

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

DEEMED DIVIDEND

A. INTRODUCTION TO DEEMED DIVIDEND

1. Section 2(22) of the Income Tax Act, 1961 - Extract from Bare Act

(22) "dividend" includes—

- (a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company ;
- (b) any distribution to its shareholders by a company of debentures, debenture-stock, or deposit certificates in any form, whether with or without interest, and any distribution to its preference shareholders of shares by way of bonus, to the extent to which the company possesses accumulated profits, whether capitalised or not ;
- (c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not ;
- (d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933, whether such accumulated profits have been capitalised or not ;
- (e) 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, 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;**

but "dividend" does not include—

- (i) a distribution made in accordance with sub-clause (c) or sub-clause (d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets ;
- (ia) a distribution made in accordance with sub-clause (c) or sub-clause (d) in so far as such distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

shareholders after the 31st day of March, 1964, and before the 1st day of April, 1965;

- (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 ;
- (iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off;
- (iv) any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956 (1 of 1956);
- (v) any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

Explanation 1.—The expression "accumulated profits", wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956.

Explanation 2.—The expression "accumulated profits" in sub-clauses (a), (b), (d) and (e), shall include all profits of the company up to the date of distribution or payment referred to in those sub-clauses, and in sub-clause (c) shall include all profits of the company up to the date of liquidation, but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place.

Explanation 3.—For the purposes of this clause,—

(a) "concern" means a Hindu undivided family, or a firm or an association of persons or a body of individuals or a company ;

(b) a person shall be deemed to have a substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the income of such concern ;

[Note : Highlighted and Underlined Text refers to provisions relevant to Deemed Dividend]

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

2. **Legislative History of Section 2(22)(e) of the Income Tax Act, 1961.**
 - a. Section 2(6A) of the Indian Income Tax Act, 1922 corresponding to Section 2(22) of the Income Tax Act, 1961 was first introduced by the Indian Income Tax (Amendment) Act 1939.
 - b. Clause (e) was added to Section 2(6A) of the Indian Income Tax Act, 1922 corresponding to Section 2(22)(e) of the Income Tax Act, 1961 by the Finance Act, 1955. By virtue of this amendment, for the first time, the fiction of treating loans or advances to shareholders as dividend was first introduced in the Income Tax Law.
 - c. The provisions of Section 2(6A) of the Indian Income Tax Act, 1922 were incorporated in Section 2(22) of the Income Tax Act, 1961 without any amendments.
 - d. The first and only amendment to Section 2(22)(e) was made by Finance Act, 1987 (w.e.f. 01-04-1988) wherein the phrase “Shareholder who has substantial interest” then appearing was replaced by the phrase “a Shareholder who is a beneficial owner of shares holding not less than 10% of the voting power”.
 - e. The constitutional validity of the provisions of Section 2(22)(e) was upheld by the Supreme Court in the matter of Navnitlal C. Jhaveri v K K Sen, AAC [1965] 56 ITR 198 (SC).

3. **Dividend, general meaning thereof :**
 - i. ‘Dividend’, in its ordinary connotation, means the sum paid to or received by a shareholder proportionate to his shareholding in a company out of the total sum of profit distributed.
 - ii. However, The definition of Dividend u/s 2(22) is “Inclusive, Enumerative” to include certain distribution / payments by the company to its shareholders, namely :-
 - (a) distribution entails the release of all or any part of the assets of the company ;
 - (b) distribution of debentures, debenture-stock or deposit certificates in any form, whether with or without interest ;
 - (c) distribution by a company on its liquidation ;

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

- (d) distribution by a company on the reduction of its capital ;
 - (e) payment by a Closely Held Company by way of advance or loan to a shareholder who is a beneficial owner of shares holding not less than 10% of the voting power.
- iii. The phrase “Accumulated Profits, whether capitalized or not”, is uniformly used under clauses (a), (b), (c), (d) and (e) of section 2(22).

