Reportable

* IN THE HIGH COURT OF DELHI AT NEW DELHI

ITA 223 OF 2010
ITA 219 OF 2010
ITA 1204 OF 2010
ITA 309 OF 2011

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Judgment Reserved on: 24.5.2011
Judgment delivered on: 11.07.2011

(1) ITA No.223 of 2010

COMMISSIONER OF INCOME TAX . . . APPELLANT
Through: Ms. Prem Lata Bansal, Sr. Advocate with Mr. Ruchir Bhatia, Advocate.
Mr. Kiran Babu, Advocate
Mr. Kamal Sawhney, Sr. Standing Counsel.

VERSUS

M/S NATIONAL TRAVEL SERVICES . . .RESPONDENT
Through: Mr. M.S. Syali, Sr. Advocate with Mr. U.A. Rana, Mr. Mrinal Mazumdar and Ms. Husnal Syali Advocates.

(2) ITA 219 OF 2010

COMMISSIONER OF INCOME TAX . . . APPELLANT
Through: Ms. Prem Lata Bansal, Sr. Advocate with Mr. Ruchir Bhatia, Advocate.
Mr. Kiran Babu, Advocate
Mr. Kamal Sawhney, Sr. Standing Counsel.

VERSUS

M/S NATIONAL TRAVEL SERVICES . . .RESPONDENT
Through: Mr. M.S. Syali, Sr. Advocate with Mr. U.A. Rana, Mr. Mrinal Mazumdar and Ms. Husnal Syali Advocates.

(3) ITA 1204 OF 2010

COMMISSIONER OF INCOME TAX . . . APPELLANT

Through: Ms. Prem Lata Bansal, Sr. Advocate with Mr. Ruchir Bhatia, Advocate.
Mr. Kiran Babu, Advocate
Mr. Kamal Sawhney, Sr. Standing Counsel.

VERSUS

M/S NATIONAL TRAVEL SERVICES . . .RESPONDENT

Through: Mr. M.S. Syali, Sr. Advocate with Mr. U.A. Rana, Mr. Mrinal Mazumdar and Ms. Husnal Syali Advocates.

(4) ITA 309 OF 2011

COMMISSIONER OF INCOME TAX . . . APPELLANT

Through: Ms. Prem Lata Bansal, Sr. Advocate with Mr. Ruchir Bhatia, Advocate.
Mr. Kiran Babu, Advocate
Mr. Kamal Sawhney, Sr. Standing Counsel.

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M/S NATIONAL TRAVEL SERVICES . . .RESPONDENT

Through: Mr. M.S. Syali, Sr. Advocate with Mr. U.A. Rana, Mr. Mrinal Mazumdar and Ms. Husnal Syali Advocates.

CORAM:-
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MR. JUSTICE M.L. MEHTA

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. In a very recent judgment pronounced on 11th May, 2011 in a batch of appeals with lead case entitled *Commissioner of Income Tax Vs. Ankitech Pvt. Ltd. (ITA 462/2009),* this very Bench has discussed in detail the extent and scope of the provisions of Section 2(22) (e) of the Income-Tax Act (hereinafter referred to as 'the Act'). This provision reads as under:-

> " dividend includes
>
> (a) xxx xxx xxx
>
> (b) xxx xxx xxx
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> (c) xxx xxx xxx
>
> (d) xxx xxx xxx
>
> (*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 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).]"

2. This provision creates a fiction providing certain circumstances under which certain kinds of payments made to the persons specified therein are to be treated as deemed dividend income. As per this provision, the following conditions are to be satisfied:

(1) The payer company must be a closely held company.

(2) It applies to any sum paid by way of loan or advance during the year to the following persons:
   (a) A shareholder holding at least 10 of voting power in the payer company.
   (b) A company in which such shareholder has at least 20% of the voting power.
   (c) A concern (other than company) in which such shareholder has at least 20% interest.

(3) The payer company has accumulated profits on the date of any such payment and the payment is out of accumulated profits.

(4) The payment of loan or advance is not in course of ordinary business activities.

3. In ***Commissioner of Income Tax*** *Vs.* ***C.P. Sarathy Mudaliar*** [1972] 83 ITR 170, the Supreme Court analysed the provision and pointed out that in so far as payment by a company by way of advance or loan is concerned, it can be made to any of the three persons mentioned therein i.e. it had three limbs and explained the same as under:-

> "Any payment by a company, not being a company in which the public are substantially interest, of any sum (whether as representing a part of the assets

of the company or otherwise) made after 31.05.19987 by way of advance or loan.

