An Analysis of Section 2(22)(e)

In this piece of write-up, we aim to analyse the concept of 'deemed dividend', under the income tax laws right from the Income Tax Act, 1922 to current provisions. The said analysis is done with the support of various judgments at various forums on the said aspect. After a detailed deliberation, we wish to conclude with our views on the said concept.

Before understanding the said aspect in detail, a few basic concepts about taxability of dividend under the income tax laws would garner interest for the reader. The tax on any amounts which are declared, distributed or paid whether out of current or accumulated profits are to be paid by the company as per Section 115 O of Income Tax Act, 1961 (for brevity 'Act'). This is normally known as Dividend Distribution Tax (DDT). This is in addition to the normal income tax payable by the company and not a substitute for the normal tax.

Since the company pays DDT under Section 115 O, the shareholder is exempted from paying tax on such amounts as enumerated in Section 10(34) of Act. However, Section 10 (34) does not apply, in case where the situation is covered under Section 115BBDA, which states that where the total income of 'specified assessee' includes any income in aggregate exceeding ten lakh rupees by way of dividends declared, distributed or paid by domestic company or companies, such specified assessee has to pay income tax at 10% on such dividend income apart from the regular income tax.

With the basic understanding of the taxation of dividends, let us proceed to analyse the concept of dividend. The phrase 'dividend' has been defined vide Section 2(22) Act. The said section defines the phrase 'dividend' in an inclusive manner.

In other words, the phrase 'dividend' has to be understood in regular sense and also to be understood as specified by the said definition for the purposes of Act. The said section has five sub-clauses, certain exclusions and supported by four explanations. For ease of understanding, the definition is briefed as under:

Dividend includes	normal distribution to shareholders to extent of accumulated profits
	distribution to shareholders in form of debentures and any distribution to preference shareholders by way of bonus to extent of accumulated profits
	distibution to shareholders on its liquidation to extent of accumulated profits
	distribution to shareholders on reduction of capital to extent of accumulated profits
	paymets by compay by way of advance or loan to shareholder or to any concern in which such shareholder has substantial interest or payment on behalf or for individual benefit of shareholder to extent of accumulated profits

The intention for which Section 2(22) has been brought is candidly explained by the Honourable Supreme Court in the matter of Navnit Lal C Javeri v KK Sen 1964 (10) TMI 16 – SC[1] as under:

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 persons 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 realised 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 under section 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 amongst them.*

(emphasis supplied)

With the above in mind, let us proceed to analyse Section 2(22).

sub-clause (a):

The first sub-clause deals with normal dividend as everyone understands. The payments to the extent of accumulated profits are included in the definition of 'dividend' and accordingly brought into the tax net when declared, distributed or paid by the company to its shareholders.

sub-clause (b):

The second sub-clause deals with distribution of accumulated profits to the shareholders in the form of debentures or to preference shareholders in the form of bonus shares. The said payments are also called as 'dividend' and accordingly brought into the tax net when declared, distributed or paid by the company to its shareholders.

It is important to note that bonus shares issued out of accumulated profits to equity shareholders is not dividend as this clause does not cover such a situation. Further, under the sub-clause (a) or first sub-clause, the payment shall be regarded as 'dividend' only in situation where such payment entails the release of assets by company to its shareholders. In the case of bonus issue out of accumulated profits to the equity shareholders, there is no release of any assets by the company and merely reserves are transferred to capital and hence there is no 'dividend' within the meaning of the first sub-clause.

[1] The judgment was in context of Income Tax Act, 1922 where Section 2(6A) was in place of 2(22) and 23A in place of 115 O

sub-clause (c):

The third sub-clause deals with distribution to the shareholders on liquidation of the company to the extent of accumulated profits. The said payments are included in the definition of 'dividend' and accordingly brought into tax net when declared, distributed or paid by the company to its shareholders.

sub-clause (d):

The fourth sub-clause deals with distribution to the shareholders by a company on reduction of its share capital to the extent of accumulated profits. The said payments are included in the definition of 'dividend' and accordingly brought into tax net when declared, distributed or paid by the company to its shareholders.

sub-clause (e):

In the subject article, we are concerned with sub-clause (e). Hence, let us understand in detail the subject sub-clause. The bare extract is reproduced for ready reference:

(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

On a dissection of the above sub-clause (e), the following transactions are intended to be covered:

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 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*

Now, we proceed to analyse each of the above transactions in detail to understand the wide scope of sub-clause (e).

