INTER CORPORATE LOANS

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ADVANCED DIPLOMA IN CORPORATE TAXATION

NALSAR UNIVERSITY OF LAW

AGENDA FOR THE SESSION

1. Inter Corporate Deposits – ICD
2. Company law perspective
3. Loan vs Deposit
4. Multi sweep structure
5. Deemed dividend
6. GST perspective

INTER CORPORATE DEPOSITS

INTER CORPORATE DEPOSIT

- Terminology usually called as ICDs
- But is it a deposit?
- Companies Act makes it crucial to separate both

LOAN VS DEPOSIT

- The Word “Loan” is not defined anywhere in Companies Act, 2013. However in normal parlance any transaction in which money is given with the intention to be returned, with or without interest is loan.
- A deposit includes a loan, but every loan may not be a deposit.
- Deposits prohibited by private/ public limited companies unless authorized

DEFINITION OF DEPOSIT AS PER COMPANIES ACT

- As per section 73 Companies Act, 2013, deposit includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed.
- The Government through the Companies (Acceptance of Deposit) Rules, 2014 has notified which types of receipt of money does not classify as deposit.

EXCEPTIONS TO DEFINITION OF DEPOSIT

- Money received from the Central Government or a State Government or Local Authority or Statutory Authority, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government.
- Money received from foreign Governments, foreign or international banks, multilateral financial institutions (including, but not limited to, International Finance Corporation, Asian Development Bank, Commonwealth Development Corporation and International Bank for Industrial and Financial Reconstruction), foreign Governments owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to the provisions of Foreign Exchange Management Act, 1999.

EXCEPTIONS TO DEFINITION OF DEPOSIT

- Money received as a loan or facility from any banking company.
- Money received as a loan or financial assistance from Public Financial Institutions notified by the Central Government.
- Money received against issue of commercial paper or any other instruments issued in accordance with the guidelines of Reserve Bank of India.
- Money received by a company from any other company;
- Money received and held towards subscription to any securities, including share application money or advance towards allotment of securities pending allotment, so long as such amount is appropriated only against the amount due on allotment of the securities.

EXCEPTIONS TO DEFINITION OF DEPOSIT

- Money raised by the issue of bonds or debentures or bonds or debentures compulsorily convertible into shares of the company within five years.
- Money received from an employee of the company not exceeding his annual salary.
- Non-interest bearing money received or held in trust.
- Money received in the course of doing business.
- Money held as advance for the supply of goods or provision of services.
- Money brought in by the promoters of the company by way of unsecured loan.
- Money accepted by a Nidhi company.

LOAN VS DEPOSIT – TO CONCLUDE

- Hence, as per the definitions above, deposit is taken at the instance and for the benefit of the person depositing the money. Also, in deposit, the deposit is payable on demand of the depositor.
- In case of a loan, loan is taken at the instance or for the benefit of the person requesting the money. Loan are payable only when the obligation to repay the amount arises, as per the loan agreement.

GIVING LOANS UNDER COMPANIES ACT

- Section 186(2) of the Act states how a company can give loans and guarantees to other companies and body corporates. It states a company can directly or indirectly:
- Give loan to any other body corporate.
- Provide security or give a guarantee in connection with a loan given to any other body corporate.
- Acquire securities of other body corporates by way of purchase, subscription or otherwise.

- However, a company can give loans, guarantee and acquire securities of up to 60% of its paid-up share capital, securities premium account and free reserves or 100% its securities premium account and free reserves, whichever is more.

GIVING LOANS UNDER COMPANIES ACT

- A company cannot give an inter-corporate loan at a rate of interest lower than the prevailing yield of one, three, five or ten years of government security closest to the loan term.

- The company should disclose the following to its members in the financial statement:
  - Full particulars of the loans granted.
  - Full particulars of the investments made.
  - Full particulars of the guarantee or security provided.
  - Purpose for which the loan, guarantee or security is proposed to be utilised by the recipient of the loan, guarantee or security.

