Nh Securities Ltd. Vs. Dcit

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Jul-27-2006

Judge : S K Yadav, O Narayanan

Appellant : Nh Securities Ltd.

Respondent : Dcit

Judgement :

1. These are two cross appeals. The relevant assessment year is 2000-01. These cross appeals are directed against the order of the CIT(A)-VII at Mumbai dated 17-02-2004. The appeals arise out of the assessment completed Under Section 143(3) of the Income-tax Act, 1961.

2. The assessee is a limited company engaged in the business of share and stock broking, investment and trading in shares and securities, etc. The assessee company is a member of National Stock Exchange. The assessee company has returned an income of Rs. 24,25,11,(sic) for the year under assessment. The assessment was completed after carrying out a special audit Under Section 142(2A) of the Act. The income has been finally assessed at Rs. 45,70,04,550.

3. One of the major additions made by the assessing officer in finalising the impugned assessment is a sum of Rs. 21,02,77,135 made Under Section 2(22)(e) as deemed dividend.

4. The assessee company (referred to as NHSL, for short) is having regular transactions with another company M/s Panther Investrade Ltd. (referred to as PIL, for short). The assessing officer in the course or verifying the accounts of the assessee company found that the personal account of PIL reflected in assessee's ledger accounts speaks of regular transactions in between them. On further enquiry, the assessing officer found that the assessee company, NHSL and the other company PIL stand in relation to each other falling under the provisions of Section 2(22)(e) for the reason that one Shri Kirtikumar N. Parekh is having substantial share holding in both the companies over the limit prescribed under the provisions of Section 2(22)(e) of the Income-tax Act. Shri Kirtikumar N Parekh is holding 5,32,980 shares of assessee company NHSL which works out to more than 20% of the share holding.

Shri Kirtikumar N. Parekh is also holding 3,205 shares of the other company PIL, which is more than 10% of the share holding. Therefore, the assessing officer held it necessary that the nature of the transactions between the assessee and PIL as reflected in the ledger accounts of the assessee company need to be verified minutely so as to find out whether the transactions are hit by the provisions of law contained in Section 2(22)(e) or not.

5. The other company, PIL is a non banking finance company (NBFC) engaged in the business of investment and trading in shares. The assessee company, NHSL, as already stated, is mainly in thp business of broking. According to the assessee company, it is acting as the broker for PIL whenever the other company purchased shares and securities and sold shares and securities. When purchases are made by the assessee company on the instruction of PIL, the assessee will debit the account of PIL and correspondingly suffered in trading of the shares on the directions of PIL, the entries are passed in the above manner. When shares are sold by the assessee company on the instructions of PIL and proceeds are received, the account of PIL will be credited in asseessee's accounts and the assessee's account will be debited in the accounts of PIL. In short, the assessee company as well as PIL have been passing respective entries in their books of account depending upon the nature of transactions they had entered into.

6. In the light of the above facts, the assessing officer came to the following conclusions: (i) That M/s PIL is a company in which public are not substantially interested within the meaning of the provisions of Section 2(18) of the Income-tax Act, 1961.

(ii) Money lending is not a substantial part of the business carried on by PIL.

(iii) Shri Kirtikumar N. Parekh is holding more than 20% shares in the assessee company and more than 10% of the shares in PIL.

7. In the light of the above findings, the assessing officer treated the payments made by PIL to the assessee company as deemed dividend by virtue of the common share holding of Shri Kirtikumar N. Parekh. The assessing officer thus added the sum of Rs. 21,02,77,135 as deemed dividend in the hands of the assessee company.

8. In first appeal, the CIT(A) agreed with the findings arrived at by the assessing officer and the propositions relied on by him. But the CIT(A) examined the composition of the sum of Rs. 21,02,77,135 treated by the assessing officer as accumulated profit for the purpose of deemed dividend. He found that a sum of Rs. 21,87,500 belonged to share premium account reflected in the balance-sheet of PIL and, therefore, it would not form part of the accumulated profit as share premium account cannot be utilised for distribution of dividend. Therefore, the CIT(A) deleted the said amount of Rs. 21,81,500 and confirmed the balance. It is against the above that the assessee has come in second appeal before us.

9. The assessing officer has also made certain other disallowances and additions in the course of assessment relating to exemption Under Section 10(33) being dividends, penalty paid to NSE, interest attributable to borrowed funds hut stated to be used for giving interest free advances, etc.