Advance or Loan to Shareholder:

The payment made by company, not being a company in which public are substantially interested, of any sum by way of advance or loan to shareholder, being a person who is beneficial owner of shares holding not less than ten percent of voting power is covered under the first limb of sub-clause (e).

Hence, to fall under the first limb, the following conditions has to be satisfied:

- a payment has to be made by company
- such company should not be a company in which public are substantially interested[2]
- such payment should be a sum by way of advance or loan to a shareholder
- such shareholder should be a beneficial owner of shares
- such shareholder should be holding not less than 10% of voting power

Of all the above conditions, the condition pertaining to the ownership of shares is of contentious issue. The earlier provisions till 1961 was dealing with only shareholder and not qualified by any other phrase. Hence, issues arose, about the taxability of payments in case where companies advanced loan to beneficial shareholders but not registered shareholders.

From 1988, the definition was amended to include beneficial shareholders to plug the above loose ends. However, after such amendment, the courts have interpreted that nothing has changed post amendment and taxability arises only when the shareholders are both registered and beneficial. If shareholder is either registered or beneficial, the courts have held that there would not be any tax liability on such payments made by company.

Let us examine all the crucial judgments which lead to the above conclusions. The analysis is made on a chronological basis.

Sarathy Mudaliar's case[3]:

This issue has first come up before the Honourable Supreme Court in the matter of CIT, Andhra Pradesh v CP Sarathy Mudaliar. The said matter was under the provisions of Income Tax Act, 1922. The phrase 'dividend' has been laid under Section 2(6A) of the said Act. The said definition has only stated that advance to a shareholder is considered as dividend and nowhere mentioned that the shareholder should be a registered or beneficial shareholder. In such context, the Honourable Supreme Court was called upon to interpret the phrase 'dividend'.

In the facts of the case, the company has advanced a loan to Hindu Divided Family (HUF). The members of HUF were the shareholders of the company. The matter before the apex court is whether loan provided to HUF which is not the registered shareholder of the company can be called as dividend for the purposes of Section 2(6A).

The apex court has held the intention of insertion of Section 2(6A) on the statute book is to include certain payments which are not normally understood as dividends to be dividends. Hence, the said section requires strict interpretation. Since the definition nowhere used the phrase beneficial shareholder, it has to be understood that the definition meant only registered shareholders. Since the HUF is not and cannot be a registered shareholder of the company, the loan provided by the company to HUF cannot be called as 'dividend' since HUF is not a shareholder.

Rameshwari Lal Sanwarmal's case[4]:

[2] The phrase 'company in which public are substantially interested' is defined vide Section 2(18) of Act
[3] 1971 (10) TMI 8 - SC

Another similar matter has reached the consideration of the apex court. A company has advanced loan to the HUF. The shares in the company are registered in the name of Karta of HUF. The tax authorities have tried to tax such receipt stating that such amounts constituted 'dividend' in terms of Section 2(6A) of Income Tax Act, 1922. However, the apex court following its earlier judgment in the case of Sarathy Mudaliar, has stated that such amounts cannot be called as dividend since HUF is not a registered shareholder.

The effect of the above two judgments is that to call an advancement of loan to the extent of accumulated profits to the shareholder of company as 'dividend', the shareholder should be a registered shareholder and nothing to do with beneficial ownership of shares. Post the above two judgments, the Income Tax Act, 1922 was repealed and Income Tax Act, 1961 has been introduced. The new Act vide Section 2(22) has carried the definition of 'dividend'.

Even after the introduction of the new act, the definition of 'dividend' was still used the phrase 'shareholder' and was not qualified by any other phrase. In 1988, the said definition was amended to include shareholder who is the beneficial owner of shares holding not less than 10% of voting power. Hence, from 1922 to 1988, the shareholder has to be understood as 'registered' and not 'beneficial'. However, from 1988, such shareholder is understood as 'beneficial'.

Bhaumik Colour Private Limited's case[5]:

The matter was before a special bench of Income Tax Appellate Tribunal. The facts of the said case were Bhaumik Colour Private Limited (BCPL) took an interest-bearing loan of Rs 9 lakhs from Umesh Pencil Private Limited (UPPL). Both of the said companies do not have cross holding, however, there is one common shareholder in the both the companies, which is Narmadaben Nandlal Trust (NNT). NNT has 20% shareholding in BCPL and 10% in UPPL. The tax authorities have proposed to tax such loan as 'dividend' in terms of first limb of 2(22)(e).

