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**Court :** Income Tax Appellate Tribunal ITAT Delhi

**Decided On :** Oct-28-2005

**Reported in :** (2006)6SOT292(Delhi)

**Appellant :** R.K. Soni

**Respondent :** ito

**Judgement :**

This is an appeal by the assessee against the order of the Commissioner (Appeals) dated 21-7-2003 pertaining to the assessment year 1997-98 arising out of the order of the assessment passed by the assessing officer under section 143(3) of the Income-Tax Act, 1961 (hereinafter referred to as the Act). The assessee has preferred multiple grounds of appeal in its memo of appeal but the grievance of the assessee is on a single issue relating to the action of the Commissioner (Appeals) in sustaining the stand of the Assessing Officer that the sum of Rs. 15 lakhs was assessable in the hands of the assessee as deemed dividend in terms of section 2(22)(e) of the Act.

The facts relevant for consideration of the impugned proceedings can be summarized as follows. The assessee is an individual who filed his return of income for the assessment year under consideration declaring an income of Rs. 7,80,454. The assessment has been framed by the assessing officer under section 143(3) at an income of Rs. 22,80,450 whereby an addition of Rs. 15 lakhs was made on account of section 2(22)(e) of the Act. The assessee is an equity shareholder holding 40 per cent equity capital in a company Chandigarh

Construction Co. Pvt.

Ltd. (hereinafter referred to as the Company). The assessee also is the Managing Director of the company. The assessing officer found that during the year under consideration the assessee had received a sum of Rs. 15 lakhs from the company as a loan. It was found that the company had executed a contract for construction of Satluj Yamuna Link Canal in respect of which some dispute arose with Executive Engineer, Patiala Ki Rao, Construction Division, Punjab in the earlier years. It appears that the dispute was referred for arbitration. The arbitrator gave the award on 31-8-1994 which was decreed by court of the Sub-Judge, Ropar, on 21-10-1995: whereby the company was to receive additional amount of Rs. 1,63,39,649. The said decree was challenged by the State Government of Punjab (i.e., through Executive Engineer, Patiala Ki Rao, Construction Division) before the Honble Punjab and Haryana High Court on 22-4-1996. The Honble High Court while admitting the appeal, as an interim measure, stayed the execution of the award subject to the deposit by Punjab Government a sum equivalent to 25 per cent of the award, which was ordered to be released to the company subject to it furnishing security for refund thereof in the event of the appeal being allowed. As a result, a sum of Rs. 39,67,620 was received by the company on furnishing of personal surety by the assessee subject to the final outcome of the decision of the Punjab and Haryana High Court. In the course of the assessment proceedings the assessing officer show caused the assessee as to why the sum of Rs. 15 lakhs, which was received by the assessee from the company not be treated as deemed dividend in terms of section 2(22)(e) of the Act. In terms of his reply dated 19-3-2002, the assessee submitted that the amount released to the company was conditional as it was subject to the outcome of the judgment of the Court; that the amount having been released against sureties could not be considered as having accrued to the company as income. Reliance was also placed on the decision of the Honble Supreme Court in the case of CIT v. Hindustan Housing & Land Development Trust Ltd. (1986) 161 ITR 524. However, the assessing officer rejected the submissions of the assessee. According to the assessing officer that since no cash was deposited by the company to obtain release of the amount of Rs. 39,67,620 it could not be said that the release was conditional. The assessing officer also found fault with the company that it has shown in its balance-sheet the

said sum as a liability. The assessing officer was of the view that the said amount was required to be credited by the company to its profit and loss account or in other words according to him the same was to be treated as a part of accumulated profits available with the company on the date of advancing of interest-free loan of Rs. 15 lakhs to the assessee. The assessing officer further noticed that the loan received by the assessee has been converted into Departmental Representatives with the bank and was being used by the assessee for his own purposes. He, therefore, inferred that the assessee has taken the money of the company for his own use and it was a device adopted to defeat the purpose of fiction created by section 2(22)(e) of the Act. He accordingly has treated the sum of Rs. 15 lakhs as deemed dividend in the hands of the assessee and added the same to his income. Aggrieved with the order of the assessing officer the assessee carried the matter in appeal before the Commissioner (Appeals). In appeal, the assessee contended that the assessing officer had failed to appreciate the facts of the case and also the provisions of section 2(22)(e) of the Act. The assessee reiterated his stand that the amount released consequent to the order of the Honble High Court of Punjab and Haryana could not be considered as income in the hands of the company and, therefore, there was an absence of accumulated profits in the hands of the company so as to make the provisions of section 2(22)(e) inapplicable to the impugned transaction. The assessee also submitted that the assessing officer was wrong in misinterpreting the balance-sheet of the company to the effect that the depiction of the sum of Rs. 39,67,620 as part of liabilities was wrong. It was submitted that even if the impugned amount was to be treated as a part of profits the same would at best be considered as forming part of the profits of the company at the end of the year and certainly not a part of the accumulated profits for the purposes of section 2(22)(e) of the Act.

