TAX TREATMENT OF DIVIDEND RECEIVED FROM COMPANY

Up to Assessment Year 2020-21, if a shareholder gets dividend from a domestic company then he shall not be liable to pay any tax on such dividend as it is exempt from tax under section 10(34) of the Act. However, in such cases, the domestic company is liable to pay a Dividend Distribution Tax (DDT) under section 115-O. The Finance Act, 2020 has abolished the DDT and move to the classical system of taxation wherein dividends are taxed in the hands of the investors.

Therefore, the provisions of Section 115-O shall not be applicable if the dividend is distributed on or after 01-04-2020. Thus, if the dividend is distributed on or after 01-04-2020 the domestic companies shall not liable to pay DDT and, consequently, shareholders shall be liable to pay tax on such dividend income. As dividend would now be taxable in the hands of the shareholder, various provisions of the Act have been revived such as allowability of expenses from dividend income, deductibility of tax from dividend income, treatment of inter-corporate dividend, etc.

In this part you can gain knowledge about taxability of dividend distributed by domestic companies on or after 01-4-2020.

Meaning of Dividend

Dividend usually refers to the distribution of profits by a company to its shareholders. However, in view of Section 2(22) of the Income-tax Act, the dividend shall also include the following:

(a) Distribution of accumulated profits to shareholders entailing release of the company's assets;

(b) Distribution of debentures or deposit certificates to shareholders out of the accumulated profits of the company and issue of bonus shares to preference shareholders out of accumulated profits;

(c) Distribution made to shareholders of the company on its liquidation out of accumulated profits;

(d) Distribution to shareholders out of accumulated profits on the reduction of capital by the company; and

(e) Loan or advance made by a closely held company to its shareholder out of accumulated profits.

Taxability of dividend received on or after 01-04-2020

The taxability of dividends in the hands of the company as well as shareholders from Assessment Year 2021-22 would be as under:

Obligation of the domestic companies

The domestic companies shall not be liable to pay DDT on dividend distributed to shareholders on or after 01-04-2020. However, domestic companies shall be liable to deduct tax under Section 194.

As per the Section 194, which shall be applicable to dividend distributed, declared or paid on or after 01-04-2020, an Indian company shall deduct tax at the rate of 10% from dividend distributed to the resident shareholders if the aggregate amount of dividend distributed or paid during the financial year to a shareholder exceeds Rs. 5,000. However, no tax shall be required to be deducted from the dividend paid or payable to Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC) or any other insurer in respect of any shares owned by it or in which it has full beneficial interest. However, where the dividend is payable to a non-resident or a foreign company, the tax shall be deducted under Section 195 in accordance with relevant DTAA

Taxability in hands of shareholders

Section 10(34), which provides an exemption to the shareholders in respect of dividend income, is withdrawn from Assessment Year 2021-20. Thus, dividend received during the financial year 2020-21 and onwards shall now be taxable in the hands of the shareholders. Consequently, Section 115BBDA which provides for taxability of dividend in excess of Rs. 10 lakh has no relevance as the entire amount of dividend shall be taxable in the hands of the shareholder.

The taxability of dividend and tax rate thereon shall depend upon many factors like residential status of the shareholders, relevant head of income. In case of a non-resident shareholder, the provisions of Double Taxation Avoidance Agreements (DTAAs) and Multilateral Instrument (MLI) shall also come into play.

Taxable in the hands of resident shareholder

A person can deal in securities either as a trader or as an investor. The income earned by him from the trading activities is taxable under the head business income. Thus, if shares are held for trading purposes then the dividend income shall be taxable under the head business or profession. Whereas, if shares are held as an investment then income arising in nature of dividend shall be taxable under the head other sources.

The income, taxable under the head PGBP, is computed in accordance with the method of accounting regularly followed by the assessee. For the purpose of computation of business income, a taxpayer can follow either mercantile system of accounting or cash basis of accounting. However, the method of accounting employed by the assessee does not affect the basis of charge of dividend income as Section 8 of the Act provides that final dividend including deemed dividend shall be taxable in the year in which it is declared, distributed or paid by the company, whichever is earlier. Whereas, interim dividend is taxable in the previous year in which the amount of such dividend is unconditionally made available by the company to the shareholder. In other words, interim dividend is chargeable to tax on receipt basis.