First limb

a) 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 percent of the voting power,

Second limb

b) or to my 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)

Third limb

c) or any payment by any such company on behalf, or for the individual benefit, or any such shareholder, to the extent to which the company in either case possesses accumulated profits."

4. In *Ankitech* (supra), this Court was concerned with the second limb and the question that arose was: when the payment is made to "a concern" in which such share holder is a member or partner and he has a substantial interest, whether deemed dividend income would be treated as income in the hands of such concern or in the hands of such share holder? It was answered by holding that the provision of Section 2(22)(e) of the Act are not applicable to such a concern which has received the payment but is not a share holder as it is the share holder who is a member or a partner in such a company which has made the payment and that

member or partner shall have substantial interest be treated as receiptment of deemed dividend income. The operative portion of that judgment reads as under:-

> "25. Further, it is an admitted case that under normal circumstances, such a loan or advance given to the shareholders or to a concern, would not qualify as dividend. It has been made so by legal fiction created under Section 2(22)(e) of the Act. We have to keep in mind that this legal provision relates to "dividend". Thus, by a deeming provision, it is the definition of dividend which is enlarged. Legal fiction does not extend to "shareholder". When we keep in mind this aspect, the conclusion would be obvious, viz., loan or advance given under the conditions specified under Section 2(22)(e) of the Act would also be treated as dividend. The fiction has to stop here and is not to be extended further for broadening the concept of shareholders by way of legal fiction. It is a common case that any company is supposed to distribute the profits in the form of dividend to its shareholders/members and such dividend cannot be given to non-members. The second category specified under Section 2(22)(e) of the Act, viz., a concern (like the assessee herein), which is given the loan or advance is admittedly not a shareholder/member of the payer company. Therefore, under no circumstance, it could be treated as shareholder/member receiving dividend. If the intention of the Legislature was to tax such loan or advance as deemed dividend at the hands of "deeming shareholder", then the Legislature would have inserted deeming provision in respect of shareholder as well, that has not happened. Most of the arguments of the learned counsels for the Revenue would stand answered, once we look into the matter from this perspective.

> 26. In a case like this, the recipient would be a shareholder by way of deeming provision. It is not correct on the part of the Revenue to argue that if this position is taken, then the income "is not taxed at the hands of the recipient". Such an argument based on the scheme of the Act as projected by the learned counsels for the Revenue on the basis of Sections 4, 5, 8, 14 and 56 of the Act would be of no avail. Simple answer to this argument is that such loan or advance, in the first place, is not an income. Such a loan or advance has to be returned by the recipient to the company, which has given the loan or advance.
>
> 27. Precisely, for this very reason, the Courts have held that if the amounts advanced are for business transactions between the parties, such payment would not fall within the deeming dividend under Section 2(22)(e) of the Act."

5. We may also point out that while coming to this conclusion, this Court concurred with the same view expressed by the Bombay High Court in *Commissioner of Income Tax Vs.* Universal Medicate (P) *Ltd.* 190 Taxman 144 (Bom.) which had approved the decision of the Special Bench Mumbai in the case of *ACIT* Vs. *Bhaumik Colour (P) Ltd. 118 ITD* 1 (Mum.) (SB) and Rajasthan High Court in the case of *Commissioner of Income Tax* Vs. *Hotel Hilltop* 217 CTR (Raj.) 527.

6. Though, in these appeals also we are concerned with the provisions of Section 2(22)(e) of the Act, another facet of this

provision has arisen for consideration because of which we have to proceed further from the stage where we left at *Ankitech Pvt. Ltd.* (supra).

