

Chapter - 1

Introduction

Under the Income-tax Act, a receipt is income when it accrues, arises or is received, or when it is by fiction deemed to accrue, arise or is deemed to be received. Receipt is not the only test of chargeability to tax; if income accrues or arises it may become liable to tax. The two words are used to contra-distinguish the word "receive" income is said to be received when it reaches the assessee: when the right to receive the income becomes vested in the assessee, it is said to accrue or arise. It is noteworthy that the Income Tax Act nowhere provides that whatever is received by a person must be regarded as income liable to tax. In all cases in which a receipt is sought to be taxed as income, the burden lies upon the department to prove that it is within the taxing provision. However, if the receipt is in the nature of income, the burden of proving that it is not taxable, because it falls within an exemption provided by the Income Tax Act, lies upon the assessee.

Deeming provision has to be interpreted strictly

It is settled principle of interpretation of tax statute that a deeming provision has to be interpreted strictly in terms of the language employed. It is also a cardinal principle of interpretation of taxing statute that a deeming fiction over a deeming fiction cannot be applied.

Concept of deemed income

In Black's Law Dictionary, word 'deemed' has been defined as under:—

"To treat (something) as if (1) it were really something else, or (2) it has qualities that it does not have although the document was not in fact signed until April 21, it explicitly states that it must be deemed to have been signed on April 14(2). To consider, think, or judge she deemed it necessary.

"Deem' has been traditionally considered to be a useful word when it is necessary to establish a legal fiction either positively by deeming something be what it is not or negatively by 'deeming' something not to be what it is...All other uses of the word should be avoided.... Phrases like 'if he deems fit' or 'as he deems necessary' or nothing in this Act shall be deemed to...'are objectionable as necessary deviations from common language. 'Thinks' or 'considers' are preferable in the first two examples and 'construed' or 'interpreted' in the third...Deeming' creates an artificiality and artificiality should not be resorted to if it can be avoided. "G.C. Thornton, Legislative Drafting 99 (4th ed. 1996)"

The word 'deemed' is frequently used, in law, to create a legal fiction which means for the purpose of respective law. What is deemed to be, must be regarded as being, in fact also.

In *Sudha Rani Garg v. Jagdish Kumar*, AIR 2004 (SC) 5120, their Lordships ruled that the word 'deemed' is used to put beyond doubt a particular construction that might otherwise be uncertain.

The court clarified that a "deemed" provision is a legal fiction, created to establish a fact without needing further evidence. The Supreme Court held that the word "deemed" in a statute is used to create a legal fiction to remove doubt or uncertainty about a particular construction.

In *Rishabh Agro-Industries Ltd. v. P.N.B. Capital Services Ltd.*, (2000) 25 SCL 461, their Lordships held that the word 'deemed' means 'supposed', 'considered', 'construed', 'thought', 'taken to be', or 'presumed'.

In *Governor of Andhra Pradesh v. H.E.H., Nizam* (1996) 3 SCC 282, their Lordships ruled that the word 'deemed' used in section 10(3) of the Act is used to give effect to the operation of a statutory provision from a particular date or from the date the Act was brought into force.

In *Consolidated Coffee Ltd. v. Coffee Board*, AIR 1980 (SC) 1468, their Lordships held that a deeming provision might be made to include what is obvious or what is uncertain or to impose, for the purpose of a statute, an artificial construction of a word or phrase that would not otherwise prevail. The Hon'ble Apex Court held as under—

"the word 'deemed' is used a great deal in modern legislation in different senses and it is not that a deeming provision is every time made for the purpose of creating a fiction. A deeming provision might be made to include for the purpose of a statute an artificial construction of a word or phrase that would not otherwise prevail but in each case it would be a question as to with what object the Legislature has made such a deeming provision."

In *CIT v. Calcutta Stock Exchange Association* (1959) 36 ITR 222 (SC), their Lordships held that the use of word 'deemed' shows that the Legislature is deliberately using the fiction of law treating a thing as something which otherwise may not have been.