4. Is it “Deemed Dividend”?

- (a) Ironically, the word “Deemed” is not used even once in the Section 2(22).
- (b) In this Section 2(22), certain payments by the Company to shareholder are construed as Dividend which would not be dividend under the Ordinary commercial parlance or ‘The Companies Act, 1956’ and hence the term ‘Deemed Dividend’.
- (c) In *Kantilal Manilal v. CIT* (1961) 41 ITR 275 (SC), Held that Section 2(22) creates a fiction by which certain receipts or parts thereof are treated as dividend for the purpose of levy of Income-tax .

5. Intention of Legislature behind introduction of Section 2(22)(e).

Section 2(22)(e) of the Income Tax Act, 1961 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 companies pay or distribute, what would legitimately be dividend in the hands of shareholders, money in the form of advance or loan. - Read in *CIT v. Raj Kumar* (2009) 181 Taxmann 155 (Delhi).

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

B. SCOPE OF SECTION 2(22)(e)- AN IN DEPTH ANALYSIS

There are 5 (five) aspects (conditions) inherent in the provisions of Section 2(22)(e) - all of which must be cumulatively satisfied - for a payment from a company to the shareholder - to be deemed as dividend u/s 2(22)(e) in a particular assessment year :-

- I. TYPE OF COMPANY
- II. NATURE OF PAYMENTS
- III. PERSONS COVERED
- IV. AMOUNT (ACCUMULATED PROFITS)
- V. ACCRUAL (IN WHICH ASSESSMENT YEAR)

I. TYPE OF COMPANY

1. DEFINITION OF CLOSELY-HELD COMPANY

- i. The phrase 'closely-held company' is not explicitly defined under the Income Tax Act, 1961 but it means a 'company in which the public is not substantially interested'.
- ii. Section 2(18) of the Income Tax Act, 1961 defines 'a company in which the public is not substantially interested' to include :-
 - a. *a company owned by the Government or the RBI or more than forty percent of the shares are owned by Government or the RBI or a corporation owned by the RBI.*
 - b. *a company registered under section 25 of the Companies Act, 1956.*
 - c. *a company not having share capital and declared by the Board to be such company*
 - d. *Mutual Benefit Finance Company - business of acceptance of deposits from members and notified by the Central Government u/s 620 of the Companies Act, 1956.*

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

- e. *a company, whose more than 50% Equity Shares (not being Preference Shares) held by one or more Co-operative Societies throughout the previous year.*
 - f. *a company not being a Private Company as defined in the Companies Act, 1956, whose Equity Shares were listed on the 31 March of the previous year in a Recognised Stock Exchange.*
 - g. *a 'Government Company' not being a 'Private Company' (both terms being defined in the Companies Act, 1956).*
- iii. As a corollary to the definition of 'a company in which the public is substantially interested', a 'closely held company' will include :-
- a. a Private Company as defined in the Companies Act, 1956 ; and
 - b. a Company not being a Private Company as defined in the Companies Act, 1956 and whose Equity Share are not listed on the 31 March of the previous year in a Recognised Stock Exchange.

2. APPLICABILITY ON FOREIGN COMPANIES

- i. Section 2(22)(e) does not distinguish between an Indian or a Foreign Company.
- ii. Section 2(17) defines "company" to include a body corporate incorporated by or under the laws of a country outside India.
- iii. Sum paid by a Foreign Company to a resident shareholder has been held as dividend - See Gautam Sarabhai v. CIT (1964) 52 ITR 921 (GUJ.)
- iv. It is further pertinent to note that a Recognised Stock Exchange has been defined in the Income Tax Act, 1961 to mean a stock exchange recognised as such by the Central Government under section 2(f) of the Securities Contracts Regulation Act, 1957 (SCRA). Further, at present only stock exchanges operating in India have been recognised by the Central Government. Accordingly, as a corollary, a Stock Exchange outside India is not Recognised by the Central Government and a Foreign Company listed outside India or also an Indian Company listed outside India (and Not listed in India on the 31 March of the previous year) will be a 'Closely Held Company' for the purpose of Section 2(22)(e).

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

II. NATURE OF PAYMENTS

- (i) Any payment by way of advance or loan; OR

Exception: Loan or advance is granted in the ordinary course of its business and lending of money is a substantial part of the company's business. (See Section 2(22)(ii))

- (ii) Any payment, on behalf of, or for the individual benefit of such Shareholder.