10. In respect of the above disallowances/additions made by the assessing authority, the CIT(A) accepted the contentions of the assessee and held that the amount of Rs. 5,05,886 is to be treated as dividend within the meaning of Section 10(33) r.w. Section 115-O and, therefore, exempt from tax. He also deleted the

addition of Rs. 6,80,129, made by the assessing authority on the ground of penalty charged by NSF. The CIT(A) also held that there is no justification in making an addition of Rs. 16,56,000 towards inadmissible interest.

11. Revenue is aggrieved by the above modifications grantee by the CIT(A) and, therefore, in cross appeal before us.

12. The grounds raised by the assessee company in its appeal have two segments. The first segment of the grounds raised by the assessee company is against invoking of the provisions of Section 142(2A) of the Act, by the assessing officer allegedly for extending the period of limitation. The second segment of the grounds raised by the company is on the merits of the addition made by the assessing authority Under Section 2(22)(e). The principal ground in the second segment is that there is no ground whatsoever to make an addition of Rs. 21,02,77,135 as deemed dividends Under Section 2(22)(e) for the reason, according to the assessee company, that PIL had not made any payment to the assessee company in the nature of advances or loans. The other grounds missed by the assesse company in the second segment are alternative in nature mainly relating to the quantum of the accumulated profits, to be considered for Section 2(22)(e) if at all so necessary.

13. The assessee company has also raised two other grounds, one relating to the disallowance of Rs. 8,68,081 pertaining to donations and the other one relating to levy of interest Under Section 234B and 234C.14. Shri S.E. Dastur, the learned senior Counsel appearing for the assessee company stated that the deeming provisions of law contained in Section 2(22)(e) are not to apply in an instant and automatic manner whenever transactions are reflected in the accounts of related concerns. He sated that the payments made between the concerned parties should acquire the colour of advance or loan in a demonstrative manner so as to impose the deeming provisions contained in Section 2(22)(e).

Otherwise, the law will create such an anarchic situation whereby no related concern can enter into normal business transactions. He stated that the scope and application of a deeming provision being very much confined and limited to the particular purpose for which it has been enacted cannot assume any role beyond

the said restricted and confined limit and it can never interfere in the normal business of the companies carried out in the ordinary course.

15. The learned senior Counsel referred to the decision of the Hon'ble Calcutta High Court in Mukundray K Shah v. CIT (sic) ITR 128 at PP 133 to explain the characteristics of the provisions of law contained in Section 2(22)(e). He referred to the said judgment and stated that the said section applies to three categories of cases. The first category relates to any payment made by a company, in which public are not substantially interested, by way of loans or advances to shareholder having not less than 10% voting power. The second category relates to any payment of such a company to any concern in which such shareholder is a member having substantial interest not less than 20% of the voting power of such concern. The third category is the payment of any such company on behalf or for the individual benefit of any such shareholder, who enjoys the necessary voting power. He also stated that in all these three categories, the extent of the deemed dividend is confined to the accumulated profits available in the hands of such company.

16. The learned senior Counsel stated that in the light of the above statutory scenario, the present case may be examined under the second category of cases already mentioned. He stated that Shri Kirtikumar N.Parekh is holding more than 20% shares in the assessee company and more than 10% shares in PIL. Therefore, any payment by way of loans or advances made by PIL to the assessee company would he covered hy the second category case.

17. The learned senior Counsel stated that the Revenue has framed a case that the payments made by PIL to the assessee company and on (sic) behalf fall under the second and third categories, respectively. He stated that it is nobody's case that any payment has been made by PIL to the shareholder, i.e. Shri Kirtikumar N. Parekh or for his benefit or on his behalf.

18. Therefore, he submitted that in the present appeal filed by the assessee company, the two issues are to be considered. The first issue is that what is the amount of payment by way of loan or advances by PIL to the assessee company the case falling within the second category)? The second issue is that subject to

the finding on the first issue, what is the accumulated profit for the purpose of Section 2(22)(e)? 19. The contentions further made by the learned senior Counsel may be summarised as below: 1. The assessing authority has treated the entire credit entries reflected in the ledger account of PIL in the personal name of the assessee company as loans and advances. The assessing officer has not looked into the character of individual transactions made between the companies. As the sum total of those credit entries exceeded the amount of accumulated profit of PIL as on 31-03-2000 (as on the last day of the previous year relevant to the assessment year under appeal), the assessing officer has adopted the accumulated profit as a whole in the nature of deemed dividend even without examining whether the computation of the accumulated profit made by the assessing authority is correct or not. The assessing officer has adopted the amount of accumulated profit without looking into its composition.

2. As held by the Hon'ble Kerala High Court in the case of K Sridharan v. CIT 201 ITR 973 where a company is indebted to its related company and the payments are made or account of that indebtedness, the provisions of Section 2(22)(e) are not attracted.

