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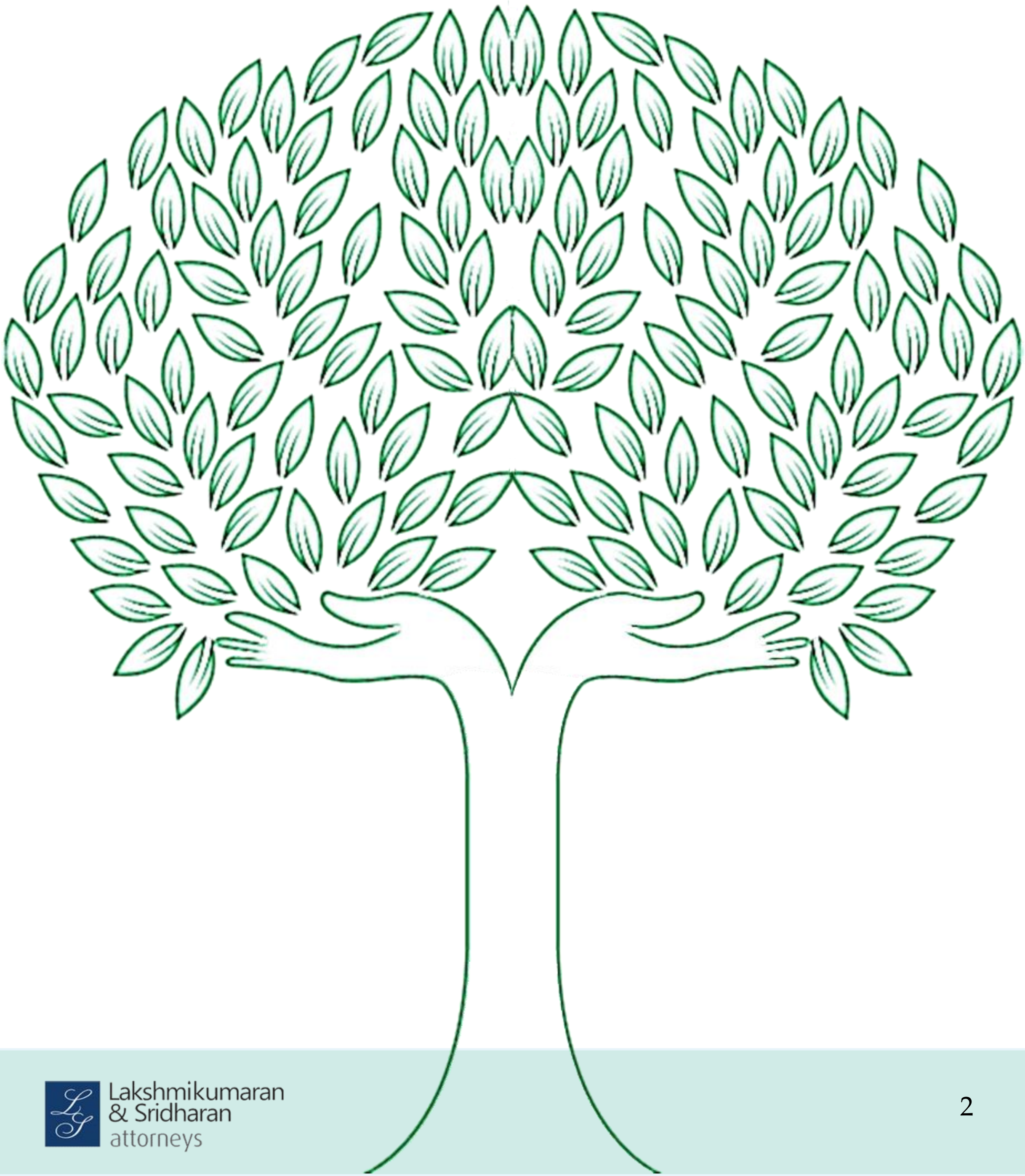

Article

Disallowance under Section 40(a)(i) on payment made to non-residents – Whether violative of Non-Discrimination Article in tax treaty?