1. What is 'Loan' or 'Advance'?

- i. The term "Loan or Advance" has not been defined under the Income Tax Act, 1961.

- ii. According to Black's Law Dictionary, 'loan' means a lending; delivery by one party to and receipt by another party of sum of money upon agreement, express or implied, to repay it with or without interest.

- iii. In the matter of G.R. Govinda Rajolu Naidu v CIT (1973) 90 ITR 13 (Mad), HELD:

- There should be an outgoing or flow of money from the company to the shareholder;
- A notional payment by way of book entries will not be included.
- On the facts of the case, the amounts due by the assessee to the company towards the first and second call monies on the shares held by it in the company - Not Deemed Dividend u/s 2(6A)(e) of the Indian Income Tax Act, 1922

- iv. The Black's Law Dictionary defines the term "advance" as "a payment made in anticipation of a contingent or fixed future liability or obligation". Ordinarily, an advance is a payment beforehand and it does not connote the idea of repayment. It is adjusted when the action, for which the money is advanced, is completed.

- v. Advances means something which is due to a person but which is paid to him ahead of the time when it is due to be paid. - CIT v Srinivasan (K.) (1963) 50 ITR 788 (Mad).

- vi. In the matter of CIT v. Raj Kumar (2009) 181 Taxmann 155 (Delhi), Held, The usual attributes of a loan are that it involves positive act of lending

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

coupled with the acceptance by the other side of the money as loan - it generally carries interest and there is an obligation of repayment. The term 'advance' is of wide import & has undoubtedly more than one meaning, depending on the context in which it is used. In its widest meaning, the term 'advance' may or may not include lending or the obligation of repayment. The Delhi High Court applied the rule of construction of noscitur a sociis - "the meaning of the word can be gathered from the context" or "by the company which it keeps." The word 'advance' which appears in the company of the word 'loan' could only mean such 'advance' which carries with it an obligation of repayment. Trade advance which are in the nature of money transacted to give effect to a commercial transactions would not fall within the ambit of the provisions of Section 2(22)(e) of the Act.

vii. Illustrations of Loans or Advances

Particulars	Citation	Included / Excluded from Loans or Advances
Advances in Kind	M.D. Jindal v. CIT [1986] 28 Taxman 509 (Cal.)	Included
Trade Advances	CIT v Jamnadas Khimji Kothari (1973) 92 ITR 105 (Bom)	Included
Imprest Balances with Directors	ACIT v Harsad V. Doshi (2011) 49 DTR 181 (Trib) (Chennai)	Excluded
Deposits	ACIT v Global Agencies Pvt. Ltd. 87 TTJ 1086 (Del)	Excluded
Inter-Corporate Deposits	Bombay Oil Industries Ltd. v DCIT (2009) 28 SOT 383 (Mum)	Excluded
Trade Advances	CIT v. Raj Kumar (2009) 181 Taxmann 155 (Delhi)	Excluded

viii. Examples of Advances

Example 1 In the matter of CIT v P.K. Abubucker (2003) 259 ITR 507 (Mad):

Facts A company had advanced to a shareholder a sum for construction of a building to be taken on lease, and the amount so advanced was to be adjusted against future rent.

Held Liable to be assessed as Deemed Dividend.

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

Example 2 In the matter of Dr. Shiv Kant Mishra v Dy CIT (2009) 118 ITD 347 (Luck):

Facts A MoU was entered into between the assessee and the company whereby the company advanced money to the assessee for purchase of land and, in turn, he was to transfer by way of lease a portion of land in favour of the company. Factually, the assessee constructed a residential building for his personal use on the said land.

Held Tribunal held that neither the business of the company was to carry on construction or deal in real estate nor did the assessee's case fall in the exception provided in section 2(22). The Tribunal held that the MoU between the company and the assessee was a colourable device adopted for transfer of accumulated profits as loan for an indefinite period. Accordingly, the inclusion of such amount as deemed dividend in the hands of the assessee was upheld by the Tribunal. Thus, the decision went in favour of the revenue.