This crucial aspect has not been looked into by the assessing officer and he has not taken into consideration that PIL is indebted to the assessee company and many of the payments made by PIL to the assessee company were on account of those indebtedness.

3. PIL is a non banking finance company whereas the assessee company is a broker. It is the regular business of PIL to purchase shares and securities for the purpose of investment as well as for the purpose of trading. The assessee company, as a broker, purchases shares and securities on behalf of PIL on its direction and when such shares are purchased, the accounts of PIL ore debited and when payments are received from PIL, it accounts are credited. It is very clear that in such circumstances, the payments were made by PIL to pay off the debts already existed and it was only settling the accounts in its ordinary course of business. Such payments made by PIL to the assessee company cannot be treated as a loan or advance.

4. The Hon'ble Bombay High Court in the case of CIT v. Nagindas M. Kapadia 177 ITR 393 and the Hon'ble Delhi Bench of the Tribunal in the case of ACIT v. Global Agencies Pvt. Ltd. 1 SOT 570 (Del) have held that such regular business transactions did not amount to loans or advances.

5. There are also certain payments made by PIL on behalf of the assessee company. Such transactions made by PIL on behalf of the assessee company also do not come under the ambit of Section 2(22)(e) for the reason that such payments on behalf of the assessee company result again in a debt subject to further settlement and do not partake the character of loan or advance. Even otherwise in the light, of the specific facts of the present case, those payments made by PIL on behalf of the assessee company are not covered by Section 2(22)(e) because as already stated, the third category of cases cover payments made by PIL on behalf of or for the individual benefit of a shareholder, i.e. Shri Kirtikumar N. Parekh in the present case, and not on behalf of or for the benefit of the company in which such person is a shareholder. In the present case PIL has not made any such payment for and on behalf and for the benefit of Shri Kirtikumar N Parekh as such payments were made only for the assessee company. Therefore, it is obvious that such transactions do not come under the parview of Section 2(22)(e).

6. Without prejudice, the other relevant contentions to be highlighted by the assessee company, if the above mentioned three types of payments, viz. the payments made by PIL to the assessee company against existing debit balance, payments on account of regular business transactions and payments on behalf of the assessee company which will not come Under Section 2(22)(e) are excluded, the amount that could be regarded as loan or advance by PIL to the assessee company (without any prejudice), would be Rs. 3,86,81,885 against the amount of Rs. 21,02,77,135 adopted by the assessing authority.

7. Where an assessee is liable to pay off debts to any other company and when payments are made by the company in excess of the amount payable at that point of time, such excess payments also cannot be treated as a loan or advance. This is because a loan presupposes lending of a sum of money on the basis of an

expressed or an implied agreement to repay the same to the lender with or without interest.

The excess payment made by a debtor to a creditor is a payment on account of which has not fulfilled the characteristics of a loan. As held be the Hon'ble Bombay High Court in the case of Penwalt India Ltd and Ors. v. Registrar of Companies 62 Com. Cases 112 (Bom), if a payment is to be treated as loan the entire payment made of the person should have the characteristic of a loan and the payment cannot be divided into between as other payments and loan payments.

A payment as such should be in the character of a loan. This proposition has been followed also by ITAT Delhi Bench in the case of Ardee Finance (P) Ltd v. DCIT 79 ITD 547 (Del). In the present case, there are so many such payment made by PIL to the assessee company on account but the payments occasionally exceeded the amounts payable by PIL to the assessee company at the moment of such payments. On that way the personal account of PIL occasionally showed credit balanaces in the accounts of the assessee company. In the light of the above legal position, such excess amounts paid to the assessee company cannot be regarded as loans or advances. If such excess amounts are also reduced, the remaining amount that could be considered for the discussion whether they are loans or advances would be reduced to Rs. 1,17,02,010.

8. The learned senior Counsel submitted that without prejudice to the argument of the assessee company that payments made between the related concern in the ordinary course of the business carried on by them cannot be treated as payment of loans or advances so as to attract the deeming provisions of Section 2(22)(e), still, the quantum of deemed dividend worked out by the assessing officer at Rs. 21,02,77,135 is without any basis and when the payments made by PIL towards its debts to the assessee company, the payments of regular business transactions and payments on behalf of the assessee company along with occasional excess payments are excluded, the disputable amount would be reduced to Rs. 1,17,02,010 as explained.

