



NEWSLETTER

February - 2023

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Concept of Deemed Dividend

Dividend is the return(s) that a shareholder receives for its company's shares.

- However, dividend also includes deemed dividend under its confines which falls under Section 2(22)(e) of the Income Tax Act 1961.
- Closely held companies instead of distributing the accumulated profit as dividend distribute them as loans or advances to shareholders.
- Resulting in the shareholders enjoying the profits of the company without paying any tax on the dividend
- The intention behind Section 2(22)(e) is to tax dividend in the hands of the shareholders

What is Deemed dividend as Section 2(22)(e) of the Income Tax Act

Amount deemed as income-

Any payment of any sum (whether as representing a part of the assets of the company or otherwise) made after the 31st day of May, 1987

Payer

By a company not being a company in which the public are substantially interested

Payee

- 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 10% 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

Payment vs. Distribution

Distribution is division amongst several persons.

Distribution connotes an idea of apportionment among more than one person.

In the case of 'distribution' the recipients would be more, than one, while in the case of 'payment' the recipient may be a single person.

Sub-clauses (a) to (d) of Sec 2(22) refer to distribution by company and sub-clause (e) includes in the definition of 'dividend' any payment by a company in which the public are not substantially interested.

However, where there is no payment but only a journal entry is passed, the provisions of clause (e) would not be applicable. (*CIT vs. Parle Plastics Ltd. (2011)*)

Whose payment is treated as deemed dividend

- The payment should be by a company in which public are not substantially interested ("closely held company").
- Section 2(18) of the Income Tax Act defines "a company in which public are substantially interested".

Whether the provisions of section 2(22) (e) would be attracted in a case where the loan or advance was given when the company was a closely held company and subsequently the shares were listed on the last day of the previous year?

One view can be- As on the date on which loan or advance was given, the company was a closely held company, the provisions of section 2(22)(e) would be attracted.

Other view can be- As per the definition under section 2(18) of the Income Tax Act., if the shares of the company are listed on the last day of the previous year, the company is not a closely held company. Accordingly, the provisions of section 2(22)(e) would not be applicable.

Beneficial owner and Registered owner for deemed

In terms of sec. 2(22)(e) dividend income is assessable only in hands of shareholders of lending company, who is the beneficial owner of shares and holding not less than 10% of the voting power. (*Chief CIT Vs. Sarva Equity P Ltd*)

Excluded categories of shareholders from the concept of deemed dividend

registered shareholder but not the beneficial owner - .(*Rameshwarlal Sanwarmal vs. CIT 122 ITR 1 [1980] (SC)*)

beneficial owner who is not a registered shareholder, - .(*CIT v. Standipack (P.) Ltd. [2012] 20 taxmann.com 19 (Delhi) Makhija Construction Co. v. ACIT [2011]*)

shareholder is also a creditor or a supplier of goods and payment is made towards supply of goods,

Shareholding of COMMON shareholder could not be taken into consideration for applying sec.2(22)(e)

Where a loan or advance is made to a concern in which shareholder as referred in the section is substantially interested, tax liability should not arise in the hands of that concern but in the hands of the shareholder having beneficial interest in the concern and that too when the money is finally received by that shareholder. (*CIT Vs, Ankitech Pvt. Ltd. ITA No 462 of 2009 (Del)*)

Deeming fiction of s. 2(22)(e) can be applied only in the hands of the shareholder and not the non- shareholder. (*Sadana Brothers Sales (P.) Ltd. v. Asstt. CIT [2011] (Indore-ITAT)*)

Advances vs Loan

Loan involves positive act of lending coupled with acceptance by the other side:

Generally loan carries an interest and there is an obligation of re-payment.

"Advance" may or may not include lending and

May or may not include the obligation of repayment. If it does then it would be a loan.

Thus, Trade advance which are in the nature of money transacted to give effect to a commercial transaction would not fall within the ambit of the provisions of Section 2(22)(e) of the Act. *CIT v. Raj Kumar [2009]*

Bagmane Constructions (P.) Ltd. V. CIT [2015]: Payment as trade advance as a consideration for goods received or for purchase of a capital asset which indirectly would benefit company advancing loan, would not fall within ambit of provisions of section 2(22)(e).

Pradip Kumar Malhotra V. CIT: Gratuitous loan or advance given by the company to that class of shareholders would come within the purview of Sec 2(22) but not to the cases where the loan or advance is given in return to an advantage conferred upon the company by such shareholder.

Exceptions to deemed dividend

Few transactions, although has the nature of lending advances, are not treated as a deemed dividend, such as,

Loans given by company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company like banking company, NBFC, etc.

Loans adjusted as dividend declared and distributed- loan or advance is given by a closely held company, and if subsequent dividend is adjusted against the loan or advance.

Where the public are substantially interested

Loans given to shareholders who do not have a substantial interest in the company.

Payments made by a company with the object of buying back its own shares.

Distribution of shares by the resulting company to the shareholders of a demerged company.