2. EXCLUSIONS FOR LOANS OR ADVANCE IN THE ORDINARY COURSE OF BUSINESS AND WHERE LENDING OF MONEY IS A SUBSTANTIAL PART OF BUSINESS

Clause (ii) of Section 2(22) - "... but "dividend" does not include -

(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; ... ”

Accordingly, to avail the Exclusion, there are 2 (Two) cumulative conditions:-

- (i) Advance or loan made to shareholder is in the "ordinary course of business"; and
 - a. 'Ordinary course of business' shall mean that the loan or advance should be given to such shareholder at the same rate and terms as it is given to other borrowers. - CIT v V.S. Sivasubramaniam (1998) 231 ITR 656 (Mad)]
 - b. Merely because the company did not have any money lending license, lending of money will not be treated as deemed dividend, if the assessee was lending money in the ordinary course of its business. -Jhamu V. Sughend v DCIT (2006) 284 ITR (AT) 82 (Mum).

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

- (ii) Lending of money is a substantial part of the business of the company;
“substantial part of business of the company” is not defined under the Income Tax Act, 1961

In CIT v. Parle Plastics Ltd. (2011) 196 Taxmann 62 (Bom.), Held :-

- a. Stroud’s Judicial Dictionary defines “substantial” as “A word of no fixed meaning, it is an unsatisfactory medium for carrying the idea of some ascertainable proportion of the whole”.
- b. “substantial” does not mean “major”
- c. Various factors to be looked into to determine whether the business is substantial or not, namely :- Turnover, Profits, Capital Employed, Human Resources.
- d. Any business which the company does not regard as small, trivial, or inconsequential as compared to the whole of the business is substantial business.

3. PAYMENTS ON BEHALF OF OR FOR THE INDIVIDUAL BENEFIT OF SUCH SHAREHOLDER - EXAMPLES

- a. In the matter of CIT v. L. Alagusundaram Chettiar[1977] 109 ITR 508 (Mad.),

Facts A managing director of a company, whenever he needed money used to ask an employee to take a loan from the company and the company would pass it on to the employee even without executing any pronote. The employee advanced the loan to the assessee almost immediately and in toto.

Held The loans made by the company to the employee fell in the category of “benefit” to the assessee managing director and were, therefore, assessable as deemed dividends in his hands.

- b. In the matter of Nandlal Kanoria v. CIT [1980] 122 ITR 405 (Cal.),

Facts The assessee, having substantial interest in a company X, obtained from company Y two loans of Rs. 75,000 and Rs.2,00,000 on July 30, 1968 and September2, 1968, respectively. Y had made the loans of Rs. 75,000 to the assessee out of loans received by Y from X on the same date.

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

Further, Y had made the loans of Rs. 2,00,000 to the assessee out of loans received by Y from X and another source on the same date.

Held This amount of Rs. 75,000 was a payment by X for the benefit of the assessee and fell within the mischief of section 2(22)(e). The same could not be said of the loan of Rs. 2,00,000, as on the date of making that loan, Y had received loans not only from X but from another source also and the loan was made out of blended amount.

III. TO PERSONS' COVERED

- (i) Any shareholder who is a beneficial owner of 10% or more of Voting power of the Company (but the shares shall not be entitled to a fixed rate of dividend, whether with or without a right to participate in profits); Or
- (ii) (a) To a concern (includes {HUF, Firm, AOP or BOI, Company}) in which such shareholder is a partner or a member , AND;
 - (b) has substantial interest (when entitled to 20% or more of the income of such concern).

1. The Shareholder v. Beneficiary controversy

- a. Shareholder - means a Registered Shareholder - whose name appears in the Register of Member u/s 150 of The Companies Act, 1956
- b. Beneficiary - whose name does not appear in the Register of Member u/s 150 but has a beneficial interest in such shares by virtue of Declarations furnished u/s 187-C of The Companies Act, 1956.
- c. The word shareholder used in section 2(22)(e) can only mean a registered shareholder. It is difficult to see how a beneficial owner of shares whose name does not appear in the register of shareholders of the company can be said to be a "shareholder". He may be beneficially entitled to the shares but he is certainly not a "shareholder". - Rameshwarlal Sanwormal v CIT (1980) 122 ITR 1 (SC)
- d. In case of non-corporate entities, such as Trusts (Public Charitable or Private), Hindu Undivided Family, Partnership Firms, etc the shares are held in the name of Trustees, Karta (Manager) or the Partner, respectively, whereas the beneficial owner of the Shares is the