7. The respondent/assessee is a partnership firm consisting of three partners namely Mr. Naresh Goyal, Mr. Surinder Goyal and M/s Jet Enterprises Pvt. Ltd. having profit sharing ratio of 35%, 15% and 50% respectively. The assessee firm had taken a loan of ₹ 28,52,41,516/- from M/s Jetair Pvt. Ltd. New Delhi. In this company the assessee has invested by subscribing to the equity share numbering 1,43,980 of ₹ 100 each which constitute 48.18%. However, the shares were purchased in the name of the two partners namely Mr. Naresh Goyal and Mr. Surinder Goyal. Thus, whereas, Mr. Naresh Goyal and Mr. Surinder Goyal are the respective share holders, the assessee is the beneficial share holder. On these facts, in this appeal we are concerned with the first limb [in contradiction to second limb that fell for interpretation in Ankitech (supra)] and are called upon to examine as to whether this first limb of Section 2(22)(e) of the Act has been satisfied. We should point out at the outset that it is an admitted position that all other conditions stipulated in Section 2(22)(e) of the Act are fulfilled. The

extent of share holding is also so high that the assessee has indubitably substantial interest in Jetair Pvt. Ltd.

8. For attracting first limb, the requirement of the provision is that the payment is made by a company "by way of advance or loan to a share holder, being a person who is the beneficial owner of shares". The question which calls for interpretation is as to whether same is to be paid by way of advance or loan to a share holder who is also the beneficial owner of the shares. To put it otherwise, is it necessary that both the conditions have to be satisfied namely such a person to whom the payment is made is not only a registered share holder but a beneficial share holder as well.

9. Before we proceed to answer the question, we would like to repel the preliminary submission advanced by Mr. Syali, learned Senior Counsel for the assessee, that this aspect is also covered by the judgment in *Ankitech* (supra). Mr. Syali ventured to make this submission emboldened by the fact that the decision of special Bench Bombay in *Bhaumik Colour* (supra) has been upheld by the Bombay High Court in *Universal Medicare* (supra) and in *Ankitech* (supra) this Court has concurred with the said opinions. On this basis, it was pointed out that following observations of the Special Bench

Mumbai in para 24 squarely answered the question posed in these appeals which is reproduced in *Ankitech* (supra) also. This para reads as under:-

> "24. The expression "shareholder being a person who is the beneficial owner of shares" referred to in the first limb of Section 2(22)(e) refers to both a registered shareholder and beneficial shareholder. If a person is a registered shareholder but not the beneficial then the provision of Section 2(22)(e) will not apply. Similarly if a person is a beneficial shareholder but not a registered shareholder then also the first limb of provisions of Section 2(22)(e) will not apply."

10. No doubt, Ankitech (supra) affirmed the view taken by the Special Bench in *Bhaumik Colour* (supra). However, the entire judgment in *Ankitech* (supra) is confined to second limb of Section 2(22)(e) of the Act and it is that aspect only, as highlighted above as well, which was the focus of attention and answered. No doubt, in the aforesaid para of *Bhaumik Colour (supra)* Special Tribunal has commented upon the first limb of Section 2(22)(e) of the Act as well but the veracity thereof had not arisen for consideration as that was not the issue involved. It is trite that the ratio of a case is to be culled out from the question that specifically arose, discussed and answered and not what can be logically deduced therefrom. The issue with which we are concerned was neither the issue nor deliberated upon. It is for this

reason that we need to give a fresh look to this question in the present case. It would be a different matter, whether we ultimately agree with the aforesaid view of the Tribunal i*n* *Bhaumic Colour* (supra) or not.

11. Mr. Syali, learned Senior Counsel submitted that under the Income Tax Act, for the purposes of Income Tax partnership firm is different from the partners. The income earned by the partnership firm is also assessed at the hands of the partnership firm which is required to file its own return. The profits distributed thereafter to the partners become income at the hands of the partners and partners are separately assessed under the Income Tax Act. He also referred to various provisions of the Companies Act to buttress his submission that the partnership firm in its own right can be the shareholder as distinguished from the partners themselves. Specific attention was drawn to Section 187 (c) of the Companies Act which draws distinction between the registered shareholder and a person holding a beneficial interest in any share. He also referred to the guidelines issued by the SEBI on joint share holding in respect of partnership firm interpreting the provisions of Section 187 (c) of the Companies Act. Vide Circular No.8/18/75-CL-V dated

1^{3th} March, 1975. The SEBI has clarified the position in the following manner:-