20. Besides the contentions advanced by the learned senior Counsel in the light of the details and characteristics of the payments involved in this case, he has further

raised his contention on the basic proposition governing the provisions of law contained in Section 2(22)(e). He explained that the payments were made between assessee company and PIL, on account. The account between the assessec company and PIL is mutual, open and current in nature. Therefore, no part of that running account could be treated as loans or advances as the account is a continuously moving one and the balances reflected in that running account are momentary in nature and subject to frequent changes. The learned senior Counsel invited our attention to the provisions contained in Schedule to Limitation Act, 1963 to explain the distinction provided by the statute between a mutual, open and current account and a loan account, for the purposes of limitation. As per Articles 1 & 19 of Schedule to Limitation Act, 1963, the limitation period prescribed in case of mutual, open and current account is three years from the close of the year in which the last item is admitted or proved as entered in the account whereas in the case of a loan the limitation period is three years from the dale on which the loan is made. The learned senior Counsel explained that the distinction made by the Limitation Act, 1963, in respect of various items is recognised by the courts to determine the exact nature of those transactions. The learned senior Counsel relied on the decisions of the Hon'ble Bombay High Court in the cases of Durgaprasad Mandelia and Ors. v. Registrar of Companies 61 Com. Cases 479 and Penwalt and Ors. v. Registrar of Companies 62 Com. Cases 112.

21. In the light of the above contentions, the learned senior Counsel argued that a running account maintained by two concerns even if they are related concerns Under Section 2(22)(e) in the normal course of business and cannot be treated as loans or advances.

22. After explaining the nature of the deeming provisions contained in Section 2(22)(e), the characteristic features of the payments made by PIL to the assessee company and after identifying the amounts to be excluded from the ambit of loans and advances if at all necessary, the learned senior Counsel referred to the second limb of his contention on Section 2(22)(e) in respect of "accumulated profits". He explained that "accumulated profits" is defined in Explanation 2 to Section 2(22) to mean all profits of the company upto the date of payment referred to in Clause (e). The learned Counsel explained that the Explanation 2 to Section

2(22), as it appears in the Income-tax Act, 1961, was not there in the corresponding Section 2(6A) of the Income-tax Act, 1922, as noted by the Hon'ble Supreme Court in CIT v. M. Damodaran 121 ITR 672, it was settled by a long line of judicial pronouncements that the words "accumulated profits" in Section 2(6A) of the Income-tax, 1922 cannot be construed to include current profits. He explained that all that Explanation 2 in Section 2(22)(e) in the Income-tax Act, 1961, does is to include any "accumulated profits", profit or income which had accrued upto the date of grant of the loan, i.e. to include income which arises on a specific day like rental income or capital gains. He explained that however, in spite of the insertion made by Explanation 2, it does not cover income which does not arise on a day to day basis but recognised only at the end of a particular previous year. The example is profits from business.

23. The learned senior Counsel relied on the decision of the Hon'ble Bombay High Court in the case of Bhogilal Laherchand v. CIT 28 ITR 919 where it has been held by the court that the profits or losses of a company from a commercial point of view could be ascertained only at the end of each year and it would not be possible to predict that the company has made profit or incurred any loss on any particular day preceding or prior to the year end of that particular year. Therefore, globally it is accepted that profits of a business is recognised, as accrued, at the end of that particular year. Therefore, even in the context of Explanation 2 to Section 2(22) of the Act, the "accumulated profits" cannot include profits and gains of business which is not accrued to the company on the date of payment of deemed dividend. In computing the accumulated profits, upto the date of payment of deemed dividend, the profits which have accrued as on that day alone could be considered. The Ahmedabad Bench of ITAT in MB Stock Holding (P) Ltd. v.ACIT 84 ITD 542 has held that the Explanation to Section 2(22)(e) does not have the effect of inclusion in "accumulated profits" the current years business profits. ITAT, Mumbai Bench in DCIT v. Sunil Umashankar Purta 94 TD 329 has held that current year profits cannot be treated as part of accumulated profits for the purposes of Section 2(22)(e). The learned senior Counsel further invited our attention to the decision of the Hon'ble Supreme Court in the case of CIT v. Getty Chetliar 83 ITR 599 that an interpretation clause which extends the meaning of a word does not like away its ordinary meaning. An interpretation clause is not

meant to prevent the word from receiving its ordinary, popular and natural meaning whenever that would be properly applicable, but to enable the word as used in the statute, when there is nothing in the context or the subject-matter to the contrary, to be applied to something to which it would not ordinarily be applicable. Such ordinary, popular and natural meaning need not be sidelined unless there is anything contrary to the context or the subject matter.