By **Harshit Khurana and Kanupriya Sharma**

This article in this issue of Direct Tax Amicus seeks to analyze the applicability of the non-discrimination article in tax treaties on disallowance of expenses on payment made to non-residents without withholding the applicable taxes. Decoding the legal position, the authors delve into the litigation trends and ponder over the question as to whether Section 40(a)(i) of the Income Tax Act, 1961 in its present form is violative of non-discrimination Article in tax treaty. They in this regard discuss various arguments which may be taken both by the taxpayer and the taxman. According to them, the strength of taxpayer's arguments may outweigh the Taxman's arguments.

Disallowance under Section 40(a)(i) on payment made to non-residents – Whether violative of Non-Discrimination Article in tax treaty?

By Harshit Khurana and Kanupriya Sharma

The Indian domestic tax laws contain certain provisions which provide differential tax treatment in transactions involving residents and non-residents. Some of the provisions have the effect of causing discrimination in transactions involving non-residents. While the domestic tax law does not contain any provisions which seek to prevent such discrimination, the tax treaty comes to the rescue of the taxpayers in such situations. In most of the tax treaties entered by India, there exists a non-discrimination article which seeks to prohibit discrimination based on nationality or residency in the tax framework in certain situations. One of the situations dealt with in the article seeks to prevent disallowance of expenses paid to non-residents, if such expenses are allowable in cases where payment is made to residents.

This article seeks to analyze the applicability of the non-discrimination article on disallowance of expenses on payment made to non-residents without withholding the applicable taxes.

Decoding the legal position

Section 40(a)(i) of the Income Tax Act, 1961 ('**IT Act**') disallows any sum, chargeable to tax under the IT Act, paid by a taxpayer to a non-resident without deduction of tax at source ('**TDS**'), in calculating the income of the assessee. Further, sub-clause (ia) disallows only 30% of any sum paid by a taxpayer to a resident without deduction of the applicable TDS, in calculating the income of the taxpayer.

The non-discrimination article in majority of the tax treaties provides that interest, royalties, and other disbursements paid by a resident of India to a resident of the other country (e.g., USA) shall, for the purposes of determining the taxable profits of the Indian entity, be deductible **under the same conditions** as if they had been paid to a resident of India. The said rule is not applicable in case the discrimination is on account of Article 9 (Associated Enterprise) wherein disallowance can be made if the transaction is between Associated Enterprises ('**AEs**') and the pricing is not at arm's length.

Litigation trends

In the past, there has been litigation in India on the applicability of non-discrimination article on disallowance of expenses paid to non-residents under Section 40(a)(i) of the IT Act. The provisions of Section 40(a) have undergone significant amendments since its introduction. Till 2004, only the expenses paid to non-residents could be disallowed under Section 40(a)(i) and there was no provision for disallowing expenses upon non-deduction of tax in case of payments to resident. Section 40(a)(ia) was introduced into the IT Act *vide* the Finance Act 2004. However, at that point of time, the provision was made applicable for disallowing certain specific expenses incurred towards residents which included interest, commission, fees for professional or technical services. Subsequently, the provision was again amended *vide* the Finance Act, 2014 and by virtue of the amendment all payments made to residents without deduction of applicable TDS were covered within the ambit of Section 40(a)(ia). However, the quantum of disallowance was restricted to 30% of the payment in case of payment to residents.

In the case of *Herbalife International*[1], the relevant period in question pertained to AY 2001-02 *i.e.*, before the insertion of sub-clause (ia) to Section 40(a). The taxpayer had made payment for fee for technical services to non-resident AE without deduction of TDS. In said facts, the Hon'ble Delhi High Court held that the expenses paid to USA resident could not be disallowed due to application of the non-discrimination article in the tax treaty. In view of the Court, by requiring the taxpayer to deduct TDS upon payment to non-resident, an additional condition was imposed for claiming the expense. This condition was not present when payment was made to residents. The Court also observed that the fact that the payment was made to AE would not change the conclusion. This is because the disallowance in Section 40(a)(i) was not dependent on whether the payee is AE or not. Also, as an undisputed fact, the disallowance was not on account of application of transfer pricing principles.

Recently, in the case of *Mitsubishi Corporation*[2], the High Court of Delhi decided the matter in favour of the taxpayer by concluding that purchases made by a resident taxpayer from non-resident having PE in India could not be disallowed due to application of non-discrimination article in the tax treaty. The

[1] *CIT* v. *Herbalife International India (P.) Ltd* [2016] 69 taxmann.com 205 (Delhi)

[2] *Mitsubishi Corporation India Pvt. Ltd.* [TS-106-HC-2024 (DEL)].