> "(6) Partnership Firms.- Where in the case of partnership firms, shares are acquired in the names of one or more or other partners, the partners will have to file a declaration both under sub Section 91(i) and under sub section (2) because they have also beneficial interest in the shares held by them on behalf of all the partners.
>
> *Department's view.-* A partnership firm is not a person capable of being a member within the meaning of Section 41 of the Companies Act, 1956 and since a partnership is not a legal entity by itself but only a compendious way of describing the partners constituting the firm, it is necessary that the names of all the members of the partnership firm should be entered in the Register of Members in order that the right of the partnership as a whole to the shares in question may prevail. The holding of shares by only one or more partners on behalf of other partners of a firm should not, therefore, ordinarily arise. However, where in a given case, the name or names, of only one or some of the partners is entered in the Register of Members while the intention is that the partnership as a whole should have the right of membership in respect of the shares in question, it is obviously necessary for such partners who hold shares not only for respect of the shares in question, it is obviously necessary for such partners who hold shares not only for themselves but for the benefit of all partners constituting the firm whose names are not entered in the Register of Members, to comply with the rules under Section 187C."

12. Sub Section (2) and (7) of Section 187-C of the Companies Act are reproduced as under:-

> "S.187-C. Declaration by persons not holding beneficial interest in any share
>
> (1).....
>
> (2) Notwithstanding anything contained elsewhere in this Act, a person who holds a beneficial interest in a share or a class of shares of a company shall, within thirty days fro the commencement of the Companies (Amendment) Act, 1974, or within thirty days after his becoming such beneficial owner, whichever is later, make a declaration to the company specifying the nature of his interest, particulars of the person in whose name the shares stand registered in the books of the company and such other particulars as may be prescribed.
>
> (3).....
>
> (4).....
>
> (5).....
>
> (6).....
>
> (7) Nothing in this section shall be deemed to prejudice the obligation of a company to pay dividend in accordance with the provisions of Section 206, and the obligation shall, on such payment, stand discharged
>
> [The provision of this section shall not apply to the trustee referred to in Section 187B on and after the commencement of the Companies (Amendment) Act, 2000]

13. He also referred to the provisions of Section 153 in conjunction with Section 147 of the Companies Act. Section 150 of the Act mandates every company to keep register of

its members and enter particulars as specified in that provision which includes the name, address and the occupation, if any of each member. On this basis, it was argued that a member whose name is entered in the said register is to be treated as 'shareholder'. Section 41 defines 'member' and gives the definition of 'member' inter alia stipulating that person who has registered his name in the register of a company and whose name is entered in its register of members, shall be a member of the Company. Sub Section (3) of Section 41 deals with beneficial owner in the following manner:-

> "41. Definition of "member"
>
> (1)....
>
> (2)....
>
> (3) Every person holding equity share capital of company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of a concerned company."

14. It was thus argued that only that beneficial owner whose name is entered as beneficial owner in the records of the depository, would be deemed to be a member of the concerned company. Unless this condition is satisfied, a beneficial owner cannot be treated as "member" or "shareholder" of a company.

15. Mr. Syali also relied upon the judgment of Allahabad High Court in the case of *Commissioner of Income-Tax Vs. Raj Kumar Singh & Co.* 295 ITR 9 (All) wherein the Court held that the conditions stipulated in Clause (e) of Section 2 (22) of the Act were not satisfied where the assessee firm was not the shareholder of a company which gave the loan and the partners of the firm were shareholders in the books company. This judgment was rendered following Supreme Court judgment in the case of *Commissioner of Income Tax* Vs. *C.P. Sarathy Mudaliar,* 83 ITR 170 (SC). Following observation from the said judgment was quoted by the Allahabad High Court wherein the Supreme Court has held that only loan advanced to shareholder could be deemed to be dividends under Section 2 (6A) (e) of the Old Act (corresponding to section 2 (22) (e) of the present Act):-

> "What Section 2(6A)(e) is designed to strike at is advance or loan to a "shareholder" and the word "shareholder" can mean only 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". It is only the person whose name is entered in the register of shareholders of the company as the holder of the shares who can be said to be a shareholder qua the company, and not the person beneficially entitled to the shares. It is the former who is a "shareholder" within the matrix and scheme of

> the company law and not the latter. We are, therefore, of the view that it is only where a loan is advanced by the company to a registered shareholder and the other conditions set out in Section 2(6A)(e) are satisfied that the amount of the loan would be liable to be regarded as 'deemed dividend" within the meaning of Section 2(6A)(e).