Current year income from House Property or capital gains gained during the year or interest or dividend income attributable to that year is ascertainable on a particular date and those items could form part of the accumulated profits for the purpose of Section 2(22)(e), unlike business profit. If any other view is adopted on this point, it wili lead to absurdity as it would be not only improbable but impossible to work out the profit of a business on a particular day within the year for the reason that there is no concept of daily profit in the case of business income. In the case of a business, various closing and adjusting entries are required to be passed at the close of the accounting year and necessary provisions are to be provided in the accounts like gratuity liability on the basis of actuarial valuation, etc. If the business profit is also to be worked out on the date of payment of deemed dividend for the purpose of Section 2(22)(e), a company would be called upon to obtain the actuarial valuation on the date of payment of deemed dividend to work out the liability on account of gratuity. So many such exorcises are required in order to obtain the true and correct profit of a business on a particular day within the accounting year. Such things are almost next to impossible. Even if such a computation or exercise is contemplated, then the burden is on the Revenue to determine the accumulated profit in respect of business income on a day to day basis. Therefore, Explanation 2 to Section 2(22) needs to be read harmoniously with the ordinary meaning of the expression "accumulated profits" so as to include only such income of a current year which is accrued, identified and ascertainable on the date of its computation and not unascertairnable income like business income.

24. The learned Counsel stated that as observed by the Supreme Court in the case of Navnitlal Jhaveri 56 ITR 198, the provisions of Section 2(22)(e) must be made applicable where dividend disguised as a loan is paid by a company. The

concept should not be stretched too far to involve any absurdities. The learned Counsel further relied on the decision of the Supreme Court in the Case of CIT v. CP Sarathy Mudaliar 83 ITR 170 and Kerala High Court in the case of CIT v. PV John 181 ITR 1 to bring home the point that the deeming provisions of Section 2(22)(e) must receive a strict construction.

25. As per Schedule B of Reserves & Surplus forming part of the balance-sheet of PIL shows a total amount of Rs. 21,02,77,135 as on 31-03-2000 and Rs. 1,08,41,231 as on 31-03-1999. The assessing officer has adopted the total of Reserves & Surpluses as on 31-03-2000 (the last date of the previous year) of Rs. 21,02,77,135 as "accumulated profits" for the purposes of Section 2(22)(e). The above amount consisted of profit & loss account, share premium arrount, statutory reserve and general reserve. The CIT(A) has excluded the amount of share premium of Rs. 2,18,75,000 from the computation of accumulates profits, but has not given any finding in respect of the statutory reserve of Rs. 4,21,50,000 which was required to be maintained in terms of Section 45-IC of the Reserve Bank of India Act, 1934 which is not available for distribution of dividends. In CIT v. Urmila Ramesh 93 Taxman 553, the Supreme Court has held that the accumulated profits should be in the named which a company could distribute it to its shareholders. Therefore, the statutory reserve credited in terms of the Reserve Bank of India Act, 1934 needs to be excluded from the computation of "accumulated profit" for the purpose of computation provided Under Section 2(22)(e).

26. The learned senior Counsel submitted that it these factors are taken into consideration, the accumulated profits amount would be Rs. 65,03,731 being the Reserves & Surplus and any other amount of income other than business income which is ascertainable as accrued or received by the date of payment of each of the amount of deemed dividend.

27. The learned senior Counsel summarised his propositions in the following lines: 1 PIL has not advanced any loans or advances to the assessee company the account running between PIL and the assessee company is mutual, open and current.

2. Without prejudice to the above basic proposition, the maximum amount that could be regarded as loan is Rs. 1,17,02,010.

3. In the alternative, the maximum amount that could be regarded as loan does not exceed Rs. 3,86,81,885.

4. Whatever may be the amount that could be regarded as loans and advances in the light of the above, the amount to be assessed as deemed dividend cannot exceed the "accumulated profits" which in the present case is Rs. (sic).

28. Dr. P Daniel, the learned standing Counsel appearing for the income-tax department argued for the Revenue and supported the orders of the lower authorities on this point. The learned standing Counsel invited our attention to the expression used in Section 2(22)(e) to convince the propositions made by the Revenue. He stated that "any payment by a company by way of advance or loan to a share holder..." comes under the purview of the deeming provisions contained in Section 2(22)(e). The learned standing Counsel explained that the stress is on the expression "any payment by a company". He, therefore, explained that it is the duty of the assessee company to show that the payments received by it are not by way of advances or loans. The learned standing Counsel explained that even if the payments and receipts of monies are reflected in a running account that does not guarantee that those receipts and payments were not in the nature of loans and advances. He explained that what is to be looked into is the character and feature of every individual payment and not the name given to the account by the parties concerned.