For this purpose, the assessee relied upon the decision of the Honble Supreme Court in the case of CIT v. Ashokbhai Chamanbhai (1965) 56 ITR 42. The Commissioner (Appeals) has, after considering the submissions of the assessee, sustained the addition made by the Assessing Officer on grounds almost similar to those taken by the assessing officer. The Commissioner (Appeals) has noted that instant was a case of Managing Director of a company who has created personal assets out of the monies received from the company, that the said assets were

free from encumbrances vis-a-vis the amount ordered to be released by the Honble Punjab and Haryana High Court. Even with regard to the element of dispute between the company and the Government of Punjab, the Commissioner (Appeals) noted that there could be an element of dispute in the quantification of receipt but there was no dispute with regard to the work having been actually performed and it was under these circumstances only that the arbitrator had awarded additional amount to the Company. It was also inferred by the Commissioner (Appeals) that the interim order of the Honble Punjab and Haryana High Court could not be construed to mean that it had barred the release of the award given by the arbitrator but instead was to be understood as having simply ordered the furnishing of security for this release of award. In this manner the addition has been sustained. Not satisfied with the order of the Commissioner (Appeals) the assessee is in appeal before us.

Before us, the learned Counsel Shri S.D. Kapila, appearing on behalf of the appellant, has at the outset taken us through the chronology of events starting from the time when the contract for the execution of Satluj Yamuna Link Canal was awarded to the company and leading up to the company advancing temporary loan to the assessee of Rs. 15 lakhs.

The learned Counsel submitted that the company was awarded work relating to execution of 2 contracts. The dates of completion of the work was 1-4-1988 and 1-5-1988 respectively. Consequent to disputes, the matter was referred for arbitration. The arbitrator gave his award on 31-8-1994 copies of which have been placed at the paper book.

Similarly the said award was decreed by the Sub-Judge, Ropar on 21-10-1995 copies of which are placed in the paper book. The learned Counsel drew our attention strongly to the interim order of the Honble High Court of Punjab and Haryana which is placed in the paper book at pages 46 to 48. The brief interim order dated 22-4-1996 whereby the execution of the award was stayed by the Honble High Court was referred to, which reads as under: Stay execution of the award subject to appellants depositing 25 per cent of the amount of award within six weeks from today. In case the amount is deposited, the same shall be paid to

the contractor on his furnishing security for the refund thereof in the event of appeal being allowed," The learned Counsel submitted that following the aforesaid interim order, the Government of Punjab through Executive Engineer, Patiala Ki Rao, Construction Division, Punjab deposited in the court of the District Judge, Ropar the requisite amount which was released to the company, subject to the assessee standing surety for the company in the said Court, in compliance with the order of the Honble High Court of Punjab and Haryana. The main contention of the assessee, on the basis of the aforesaid is, that the dispute in relation to the arbitration award was still sub-judice and the release of the money was subject to the outcome of the judgment of the Honble High Court. It was emphasized that the matter was still pending in the Honble High Court. The learned Counsel further submitted that the release of the money could not be considered as an execution of the award but was a mere conditional release. Reliance was placed on the decision of the Honble Supreme Court in the case of P.S.L. Ramanathan Chettiar v. O.R.M.Y.P.M.Ramanathan Chettiar AIR 1968 SC 1047, in this regard. Firstly, it was argued that a mere release of money in favour of the company, i.e., a decree holder, on furnishing of security, does not enable the Company to claim title to such money. Therefore, it could not be considered as income in the hands of the company till the matter is finally decided by the Court. Secondly, it was argued that the Government of Punjab in its appeal before the Honble High Court of Punjab and Haryana has challenged the very jurisdiction of the arbitrator and has also objected to the legality of the award. It was, therefore, contended that in such circumstances the entire award was in jeopardy and, therefore, there could not be any reason to presume that any income has accrued in the hands of the company. A copy of the grounds of appeal preferred by the Executive Engineer, Patiala Ki Rao, Construction Division, Punjab before the Honble High Court of Punjab and Haryana was placed before the Bench to demonstrate the aforesaid. Thirdly, it is submitted by the learned Counsel that the lower authorities have failed to appreciate the facts in proper perspective. The learned Counsel submitted that the observations of the assessing officer to the effect that the assessee had shown the amount as liability in the balance-sheet but was, in-fact profits, was erroneous having regard to the aforesaid facts. It was argued that having regard to the fact that the amount was subject to the outcome of the judgment of the Court, it could

