paper book. In our view, the expenditure incurred has not resulted in the creation of any new asset of enduring nature and therefore hold the same to be revenue in nature. In this view of the matter, we delete the disallowance of the AO's action in treating the expenditure of Rs.14,95,189/- as being capital in nature and direct the AO to withdraw the depreciation allowed to the assessee in this regard. We hold and direct accordingly. Consequently, ground No.3 of assessee's appeal is allowed.

**6. Ground No.4 – Disallowance of Interest Expenditure claimed**

6.1 In this ground (supra), the assessee contends that the CIT(A) erred in sustaining the disallowance of Rs.4,97,738/- out of interest expenditure claimed as being part of cost of new project being set up by the assessee even though the assessee had already allocated interest expenditure of Rs.85,753/- in this regard. According to the learned AR, the amount to be disallowed out of interest expenditure was actually Rs.4,11,875/- (i.e., Rs.4,97,738/- less Rs.85,753/-). The learned DR for Revenue submits that the assessee's claim may be allowed subject to verification of the assessee's claim by the AO.

6.2 We have considered the submissions / claims put forth on the correct amount of interest expenditure to be disallowed and considered as part of the new project being set up by the assessee. According to the assessee, the CIT(A) ought to have restricted the disallowance of such expenditure from Rs.4,97,738/- to Rs.4,11,875/- since the assessee had already suo moto allocated Rs.85,753/- of interest expenditure to the new project. As submitted by the learned DR, we remand this claim of the assessee to the file of the AO for examination and verification of the assessee's claim in this regard. Consequently, ground No.4 of assessee's appeal is allowed for statistical purposes.

7. **In Ground No.5 (supra)**, the assessee contends that the CIT(A) has erred in confirming the addition of Rs.7,263/- made by the AO based on reconciliation of difference between the books and 26AS. We restore this matter to the file of the AO and direct the AO to examine the veracity of the assessee's claim. Consequently, ground No.5 of assessee's appeal is allowed for statistical purposes.

8. In the result, the assessee's appeal for Assessment Year 2011-12 is partly allowed.

*Order pronounced in the open court on this 12.04.2019.*

Sd/-  
**(N. V. VASUDEVAN)**  
**Vice President**

Sd/-  
**(JASON P BOAZ)**  
**Accountant Member**

Bangalore.

Dated: 12.04.2019.

/NS/\*

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|---------------|---------------|
| 1. Appellants | 2. Respondent |
| 3. CIT        | 4. CIT(A)     |
| 5. DR         | 6. Guard file |

By order

Assistant Registrar,  
ITAT, Bangalore.