29. The learned standing Counsel further explained that "any payment" has necessarily to be construed as "every payment". Therefore, he submitted that the provisions of Section 2(22)(e) apply even to successive loans, provided other conditions specified in the provision are fulfilled.

30. The learned standing Counsel relied on the decision of the Bombay High Court in the case of CIT v. Surat Cotton Spinning & Weaving Mills Pvt. Ltd. 202 ITR 932 and explained that even deemed income has to be treated as red income for the purpuse of taxation and the nature of deemed income does not by itself dilute the

provisions of law. He also relied on another decision of the Bombay High Court in the case of CIT v. P.K. Badiani 76 ITR 369 in support of the proposition that "any other payment" means, for the purpose of Section 2(22)(e), 'every payment'. The learned standing Counsel relied on the decision of the Gujarat High Court in the case of CIT v. Mayur (sic) Mehta 85 ITR 230 and the decision of the Calcutta High Court in the case of LIT v.Bhagwat Tewari 105 ITR 62 and the Gujarat High Court in the case of Ravindra D. Amin v. CIT 815 in support of the various arguments advance the payments made by a company to a shareholder are in the nature of advances or loans or if the payment is made to a third party on behalf of a shareholder or for his benefit, then there should not be any difficulty in treating (sic) payment as dividend in the hands of the shareholder. The learned standing Counsel explained that each and every payment made by a company needs to be treated as independent payment without looking into any other aspects of the case. Every payment for that matter should be treated as payment of loan or advance and in that way susceptible to the provisions of law contained in Section 2(22)(e)(i) of the Act.

31. The learned standing Counsel also relied on the decision or the Bombay High Court in the case of Walchand & Co. Ltd. v. CIT 100 ITR 598 that any payment made by such company of a sum by way of or loan or advance to a shareholder or any payment by such company on behalf of each shareholder or for the individual benefit of such shareholder is to be treated as dividend and for the purpose of describing the payment as loan or advance even a hand loan for a short period would be treated as loan or advance as such and the various arguments of the learned senior Counsel regarding the excess payments on account made by PIL to the assessee company, etc. are not sustainable in law.

32. In reply, Shri S.E. Dastur the learned senior Counsel explained that the expression used in Section 2(22)(e) "any payment" is not an expression simplicitor, but followed by very crucial qualification that "by way of loans or advances". He, therefore, submitted that any other payment and for that matter every payment does not ipso facto come under the ambit of Section 2(22)(e) unless those payments are made by way of loans or advance. A payment made by a debtor to a creditor on account cannot be (sic) of loan or advance and, therefore,

such payments cannot be hit by Section 2(22)(e) even if as argued by the learned standing Counsel that "any other payment" or for that matter "every payment" has to be looked into in the context of Section 2(22)(e). The learned senior Counsel relied on the decision of the Supreme Court in the case of CIT v. G. Narasimhan (Deed) and Ors. 236 ITR 327 wherein the court has held that any legal fiction will have to be carried to its logical conclusion and accordingly if the payment Under Section 2(22)(e) of the Income-tax Act, 1961 is treated as a deemed dividend and is required to be so treated to that extent and the company possesses accumulated profits, the logical conclusion is that the payment must be considered as adjusted against the company's accumulated profits to the extent that it is treated as deemed dividend while calculating accumulated profits of the company for the succeeding payments. In the light of the above, the learned senior Counsel submitted that every successive payment if at all taken as loan or advance should go to reduce from the accumulated profits and if in that way the accumulated profits is computed, the quantum should come down, on every payment of loan/advance.

33. We have considered the rival arguments in detail. The issues coming up for our consideration are the following and in the following sequence: i) Whether the payments made by PIL reflected in the accounts maintained by the assessee company is a mutual, open and current account and if so come under the purview of Section 2(22)(e)? ii) Even if the account between the assessee and PIL is not outside the purview of Section 2(22)(e), whether the amounts paid by PIL against outstanding debts are to be considered as loans/advances? iii) Whether payments in respect of regular business transactions reflected in the said account are to be held as loans/advances? iv) Whether the occasional excess payment made by PIL on account to the assessee company could be treated as in the nature of loans/advanced? v) Whether the business profits of the current year need to be treated as part of accumulated profits as business profits cannot be computed on a day to day basis? vi) Whether the statutory reserve maintained under the provisions ot Section 45-IC of the Reserve Rank of India Act, 1934 could be treated as part of the accumulated profits? vii) Whether the successive bans/advances paid by PIL to the assessee company need to be successively reduced from the accumulated profits or not? 34. First we will examine the basic