It was held that Hindu Undivided Family cannot be considered to be a share holder and the loans given to HUF could not be considered as loans advanced to a shareholder of the company, therefore, could not be deemed to be its income. Referring to the aforesaid judgment, the Allahabad High Court followed the view that since the firm was not the shareholder and the shares were in the name of partners, the loan advanced by the company to the firm could not be deemed to be a dividend. Following discussion on this aspect by the Court is reproduced below:-

> "Clause (e) of Section 2(22) of the Act as it existed clearly provide that if the loan is received by the shareholder, it is only then the said loan can be deemed to be dividend in his hand. In the present case, admittedly, the assessee firm was lot the shareholder of the Company M./S Jai Prakash Associates (P) Ltd. and the partners of the firm were the shareholders in the books of the Company, therefore, the loan advanced by the Company to the firm cannot be deemed to be dividend inasmuch as loan was not to the shareholder but to the partnership firm which was not the shareholder in the books of the Company. It is

settled principle of law that the deeming provision has to be construed strictly.

In the case of Howrah Trading Co. Ltd. v. [1959]36ITR215(SC) , the Apex Court held that a person who has purchased shares in a company under a blank transfer and in whose name the shares have not been registered in the books of the company is not a "shareholder" in respect of such shares within the meaning of Section 18(5) of the Income Tax Act, notwithstanding his equitable right to the dividend on such shares, and is not, therefore, entitled to have this dividend income grossed up under Section 16(2) of the Act by the addition of the Income Tax paid by the company in respect of those shares, and claim credit for the tax deducted at source, under Section 18(5) of the Act. The Apex Court held as follows:

"The word "holder of a share" are really equal to the word "shareholder", and the expression " holder of a share" denotes, in so far as the company is concerned, only a person who, as a shareholder, has his name entered on the register of members.

The position, therefore, under the Indian Companies Act, 1913, is quite clear that the expression "shareholder" or "holder of a share" in so far as that Act is concerned, denotes no other person except a "member"....

The question that falls for consideration is whether the meaning given to the expression "shareholder" used in Section 18(5) of the Act by these cases is correct. No valid reason exists why "shareholder" as used in Section 18(5) should mean a person other than the one denoted by the same expression in the Indian Companies Act, 1913. In Wala Wynaad Indian Gold Mining Company., In re (1982) 21 Ch.D. 849, 854 Chitty, J., observed:

> "I use now myself the term which is common in the courts, 'a shareholder', that means the holder of the shares. It is the common term used, and only means the person who holds the shares by having his name on the register."
>
> Section 19A makes it clear, if any doubt existed, that by the term "shareholder" is meant the person whose name and address are entered in the register of "shareholders" maintained by the company. There is but one register maintained by the company. There is no separate register of "shareholders" such as the assessee claims to be but only a register of "members". This takes us immediately to the register of members, and demonstrates that evens for the purpose of the Indian Income Tax Act, the words "member" and "shareholder" can be read as synonymous.
>
> The words of Section 18(5) must accordingly be read in the light in which the word "shareholder" has been used in the subsequent sections, and read in that manner, the present assessee, notwithstanding the equitable right to the dividend, was not entitled to be regarded as a "shareholder" for the purpose of Section 18(5) of the Act. That benefit can only go to the person who, both in law and in equity, is to be regarded as the owner of the shares and between whom and the company exists the bond of membership and ownership of a share in the share capital of the company."

16. Coming to the merits of the issue, submission of learned Counsel for the appellant was that language of Section 2 (22) (e) of the Act clearly spells out that a beneficial owner is treated as share holder under this provision. She took the matter at the pedestal of first principles on which the relationship of the partners vis-ã-vis partnership is generally construed. Expanding this argument, she referred to

Sections 14,15,16 and 18 of the Partnership Act and argued that as per these provisions, a partnership firm has no separate entity and it is synonyms with the partners (in contradistinction to a company incorporated under the Companies Act which enjoys the status of an independent legal entity and is a juristic person, separate from its members i.e. the share holders). She thus argued that when the shares are bought by a partnership firm (which is admittedly a beneficial owner), for want of its own legal entity, per force these share are to be bought in the name of partners. However, for all intent and purposes it is a partnership firm which would be the shareholder as well for the purposes of Section 2(22)(e) of the Act. Otherwise, argued the learned senior Counsel, the very purpose of this provision would be defeated in the case of a partnership firm, as in no case shares would be bought in the name of partnership firm since it is not permissible in law. She further submitted that one does not have to resort to the provision of the Companies Act to find out who is the shareholder. She also submitted that the Supreme Court judgment in *Mudaliar* (supra) was rendered before the amendment to Section 2(22)(e) of the Act. She also argued that there is a difference between the HUF and the

partnership firm which is eloquently brought out by the CIT (A) in his order passed in ITA 1204/2010.