Court observed that in the case of similar purchases made from residents, no disallowance could be made for AY 2006-07 for default of deduction of tax at source. Thus, the Court held that disallowing expenses for default of tax deduction where similar purchases were made from non-residents having PE in India triggered non-discrimination which was not permitted as per the tax treaty. For arriving at the conclusion, the Court followed the ruling in the case of *Herbalife* (*supra*). Similar view has been expressed in the case of *Honda Cars India Ltd.*[3] by ITAT Delhi Bench.

Section 40(a)(i) in its present form violative of non-discrimination Article in tax treaty?

Post amendment made by the Finance Act, 2014, while parity has been achieved in the scope of payments which can be disallowed in case of payments to resident and non-resident, there still exists disparity in the quantum of payments which can be disallowed. Although sub-clause (i) disallows the entirety of a sum paid to a non-resident without deduction of TDS, sub-clause (ia) disallows only 30% of a sum paid to a resident without deduction of TDS.

In view of the above disparity, it can be argued that the non-discrimination article in tax treaties should be triggered to prevent excess disallowance of 70% in case of payment to non-residents. This is because the conditions imposed for allowability of expenses paid to non-residents are discriminatory as compared to allowability of similar payment made to residents.

The Taxman may argue that the difference in quantum of disallowance is not discriminatory as the non-discrimination article only requires that the condition for disallowance of expense in case of non-residents should not be discriminatory. It does not refer to the quantum of expense which can be disallowed. Accordingly, by covering the same scope of payments within the purview of clause (i) and (ia) of Section 40(a), the provision is no more discriminatory. The Revenue may also argue that the scope of non-discrimination article is restricted to differential treatment of expenses incurred towards residents and non-residents. Normally, if a payer complies with tax deduction obligation, the provisions of IT Act do not discriminate claim of deduction in relation to expenses incurred towards resident and non-residents. Thus,

[3] *Honda Cars India Ltd.* v. *Deputy Commissioner of Income-tax, (LTU) New Delhi*, [2016] 72 taxmann.com 253 (Delhi - Trib.).

principally, there is no discrimination if requisite taxes are deducted at source. The disallowance under Section 40(a)(i) or Section 40(a)(ia) is a consequence of default of deduction of tax at source. Thus, the differential treatment is a consequence of default of compliance of tax deduction. Seen from this perspective, the Taxman could argue that the scope of non-discrimination article does not extend to circumstances where differential treatment is extended because of default in compliance with the provisions of domestic law.

In Authors' view, since the consequence of non-compliance is intended to interfere with the claim of deduction of expense, the non-discrimination provisions should apply if a differential treatment is offered for payments made to residents and non-residents. Given the fact that only 30% of payment is disallowed upon payment to residents, the said condition should equally apply even in case payment is made to non-resident due to application of the non-discrimination article in the tax treaty. Accordingly, excess disallowance of 70% on payment made to non-residents can be argued to be discriminatory.

Conclusion

The application of the non-discrimination article in relation to Section 40(a)(i) of the IT Act, as it exists today, is yet to be tested before Courts. This issue is likely to yield another round of litigation in the future. While it will be interesting to see the tussle between the Taxpayer and the Taxman, in authors' view, the strength of taxpayer's arguments may outweigh the Taxman's arguments. In cases where dispute is already pending under Section 40(a)(i), the Taxpayer will be keen to add another leg of argument to strengthen their position and reduce the risk of disallowance to 30% of the total disallowance.

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Notifications & Circulars

- Trusts – Taxability of balance 15% of donations made to other trust/fund
- Trusts – Form 10B and 10BB – Timelines extended to 31 March 2024 in certain cases
- Jurisdiction of certain Principal Chief Commissioners of Income-tax
- Exchange of information with respect to taxes – Agreement between Government of India and Government of Samoa notified
- Income Tax Return Forms 2, 3 and 5 – Certain changes notified
- Income Tax Return-7 notified
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Trusts – Taxability of balance 15% of donations made to other trust/fund

Income of any trust or institution referred to in sub-clause (iv), (v), (vi) or (via) of Clause (23C) of Section 10 of the Income Tax Act or any trust or institution registered under Section 12AA or 12AB of the Act is exempt, subject to the fulfilment of certain conditions as provided under the respective sections of the Act. These conditions *inter-alia* include the following for the trusts/institutions:

- At least 85% of income of trust/institution should be applied during the year towards the charitable or religious purposes;
- Trust/institutions are allowed to apply mandatory 85% of their income either themselves or by making donations to the trust/institution with similar objectives; and
- If donated to other trust/institution, the donation should not be towards corpus to ensure that the donations are applied by the donee trust/institution for charitable or religious purposes.