Trade Advance in the nature of commercial transaction. [Circular No. 19/2017, dated 12.06.2017]

Inter-corporate deposits (*IFB Agro Industries Ltd. v. JCIT 63 SOT 207 (KOL)*)

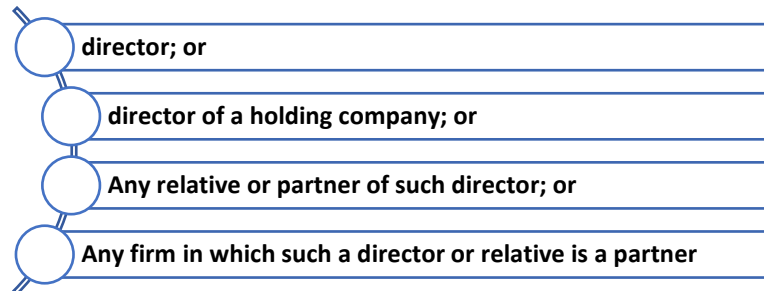
Where the assessee-firm (Concern) was not the shareholder of the lender company the amount received by the assessee as **security deposit** under an agreement coupled with certain obligations to be complied [*DCIT v. Atul Engineering Udyog [2011] 10 taxmann.com 162 (ITAT-Agra)*]

Security Deposit by exporters with assessee, buying agent of foreign principal in India to ensure quality of goods exported after securing clearance from the principal and linked with the endorsement of letter of credit (*ACIT vs. Global Agencies (P) Ltd. 87 TTJ 1086 (Del.)*)

Loan to Companies, where directors are interested - Income-tax Act vs Sec 185 of the Companies Act

General prohibition under Section 185 of the Companies Act 2013

In terms of provisions of section 185 of the Companies Act, 2013, a company is not allowed to provide any loan (including a loan represented by a book debt) to or provide any guarantee or security in connection with any loan taken by:



Allowable transactions under Section 185 of the Companies Act 2013

Companies Act has permitted granting loans in the following cases:

1. Loans to Managing Director or Whole Time Director as a part of the conditions of service extended by the company to all its employees or pursuant to any scheme approved by the members by a special resolution.
2. a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and interest is charged as specified.
3. any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company for its principal business activities. ; or
4. any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company for its principal business activities.

Loans to any person in which the director of the company is interested

As per Section 185(2) of the Companies Act, a company is allowed to provide any loan or guarantee or any security in connection with any loan taken by any person in whom any of the directors of the company is interested provided

- special resolution is passed by the company in general meeting
- the loans are utilised by the borrowing company for its principal business activities.

Treatment of Loan under the Income-tax Act

- A private company, being a closely held company providing a loan to its shareholder may attract provisions of section 2(22)(e) of the Income Tax Act, 1961 i.e. deemed dividend.
- According to the provisions of section 2(22)(e) of that Act, any loans or advances given by a private company to the extent it possesses accumulated profit to the specified persons will be treated as deemed dividend.
- Therefore, if a company proposes to provide any associate inter-company loans and advances, it should ensure both Section 185 of the Companies Act 2013 and also Section 2 (22) (e) of the Income Tax Act are complied with.

Income Tax Implications

- Before 1st April 2018, the companies that payout deemed dividends would not need to pay any DDT on such payments. After 1st April 2018, it was made mandatory to repay a DDT amount of around 30% on transactions.
- In the budget for 2021, the burden of paying taxes is transferred from the company to individual shareholders. Now the companies are not responsible for paying tax on Dividend Distribution Tax while distributing the dividends to the shareholders.

Compliance Calendar – Feb -2023



FEMA			
Compliance details	Form	Applicability	Due Date
External Commercial Borrowings (ECB) - FEMA	Form ECB-2	All Companies having ECB	07/02/2023
SEBI LODR Regulations			
Compliance details	Form	Applicability	Due Date
Regulation 32 (1)	Statement of deviation(s) or variation(s). Within 45 days from the end of the quarter/Within 60 days from the end of the last quarter	All listed companies, till time the issue proceeds have been fully utilised or the purpose has been achieved	14/02/2023
Regulation 33	Financial Results along with Limited review report/Auditor's report	All Listed Entities	14/02/2023
Labour Laws			
Compliance details	Form	Applicability	Due Date
PF Payment	Monthly ECR	Entities registered with PF Authorities	15/02/2023
ESI Payment	Monthly ECR	Entities registered with ESIC Authorities	15/02/2023
INCOME TAX			
Compliance details	Form	Applicability	Due Date
Deposit of TDS	Challan 281	Non-government deductors	07/02/2023
Deposit of TCS	Challan 281	Non-government deductors	07/02/2023
GST			
Compliance details	Form	Applicability	Due Date
Return of outward supplies of taxable goods and/or services	GSTR 1	GST Taxpayers who have not opted for QRMP scheme	11/02/2023
Return of outward supplies of taxable goods and/or services	GSTR 1	GST Taxpayers who opted for QRMP scheme -Optional	13/02/2023
Summary Return of Outward and Inward Supplies along with payment of Tax	GSTR 3B	GST Taxpayers who have not opted for QRMP scheme	20/02/2023
GST Challan Payment if no sufficient ITC		GST Taxpayers who opted for QRMP scheme and not having sufficient ITC	25/02/2023
Summary Return of Outward taxable supplies and tax payable	GSTR 5	Non-Resident GST Taxpayers	20-02-2023 or within 7 days after expiry of registration, whichever is earlier
Return for persons providing OIDAR services	GSTR 5A	OIDAR services from a place outside India to a person in India other than a registered person	20/02/2023
Return for details of ITC received and distribution	GSTR 6	Input Service Distributors	13/02/2023
Return for TDS under GST	GSTR 7	Government Authorities	10/02/2023
Return for Details of Supplies and the amount of tax collector	GSTR 8	E-commerce Operator	10/02/2023
Return for details of goods and services purchased in India	GSTR-11	Taxpayer claiming Refund & having UIN	28/02/2023