



Issue of redeemable debentures are not loans for deemed dividend purposes

In a recent decision¹, the Mumbai Bench of the Income-tax Appellate Tribunal ('Tribunal') held that issue of redeemable debentures cannot be considered as a loan transaction for deemed dividend purposes under section 2(22)(e) of the Income-tax Act, 1961 ('the Act').

Background

- Jasubhai Engineering Pvt. Ltd. ('the Taxpayer') had shareholding in two companies in which the public is not substantially interested – (i) 23.75% in M/s Jasubhai Business Services Pvt. Ltd. ('Jasubhai Business') and (ii) 26.76% in M/s. ABM Steels Pvt. Ltd. ('ABM Steels').
- The Assessing Officer ('AO') observed that inter-corporate deposit was taken by the Taxpayer from ABM Steels ('Transaction 1'). The AO invoked provisions of section 2(22)(e)² of the Act on this inter-corporate deposit which had been repaid before the end of the year.
- The AO also observed that the Taxpayer had received money from Jasubhai Business on the issue of redeemable debentures ('Transaction 2'). The AO invoked provisions of section 2(22)(e) of the Act on the outstanding liability in the books of the Taxpayer contending that debentures are akin to loans and advances.

¹ ACIT vs. M/s Jasubhai Engineering Pvt. Ltd. (ITA No.7519/Mum/2016)

² Section 2(22)(e) of the Act seeks to tax as dividend any payment (to the extent of accumulated profits) made by a closely held company, by way of advance or loan, to its shareholder holding atleast 10% voting power in the company

Revenue's contention

- The inter-corporate deposit given by ABM Steels to the Taxpayer would be subject to provisions section 2(22)(e) of the Act. It relied upon various judicial precedents³ for invoking this provision on inter-corporate deposits.
- Additionally, for Transaction 2, debentures were equated with loans and advances by relying on a judicial precedent.⁴

Taxpayer's contention

- In Transaction 1, the amount taken as an inter-corporate deposit was repaid before the end of the year. Further, it was contended that inter-corporate deposits could not be equated with loans and advances by relying on certain judicial precedents⁵.
- In Transaction 2, payment was received from Jasubhai Business on the issue of debentures which are securities. During the year, redemption option was also exercised by Jasubhai Business for part of the debentures.
- Debentures fall under the category of securities and cannot be termed as a loan for the purposes of section 2(22)(e) of the Act⁶.

Tribunal's ruling

- Inter-corporate deposit taken by the Taxpayer in Transaction 1 will attract the provisions of section 2(22)(e) of the Act since:
 - Taxpayer held substantial interest in ABM Steels;
 - ABM Steels has substantial accumulated profits in its balance sheet;
 - ABM Steels is a company in which the public are not substantially interested.
- It is a settled law that deemed dividend provisions get attracted as soon as benefit is taken and it does not matter whether it is repaid within the same year. Reliance is placed on the Supreme Court⁷ ruling which held that the provisions of section 2(22)(e) of the Act are attracted even if loan is repaid at the end of the year.
- Transaction 2 involves private placement of securities which cannot be considered as a loan transaction. Debentures are security scrips that have standalone capital liability. Debentures cannot be equated with a loan since it is a current liability. Hence, provisions of section 2(22)(e) of the Act are not attracted on issue of debentures.

Dhruva's comments

- The ruling of the Tribunal on inter-corporate deposits being considered as loans and advances for the purpose of attracting the deemed dividend provisions is contrary to the principle laid down by certain judicial precedents that distinguish deposits vis-à-vis loans

³ Bajaj Auto Holding Ltd v. DCIT 95 ITD 356 (Mum); Smt. Tarulata Shyam & Others v. CIT 108 ITR 345 (SC); CIT v. Bhagwat Tewari 105 ITR 62 (Kol)

⁴ P. K. Badiani v. CIT 105 ITR 642 (SC)

⁵ Bombay Oil Industries Ltd. v. DCIT 28 SOT 383 (Mum); IFB Agro Industries Ltd. v. JCIT 63 SOT 207 (Kol)

⁶ DCIT v. Sahara India Commercial Corp. Ltd 147 ITD 176 (Del)

⁷ Miss P. Sarada v. CIT 229 ITR 444 (SC)

and advances. The Tribunal has not commented on such precedents which were relied upon by the Taxpayer.

- With regard to debentures, this is a welcome ruling by the Tribunal affirming that the issue of debentures is not akin to a loan transaction for the purpose of attracting the deemed dividend provisions. Such a ruling will have a positive impact on group companies which provide cash to other group companies through issue of debentures.
- The other instruments which are popular for inter-company funding are preference shares, though the characteristics are very different from debentures and redemption of preference shares also has conditions attached to it.



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