PROCEDURE TO GIVE LOANS UNDER COMPANIES ACT (1/2)

- Conduct a Board of Directors meeting after providing notices and proposals for giving an inter-corporate loan, guarantee or security within the prescribed limit provided under Section 186(2) of the Act.
- Pass a resolution in the meeting of the Board of Directors with the consent of all the directors present at the meeting for giving the inter-corporate loan, guarantee or security.
- The Board of Directors needs to check whether the company has an existing loan from a public financial institution. If there is an existing loan from a public financial institution, the prior approval of that public financial institution is needed to grant a subsequent loan to other companies.
- However, the prior approval of the public financial institution is not required when the grant of the aggregate loan, guarantee, investment, and security is within the prescribed limit provided under Section 186(2) of the Act, and there is no default in the repayment of the interest or loan to the public financial institution.
- The Board of Directors has to authorise one director or any other person to apply for the approval of the inter-corporate loan to be granted to other body corporates after deciding the fund and quantum of the loan.

PROCEDURE TO GIVE LOANS UNDER COMPANIES ACT (2/2)

- When the company grants loans, guarantee or securities above the prescribed limit provided under Section 186(2) of the Act, the Board of Directors need to conduct a general meeting with the shareholders after providing proper notices and pass a special resolution in the general meeting for granting such inter-corporate loan, guarantee or security.
- File the copy of the special resolution in Form MGT-14 with the required documents and pay the fee as prescribed under Companies Rules,2014 with the Registrar of Companies within 30 days of passing the resolution.
- Maintain the registers in the Form MBP-2 after providing the loan, guarantee, security or making an acquisition.
- Make entries in the register regarding the grant of each loan, guarantee, security or making an acquisition.
- The company must keep the register at its registered office, and it must be open to inspection. The company members can take extracts and copies from the register upon payment of the prescribed fees.
- The company must disclose particulars of the granted loans, guarantees, securities or investments made in the financial statements and the purpose for which such loan, guarantee or security is proposed to be used by the recipient of such loan, guarantee or security.
- Scrutinise the company's repayment history about the repayment of deposits or interest.

MULTI SWEEP STRUCTURES

- Loans from group entities
- Entity A and B have a common Parent Company P
- A has cash surplus and B has cash deficit
- Instead of going to external banks, Entity B will take surplus money from Entity A
- Since they have common parent P, deemed dividend provisions can become applicable?
- Daily settlement may happen instead of periodic
- P.S. Companies Act provisions – sections 185/186 to be followed as well
- P.P.S. FEMA to be evaluated as well in case all group entities are not in India

INCOME TAX IMPLICATIONS ON ICD

- No direct mention of ICDs under ITA
- Capital transactions
- Interest is taxable
- Effect – Deemed dividend!
- No clarity in law
- Case law driven

[CIT V. BAZPUR CO-OPERATIVE SUGAR FACTORY LTD., (1988) 38 TAXMAN 195 (SC), (1988) 172 ITR 321 (SC), (1988) 70 CTR 94 (SC)]

[For the purpose of: section 36(1)(iii) and 4 of the Income-tax Act, 1961 and Co-operative Societies Act, 1912]

The circumstance that there was no certainty that any balance would remain for refund to the members would in itself indicate that the ***deposits could not be regarded as loans. A loan necessarily supposes a return of the money loaned.***

…

The essence of a 'deposit' is that there must be a liability to return it to the party by whom or on whose behalf it is made on the fulfilment of certain conditions.

…

The essence of a deposit is that there must be a liability to return it to the party by whom or on whose behalf is made on the fulfillment of certain conditions. Under the amended bye-law, the amounts deducted from the price and credited to the said fund were first liable to be used in adjusting the losses of the respondent society in the working year; thereafter in the repayment of initial loan from the Industrial Finance Corporation of India and then for redeeming the Government share and only in the event of any balance being left, it was liable to be converted to share capital. The primary purpose for which the deposits were liable to be used were not to issue shares to the members from whose amounts the deductions were made but for the discharging liabilities of the respondent-society. In these circumstances, the receipts constituted by these deductions were really trading receipts of the assessee society and are liable to be included in its taxable income.

RAM JANKI DEVI V. JUGGILAL KAMLAPAT, AIR 1971 SC 2551, (1971) 1 SCC 477, (1971) 3 SCR 573 (SC)]

… the answer to the question as to whether it was a loan or deposit would not depend merely on the terms of the document but had to be judged from the intention of the parties and the circumstances of the case. That is manifestly the correct approach.