In order to ensure intended application towards charitable or religious purposes, Finance Act, 2023 has inserted clause (iii) in Explanation 2 to third proviso of clause (23C) of Section 10 of the Act and clause (iii) in Explanation 4 to sub-section (1) of Section 11 of the Act. The said amendments have provided that eligible donations made by a trust/institution shall be treated as application for charitable or religious purposes only to the extent of 85% of such donations.

Consequent to the said amendment, various queries were received by the CBDT raising the concern whether the balance 15% of donation to other trust / institution would be taxable or is eligible for 15% accumulation since the funds would not be available having been already disbursed.

In this regard, the CBDT has *vide* Circular No. 3/2024, dated 6 March 2024 clarified that donations made by trusts or institutions to others for charitable purposes will be considered as application towards charitable or religious purposes to the extent of 85%. The remaining 15% will not require investment in specified modes as given under Section 11(5), ensuring the entire donated amount is exempt under applicable regimes as mentioned in Section 10(23C) and Section 11(1).

Trusts – Form 10B and 10BB – Timelines extended to 31 March 2024 in certain cases

The due date to file Form 10B and 10BB has been extended from 31 October 2023 to 31 March 2024 *vide* Circular No. 2/2024 dated 5 March 2024 in certain cases. Accordingly, trusts/institutions which have furnished audit report on or before 31 October 2023 in Form No. 10B where Form No. 10BB was applicable and *vice-versa*, need to furnish the audit report in the applicable Form No. 10B/10BB for the assessment year 2023-24, on or before 31 March 2024.

Jurisdiction of certain Principal Chief Commissioners of Income-tax

Section 118 of the Income Tax Act, 1961 ('**Act'**) provides that the Central Board of Direct Taxes ('**CBDT**') has power to specify the hierarchy of income tax authorities. The CBDT *vide* Notification No. 106/2022/F. No. 279/Misc./66/2014-ITJ(Pt.) dated 2 September 2022, had already notified the hierarchy for the income tax authorities as mentioned in the Schedule given in such notification. However, with effect from 22 January 2024 in the Notification No. 20/2024/F. No. 279/Misc./66/2014-ITJ(Pt.) dated 6 February 2024, the CBDT has inserted another Schedule called 'Second Scheule' comprising of the jurisdiction of 4 Principal Chief Commissioners of Income-tax and the Commissioners of Income Tax (Appeals) subordinate to them.

Exchange of information with respect to taxes – Agreement between Government of India and Government of Samoa notified

Clause (c) of sub-section 1 of Section 90 of the Income-tax Act provides that the Central Government ('**CG**') may enter into agreement with the Government of any country outside India for exchange of information for the prevention of evasion or avoidance of income tax under the Act. The CG entered into an agreement with Government of Samoa for exchange of the said information. With effect from 12 September 2023, the CBDT *vide* Notification No. 21/2024, F. No. 503/06/2012-FTD.II dated 7 February 2024, has notified that all the provisions of the said agreement shall be given effect to in the Union of India.

Income Tax Return Forms 2, 3 and 5 – Certain changes notified

The CBDT has *vide* Notification No. 22/2024/ F. No. 370142/47/2023-TPL dated 21 February 2024, notified certain charges in ITR Form No. 2, 3 and 5. The said changes made in the forms are as under:

S. No.	ITR Form	Schedule	Changes Notified
1.	2	80DD	- Schedule 80DD has been revised.
2.	3	80DD	- Schedule 80DD has been revised.
		80U	- Schedule 80U has been revised.
3.	5	CG	- In row B, in sub-row (1), in item (d), Section 54D/54EC/54G/54GA is substituted in place of Section 54EC/54G/54GA.
			- In row B, in sub-row (10), in the table item (a), in row (ii), section 54D/54EC/54G/54GA is substituted in place of section 54EC/54G/54GA.