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

respective Entity. Section 2(22)(e) applies only in case The beneficiary and the shareholder are the same person and not applicable in case The beneficiary is not the Registered Shareholder ; or The Registered Shareholder is not the beneficiary. Similar views have been expressed in CIT v. C P Sarathy Mudaliar (1972) 83 ITR 170(SC) ; ACIT v. Bhaumick Color (P) Ltd. (2009) 118 ITD 1 (MUM.) (SB) ; CIT v. National Travel Services (2011) 202 Taxmann 327 (Delhi)

2. VOTING RIGHTS > 10%

- a. Shareholder who is a beneficial owner of 10% or more of the Voting Power of the Company - on the date of loan or advance.
- b. Section 86(a)(ii) of 'The Companies Act, 1956' permits shares with Differential Rights as to Dividend, Voting or otherwise.
- c. In such case, The Voting Right of the shareholder must be more than 10% of the Total Possible Votes of all classes of Share Capital (other than Preferred Share Capital)
- d. Even if the whole or part of dividend on the preferred capital is remaining unpaid, and by virtue of Section 87(b) of 'The Companies Act, 1956', a preferred shareholder is entitled to vote, these shares are to be excluded if such shares are entitled to a fixed rate of profit.

3. PAYMENT TO A CONCERN OF SUCH SHAREHOLDER

- i. A person shall be deemed to have a substantial interest in a concern, at any time during the previous year,
 - (a) other than a company if he is, beneficially entitled to not less than 20% income of such concern.
 - (b) In the case of a company, if he beneficially holds at least 20% equity capital of the company.

Explanation 3(b) to Section 2(22).

- ii. If the loan or advance is given to a concern (HUF, Company, Firm, AOP or BOI) in which the shareholder and beneficiary has a substantial interest, then the deemed dividend u/s 2(22)(e) will be included in the

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

Total Income of THE SHAREHOLDER and NOT THE CONCERN. This view has been expressed in ACIT v. Bhaumick Color (P) Ltd. (2009) 118 ITD 1 (MUM.) (SB) ; CIT v Universal Medical Pvt. Ltd. (2010) 190 Taxman 144 (Bom) ; CIT v. Ankitech (P) Ltd. (2011) 11 taxmann.com 100 (Delhi) ; CIT v. National Travel Services (2011) 202 Taxmann 327 (Delhi). Further, the Circular No. 495 dated 22-9-1997 issued by CBDT - making payments to be included in the Total income of the concern is over-ruled by these decisions.

Rationale: The Legal fiction created under section 2(22)(e) enlarges definition of dividend only; legal fiction is not to be extended further for broadening concept of shareholders.

4. IF SHAREHOLDER IS NON-RESIDENT?

Section 2(22)(e) does not distinguish between a Resident or Non-resident shareholders. Further, it is pertinent to note that by virtue of Clause (iv) sub-section (1) of section 9, “any dividend paid by an Indian company outside India” is ‘Income deemed to accrue or arise in India’. Therefore, Deemed Dividend u/s 2(22)(e) is subject to tax in India in the hands of a Non-resident Shareholder subject to DTAA relief.

IV. AMOUNT

Amount of Advance or Loan.

Subject to maximum of Accumulated Profits .

1. What are Accumulated Profits?

- i. In the matter of P. K. Badiani v. CIT (1976) 105 ITR 642 (SC), Held, Accumulated profits mean commercial profits and not assessed income....It does not mean the aggregate of the assessed income arrived at after disallowing disbursements and expenditure in fact incurred..
- ii. **Exception:** In Navnitlal C. Jhaveri v. CIT[1971] 80 ITR 582(Bom), Held, While calculating accumulated profits, an allowance for depreciation at the rates provided by the Income-tax Act itself has to be made by way of deduction.