not have been appropriated by the company as its income. It was submitted that the amount was released after the assessee, being the Managing Director of the company, furnished personal surety which was to the satisfaction of the Court. It was also argued that the inference drawn by the lower authorities that there was no element of cash security and, therefore, it could not be construed that the amount was released against security, was unjustified. According to the learned Counsel it is undeniable that the amount was released after the court was satisfied with the security offered and therefore, it was not open for the revenue to construe it differently. In nutshell, the learned Counsel has submitted that the release of Rs. 39,67,620 to the company, can at best be construed as a temporary relief which was subject to the final decision of the High Court. It was pointed out that the Company did not possess any accumulated profits and thus the requisite condition envisaged by section 2(22)(e) was not fulfilled, our attention was invited to the Balance Sheet and Profit and Loss Account for the period ended 31-3-1997 of the Company which is placed in the Paper book at page 102. The Company was making losses and its cumulative loss stood at Rs. 2,58,526, therefore, according to him, it could not be said that the Company possessed any accumulated profits.

On the other hand, the learned Departmental Representative Dr. Shikha Darbari appearing on behalf of the respondent-revenue has placed reliance on the orders of the lower authorities in support of her submissions. According to the learned Departmental Representative, the nature of the arbitration award was a relevant factor to be considered.

According to her the assessee-company had executed the work relating to the contract and the receipts as a result of the award was nothing but part of the receipts for the work carried out in the earlier years and, therefore, was to be considered as part of the profits relating to the work executed. It was argued that the Commissioner (Appeals) has noted that the dispute in arbitration related to the quantification of the amounts due to the company and, therefore, the receipts as a result thereof have to be taken as receipts from business. It was, therefore, stated that the company has wrongly depicted the same as liability in its balance-sheet whereas the release of money, however temporary, was to be taken as profits in the hands of the company. It was further argued by the learned Departmental

Representative that the provisions of section 2(22)(e) envisaged a deeming legal fiction and the same per force comes into play when any sum is paid by the company to its shareholders. According to her, if the amount released to the Company was considered as part of profits, the losses would be wiped out and the Company can be said to possess accumulated profits to that extent.

Therefore, the loan advanced to the assessee has been rightly taxed by the lower authorities.

We have considered the rival submissions, the relevant material on record as also the authorities cited at Bar and proceed to dispose of the issue in the following lines.

The crux of the issue before us is as to whether or not the provisions of section 2(22)(e) of the Act are attracted to the amount of Rs. 15 lakhs received by the assessee from the company. The facts which have a bearing on the issue lie in a very narrow compass and have been noted by us succinctly in the earlier part of the order and, therefore, the same are not repeated for the sake of brevity. However, it will be appropriate to recapitulate the salient fact situation. The assessee is a shareholder in the company. The company has released Rs. 15 lakhs as a temporary interest free loan to the assessee out of the amount of Rs. 39,67,620 received by it in terms of the interim order passed by the Honble Punjab and Haryana High Court dated 22-4-1996. The order of the High Court was relating to the award decreed by Sub-Judge, Ropar which was stayed on an appeal by the Executive Engineer, Patiala Ki Rao, Construction Division, Punjab. The High Court directed the Executive Engineer, Patiala Ki Rao, Construction Division, Punjab to deposit 25 per cent of the award in the Court which was to be released to the company against furnishing of security. The Sub-Judge, Ropar has since released the said amount on furnishing of personal surety by the assessee being the Managing Director of the Company. The amount so released has been shown by the Company as a liability in its balance-sheet.