The shares in BCPL were held by three trustees of NNT which had five beneficiaries. The special bench after considering the Sarathy Mudaliar's case and changes in the definition of 'dividend' from 1922 to 1988 has held that the expression 'shareholder' used in first limb of sub-clause (e) refers both to the registered and beneficial shareholder. The special bench held that if a person is a registered shareholder but not a beneficial shareholder then the provisions of Section 2(22)(e) shall not apply. Similarly, if a person is a beneficial shareholder but not a registered shareholder then also provisions of Section 2(22)(e) will not apply.

In view of the facts, since NNT was not a beneficial shareholder and just a registered shareholder and accordingly the first limb fails, and no tax is required to be paid.

Ankitech Private Limited's case[6]:

In this matter also, the Honourable Delhi High Court has held as under:

Under the existing provisions of sec. 2(22)(e), payment made by way of advance or loan to a shareholder having "substantial interest" in the company was treated as deemed dividend. The shareholder having substantial interest as per provision of clause (32) of sec. 2 of the Act, was the one carrying not less than 20% voting power. In other words, earlier sec.2(22)(e) was applicable to shareholders having substantial interest in the company and the benchmark of the substantial

[4] 1972 (12) TMI 1 - SC
[5] 2008 (11) TMI – 273 – ITAT Bombay
[6] 2011 (5) TMI – 325 – Delhi High Court

interest was 20% of the voting power. By Finance Act, 1987, this benchmark of substantial interest was done away with. It is important to note here that section 2(32) defining the expression "person who has substantial interest in the company" was not amended. ***Therefore, to widen the scope of sec.2(22)(e), it was necessary to provide for the category of shareholders to whom the section would apply and it was provided by inserting the words "a shareholder, being a person who is beneficial owner of shares holding not less than 10% f the voting power". The concept of "voting power" was in built on the provisions of sec.2(22)(e) as it existed prior to 1987 amendment. The insertion of the words "beneficial owner of shares holding not less than 10% of the voting power" to "10% of voting power. A beneficial owner of shares cannot exercise voting power because to exercise the right to vote his/her name must appear in the register of members. In this view of the matter, it will not be correct to say that the ratio laid down by Hon'ble Supreme Court in Rameshwarlal Sanwarmal Vs. CIT 122 ITR 1 that word —shareholder in section 2(22)(e) is no more applicable. Moreover, since the purpose of sec. 2(22)(e), as stated in Circular No.495 dated 22.09.1987, is to tax the distribution of profits to shareholders, where the same is distributed not by way of dividend but by way of loan or advances, therefore, the view that word —shareholder has been used as —registered shareholder cannot be found fault with. Any other view would be against the very spirit of sec. 2(22)(e) of IT Act. The condition of 10% of the voting power is to be seen qua the shareholder; otherwise, the condition would be of no relevance.***

The Honourable High Court has concluded that in order to fall under the ambit of first limb of Section2(22)(e), the company should make a payment to a shareholder who is both beneficial and registered shareholder. The High Court has stated that the judgment of apex court in the case of Rameshwari Lal Sanwarmal is still valid post amendment too. The amendment has made it clear that shareholder should be a beneficial and it has never said he need not be registered. Hence, the apex court judgment in the case of Rameshwari Lal Sanwarmal still holds the ground post amendment since the judgment insisted that the shareholder has to be registered and not required to beneficial.

Madhur Housing and Development Company's case[7]:

The said matter was before the Honourable Apex Court. The Apex court after hearing the arguments made by both the parties, has confirmed the decision in the case of Ankitech Private Limited passed by Delhi High Court and agreed that the for the purposes of Section 2(22)(e) that shareholder should be both registered and beneficial and if the shareholder is beneficial and not registered, then the provisions will fail and vice versa.

National Travel Service's case[8]:

The said interpretation which was confirmed by Delhi High Court in the case of Ankitech (supra) and Supreme Court in the case of Madhur Housing and Development Company (supra), came upon for consideration again in the instant case in National Travel Service.