The Hon'ble Supreme Court in *Commissioner of Income-tax/Excess Profits Tax, Bombay City v. Bhogilal Laherchand* (1954) 25 ITR 50 (SC) while interpreting Section 4 of the Income-tax Act held that the term 'deemed' brings within the act of chargeability income not actually accruing but which is supposed notionally to have accrued.

Thus, whenever word 'deemed' is used in the statute in relation to a person or thing, it implies that the legislature after due consideration exercised their judgment in conforming with the status attributed to a person or thing. It follows that deemed income does not have any source, it neither accrues nor arises nor is received or is deemed to be received. There is no right to receive such deemed income. Where conditions laid down in the relevant provision (like Sections 102/103, etc.) are satisfied then cash credits or investments or expenditures are deemed as incomes for aggregation purposes. One cannot infer that same cash credit could be deemed income in two hands. It will be deemed income (like the one under section 102) in the hands of the person in whose book credits appear. In the hands of other person, it cannot be taxed under section 102 as deemed income.

Sections dealing with Deemed Income

S. No.	Section	Corresponding to the Income Tax Act, 1961	
1.	2(40)(e)	2(22)(e)	Deemed dividend
2.	2(49)(o)	2(24)(x)	
3.	2(49)(p)	2(24)(xi)	Any sum received under Keyman Insurance Policy
4.	7	7	Incomes to be deemed to be received in the tax year
5.	8	9B	Income on receipt of capital asset or stock-in-trade by specified person from a specified entity on dissolution or reconstitution
6.	9	9 & 9A	Income deemed to accrue or arise in India
7.	26(2)(h)	28(va)	Income referred to in Section 26(2)(h)
8.	26(2)(j)	28(via)	Fair Market Value of Inventory referred in section 28(via)
9.	29(1)(e)	36(1)(va)	Employee's contribution deposited after due date prescribed under relevant statute
10.	36(5)	40A(3A)	Deemed earlier allowed expenditure as business income
11.	38	41	Deeming provisions of Section 41
12.	92(2)(h)	56(2)(ix)	Forfeiture of advance money on failed negotiation
13.	92(2)(m)	56(2)(x)	Money/Property received without consideration or inadequate consideration
14.	95	59	Profits chargeable to tax

15.	102	68	Unexplained Credits
16.	103	69	Unexplained investment
17.	104	69A	Unexplained asset
18.	105	69C	Unexplained expenditure
19.	106	69D	Amount borrowed or repaid through negotiable instrument, Hundi, etc.
20.	195	115BBE	Tax on Income referred to in Sections 102 or 103 or 104 or 105
21.	278	145B	Taxability of certain Income
22.	320	176	Recovery after Discontinuance of Business or Profession
23.	352	115TD, 115TF	Tax on Accreted Income

Chapter - 2

Deemed Dividend

[Section 2(40)(e)]

[Corresponding to Section 2(22)(e) of the Income Tax Act, 1961]

Section 2(40) of the Income Tax Act, 2025 provides the definition of “dividend.” Specifically, sub-clause (e) deals with what is commonly known as “Deemed Dividend.” Under this provision, a “dividend” includes any payment by a company (which is not a company in which the public are substantially interested) of any sum by way of advance or loan to :

- A shareholder who is the beneficial owner of shares holding not less than 10% of the voting power.
- Any concern (like a firm, HUF, or AOP) in which such a shareholder is a member or partner and has a substantial interest (usually 20% or more).
- Any person, on behalf of, or for the individual benefit of such a shareholder.

If a company (which is not a company in which public are substantially interested) makes any payment by way of loan or advance to a shareholder, who holds not less than 10% of the voting power in the company, such receipt will be deemed to be dividend income in hands of the receiving shareholder. This section also covers instances where, if such company gives loans or advance to any concern in which such shareholder is a member/partner beneficially holding at least 20% of its income, such receipt will also be deemed to be dividend income for the receiving shareholder.