17. We have given our thoughtful consideration to the submission of the counsel for both the parties. According to us the outcome of this appeal depends on the following two questions:-

(1) To attract the first limb of Section 2 (22)(e) of the Act, is it necessary that the person who has received the advance or loan is a shareholder and also beneficial owner. To put it otherwise, whether both the conditions are required to be satisfied will depend upon the interpretation to be given to the words " being a person who is a beneficial owner of shares...." Which was inserted by amendment in the aforesaid provision carried out by the Finance Act, 1987 w.e.f. 1st April, 1988.

(2) Whether the assessee who is a partnership firm can be treated as 'shareholder' because of the reason that it has purchased the shares in the name of the two partners.

18. In so far as first question formulated above is concerned, answer to that can be found in *Rameshwarlal Sanwarmal Vs. CIT 122 ITR 1 (SC)* which followed the judgment in the case of ***Commissioner of Income Tax*** *Vs.* ***C.P. Sarathy Mudaliar***

[1972] 83 ITR 170. That was a case where the assessee was HUF which had obtained certain loans of a company whose shares it beneficially owned. However, these shares stood in the name of S.M. Sharia (Karta) of the said HUF in the register of shareholders of the company. The loans were advanced by the company to three concerns which were owned by the assessee/ HUF. The Court held that conditions stipulated in Section 2 (6A) (e) of the Income Tax Act, 1922 (which is akin to Section 2 (22)(e) of the present Act) were not satisfied and the amount of loan would not fall within the mischief of this Section as the HUF was not the shareholder even when it was beneficial owner of the shares. It is clear therefrom that both the conditions have to be satisfied. This view has been followed by the Rajasthan High Court in the case of ***Harish Chand Golecha Vs. CIT, 132 LTR 30*** while dealing with the present provision contained in the Income Tax Act, 1961. The expression "being a person as a beneficial owner of shares" qualifies the word 'shareholder'. Thus to attract the provisions of Section 2 (22) (e) of the Act, the person to whom the loan or advance is made should be a shareholder as well as beneficial owner.

19. This brings us to the more important issue viz. whether the assessee firm can be treated as a shareholder having

purchased shares through its partners in the company which has paid the loans or is it necessary that a shareholder has to be a 'registered shareholder'. If the contention of the assessee is accepted, in no case a partnership firm can come within the mischief of Section 2 (22) (e) of the Act because of the reason that shares would be purchased by the firm in the name of its partners as the firm is not having any separate entity of its own. With the name of the partner entering into the register of members of the company as shareholder, the said partner shall be the 'shareholder' in the records of the company but not the beneficial owner as 'beneficial owner' is the partnership firm. This would mean that the loan or advance given by the company would never be treated as deemed dividend either in the hands of the partners or in the hands of partnership firm. In this way the very purpose for which this provision was enacted would get defeated. The object behind this provision is succinctly stated in the Circular No. 495 of 22nd September, 1987 particularly in the Explanatory Notes to Finance Act, 1987 when this provision was amended. It reads as under:-

> "With the deletion of Section 104 to 109 there was a likelihood of closely held companies not distributing their profits to shareholders by way of dividends but by way of loans or advances to that these are not taxed in the hands of the shareholders. The forestall this manipulation, sub –clause (3) of clause (22) of Section 2 has

been suitably amended. Under the existing provisions, payments by way of loans or advance to shareholders having substantial interest in a company to the extent to which the company possesses a accumulated profits is treated as dividend. The shareholders having substantial interest are those who have a shareholding carrying not less than 20 per cent voting power as per the provisions of clause (32) of Section 2. The amendment of the definition extends its application to payments made (i) to a shareholder holding not less than 10 per cent of the voting power, or (ii) to a concern in which the shareholder has substantijal interest. Concern as per the newly inserted Explanation 3 (a) to Section 2 (22) means a HUF or a firm or an association of persons or a body of individuals or a company. A shareholders having a substantial interest in a concern as per part (b) of Explanation 3 is deemed to be one who is beneficially entitled to not less than 20 per cent of income of such concern.