contention raised by the learned senior Counsel that a mutual, open and current account operated between the parties will not come under the purview of Section 2(22)(e). We refer back to the provisions of Limitation Act, 1963, referred to by the learned senior Counsel to point out the statutory distinction between mutual, open and current account AND an advance/loan. As per the Schedule to the Limitation Act, 1963 and as per Articles 1 & 19 thereto, the limitation period prescribed in the case of mutual, open and current account is three years from the close of the year in which the last item is admitted or proved as entered in the account. On the other hand, in the case of a loan, the limitation period is three years from the date on which the loan is made. This throws light on the characteristic feature of a running account and a loan account in a subtle manner. The Limitation Act, 1963 recognises the running character of a mutual, open and current account by taking the last acknowledged transaction as the starting point of limitation. But in the case of the loan, once for all and single transaction, that single transaction itself is the starting point of limitation. This statutory distinction reflected in the Limitation Act, 1963 is a pointer towards the basic difference between a running account and a loan account. The law relating to limitation as explained above, has been recognised by the Bombay High Court in the case of Durgaprasad Mandslia and Ors. v.Registrar of Companies 61 Com. Cases 479 and Penwalt and Ors. v.Registrator of Companies 62 Com. Cases 112.

35. In the light of the above broad distinction between a mutual open and current account and an advance/loan account, it is useful to refer to the decision of the Kerala High Court in the case of K. Sridharan v.CIT and Anr. 201 ITR 973. In that case, a company had given loan to its shareholder which was treated as deemed dividend Under Section 2(22)(e), by the Revenue Authorities. The explanation of the assessee was that the company had owed money to its shareholder and the money was paid as repayment of that loan. The court held that in such circumstances where a company repays the loan due to its shareholder cannot be treated as a deemed dividend under Section 2(22)(e).

36. In the light of the above judgment of the Kerala High Court it is possible to hold a view that wherever payments made by a limited company to its shareholder is proved by its characteristic as other than loan/advance; in other words, the

payment is for the purposes of repayment of loan or such other existing liability, the question of Section 2(22)(e) applying, does not arise. The nature and character of the payments made by a company is very important in examining whether a payment made by the company falls Under Section 2(22)(e) or not. Where a company pays to its shareholder any amount against repayment of an existing loan or advance or against purchase or availing of service or paying on account on any other ground, such payments made in the ordinary course of carrying on of the business of that company cannot be brought under the purview of Section 2(22)(e). That is why Section 2(22)(e) provides that any payment by a company by way of advance or loan to a shareholder alone is to be considered for the purpose of deemed dividend. The above legal propositions arc further made clear by the Bombay High Court in the case of CIT v. Nagindas M. Kapadia 177 ITR 393. In the said case, the assessee was a shareholder having substantial interest in the company for the purpose of Section 2(22)(e). The assessee also carried on a proprietory business. The company had maintained a running account in the name of the proprietory business run by the shareholder. In the assessment years 1968-69 and 1969-70, the running account disclosed cash payments by the company to the assessee at Rs. 1,31,672 and Rs. (sic) respectively which were held iu be deemed dividend Under Section 2(22)(e) by the assessing authority. The Tribunal found that payments other than Rs. 28,500 and Rs. 10,000 in the assessment years 1968-69 and 1969-70 were made as advances towards purchases to be made by the company from the proprietory concern of the assessee and, therefore, only Rs. 28,500 and Rs. 10,000 fell within the meaning of Section 2(22)(e) which could be treated as deemed dividend. While the High Court confirming the action of the Tribunal in treating the payments of Rs. 28,500 and Rs. 10,000 as deemed dividend, has also upheld the finding of the Tribunal that the payments made by the company to the shareholder in the account of his proprietory business for purchases would not be held as deemed dividend for the purpose of Section 2(22)(e).

37. In the light of the discussions made in paragraphs above, it is to be seen that payments made by a company through a running account in discharge of its existing debts or against purchases or for availing services, such payments made in the ordinary course of business carried on by both the parties could not be

treated as deemed dividend for the purpose of Section 2(22)(e). The deeming provisions of law contained in Section 2(22)(e) apply in such cases where the company pays to a related person an amount as advance or a loan as such and not in any other context. The law does not prohibit business transactions between related concerns and, therefore, payments made in the ordinary course of business cannot be treated as loans and advances. Therefore, in the facts and circumstances of the case and in the light of the judicial pronouncements considered above, especially in the light of decision of the Bombay High Court in the case of CIT v. Nagindas M. Kapadia 177 ITR 393 we hold that payments made by a company in the course of carrying on of its regular business through a mutual, open and current account to a related party do not come under the purview of Section 2(22)(e) of the Act.

