

What's New

News Flash



June 2017

CBDT clarifies that trade advances in the nature of commercial transaction do not fall within the ambit of section 2(22)(e) of the Income-tax Act, 1961

Background

The provisions of section 2(22)(e) of the Income-tax Act, 1961 (Act) create a fiction and bring amounts paid otherwise than as dividends, in the form of loans or advances, into the net of dividends. These provisions were intended to bring into the tax net, the distribution of accumulated profits by closely held companies to shareholders or connected concerns, otherwise than by declaration of dividend to escape taxation.

The deeming provisions excluded the payment of loan or advance in the ordinary course of business; however, this exclusion was limited to cases in which the lending of money was a substantial part of the business. The general nature of these deeming provisions led to widespread litigation involving genuine advancement of monies as part of normal business/ trade transactions brought into the tax net as dividends.

A plethora of rulings has held these deeming provisions to be not applicable in cases involving genuine advancement of monies for trade/ business transactions.

Clarification by Central Board of Direct Taxes (CBDT)

To reduce litigation, the CBDT, *vide* Circular no. 19/ 2017 dated 12 June, 2017, has recognised the view propounded in various rulings and clarified that trade advances, which are in the nature of commercial transactions, would not fall within the ambit of the deeming provisions of section 2(22)(e) of the Act.

While recognising this position as being the settled view of the matter, few illustrations of trade advances/ commercial transactions, based on past rulings, have been mentioned in the CBDT Circular, which are as follows:

- Advances made by a company to a sister concern and adjusted against the dues for job work done by the sister concern.
- Advances made by a company to its shareholder to install plant and machinery at the shareholder's premises to enable him to do job work for the company to enable the company to fulfil an export order.
- Floating security deposit given by a company to its sister concern for use of electricity generators to supply electricity at concessional rates to the sister concern

It has also been instructed that appeals may not be filed by the department on this ground and those already filed may be withdrawn/not pressed.

Key takeaways

This Circular is another addition to the administrative circulars issued by the CBDT to provide certainty on tax positions and reduce litigation. However, the practical applicability of this clarification and acceptability of the taxpayer's contentions in different fact patterns will depend on the approach and interpretation of tax officers at lower levels.

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