Abolition of Dividend Distribution Tax

What is the issue?

- The abolition of the Dividend Distribution Tax (DDT) in Budget 2020 is hailed as a big relief for corporates and non-resident shareholders.
- There will be no disputes regarding disallowance of expenses in terms of Section 14A of Income Tax (I-T) Act read with Rule 8D of I-T Rules.

What is dividend and DDT?

- **Dividend** is a return given by a company to its shareholders out of the profits earned by the company in a particular year.
- Dividend constitutes income in the hands of the shareholders which ideally should be subject to income tax.
- However, the Indian income tax laws provide for an exemption of the dividend income received from Indian companies by the investors.
- **DDT** is levied on any domestic company which is declaring/distributing dividend and is paid at the rate on the gross amount of dividend.

What are the current regulations?

- **Section 14A** provides that any expense concerning income not forming part of total income would not be allowed as deduction.
- Presently, the dividend income is not taxable in the hands of shareholder and does not form part of total income.
- **Section 56** charges income tax on the dividend.
- **Section 57** allows certain deductions while computing income from other sources.
- All expenses incurred wholly and exclusively to earn income taxable under Section 56 are allowed as deduction.

What does the Budget 2020 propose?

- It proposes a proviso to Section 57 that states that no deduction shall be allowed against dividend income other than interest expenses.
- The deduction on account of interest will be restricted to 20% of the dividend income.
- The cap of 20% is based on the amount of income earned and offered to tax in the previous year.

- Hence, in case, no dividend income is earned in a year even though the assessee incurs interest expenditure or fee on investment managers, she cannot claim any deduction.

What are the other proposals?

- Besides restricting the quantum of deduction in respect of interest, the amendments change the regime of taxation from being net to gross.
- The intention cannot be to discourage investors from borrowing heavily to invest in shares or paint all dividend earned as a windfall, nor can there be a fear of an excessive claim of expenses.
- Presently, expenses are allowed to be deducted as per Section 57, and it is nobody's case that it has resulted in a massive leakage of revenue.

How income is taxed now?

- Income may be interpreted in a wide manner to include receipts, windfalls and gifts.
- When the income like **profit** is taxed, the mechanism provided to tax it would allow for a deduction of expenses.
- Certain incomes like **royalty, fee** for technical service, etc, are subject to taxation on a gross basis.
- In case of **income from house property**, there is a cap on deduction towards interest paid on borrowed capital.
- The rationale is that the annual lettable value of a self-occupied property is deemed as nil.
- Where the assessee claims that dividend is **business income**, it may be possible to claim all expenses regarding it.
- However, the debate of whether dividend can ever constitute business income is already before the courts.

What would be the impact?

- The abolition of DDT and reintroduction of tax on dividends in the hands of the shareholder has brought relief to non-resident investors.
- However, this change is likely to increase the pain of resident shareholders, especially those falling in higher tax brackets.

Source: Financial Express



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