

Issuance of cheque, not presented and subsequently returned, is not “payment” – Not dividend under section 2(22)(e) of the Income-tax Act

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In brief

In a recent decision,¹ the Allahabad High Court (HC) held that the provisions of section 2(22)(e) of the Income-tax Act, 1961 (the Act) could not be attracted where a cheque was issued then not presented and subsequently returned, as it does not amount to “payment” or actual receipt of money.

In detail

Facts

- The taxpayer disclosed a credit balance in its books of accounts in the name of its sister concern.
- The tax officer added the said amount to the income of the taxpayer, treating the same as deemed dividend under section 2(22)(e) of the Act.
- The taxpayer contended that it did not receive the said amount during the year. A cheque was issued but not presented for payment and thus returned. However, the rectification entries were made in the next financial year and there was no real transaction of payment of money between the taxpayer and its sister concern. It was only an accounting entry.
- The Commissioner of Income-tax (Appeals) deleted the addition and ruled in favour of the taxpayer, holding that the entries made in the books of account did not represent the payment of any money by the sister concern to taxpayer.
- The Lucknow Bench of the Income-tax Appellate Tribunal (the Tribunal) ruled in favour of the taxpayer and held that mere issue of cheque does not create any legal right, and as such, no relationship of lender/ borrower comes into existence unless and until the cheque was presented to the bank and was honoured.
- Aggrieved by the Tribunal’s order, the Revenue filed an appeal before the High Court (HC).

Issue before the High Court

Whether the amount credited to the taxpayer’s books of account by its sister concern could be treated as deemed dividend within the meaning of section 2(22)(e) of the Act?

High Court’s decision

- The HC opined that the legislature seeks to tax certain payments made by specified persons as deemed dividend under section 2(22)(e) of the Act, by treating such payments to be dividend payment on notional basis.
- The HC held that in order to apply a notional provision, the Revenue should have shown that there was

¹ ITA No. – 532 of 2011 order dated 1 December 2017

was actual payment. Mere issuance of a cheque, which was subsequently cancelled and returned without ever being presented for encashment and without any money having been paid against it to the taxpayer, could never constitute payment of any sum.

- The HC relied upon the

principles cited in the judgements of other High Courts² and held that in the absence of satisfaction of the statutory precondition of “payment” of “any sum” to the taxpayer, the provisions of section 2(22)(e) could not be attracted.

The takeaway

This is a welcome decision of the

HC, which clarifies that there must be actual receipt of money in order to trigger the limb “the loan or advance” of deemed dividend provisions.

Let’s talk

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

² CIT v. Smt. Savithiri Sam [1999] 236 ITR 1003 (Madras) and CIT v. Pravin Bhimshi

Chheda [2014] 48 taxmann.com 151 (Bombay)

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