The case of a deposit is something more than a mere loan of money. It will depend on the facts of each case whether the transaction is clothed with the character of a deposit of money. The surrounding circumstances, the relationship and character of the transaction and the manner in which parties treated the transaction will throw light on the true form of the transaction.

RAM JANKI DEVI V. M/S. JUGGILAL KARNLAPAT, (1971) 3 SCR 573 AS EXPLAINED IN MANSA RAM AND SONS (BANKERS) V. JANKI DASS OM PRAKASH, AIR 1984 ALL 267

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FEW OTHER CASE LAWS

There is a clear distinction between loan and deposit although, in a particular case, loan may include deposit. But then, every loan is not a deposit.

[V.E.A. Annamalai Chettiar v. S.V.V.S. Veerappa Chettiar, AIR 1956 SC 12 explained in V. Srinivas v. Machines & Machine Tools (P) Ltd, (2002) 110 CompCas 55 (CLB)]

Debentures cannot be equated with loans.

[For the purpose of: Interest Tax under the Interest-tax Act, 1974]

[CIT v. Gujarat Industrial Investment Corporation, TS-541-SC-2016]

FEW OTHER CASE LAWS

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[For the purpose of: section 36(1)(iii) of the Income-tax Act, 1961]

[CIT v. Bazpur Co-operative Sugar Factory Ltd., (1989) 44 TAXMAN 281 (SC), (1989) 177 ITR 469 (SC), (1989) 77 CTR 136 (SC)]

PERSPECTIVE OF DEEMED DIVIDEND

The term "advance" may or may not include lending. The word "advance" if not found in the company or in conjunction with the word loan may or may not include the obligation of repayment. If it does then it would be a loan.

[For the purpose of: section 2(22)(e) of the Income-tax Act, 1961 providing that dividend shall include loans and “advances” to certain shareholders to the extent of accumulated profits]

[Bagmane Constructions (P.) Ltd. v. CIT, (2015) 57 taxmann.com 120 (Kar), (2015) 231 TAXMAN 260 (Kar)]

PERSPECTIVE OF DEEMED DIVIDEND

Section 2(7) of the Act uses the expression "loan and advances". Therefore, we have also to determine is as to whether the said deposit in the form of intercorporate deposit can be treated as "advance" so as to attract the provisions of section 2(7) of the Act. We are of the opinion that the expression "advance" occurring in section 2(7) along with the expression "loan" should take its colour from "loan" and cannot be given wider interpretation to include deposit as well. Otherwise, money deposits given in the form had been investments, etc., would also qualify as "advances" and interest thereon would become exigible to the Interest-tax Act. Such a situation was never contemplated by the Legislature.

[For the purpose of: section 2(7) of the Interest-tax Act which defnied interest on “advance”]

[Held: “Advance” does not include intercorporate deposit]

[CIT v. Visisth Chay Vypapar Ltd., (2012) 20 taxmann.com 377 (Del), (2011) 339 ITR 157 (Del)]

PERSPECTIVE OF DEEMED DIVIDEND

Interest bearing intercorporate deposits placed by a company with its shareholders are neither a loan nor an advance by the company to the shareholders.

[For the purpose of: section 2(22)(e) of the Income-tax Act, 1961 defining dividend to include loan or "advance" to a shareholder]

[Bombay Oil Industries Ltd. v. DCIT, (2009) 28 SOT 383 (Mum)]

PERSPECTIVE OF DEEMED DIVIDEND

The term "loans and advances" should be understood conjointly and not in isolation. If so read, the advances which are in the nature of loan alone should be covered in the term. As observed by the Madras High Court and the Privy Council decisions aforesaid, the advances may in certain circumstances be loan but not necessarily always. Ordinarily an advance is a payment beforehand and it does not connote the idea of repayment. It is adjusted when the action for which the money is advanced is completed and if not repaid on expiry of the loan like a deposit. The company is not bound to accept the deposit made, if proceeding on the basis of the prospectus a person interested to make a deposit. By issuing prospectus the company invites offer for making deposit and that is not offer to receive deposit whereas in case of loan the assessee prays for a loan. It offers to borrow money and once that offer is accepted, the lender is bound to give money to the borrower on terms settled.

...We accordingly hold that intercorporate deposit can neither be a loan nor an advance.

