Advances received by HUF from closely-held company is taxable as deemed dividend under section 2(22)(e) in hands of HUF

January 12, 2017

In brief

The Apex Court, in a recent decision,[1] held that as the *karta* of the Hindu Undivided Family (HUF) was a registered shareholder, and also had a substantial interest in the HUF, advances received by the HUF from the company would be treated as 'deemed dividend' under the provisions of section 2(22)(e) of the Income-tax Act, 1961 (the Act).

In detail

Facts

- The taxpayer[1] was an HUF, holding 37.12% shares in a private limited company (company).
- The shares were registered in the name of the *karta* of the HUF.
- During the relevant previous year, the taxpayer received certain advances from the company.
- The tax officer (TO) considered the advances received as the taxpayer's income in the form of deemed dividend under section 2(22)(e) of the Act.
- The taxpayer filed an appeal with the Commissioner of Income-tax (Appeals), who upheld the TO's order. The Income-tax Appellate Tribunal (Tribunal), relying on a Mumbai bench decision,[2] held that the HUF could not have been a registered shareholder or beneficial shareholder and therefore, the provisions of section 2(22)(e) were not applicable to the taxpayer.
- However, the High Court reversed the Tribunal's judgement and restored the case back to the TO.

Issues before the Supreme Court

In view of the settled principle that an HUF could not be a registered shareholder in a company, could the advances received by the HUF be deemed as dividend within the meaning of section 2(22)(e) of the Act?

Key contentions of the taxpayer

- The HUF could not be either a beneficial owner or a registered owner of the shares.[3]
- The shares of the company were issued in the name of the *Karta* of the HUF, and not in the HUF's name, as shares could not be directly allotted to an HUF.
- Therefore, section 2(22)(e), should not have been attracted.

Supreme Court's ruling

- The provisions of section 2(22)(e) were in the nature of deeming provisions, and hence, must be given strict interpretation.
- Thus, unless all the prescribed conditions were fulfilled, the receipt could not be deemed to be dividend.
- In case of doubt or two possible views, benefit would

[1] [2017] 77 taxmann.com 71 (SC)

[2] Binal Sevantilal Koradia (HUF) *v.* DIT ITA No. 2900/ Mum/ 2011

[3] Andhra Pradesh *v.* C.P. Sarathy Mudaliar 1972 SCR 1076

accrue in favour of the taxpayer.

- Section 2(22)(e) applies to a company giving advance or loan to a shareholder.
- The section also applies to an advance or loan made by the company to any *concern* in which such shareholder is a member or a partner having substantial interest (i.e., more than 20% of the income of the concern). Explanation 3 to section 2(22) defined "concern" to include HUF.
- Thus, as the shares were held by the *Karta* who, being a member of the HUF, and was entitled to > 20% of the HUF's income, section 2(22)(e) applied to the advances received by the HUF. In such a case, it was not even necessary to determine whether the HUF was a shareholder or not.
- The money towards the shares was given by the taxpayer and it could not be doubted that the HUF was the beneficial shareholder.

The takeaways

This Supreme Court decision will have a far-reaching effect on taxability of deemed dividend in the hands of shareholders.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor.

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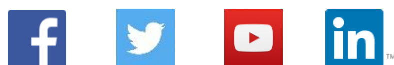

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