Income Tax Return-7 notified

The CBDT has *vide* Notification No. 24/2024/F. No. 370142/1/2024-TPL (Part-1) dated 1st March 2024 notified ITR-7 [For persons including companies required to furnish return under Sections 139(4A) or 139(4B) or 139(4C) or 139(4D) only] under Section 139 of the Income-tax Act for AY 2024-25.

Expenditure on scientific research under Section 35 – Panjab University notified

Clause (ii) of sub-section (1) of Section 35 of the Income-tax Act provides for specifying association, university, college or other institution to which sum can be paid for scientific research and deduction to the extent of 150% can be availed of such amount paid. The CBDT *vide* Notification No. 23/2024, F. No. 203/24/2023/ITA-II dated 26 February 2024, has approved 'Panjab University, Chandigarh (PAN: AAAJP0325R)' under the category of 'University, College or other institution'. This notification shall be applicable from Assessment Years 2024-25 to 2028-29.

Ratio Decidendi

- Payment to non-residents not to be disallowed under Section 40(a)(i) (existing for AY 2006-07), being violative of non-discrimination article in tax treaty – Delhi High Court
- Royalty and FTS under India-UK DTAA – Undertaking of background checks of employees or verification services is not covered – Delhi High Court
- Disallowance under Section 14A cannot be computed without examining correctness of the claim regarding expenditure incurred for earning exempt income – ITAT Mumbai
- Letter of comfort declared as contingent liability in financial statement should be treated as a corporate guarantee which requires charging of arm's length consideration – ITAT Mumbai
- Excess TDS deposited on basis of estimated earnings cannot be unjustifiably retained by Department if conditions of CBDT Circular dated 23 October 2017 are satisfied – Delhi High Court
- Deemed dividend – Section 2(22)(e) is attracted in hands of entity who is beneficial owner of shares, and not in hands of borrower entity in which the beneficial owner holds substantial interest – ITAT Kolkata

Payment to non-residents not to be disallowed under Section 40(a)(i) (existing for AY 2006-07), being violative of non-discrimination article in tax treaty

In this case, the assessee-company entered into certain transactions with its group companies and resultantly made remittances without deducting tax at source. Such group companies were from USA, Japan, Thailand and Singapore. The matter was a reference before a third judge and arose as a result of the difference in opinion of the Division Bench.

Upon assessment, the Assessing Officer disallowed the payments made by the assessee to its group companies from being claimed as a deductible expenditure from the income of the assessee under Section 40(a)(i) of the Income-tax Act.

For applicability of Section 40(a)(i), the income should be chargeable to tax in India and TDS should be deducted on it. The AO found that all the recipients of payment by the assessee constituted PE in India and therefore held that the payments should have been subject to TDS.

The assessee did not contest the constitution of PE of the USA and Japan entities in India and instead resorted to Article 24(3) and 26(3) of the India-Japan and India-USA DTAA for non-applicability of Section 40(a)(i) on the ground that the section discriminated between a resident and a non-resident. Regarding the Thai and Singaporean entities, the Assessee contested that no PE was being constituted in the relevant year in India and therefore their business income was not chargeable to tax in India.

The ITAT on the issue of non-applicability of Section 40(a)(i) being discriminatory held that Article 24(3) and 26(3) of the India-Japan and India-USA DTAA were beneficial to the assessee and therefore the disallowance was directed to be deleted. With respect to the Thai and the Singaporean entities, ITAT held that no PE was constituted in India and hence no tax was to be withheld as Section 195 was not attracted.

As per Article 24(3) and 26(3) of the India-Japan and India-USA DTAA subject to condition prescribed, payments made by a resident to a non-resident, for the purpose of determining taxable profits, be deductible under the same condition as if the payment has been made to a resident.

The High Court held that Section 40(a)(i) as it existed in AY 2006-07 was discriminatory as it was only applicable to non-residents in the case of payment which fell under the phrase 'other sums chargeable to tax under the Income-tax Act'. Although the provision was amended by the Finance Act of 2014 and the pit was extended to residents as well, the same was seen as irrelevant in the present case.

Further, emphasizing upon the finding of ITAT that the Thai and Singaporean entities did not have PE in India, the High Court held that changeability to tax is the paramount condition for triggering any withholding obligation as per section 195(1). In absence of any income chargeable to tax, no TDS was required to be withheld and hence, no disallowance can be made under section 40(a)(i) of the Act. [*Commissioner* v. *Mitsubishi Corporation India P. Ltd.* – TS-106-HC-2024(DEL)]

Royalty and FTS under India-UK DTAA – Undertaking of background checks of employees or verification services is not covered

The assessee was a tax resident of the UK. During the AY 2019-20 and AY 2020-21, the assessee received certain amounts towards provision of services. The nature of services rendered by the assessee included verification, background screening, and due diligence services etc. The assessee claimed that the receipts from rendering services in India are exempt under India–UK DTAA.