However, the amount of such deemed dividend will be restricted to the accumulated profits in the company. Thus, if a Pvt. Ltd. Company gives a temporary loan to one of its shareholders (say Mr. A) holding more than 10% of voting power, the said amount will be deemed as dividend income in the hands of Mr. A. Further, if a Pvt. Ltd. Company gives temporary loan to another company in which Mr. A owns more than 20% shares, the amount shall also be deemed as dividend income in the hands of Mr. A.

Therefore, even if such shareholder has received temporary money from the company which he has returned to the company after a certain period of time, the receipt will be deemed to be his dividend and he will be required to pay tax on such ‘deemed income’.

To understand how Section 2(40)(e) works in practice, imagine a scenario involving a closely-held company (one where the public does not trade shares) and its major shareholder.

The Scenario

Let's look at XYZ Pvt. Ltd., a private company with two shareholders.

- Shareholder A : Owns 15% of the shares (Voting Power).
- Shareholder B : Owns 85% of the shares.
- Accumulated Profits : The company has undistributed profits of ₹ 50,00,000.

The Transaction

In October 2025, Shareholder A wants to buy a personal luxury car. Instead of the company paying him a "dividend" (which he would have to pay tax on immediately), the company gives him a "Personal Loan" of ₹ 10,00,000 at a 0% interest rate.

APPLICATION OF SECTION 2(40)(e) :

Under the Income Tax Act, 2025, the tax authorities will look at this "loan" and treat it as a Deemed Dividend:

- (i) Is it a Private Company? Yes (XYZ Pvt. Ltd).
- (ii) Is the Shareholder "Substantial"? Yes, Shareholder A owns 15% (the threshold is 10%).
- (iii) Are there profits ? Yes, the company has ₹ 50,00,000 in accumulated profits.
- (iv) The Result: Even though the company's books call it a "loan," the tax department will reclassify the ₹10,00,000 as Dividend Income for Shareholder A.

Alternative Example: The "Concern" Route

Section 2(40)(e) also catches indirect payments.

- Shareholder A (the 15% owner) is also a Partner in a Law Firm.
- XYZ Pvt. Ltd. gives a loan of ₹ 5,00,000 to that Law Firm.
- The Result: Because Shareholder A has a "substantial interest" in the Law Firm, that ₹ 5,00,000 is treated as a Deemed Dividend taxable to Shareholder A.

Example - [Exception (Not Deemed Dividend)]

- Finance company whose substantial business is money-lending
- Loan given in ordinary course of business
- Not treated as deemed dividend.

NOTE:

- Taxable only to the extent of accumulated profits (including reserves, excluding capitalised profits in certain cases).
- Applies only to closely held companies.

- Trade advances in ordinary business transactions (genuine commercial transactions) generally excluded.
- Repayment of loan does not undo taxability once attracted.

Deemed dividend

Text of Section 2(40(e) of the Income Tax Act, 2025

- (e) *any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise), —*
- (i) *as an advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend, with or without a right to participate in profits) holding not less than 10% of the voting power; or*
 - (ii) *as an advance or loan to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (herein referred to as the said concern); or*
 - (iii) *made on behalf, or for the individual benefit, of any such shareholder,*
to the extent to which the company in either case possesses accumulated profits;

FOR EXAMPLE

XYZ Ltd., gave a loan of Rs. 2,00,000 to Mr. A who had 12% shares in the company. The loan is still outstanding. Thereafter the company declared dividend and has to pay a dividend of Rs. 40,000 to Mr. A and the same is set off against such loan. In this case Rs. 2,00,000 shall be deemed dividend in the hands of Mr. A.

However, dividend of Rs. 40,000 which has been set off against such loan would not be liable to tax in the hands of Mr. A. But if such dividend has been declared after the loan is refunded by Mr. A, then Mr. A would be liable to pay tax on Rs. 40,000.