Section 2(22)(e) enacts a deeming fiction. It provides that any payment made by a company to its shareholders by way of advance or loan shall be liable to be considered as dividend income subject to the fulfilment of conditions mentioned

therein. The conditions are that the company should be such in which the public are not substantially interested; that the shareholder should be beneficial owner of shares holding not less than 10 per cent of the voting power or be a concern in which such shareholder is a Member or a partner in which he has substantial interest; that the Company must possess accumulated at least to the extent of such loan or advance paid to the shareholder. It is further provided in terms of Explanation to section 2(22)(e) that the expression "accumulated profits" shall include all profits of the company up to the date of payment of loan or advances to the shareholder. It was a common ground between the parties that insofar as the requirement of the company being a company in which the public is not substantially interested and the assessee holding the prescribed percentage of shareholding is concerned the provisions of section 2(22)(e) are per se attracted. However, in order to apply the provisions of section 2(22)(e) all the conditions, that we have discussed in the earlier para, have to be cumulatively attracted. This is clear from a bare reading of the relevant provisions. The case of the assessee is that the company does not fulfil the condition of possessing accumulated profits on the date when the amount of Rs. 15 lakhs was advanced to him. Revenue, on the other hand, contends that the amount received by the assessee as interim payment of Rs. 39,67,620 is to be construed as income forming part of the "accumulated profits" for the purposes of this section. The moot question is can the amount of Rs. 39,67,620 received by the company be construed as a part of the "accumulated profits" for the purposes of section 2(22)(e) or not. If the said amount is considered as a profit in the hands of the Company, then the Company can be said to possess adequate accumulated profits.

If not, then the Company has accumulative losses, as we have seen earlier.

Insofar as this issue is concerned, in our view we find ample force in the submissions of the appellant for the reasons hereinafter. A perusal of the interim order of the Honble High Court, which has been extracted by us in earlier part of our order, leads to an irresistible conclusion that the execution of the arbitration award, by way of which the company was to receive Rs. 1,63,39,649, was stayed by the Court.

Further, the appellant, namely, Executive Engineer, Patiala Ki Rao, Construction Division, Punjab was directed to deposit 25 per cent of the amount in the court which has been released to the company on furnishing of security. Therefore, it follows that what the company has received could not be considered as having been received in the course of execution of the award inasmuch as the same stood stayed by the Honble High Court. The decision of the Supreme Court in the case of P.S.L. Ramanathan Chettiar (supra) is worthy of notice at this stage.

The Honble court was dealing with the nature of deposit of money made into the court to stay the execution of decree on the pleas of the judgment debtor and the release of the same to decree-holder on furnishing security. With regard to the real effect of deposit of money in court in such situations, the Honble court said as under: "On principle, it appears to us that the facts of a judgment-debtors depositing a sum in court to purchase peace by way of stay of execution of the decree on terms that the decree-holder can draw it out on furnishing security, does not pass title to the money to the decree-holder. He can if he likes take the money out in terms of the order; but so long as he does not do it, there is nothing, to prevent the judgment-debtor from taking it out by furnishing other security, say, of immovable property, if the court allow him to do so and on his losing the appeal putting the decretal amount in court in terms of order 21 rule 1. C.P.C. in satisfaction of the decree.

The real effect of deposit of money in court as was done in this case is to put the money beyond the reach of the parties pending the disposal of the appeal. The decree-holder could only take it out on furnishing security which means that the payment was not in satisfaction of the decree and the security could be proceeded against by the judgment-debtor in case of his success in the appeal. Pending the determination of the same, it was beyond the reach of the judgment-debtor." (Emphasis supplied) Therefore, having regard to the aforesaid legal position, when applied to the instant case, it follows that the company did not possess an unqualified right to appropriate the amount of Rs. 39,67,620, which was released to it conditionally subject to the outcome of the judgment of the High Court. Therefore, if the decision of the Honble Punjab and Haryana High Court went against the Company finally, it was liable to refund the money. Thus, the release of