38. The nature and character of the payments involved on the present case have been sufficiently discussed in paragraphs above while dealing with the facts or the case and while referring to the orders of the lower authorities, The payments are in the nature of payments other than advances and loans. The payments in the present case were made by PIL in settlement of its accounts with the assessee company in the ordinary course of business where the assessee company is acting as the broker of PIL in carrying on the business of purchase and sale of shares. The payments were made by PIL either in settlement of existing debts or on account. Therefore, in the facts and circumstances of the case we hold that the payments trade by PIL to the assessee company through the mutual, open and current account involved in the present case were the payments made in the ordinary course of business and, therefore, do not come under the purview of Section 2(22)(e).

39. In the facts and circumstances of the case we delete the addition of Rs. 21,02,77,135 made by the assessing authority as deemed dividend Under Section 2(22)(e) of the Act.

40. As the issue raised in this appeal regarding the deemed dividend has been decided on the basic question regarding the character of a mutual, open and current account, it is not necessary for us to (sic) other various legal qrounds

raised by the assessee in this appeal.

41. Another qround raised by the assessee company is regarding the direction of the assessing officer given to the assessee company Under Section 142(2A). As the main issue involved in this appeal has been decided on its own merit, this ground is not so relevant in deciding the appeal and, therefore, it is rejected.

42. The third ground raised by the assessee is that the CIT(A) has erred in confirming the disallowance of Rs. 8,68,081 out of the donations paid by the assessee during the year. Donations are only appropriation of income and, therefore, not entitled for deduction in computing the taxable income. This ground is rejected.

43. The fourth and last ground raised by the assessee in its appeal is regarding levy of interest Under Section 234B an 234C. The assessee has raised twofold contentions on this point. The first one is that levy of interest is not proper and the second is that the assessee was not heard before (sic) the interest. As far as the quantum of the interest is concerned, it is only consequential and will be subject to our order deleting the addition of Rs. 21,02,77,135.

44. With regard to the legal contention raised regarding the levy of interest Under Section 234B and 234C, they are not sustainable in view of the decision of the Delhi Special Bench in the case of Motorola Inc 95 ITD (sic). Therefore, this ground is also rejected.

46. Next we will consider the appeal fiied by the Revenue. The first ground raised by the Revenue is that the CIT(A) has erred in coming to a conclusion that the income of Rs. 5,05,886 is dividend within the meaning of Section 10(33) r.w. Section 115-O and accordingly exempt Under Section 10(33) of the Income-tax Act, 1961. As rightly pointed out by the CIT(A), the law does not distinguish between the dividend received by a trader and the dividend received by an investor. The condition for qualifying for the exemption is that the receipt must be in the nature of dividends. Therefore, the CIT(A) has rightly held that the assessee is entitled for the exemption Under Section 10(33). This ground is accordingly rejected.

47. The second ground raised by the Revenue is that the CIT(A) has erred in deleting the addition of Rs. 6,80,129 being penalty charged by National Stock Exchange for violation of rules and regulations. The amount has been paid by the assessee company to NSE for regularising the violations committed in the matter of delay in reporting, fund shortage and other contractual violations. The payments were not made as penalty for contravention of any law of the land. There are all violations made by the assessee in the course of carrying on of its business as a share broker and not relating to violation of any law or opposed to public policy. The penalties were imposed by NSE for technical violations of its internal rules of business. Therefore, there is no reason to disallow the said expenditure. The CIT(A) has rightly deleted the disallowance.

48. The third ground raised by the Revenue is that the CIT(A) has erred in deleting the addition of Rs. 16,56,000 made by the assessing officer as interest attributable to interest bearing loans taken by the assessee but disbursed as interest free loans and advances. The CIT(A) has considered the issue in detail at pages 10, 11 & 12 of his order.

The CIT(A) has found the assessing officer himself has verified and found that loan funds were not utilised by the assessee for giving any interest free loans and advances. The CIT(A) had asked for a remand report from the assessing officer on this point. The assessing officer has not given any adverse finding which is specific against the assesse even in the remand report. When the assessing officer has not pointed out any case where the assessee had utilised interest bearing loan funds for non business purposes, the normal presumption is that interest bearing loan funds were used by the assessee for its business purpose. Therefore, the CIT(A) has rightly deleted the said disallowance relating to interest.

50. In result, the appeal filed by the assessee is partly allowed and the appeal fifed by the Revenue is dismissed.