Distribution of accumulated profits by way of advance or loan – Deemed dividend [Section 2(40)(e)]

Any payment by a company (other than a company in which the public are substantially interested), of any sum (whether as representing a part of the assets of the company or otherwise) by way of advance or loan, to the extent of accumulated profits (excluding capitalised profits) to —

- (a) an equity shareholder, who is beneficial owner of shares holding not less than ten per cent of the voting power; or
- (b) any concern in which such shareholder (holding not less than 10% voting power) is a member or a partner and in which he has a substantial interest; or

- (c) any person, on behalf, or for the individual benefit, of any such shareholder. Such shareholder here means a shareholder who is beneficial owner of share holding not less than 10% voting power, shall be treated as deemed dividend in the hands of the shareholder.

Application of Dividend Distribution Tax to Deemed Dividend under section 2(22)(e) of the Income-tax Act, 1961 [Applicable up to Assessment year 2020-21]

With effect from 01.04.2018, Dividend Distribution Tax chargeable under section 115-O also included dividend under section 2(22)(e) in the hands of company @ 30% (without gross up). With effect from 01.04.2018, Dividend Distribution Tax (DDT) structure—

- Dividend covered under section 2(22)(a) to 2(22)(d) – DDT @ 15% (with gross up)
- Dividend covered under section 2(22)(e) – DDT @ 30% (without gross up)

Deemed Dividend under section 2(22)(e) of the Income Tax Act, 1961 is chargeable to Dividend Distribution Tax (DDT) @ 30% in hands of closely held company.

Conditions for applicability of section 2(40)(e)

- (a) It should be a closely held company. There must be a payment by the company not being a company in which public are substantially interested (i.e. closely held company). This would mean that only private limited companies would be covered and the listed companies obviously are outside the scope of this provision.
- (b) The payment is made to a shareholder being a person who is the beneficial owner of shares. The requirement is not registered ownership and it is the beneficial ownership of shares if held by the recipient, then such advance or loan is covered.
- (c) It should not be banking or money landing company.
- (d) The person to whom loans and advances have been granted should have substantial interest in that company at that time. The term 'substantial interest' for this purpose would mean beneficially entitled to not less than 20% of the income of such concern.
- (e) The recipient shareholder must hold not less than 10% of the voting power in the company.
- (f) Whether loan or advance is given on interest or not, does not effect the applicability of section 2(40)(e).
- (g) The shareholder should have 10% voting power on the date the advance or loan is given to him whereas if the loan is given to a

concern in which such shareholder has 20% share in profits/voting power, both the following conditions are to be satisfied:

- (i) the shareholder should have 10% voting power in the closely held company on the date when loan is given to the concern and
 - (ii) the shareholder should have 20% share in profits/voting power in the concern to whom loan is given at any time during the previous year. However, he should be a member/partner on the date the loan is given to such concern.
- Treated as dividend to the extent to which the company possesses accumulated profits.

In other words, following conditions are required to be fulfilled for the applicability of section 2(22)(e):—

- TYPE OF COMPANY – should be one in which the public are not substantially interested i.e. should be a closely held company.
- PERSON – should be a shareholder having not less than 10% of voting power.
- PAYMENT – should be by way of Advance or Loan, and made out of Accumulated Profits of the company.
- In case loan or advance is to a concern, shareholder should have a substantial interest in that concern at any time during the year.

Substantial Interest

A person shall be deemed to have a substantial interest in a concern other than a company if he is, at any time during the previous year, beneficially entitled to not less than 20% income of such concern. In the case of a company, if he beneficially holds atleast 20% equity capital of the company.

This provision is applicable only with effect from 01.06.1987 and is applicable only to companies in which the public are not substantially interested, i.e., closely held companies. Further, such loan and advance given to such person shall be deemed to be dividend only to the extent to which it is shown that the company possesses accumulated profits on the date of loan, etc. (exclusive of capitalised profits).

Meaning of Accumulated Profits

All profits upto the date of distribution or payment. Except for section 2(22)(c) wherein all profits upto the date of liquidation.