The matter travelled before ITAT. The question before the ITAT was whether the reports provided by the assessee to its clients resulted in the use of copyright by its clients and resultantly chargeable to tax as royalty. Further, whether the services provided by the assessee to its clients could be classified as fee for technical services (FTS) for the purpose of Article 13(4) of the India-UK DTAA.

With respect to the royalty issue, the ITAT placed reliance on the judgement of Hon'ble Supreme Court in the case of *Engineering Analysis Centre of Excellence (P) Ltd.* v. *CIT* [2021] 423 ITR 471 (SC). The ITAT noted that the consideration received by the assessee under the terms of the agreement is purely towards provision of background screening services and does not include any consideration for use or right to use any copyright or a literary, artistic or scientific work, patent, trademark, design, model, plan, secret formula, or process or information. The ITAT also noted that the assessee does not provide access to its databases to its clients and therefore mere summary of personal details of the candidates would not amount to a transfer of skill or knowledge. Hence, the income was not to be treated as royalty under Article 13(3) of India-UK DTAA.

While dealing with the FTS issue, the ITAT held that the assessee's role was restricted to the verification of information and hence services rendered by the assessee did not involve any technical skill/ knowledge, experience, skill, know-how or process. Hence, the service was not considered as FTS under Article 13(4) of India-UK DTAA.

The High Court upheld the ITAT order and noted that mere undertaking of background checks of employees or verification cannot be classified as the use of technical knowledge or experience and that in the absence of transfer of data or information which could be described as "technical", the payment for services rendered by the assessee could not be classified as FTS under Article 13(4) of India-UK DTAA. [*Commissioner* v. *Hireright Ltd.* – TS-154-HC-2024(DEL)]

1) Disallowance under Section 14A cannot be computed without examining correctness of the claim regarding expenditure incurred for earning exempt income

2) Letter of comfort declared as contingent liability in financial statement should be treated as a corporate guarantee which requires charging of arm's length consideration

In the first issue, the assessee earned a certain dividend income which was claimed as an exempt under Section 10 of the Act. The assessee *suo-moto* made a disallowance of expense incurred for earning the aforesaid exempt income.

The AO disagreed with the correctness of the claim of expenditure made by the assessee and held that inadequate interest and administrative expenses have been disallowed for earning the exempt income. Accordingly, the AO computed the disallowance under Section 14A read with Rule 8D of the Rules, after considering the *suo-moto* disallowance made by the assessee.

The CIT(A), *vide* impugned order, restricted the quantum of disallowance made under Section 14A read with Rule 8D after granting relief to the assessee with respect to the proportionate interest amount computed on interest incurred for the normal running of the business. Both the assessee and authority appealed the order.

The ITAT by relying upon the case of *Godrej & Boyce Manufacturing Company Ltd.* v. *DCIT* - [2017] 394 ITR 449 (SC) observed that under Section 14A, satisfaction required to be recorded is not merely limited to disagreeing with the assessee. It also requires the AO to provide the basis for reaching the conclusion.

Upon perusal of the factual submission of the assessee and the findings of the AO it was held that the AO did not have any material on record to disregard the correctness of assessee's submission and accordingly the disallowance made by the AO was directed to be deleted.

In the second issue, the assessee had provided certain non-contractual letters of comfort/support to banks on behalf of its associate entities without charging any consideration. Subsequently, the associate entities were granted loans against the security of debt presented by the associate entities. No costs were incurred by the assessee for granting such letter of comfort and the assessee was not obligated to bear the cost of repayment of the loan in the event of default in repayment of the loan by the associate entities.

During the assessment proceeding, the AO made reference to the TPO for the determination of ALP. The TPO questioned the assessee on why the letter of comfort was not an international transaction and upon disagreement with the submissions of the assessee, the TPO classified such letters as a corporate guarantee. Accordingly, an upward transfer pricing adjustment was made to the income of the assessee.

The CIT(A) relied upon the position of the AO and merely reduced the quantum of the adjustment.