The apex court after considering all the above judgments has held that it will be very hard and defeating to accept the judgment in the matters of Ankitech and Madhur Housing and Development Company. The reasoning is as under:

This is why "shareholder" now, post amendment, has only to be a person who is the beneficial owner of shares. One cannot be a registered owner and beneficial owner in the sense of a beneficiary of a trust or otherwise at the same time. It is clear therefore that the moment there is a

[7] 2017 (10) TMI 1279 – SC
[8] 2018 (1) TMI 1159 – SC

shareholder, who need not necessarily be a member of the Company on its register, who is the beneficial owner of shares, the Section gets attracted without more. To state, therefore, that two conditions have to be satisfied, namely, that the shareholder must first be a registered shareholder and thereafter, also be a beneficial owner is not only mutually contradictory but is plainly incorrect. Also, what is important is the addition, by way of amendment, of such beneficial owner holding not less than 10% of voting power. This is another indicator that the amendment speaks only of a beneficial shareholder who can compel the registered owner to vote in a particular way, as has been held in a catena of decisions starting from Mathalone vs. Bombay Life Assurance Co. Ltd., [1954] SCR 117.

The apex court has found that the judgment in the case of Ankitech (supra) and Madhur Housing and Development Company (supra) to be incorrect since the amendment has been made with an intention to bring in the beneficial shareholder into the ambit and nothing to do with the registration of such shareholder. The apex court judgment authored by Justice R F Nariman states that once a shareholder is beneficial owner, then the section attracts despite of the fact that he is not a member in the register of the company.

Based on the above reasoning, the apex court has referred to an appropriate bench to reconsider the matter of Ankitech and Madhur Housing and Development Company. Till such bench is constituted, the matter is considered, and judgment is delivered, the matter whether the first limb covers only beneficial shareholder or beneficial and registered shareholder would not attain clarity.

Conclusion:

In our view, the judgment in the matter of National Travel Service's case is the right exposition of the law. Once the shareholder is a beneficial owner, there is no requirement to be a registered shareholder to fall under the ambit of first limb of Section 2(22)(e), since the amendment tries to cover such shareholders who are beneficial owners and nothing to do with registration. In other words, the amendment made in 1988, is to overcome the judgments of the apex court in the case of Sarathy Mudaliar's and Rameshwari Lal Sanwarmal's. Hence, looking in that perspective, we conclude that for the purposes of first limb of 2(22)(e), the shareholder if beneficial would be enough and need not be registered.

Payment to any Concern:

The next limb under sub-clause (e), is payment to any concern in which such shareholder is a member or partner and in which he has substantial interest. Hence, to fall under the second limb, the following conditions has to be satisfied:

- a payment has to be made by company
- such company should not be a company in which public are substantially interested
- such payment should be made to any concern
- such shareholder should be a member or partner in such concern
- such shareholder who is a member or partner should have substantial interest in such concern

It is important to note that the second and third limb uses the phrase 'such shareholder'. This would mean that such shareholder who was referred in the first limb. Leaving aside the issue whether such shareholder should be a beneficial or beneficial and registered, the second limb and third limb would come into play only once a shareholder who is a beneficial owner and having not less than 10% of

voting power is available. Hence, when we are dealing with second and third limb, it is important to see that the condition mentioned in the first limb as far as shareholder is concerned gets satisfied.

In addition to the above, it is important to note that the first limb covers only payments which are in the nature of advance or loan, whereas the second limb covers any payment. It is not necessary that such payments should be in nature of loan or advances. Since the payments made to any 'concern' in which such shareholder is a member or partner having substantial interest, the phrases 'concern' and 'substantial interest' assumes significance.

Such phrases are defined vide Explanation 3 of the Section 2(22). The phrase 'concern' is defined as to mean the following:

- Hindu Undivided Family
- A Firm
- An Association of Persons
- A Body of Individuals
- Company

The above is different from the definition of 'person' as laid down vide Section 2(31) of Act. The definition of 'person' covers various other species; however, the definition of 'concern' covers only limited species as detailed above.

Let us examine the ambit of phrase 'concern' by taking an example. ABC Private Limited has made a payment to ABC Society. The shareholders of ABC Private Limited are also members of the ABC Society. In such a scenario, whether such payment made by ABC Private Limited to ABC Society would fall under the second limb of sub-clause (e).