[For the purpose of: section 2(7) of the Interest Tax Act, which defined interest on “advance”]

[Utkarsh Fincap Pvt. Ltd. v. ITO, (2006) 99 ITD 259 (Ahd), (2007) 288 ITR 38 (Ahd), (2006) 101 TTJ 210 (Ahd)]

PERSPECTIVE OF DEEMED DIVIDEND

Merely because an amount is advanced by one company to other with shareholders having substantial shareholdings, deemed dividend is not taxable in hands of shareholders. Advances in nature of commercial transaction would not fall within ambit of section 2(22)(e). In other words, deemed dividend would not apply to normal commercial transactions. In both companies RTPL and RSPL, petitioner-assessee was a substantial shareholder. RSPL advanced monies to RTPL in ordinary course of its business as inter-corporate loan. Therefore, the advances received will not be taxed as deemed dividend in hands of the shareholder-assessee.

[R. Chitra v. Vice Chairman, ITSC [2020] 120 taxmann.com 49 (Madras)

PERSPECTIVE OF DEEMED DIVIDEND

Where assessee received certain amount from subsidiary company as advance towards security for providing corporate guarantee, it could not be brought to tax as deemed dividend under section 2(22)(e). In appellate proceedings, assessee explained that amount received from subsidiary company was only an advance towards security for providing corporate guarantee. Moreover, assessee had paid interest on said amount at rate one per cent higher than normal banking rate. Tribunal having accepted assessee's explanation, deleted addition made by Assessing Officer. Since finding recorded by Tribunal was a finding of fact, no substantial question of law arose therefrom.

[CIT v. Accel Limited [2020] 118 taxmann.com 103 (Madras)

PERSPECTIVE OF DEEMED DIVIDEND

Assessee, engaged in business of manufacturing of engineering goods, had beneficial shareholding in company. It had taken inter-corporatedeposit from said company and claimed that since said deposit was to be repaid before end of relevant year, it could not be treated as loan.

Held that: Even though assessee claimed it as intercorporatedeposit, it was short term loan enjoyed by assessee and, hence, provision of section 2(22)(e) was clearly attracted. Any credit or advantage taken by persons having substantial interest will attract provision of section 2(22)(e); it does not matter whether it is repaid within same year.

[Assistant Commissioner of Income-tax, Mumbai v. Jasubhai Engineering (P.) Ltd. [2020] 118 taxmann.com 430 (Mumbai - Trib.)

SECTION 57

Where assessee paid interest to sister concern on money borrowed and subsequently it earned interest income on inter-corporatedeposits (ICDs), since there was direct nexus between interest paid and interest earned, interest paid to sister concern was deductible u/s 57 while bringing interest income to tax as income from other sources

[PCIT v. Jubilant Energy Nelp-V (P.) Ltd. [2019] 102 taxmann.com 97/261 Taxman 194 (Delhi)]

GST PERSPECTIVE

'A' Ltd. given a loan to 'B' Ltd. 'B' Ltd. paying interest to 'A' Ltd on a loan taken from 'A' Ltd.

Q- Is GST leviable?

Taxable event under GST – supply of goods/ service

Whether giving ICD is a service? Arguably yes

So taxable under GST?

GST PERSPECTIVE

Notification No. 12/2017- Central Tax (Rate) dt. 28.06.2017 and Notification No. 9/2017-Integrated Tax (Rate) dt. 28.06.2017 as amended, provides a list of services exempted from payment of Central Tax on intra-State supply and Integrated Tax on Inter-State supply. Entry 27(a) of the Notification No. 12/2017 and Entry 28(a) of the Notification No. 9/2017 relates to services by way of extending deposits, loans or advances in so far as the consideration is represented by way of interest.

GST is exempted!

GST ON CORPORATE GUARANTEE

Parent company – guarantees loan of subsidiary company instead of ICD

GST implications?

Earlier – very arguable

From 26 October 2023 – changed

As per the CBIC order, 18% GST will apply to corporate guarantees between parent and subsidiaries and other related parties either on the financial consideration charged by the guarantor for that service, or 1% of the value of the guarantee, whichever is higher.

In the case of corporate guarantees issued to a bank by a director against loans sanctioned to a company, and where no fee is paid to the director for that service, no GST would apply.

THANK YOU

PLEASE FEEL FREE TO ASK QUESTIONS

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