money to the Company was accompanied by a rider. Can such an amount be considered as income in the hands of the Company. At this stage, we may also refer to the reasoning enunciated by the Apex Court in the case of Hindustan Housing & Land Development Trust Ltd. (supra). The Honble Apex Court was dealing with the award of additional compensation on compulsory acquisition of land. The award was being disputed by the Government but the same was deposited in court by the Government. The assessee therein was permitted to withdraw the same on furnishing of security subject to the outcome of dispute. The issue was as to whether in such circumstances the additional compensation would be construed as an income having accrued to the assessee. The Honble Apex Court held that the assessee under such circumstances did not have any absolute right to receive the amount at that stage. Therefore, it was held that no income arose or accrued as a result of the release of money to the assessee which was subject to the furnishing of security and also subject to the outcome of the dispute. Now coming back to the instant case, we find that the Executive Engineer, Patiala Ki Rao, Construction Division, Punjab has challenged the arbitration award decreed by Sub-Judge, Ropar both on facts and in law. A perusal of the grounds of appeal preferred by the Executive Engineer, Patiala Ki Rao, Construction Division, Punjab shows that the award is being challenged as being patently wrong and the jurisdiction of the arbitrator is also challenged. That the appeal challenging the arbitration award by the Executive Engineer, Patiala Ki Rao, Construction Division, Punjab, on such grounds, has not only been admitted but its execution stayed by the Honble High Court, only demonstrates that the disputes raised therein have been regarded by & Honble High Court as real and substantial. This is further strengthened by the fact that the company was permitted to withdraw amount deposited by the Executive Engineer, Patiala Ki Rao, Construction Division, Punjab in the Court, only against the furnishing of security. Therefore, it is safe to deduce that the very foundation of company's claim, namely the arbitration award was in serious jeopardy and nothing would be due to it if the appeal was decided against the Company. Hence, it could not be said that the amount released was in the nature of income as the very basis was disputed. Infact, the Company did not have an absolute right to receive the amount at that stage. Therefore, in such circumstances when the right to receive the payment was itself

in dispute, there does not remain any element of income which can be said to have accrued.

Therefore, we are of the view that the amount of Rs. 39,67,620 could not be construed as "accumulated profits" in the hands of the company for the purpose of section 2(22)(e) of the Act, Now, the stand of the Commissioner (Appeals) that there has been no cash security provided by the company to secure the release of the money and, therefore, the release cannot be termed as conditional. This argument, in our considered view, only deserves to be rejected, as it is fallacious both in law and on facts. Insofar as the legal position is concerned, the jurisdictional Honble High Court of Punjab and Haryana in the case of CIT v. Jai Prakash Om Prakash Co. Ltd. (1961) 41 ITR 718, has answered the said objection. The facts were that the assessee therein instituted a suit for recovery against one B, The suit was decreed in favour of the assessee but an appeal there from was pending in the High Court. The question was as to whether the amount decreed could be brought to tax pending the dispute in the High Court.

It was held not includible as income for the reason that no real income could be said to have actually accrued or arisen, since the very foundation of the claim was in jeopardy as the appeal could have been decided against the assessee, then nothing would have come into the hands of the assessee. Thus it is to be understood that pending the outcome of a dispute in the Court, the entitlement to the money thereof, is only an inchoate right and the release of the money, that too, on intervention of the Court, would not make any income accrue in the hands of the recipient party. Therefore, in the instant case, irrespective of the personal surety furnished by the assessee, it is an admitted position that the dispute is pending in the High Court and therefore, the amount released to the Company in the meantime, cannot acquire the character of income for the purposes of taxation. In any case, this is not a case where the amount have been released without any security. The amount deposited in court has been released to the Company on furnishing of personal surety by the assessee, being its Managing Director. The manner in which the amount is released and the nature of security are considerations for the respective court but the same is an irrelevant factor for the revenue authorities. The fact remains that the amount is disputed. Thus, on facts

also, we do not find any cogent reasons to consider the said objection as relevant for the dispute on hand.

In the result, in view of the aforesaid discussion, in our view since the amount of Rs. 39,67,620, out of which the impugned amount of Rs. 15 lakhs has been issued to the assessee, cannot be considered as constituting part of the accumulated profits of the company as envisaged in section 2(22)(e) of the Act. Thus, the provisions of section 2(22)(e) are inapplicable to the amount of Rs. 15 lakhs in the hands of the assessee before us. As a result, we set aside the order of the Commissioner (Appeals) and direct the assessing officer to delete the addition. Appeal of the assessee is thus allowed.

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