The ITAT upheld the findings of CIT(A) on the basis that the assessee had declared the letters of comfort/support issued to banks on behalf of its associate entities as its contingent liability in Notes to the Financial Statements for the relevant year. Further, the loan documents of one of the associate entities stated that the loan was granted considering the letter of comfort/support issued by the assessee.

Based on the above-mentioned observations, the ITAT upheld the findings of CIT(A). [*Asian Paints Ltd.* v. *Asstt. Commissioner* – TS-81-ITAT-2024(Mum)-TP]

Excess TDS deposited on basis of estimated earnings cannot be unjustifiably retained by Department if conditions of CBDT Circular dated 23 October 2017 are satisfied

The petitioner was engaged in the business of manufacturing and trading of molded plastic items. It imported molds during the concerned AY from a USA-based company and entered into a rental agreement with the USA company whereby the mold lease rent was agreed to be paid by the petitioner on the basis of actual production days. During the course of the business, certain deliberations were being made between the two entities to increase the rent. The petitioner made a provision for higher rentals in the books of accounts, even before the negotiation was finalized and accordingly deposited TDS on the revised rental figure.

Later, the negotiations did not result in any increase in the rent and this resulted in deposit of excess TDS by the petitioner. The petitioner made applications before the Assessing officer for a refund but no relief was provided. The petitioner referred to the CBDT circular dated 23 October 2017 which stipulates that in such cases where income does not either accrue to the non-resident or it accrues but the excess amount in respect of which refund is claimed, is borne by the deductor, then the TDS on the aforesaid income belongs to the deductor.

The petitioner filed a writ petition before the High Court against the orders passed by the income tax authorities. Before the High Court, the petitioner also submitted that if any amount which is credited to the Government does not fall into the category of tax, the said amount cannot be unjustifiably retained by the Government.

The High Court allowed the writ petition. It noted that since no income arose to the USA company *qua* the excess TDS paid by the petitioner, the respondents did not have the right to retain this amount. This is because Article 265 of the Constitution of India states that duty of imposition or collection of taxes can only be exercised by the authority of law and not otherwise. The High Court further held that the case of the petitioner squarely fell within the ambit of CBDT circular (*supra*). The High Court also placed reliance on the latin maxim "*jure naturae aequum est, neminem cum alterius detrimento, et injuria fieri locupletioremit*" which translates to and settles the position that by natural law, it is just that no one should be enriched by another's loss or injury. Put otherwise, no one can be unjustly enriched at the expense of others.

Consequently, the High Court held that by no prudent stretch of imagination, the tax authority was entitled to withhold the excess TDS deposited by the assessee by virtue of an anticipated liability for the relevant year and directed the tax authority to issue a refund of the excess TDS amount. [*Tupperware India Pvt. Ltd.* v. *Commissioner* – TS-87-HC-2024(DEL)]

Deemed dividend – Section 2(22)(e) is attracted in hands of entity who is beneficial owner of shares, and not in hands of borrower entity in which the beneficial owner holds substantial interest

The assessee was engaged in the business of brand owning and consultancy. During the relevant AY, the assessee received loans/advances from another group company APL. The assessee was not a shareholder in APL but both entities had a common shareholder (KSWPL). APL had accumulated profits available in its books.

During assessment, the AO in view of the above-stated facts treated the amount of loans/advances received by the assessee from APL as deemed dividend under Section 2(22)(e) of the Income-tax Act by virtue of common shareholding in both the entities. Upon appeal, the CIT(A) confirmed the addition made by the AO and made no further addition.

Upon further appeal, the ITAT examined the provisions contained under Section 2(22)(e). The ITAT noted that for application of this section, the payment either is directly received by the shareholder or is treated as deemed dividend in the hands of beneficial shareholders. The ITAT noted that in this case, KSWPL was in the position to control the affairs of both the lender and the assessee. As per Section 2(22)(e) and definition of substantial interest under Section 2(32), the beneficial ownership of shares is with KSPWL.

The ITAT held that the deeming fiction of Section 2(22)(e) can be applied only in the hands of KSWPL, who is the beneficial owner of shares in both the lender and the receiving companies. Therefore, the additions made in the hands of the assessee under Section 2(22)(e) were deleted. [*Apeejay Surrendra Management Services Pvt. Ltd.* v. *DCIT* – TS-130-ITAT-2024(Kol)]

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