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

2. Is Profit (Loss) of Current Year included in the phrase “Accumulated Profits”?

- i. Explanation 2 - The expression “accumulated profits” shall include all profits of the company up to the date of distribution or payment referred to in sub-clauses (a), (b), (d) & (e)
- ii. However, the Supreme Court has held, “The profit accruing during the year cannot be considered as an accumulated profit for the purpose of section 2(22).” Reference is drawn to CIT v. M.V. Murugappan (1970) 77 ITR 818 (SC); CIT v. Ashokbhai Chimabhai (1965) 56 ITR 42 (SC) ; E.D. Sassoon & Co. Ltd. v. CIT (1954) 26 ITR 27 (SC).
- iii. The SC decisions to exclude current year profit (loss) from Accumulated Profits particularly, comes to aid, when there are a series of payments / repayments of loan or advance to the shareholder during the particular year - and If current year profits were included for computation of accumulated profits, then the profit will have to be determined at every point where a payment is made.

3. Examples of Accumulated Profits.

Particulars	Citation	Included / Excluded from Accumulated Profits
General Reserves	CIT v. Srinivasan K. (1963) 50 ITR 788 (Mad.)	Included
Profits generated from Exempt Income or Agricultural Income	Tea Estates India (P.) Ltd. V. CIT (1976) 103 ITR 785 (SC) ; S. Kumaraswami v. ITO [1961] 43 ITR 423 (Mad.)	Included
Capital Gains (other than Exempt)	Explanation 1 to Section 2(22)	Included
Investment Allowance Reserve		Included
Development Rebate Reserve		Included
Securities Premium	CIT v. MAIPO India Ltd. (2008) 24 SOT 42 (Delhi)	Excluded
Share Forfeiture Receipts	Navnitlal C. Jhaveri v. CIT (1971) 80	Excluded

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

	ITR 582(Bom)	
Profit / (Loss) for the Current year	CIT v. M V Murugappan (1970) 77 ITR 818 (SC)	Excluded
Balancing Charge u/s 41(2)	CIT v. Urmila Ramesh (1998) 96 TAXMAN 533 (SC)	Excluded
Additions made by AO	P. K. Badiani v. CIT (1976) 105 ITR 642 (SC)	Excluded
Capital Gains (if Exempt)	CIT v. Mangesh J. Sanzgiri, (1979) 119 ITR 962(Bom)	Excluded
Provision for Tax and Dividend	CIT v V. Damodaran (1972) 85 ITR 59 (Ker.).	Excluded

4. Profit Earlier Deemed As Dividend

In the matter of CIT v. G. Narasimhan (1979) 118 ITR 60 (Mad), Held, In determining the Accumulated profits available for the purpose of section 2(22)(e), the amount treated as deemed dividend under section 2(22)(e) in past have to be excluded, irrespective of the fact that no adjustment is made in the books of accounts. Similar view expressed in P. K. Badiani v. CIT (1976) 105 ITR 642 (SC)

5. Accumulated Profits is not restricted to Share of Shareholder.

The Amount is not restricted to the respective Shareholder's share in Accumulated Profits. This view has been expressed in CIT v. Mayur Madhukant Mehta (1972) 85 ITR 230 (Guj.) ; CIT v. Bhagwat Tewari (1975) 105 ITR 62 (Cal.) ; CIT v. Arati Debi (1978) 111 ITR 277 (Cal.).

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

V. ACCRUAL

1. Accrual in the previous year.

- a. “Deemed Dividend” accrues in the ‘previous year’ in which the payment was made. (Section 8(a)).
- b. Therefore, only payment(s) made during the “current year” is covered & any outstanding balances / interest on loans are to be ignored.
- c. The assessing officer may reopen assessment proceedings u/s 147, to bring “deemed dividend” escaping assessment to tax for the preceding assessment years.
- d. Any loan(s) which were outstanding beyond the limitation period cannot be assessed to Income-tax. The limitation period is period for which the assessing officer cannot issue Notice u/s 147 for reassessment of income.
- e. In CIT, Panaji - Goa v. Parle Plastics Ltd. (2011) 196 Taxmann 62 (Bom.), HELD, Only that amount of loans & advances, which was actually received by the assessee by way of loan or advance during the relevant previous year, could be treated as income by way of ‘deemed dividend’ and the carried forward balance of the loan of the previous year could not be treated as deemed dividend.