Purpose of the section and its interpretation

The purpose of the section is to check tax evasion in closely held companies. In *CIT v. P.V. John (1990) 181 ITR 1 : 52 Taxman 221 (Ker.)*, the High Court explains it as below:

“The purpose of enacting section 2(22)(e) is considered by the Supreme Court in the decision reported in Navnit Lal C. Javeri v. K. K. Sen, AAC (1965) 56 ITR 198 and held that the declaration of dividend in closely held company, normally, will be within the discretion of that group. When the Legislature realised that though the money was reasonably available with the company in the form of profits, those in charge of the company deliberately may refuse to distribute it as dividends to the shareholders, but adopt the device of advancing the said accumulated profits by way of loan or advance to one of its shareholders, to evade the payment of tax on accumulated profits. Therefore, it is provided that if a closely held company adopts a device of making an advance to one of its shareholders, such shareholder will be deemed to have received the said amount out of the accumulated profits and would be liable to pay tax on the basis that he has received the said loan by way of dividend. So also is the case of payments on behalf of the shareholder or payments to his benefit. It is this kind of well planned device which the section intends to reach for the purpose of taxation. The fiction created for a particular purpose cannot be extended beyond the purpose for which it is intended. Legal fictions are created for definite purposes and are limited for the purposes for which they are created and should not be extended. Since a fiction has been introduced to bring amounts paid otherwise than as dividend, as generally understood, into the net of dividend for the purpose of taxation, it has been held that the language of section 2(22)(e) should be given a strict construction.”

From the judgment of the Apex Court in *Navnit Lal C. Javeri v. K.K. Sen, AAC (1965) 56 ITR 198*, it appears that the Assessing Officer is not required to prove that the transaction is a device to invoke section 2(22)(e) and deem the loan or advance or benefit as a dividend and he can straightaway invoke the section if the conditions laid therein are met. No onus is cast on the Assessing Officer to prove the transaction to be a device to evade tax on income or dividend and that is what is meant by statement above.

Repayment of Loan

Section 2(22)(e) of the Income-tax Act, 1961 is applicable even if loan is repaid before the end of the previous year.

As per section 56(2)(i), dividends are always taxed under this head. However, dividends from domestic company other than those covered by section 2(22)(e) are exempt from tax under section 10(34). Dividend received from domestic company shall be exempt from tax under section 10(34) if it is chargeable to dividend distribution tax under section 115-O. However, as per section 115BBDA (as inserted by Finance Act, 2016), in the case of resident individual/HUF/firm, dividend shall be chargeable to tax at the rate of 10% if aggregate amount of dividend received during the year exceeds Rs. 10,00,000.

Business transactions are out of the purview of provisions of section 2(22)(e) of the Income-tax Act, 1961

As per the exceptions to clause (e) to section 2(22) provides as under:

‘But “dividend” does not include (ii) any advance or loan made to a shareholder or the said concern by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.

Therefore, the provisions of section 2(22)(e) shall not apply if—

1. payment is in the nature of an advance or loan, and
2. loan is in the ordinary course of business of money lending.

No deemed dividend under section 2(22)(e) of the Income-tax Act, 1961 on trade advance in the nature of commercial transactions

CBDT vide Circular No. 19/2017, dated 12.06.2017 has clarified that trade advances which are in the nature of commercial transactions would not fall within the ambit of word “advance” for the purposes of section 2(22)(e) of the Act and, as a result, does not qualify as dividend under such clause.

The above clarification has been issued by CBDT in the light of the various judgments wherein consistent view has been adopted on this issue.

CBDT Circular No. 19/2017, dated 12.06.2017**Subject: Settled View on section 2(22)(e) of the Income Tax Act, trade advances - Regarding**

Section 2(22)(e) of the Income Tax Act, 1961 (the Act) provides that “dividend” includes any payment by a company, not being a company in which the public are substantially interested, of any sum by way of *advance* or *loan* to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern) or *any payment* by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits.

2. The Board has observed that some Courts in the recent past have held that trade advances in the nature of commercial transactions would not fall within the ambit of the provisions of section 2(22)(e) of the Act. Such views have attained finality.