From the definition of 'concern', it is evident that 'society' has not been covered. The 'society' cannot be called as an Association of Persons or Body of Individuals and stands classified as 'artificial juridical person' as laid down by Kerala High Court in the matter of Mangalam Service Co-operative Bank Limited v Income Tax Officer[9] and Income Tax Appellate Tribunal Bangalore in the matter of Deputy Commissioner of Income Tax v Children's Education Society.

Hence, in our view, society cannot be called as 'concern' for the purposes of Section 2(22)(e), since, the said phrase does not include 'artificial juridical entity'. We also gather support from Explanation 3 vide para (b) which states that 'a person shall be deemed to have a substantial interest in a concern, other than company, if he is, at any time during the previous year, beneficially entitled to not less than 20% of the income of such concern.

From the above, it is evident that a shareholder shall be deemed to have substantial interest only he is beneficially entitled to not less than 20% of the income. Hence, we are of the view that the said definition of 'concern' covers only entities which are engaged in commercial pursuits and does not intend to cover non-profit entities. However, the said stand was not tested before any forum and hence it is advised to proceed with such caution in mind before acting.

Hence, payments made by ABC Private Limited to ABC Society, may not fall under the second limb of sub-clause (e).

[9] 2013 (7) TMI 391

Any payment on behalf, or for individual benefit:

The third limb deems any payment made by company on behalf or for the individual benefit of such shareholder as dividend. It is clear that the third limb is wider than first and second limb. It also like the second limb also covers any payment and need not be an advance or loan.

Hence, to fall under the third limb, the following conditions has to be satisfied:

- a payment has to be made by company
- such company should not be a company in which public are substantially interested
- such payment should be on behalf of such shareholder or
- such payment should be for the immediate benefit of such shareholder

Of all the three limbs, this is the trickiest one because of its ambit. As stated earlier, any payment is covered here unlike payment towards loans and advances as stated in first limb. Hence, any payment made by company on behalf of such shareholder or for the immediate benefit of such shareholder is required to be categorised as dividend for the purposes of third limb.

The phrase 'on behalf of' and 'for individual benefit' has not been defined. The said phrases need not be understood only to mean that payments are made to clear existing liabilities in light of the wider ambit of third limb.

Hence, it is important to understand the meaning of phrase 'on behalf of'. The said meaning has to be understood from the meaning of 'for individual benefit', in absence of the definition of such phrase and based on the rule of construction *nosictur a sociis,* which is explained as the meaning of the word is to be judged by the company it keeps.

So, we have to proceed to understand the phrase 'for the individual benefit' to understand the phrase 'on behalf of'. In order to understand the phrase 'for the individual benefit', we have to dig through the judgements and understand how courts see such phrase.

L Alagusundaram Chettiar's case[10]:

The facts in the said case are the company is advancing loans to an employee. Such employee immediately on receipt of such loan, gives loan to managing director of the company at a different rate of interest. Further, whenever the managing director wants money, the employee applies for loan to company and the same was loaned back to managing director.

The Honourable Supreme Court has held that when the company is advancing loan to an employee, who in turn, loans it to the managing director of the company, then it can be said that such loan advanced by company to employee is for the benefit of the managing director and accordingly deemed to be dividend under Section 2(22)(e).

Subhavarsha Infotech's case[11]:

Further, the Honourable Income Tax Appellate Tribunal of Chennai in the matter of Subhavarsha Infotech v The Deputy Commissioner of Income Tax has held that when a partnership firm receives loans from a company, in which partners are also directors, and such firm advancing part of the loan received from company to a wife of partner, there exists a benefit to the shareholder (partner whose wife has received loan) and accordingly deemed to be dividend. The Honourable ITAT has

[10] (2017) 3 Supreme Court Cases 580
[11] 2018 (12) TMI 522

held that the benefit mentioned in Section 2(22)(e) need not be direct benefit to shareholder and can also be an indirect benefit like wife of the shareholder obtaining such loan.