Deductions from dividend income

Where dividend is assessable to tax as business income, the assessee can claim the deductions of all those expenditures which have been incurred to earn that dividend income such as collection charges, interest on loan etc.

Whereas if dividend is taxable under the head other sources, the assessee can claim deduction of only interest expenditure which has been incurred to earn that dividend income to the extent of 20% of total dividend income. No deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person for the purpose of realising such dividend.

Tax rate on dividend income

The dividend income shall be chargeable to tax at normal tax rates as applicable in case of an assessee except where a resident individual, being an employee of an Indian company or its subsidiary engaged in Information technology, entertainment, pharmaceutical or bio-technology industry, receives dividend in respect of GDRs issued by such company under an Employees' Stock Option Scheme. In such a case, dividend shall be taxable at concessional tax rate of 10% without providing for any deduction under the Income-tax Act. However, the GDRs should be purchased by the employee in foreign currency.

Taxability in case of non-resident shareholders including FPIs

A non-resident generally invests in India either directly as private equity investors or as Foreign Portfolio Investors (FPIs). A non-resident person can also be a promoter of an Indian Company. A non-resident person generally hold shares of an Indian company as an Investment and, therefore, any income derived by way of dividend is taxable under the head other sources except where such income is attributable to Permanent Establishment of such non-resident in India.

As regards FPIs, securities held by them are always treated as a capital asset and not as stock-in-trade. Thus, in case of FPIs also, the dividend income shall always be taxable under the head other sources.

Tax rate on dividend income

The dividend income, in the hands of a non-resident person (including FPIs and non-resident Indian citizens (NRIs)), is taxable at the rate of 20% without providing for deduction under any provisions of the Income-tax Act. However, dividend income of an investment division of an offshore banking unit shall be taxable at the rate of 10%.

Further, where the dividend is received in respect of GDRs of an Indian Company or Public Sector Company (PSU) purchased in foreign currency, the tax shall be charged at the rate of 10% without providing for any deductions. The relevant sections under which tax is charged are as under:

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 115AC	Non-resident	Dividend on GDRs of an Indian Company or Public Sector Company (PSU) purchased in foreign currency	10%
Section 115AD	FPI	Dividend income from securities (other than units referred to in section 115AB)	20%
	Investment division of an offshore banking unit	Dividend income from securities (other than units referred to in section 115AB)	10%
Section 115E	Non-resident Indian	Dividend income from shares of an Indian company purchased in foreign currency.	20%
Section 115A	Non-resident or foreign co.	Dividend income in any other case	20%

Withholding tax

Where the dividend is distributed to a non-resident shareholder, the tax shall be required to be deducted as per section 195 of the Income-tax Act. However, where the dividend is distributed or paid in respect of GDRs of an Indian Company or Public Sector Company (PSU) purchased in foreign currency or to Foreign Portfolio Investors (FPIs), the tax shall be required to deducted as per section 196C and section 196D, respectively.

As per section 195, the withholding tax rate on dividend shall be as specified in the Finance Act of the relevant year or under DTAA, whichever is applicable in case of an assessee. Whereas, the withholding tax rate under section 196C and 196D is 10% and 20%, respectively.

The withholding tax rate on dividend distributed or paid to a non-resident shareholder can be explained with the help of following table:

Section (chargeability of income)	*Section (withholding of tax)*	*Nature of Income*	*Rate of TDS (Payee is any other non-resident)*	*Rate of TDS (Payee is a foreign company)*
Section 115AC	Section 196C	Dividend on GDRs of an Indian Company or Public Sector Company (PSU) purchased in foreign currency	10%	10%

Section 115AD	Section 196D	Dividend income of ▪ FPIs from securities ▪ Investment division of an offshore banking unit	20% 10%	20% 10%
Section 115E	Section 195	Dividend income of non-resident Indian from shares of an Indian company purchased in foreign currency.	20%*	-
Section 115A	Section 195	Dividend income of a non-resident in any other case	30%*	40%*

*If the withholding tax rate as per DTAA is lower than the rate prescribed under the Finance Act then tax shall be deducted at the rate prescribed under DTAA.