C. COMPLIANCES BY THE 'CLOSELY HELD COMPANY'

1. Corporate Dividend Tax - Not Applicable

Provisions of Corporate Dividend Tax (Section 115-O) are not attracted in case of "Deemed Dividend" & as a consequence thereof, exemption u/s 10(32) is not available. (Explanation to Chapter XII-D of the I. T. Act, 1961 - appears below Section 115-Q)

2. TDS under Section 194

- i. The principal officer of an 'Indian Company or a foreign Company which has made arrangement for payment of dividends in India' is liable to deduct income tax u/s 194 at the rate in force, before making any payment of any sum deemed to be dividend u/s 2(22)(e) of the I. T. Act, 1961.
- ii. Rule 27 of the Income Tax Rules, 1962 details the "prescribed arrangements for payment of dividends within India":-
 - (1) The share-register of the company for all shareholders shall be regularly maintained at its principal place of business within India, in respect of such assessment year from a date not later than 1st day of April of such year; and
 - (2) The general meeting for passing the accounts of the previous year relevant to the assessment year and for declaring the dividends in respect thereof shall be held only at a place within India.; and
 - (3) The dividends declared, if any, shall be payable only within India to all shareholders.

3. Consequences of Failure to Deduct Tax under Section 194

- i. No disallowance u/s 40(ia) of the Income Tax Act, 1961

Rationale: Section 40(ia) of the Income Tax Act, 1961 does not refer to payments referred to in Section 194 (dividends) ; and to disallow something, it must have been allowed at first, and Dividend are not allowed as Deduction.

- ii. However, the company may be liable to penalty u/s 271C(1)(a) of an amount equal to the 'amount of tax which such person' failed to deduct.

4. Disclosure in Audit u/s 44AB, Report Form 3CD

There is no specific provision in the Audit Report Form No. 3CD prescribed by the Income Tax Rules, 1962 for reporting of 'Deemed Dividend' paid by a Company. However, Clause 27 of Form No. 3CD requires the auditor to disclose whether the assessee has complied with the provisions of Chapter XVII-B relating to Deduction of Tax at Source. Since as per para C2 (supra) Tax is required to be deducted by the principal officer of an Indian Company u/s 194, the Auditor is obliged to report of Non-deduction of TDS u/s 194 in the Audit Report Form No. 3CD.

5. Set-off to avoid Double Taxation

- i. Subsequently, when the company declares dividend, & any such dividend is set-off against the advance, then the dividend so adjusted against the advance (which has been deemed as dividend), will not be again treated as dividend. (See Section 2(22)(iii))
- ii. If the dividend is not so set off but is paid to the shareholders while the loan remains outstanding, the benefit of this exception cannot be obtained. - Walchand & Co. Pvt. Ltd. v CIT (1993) 204 ITR 146 (Bom).

DEEMED DIVIDEND UNDER THE INCOME TAX ACT, 1961

D. COMPLIANCES BY THE RECEIPT SHAREHOLDER

1. Disclosures in Income Tax Return - Head of Income & Rate of Tax

- a. Deemed Dividend is taxed under the head Income from Other Sources.
- b. No special rate of tax is applicable to deemed dividend and it is taxed as income chargeable to tax at normal rates - slab rates in case of individuals & HUF's.

2. Burden of Proof during Assessment

- i. The burden is on the Revenue to prove that the case is falling within the mischief of the deeming provision u/s 2(22)(e) of the Income Tax Act, 1961. - Subrata Roy Sahara v. ACIT Central Circle III, Lucknow (2007) 109 ITD 1 (Luck) (TM)
- ii. However, if the assessee is claiming any exception, say
 - a. Loan or advance is in due course of the business, and lending is substantial part of the business ; or
 - b. Loan or advance is set-off against dividend declared subsequently;then the burden is on the assessee to prove that the case is falling within the exception to the deeming provision u/s 2(22)(e) of the Income Tax Act, 1961. -Walchand & Co. Ltd. v. CIT (1975) 100 ITR 598 (Bom).