PV John's case[12]:

The Honourable Kerala High Court in the matter of Commissioner of Income Tax v P.V.John has held that there cannot be any benefit to the shareholder when the company has gifted certain amounts to the sons of the shareholder. The Honourable High Court stated as under:

7. If these conditions are satisfied, sub-clause (e) has the effect of bringing to tax the dividend in the hands of the shareholders, three types of payments made by the company. They are: (a) any payment of any sum by way of advance or loan to a shareholder; (b) any payment on behalf of a shareholder; and (c) any payment for the individual benefit of a shareholder. All the conditions for attracting section 2(22)(e) have been satisfied, admittedly, except conditions (b) and (c) mentioned above in this case. ***If the gifts made to the sons of the assessee by the company are payments on behalf of the assessee or payments for the individual benefit of the assessee, then those gifts could be treated as deemed dividend in the hands of the assessee. Since an artificial definition has been given and a fiction has been introduced by the Legislature in enacting section 2(22)(e) to bring into the net of dividend any payments made on behalf of or for the individual benefit of the shareholder, we are directed to interpret it strictly …..***

11. For the year 1976–77, the amount gifted by the company to the son of the assessee was Rs. 1 lakh. That also was treated by the Income-tax Officer as deemed dividend on the assumption that such transfer is only on behalf of, or for the benefit of, the assessee. On first appeal, the Commissioner of Income-tax (Appeals) found that the Income-tax Officer had to prove strictly, expressly and explicitly that the payment was made on behalf of the shareholder and that no attempts have been made to show that the gift was made by the company to the son on behalf of the shareholder or for the benefit of the shareholder. ***The Revenue could have led evidence to show that the payment was made by the company to the sons of the shareholder, but, in reality, the amounts were received by the shareholder. There was no evidence to that effect. The Revenue could have proved that the ultimate destination of the amount is the father. But the facts adduced will show that the amount has been utilised by the donees for investment for their benefit. It is in that context that the reality of the gift has not been doubted by the Income-tax Officer.*** *There is no case that the payments have been made to discharge any liability of the assessee to the company. Apart from the assessee, his wife and father are also shareholders. Therefore, there is no material to show that the payments in question were made to the sons of the assessee on behalf of or for his benefit. From the relationship alone, a conclusion cannot be drawn to the effect that the payments are made on behalf of, or for the benefit of, the assessee, a shareholder. The other shareholders are the mother and grandfather of the payees.* ***In the circumstances, we hold that section 2(22)(e) of the Act is not applicable to the facts of the case and that the burden is on the Revenue to prove that the payment was made on behalf of, or for the benefit of, the assessee only. The assessee has discharged its burden of proving that the gifts were made to the assessee's sons and they have invested the amounts in their own names and also included the same in their wealth-tax returns. In fact, the Income-tax Officer did not doubt the genuineness of the transaction.***

(emphasis supplied)

[12] 1989 SCC Online 575

In PV John's matter (supra), where the company has gifted amounts to sons of shareholder and revenue could not prove that such amounts were actually received by the shareholders, the payments made by company cannot be deemed as dividends. In the matter of L Alagusundaram Chettiar, it is proved that every time the managing director of the company wants certain amounts, the said amounts are advanced to employee and employee has further advanced them to managing director. In the matter of Subhavarsha Infotech, the benefit of advancing loan to wife of partner is deemed to be a benefit received by partner-cum-shareholder and held that there exists deemed dividend.

On a combined reading of the above judgments, it can be inferred that there should be a benefit, direct or indirect to the shareholder to deem the payment made by company as dividend. In absence of such benefit, the payments cannot be deemed to be dividend. Hence, the phrase 'on behalf of' also has to be understood in the same manner.

Conclusion:

In a case, where the benefit is not emanating to the shareholder, we are of the view that the third limb does not attract and accordingly the amounts cannot be held as dividend.

Concluding Remarks:

It is also important to note that vide Finance Act, 2018, the obligation to pay DDT on dividend mentioned under Section 2(22)(e) was shifted on to the company making such payments as loan/advance/any other payment. Erstwhile, such dividend was chargeable in the hands of the shareholders. However, due to challenges faced to tax such dividends in the hands of shareholder, the Finance Act, 2018 shifted the liability on to the company and tax is payable @ 30%.

As laid by the Honourable Supreme Court in the case of Sarathy Mudaliar's case, the act defines certain payments as dividends even if the said payments are not understood regularly as dividends. Hence, the section dealing with the definition of 'dividend' has to be construed strictly. On the other hand, even the Apex Court asks us to construe the provision strictly, before taking a decision whether payments would fall under the mischief of 'dividend' as per Section 2(22)(e), it is highly recommended to keep the legislative intention in the backdrop. A neat balance has to be drawn between both of them and see whether the payments are falling under the ambit of this particular anti-avoidance provision.