10.3 The new provisions would, therefore, be applicable in a case where a shareholders has 10 per cent or more of the equality capital. Further, deemed dividend would be taxed in the hands of a concern where all the following conditions are satisfied:

(i) where the company makes the payment by way of loans or advances to a concern.

(ii) Where a member or a partner of the concern holds 10 per cent of the voting power in the company; and

(iii) where the member or partner of the concern is also beneficially entitled to 20 per cent of the income of such concern.

With a view to avoid the hardship in cases where advances or loans have already been given, the new provisions have been made applicable only in cases where loans or advances are given after 31st May, 1987."

These amendments will apply in relation to assessment year 1988-89 and subsequent years."

20. If the contention of the assessee is accepted than the very object for which Section 2 (22) (e) of the Act was amended would get frustrated qua the partnership firm leading to absurd results. It is a very well established principle of construction that where the plain literal interpretation of a statutory provisions produces manifestly absurd and unjust results which could never have been intended by the Legislature, the Court must modify the language used by the Legislature or even "do some violence" to it, so as to achieve obvious intention of the Legislature. Reference is made to the decision of the Supreme Court in the Case of ***K.P. Varghese Vs. ITO*** 131 ITR 597 (SC).

21. No doubt, when Section 2 (22) (e) of the Act enacts a deeming provision, it has to be strictly construed. At the same time, it is also trite that such a deeming provision has to be taken to its logical conclusion. If the partnership firm which has purchased the shares is not treated as shareholder merely because the shares were purchased in the name of the partners, that too because of the legal compulsion that shares could not be allotted to the said partnership firm which is a non legal entity, it would be impossible for such a condition to be

fulfilled. That is not the purpose of law. The partnership firm is synonym of the partners. As per the Circular issued by the SEBI dated 13th March, 1975 interpreting Section 187 (c) of the Companies Act, relied by the learned counsel for the assessee himself, a partnership firm is not a person capable of being a 'member' within the meaning of Section 47 of the Companies Act. It is further explained that since a partnership firm is not a legal entity by itself but only a compendious way of describing the partners constituting the firm, it is necessary that the names of all the members of the partnership firm should be entered in the Register of Members. Obviously then, with the purchase of shares by the firm in the name of its partners, it is the firm which is to be treated as shareholder for the purposes of Section 2 (22) (3) of the Act.

22. It would be difficult to accept the contention of Mr. Syali, predicated on the provision of Companies Act as wherever a partnership firm wants to come out of the rigors of Section 2 (22)(e) it can easily do so by not entering the names of all the members of the partnership firm in the Register of Members. In this case itself, it could be seen that Mr. Naresh Goyal holds 44.58% of shareholding in M/s Jet Air (P) Ltd. as a partner of the appellant firm. On the other hand, the said

Mr. Narersh Goyal derives 35% of the profit sharing ratio in the assessee firm. In other words, Mr. Naresh Goyal has substantial interest in the assessee firm too. Thus, he is a person who not only has substantial interest but also holds sufficient influence. Since the partnership firm is the beneficial owner and it has to per force purchase the shares in the name of the partners, it is very easy for a person like him to ensure that only the names of partners in whose name shares are purchased is entered in the records of the company and the names of all the partners are not recorded so that provisions of Section 187C of the Companies Act are not fulfilled. Likewise, it can also be ensured that for the purpose of Section 41 (3) of the Act, the name of the partnership firm is not specifically entered as beneficial owner in the records to the depository to make partnership firm as deemed member of the concern company within the meaning of Section 41 (3) of the Act. Such a situation cannot be countenanced.

23. We are, therefore, of the opinion that for the purpose of Section 2 (22) (e) of the Act, partnership firm is to be treated as the shareholder and it is not necessary that is has to be "registered shareholder". We thus answer the questions formulated in favour of the Revenue and against the

assessee as a result, this appeal is allowed setting aside the order of the Tribunal and restoring that of the Assessing Officer.

(A.K. SIKRI)
JUDGE

(M.L. MEHTA)
JUDGE

JULY 11, 2011
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