Taxability under DTAA

Dividend income is generally chargeable to tax in the source country as well as the country of residence of the assessee and, consequently, country of residence provides a credit of taxes paid by the assessee in the source country. Thus, the dividend income shall be taxable in India as per provisions of the Act or as per relevant DTAA, whichever is more beneficial.

As per most of the DTAAs India has entered into with foreign countries, the dividend is taxable in the source country in the hands of the beneficial owner of shares at the rate ranging from 5% to 15% of the gross amount of the dividends.

In DTAA with countries like Canada, Denmark, Singapore, the dividend tax rate is further reduced where the dividend is payable to a company which holds specific percentage (generally 25%) of shares of the company paying the dividend. However, no minimum time limit has been prescribed in these DTAAs for which such shareholding should be maintained by the recipient company. Therefore, MNCs were often found misusing the provisions by increasing their shareholding in the company declaring immediately before declaration of the dividend and offloading the same after getting the dividend. India does not face this situation as dividend income is exempt from tax in the hands of the shareholders. However, after the proposed amendment, India too will face the risk of tax avoidance by the foreign company by artificially increasing the holding in the dividend declarant domestic company.

India is a signatory to the Multilateral Convention (MLI) which shall implement the measures recommended by the OECD to prevent Base Erosion and Profit Shifting. MLI is a binding international legal instrument which is envisaged with a view to swiftly implement the measures recommended by OECD to prevent Base Erosion and Profit Shifting in existing bilateral tax treaties in force. With respect to dividend income, Article 8 (Dividend Transfer Transactions) of MLI provides for a minimum period of 365 days for which a shareholder, receiving dividend income, has to maintain its shareholding in the company paying the dividend to get the benefit of the reduced tax rate on the dividend.

Inter-corporate dividend

As the taxability of dividend is proposed to be shifted from companies to shareholders, the Government has introduced a new section 80M under the Act to remove the cascading effect where a domestic company receives a dividend from another domestic company. However, nothing has been prescribed where a domestic company receives dividend from a foreign company and further distribute the same to its shareholders. The taxability in such cases shall be as under:

Domestic co. receives dividend from another domestic co.

The provisions of section 80M removes the cascading effect by providing that inter-corporate dividend shall be reduced from total income of company receiving the dividend if same is further distributed to shareholders one month prior to the due date of filing of return.

Domestic co. receives dividend from a foreign co.

Dividend received by a domestic company from a foreign company, in which such domestic company has 26% or more equity shareholding, is taxable at a rate of 15% *plus* Surcharge and Health and Education Cess under Section 115BBD. Such tax shall be computed on a gross basis without allowing deduction for any expenditure.

Dividend received by a domestic company from a foreign company, in which equity shareholding of such domestic company is less than 26%, is taxable at normal tax rate. The domestic company can claim deduction for any expense incurred by it for the purposes of earning such dividend income.

Note: The Finance Act, 2022 has amended the Section 115BBD to provide that the provisions of this section shall not apply to any assessment year beginning on or after 01-04-2023.

No MAT on dividend income of a foreign company

Provisions relating to MAT apply to a foreign company only when it is a resident of a country with which India has DTAA and it carries on business through a PE situated in India. However, it should not be taxable under the presumptive taxation schemes of Section 44B, Section 44BB, Section 44BBA or Section 44BBB. Once it is determined that the foreign company is liable to pay MAT, certain adjustments are made from its profits.

However, the following incomes (and expenses claimed in respect thereof) are added back to (or reduced from) the net profit if same is credited (or debited) in the profit and loss account, if such income is taxable at a rate lower than the rate of MAT:

(a) Capital gain from securities;
(b) Interest;
(c) Royalty;
(d) FTS.

Thus, a foreign company is not liable to pay MAT on the aforesaid incomes.

Considering the taxability of dividend in the hands of the foreign company, the Finance Bill, 2021 has amended section 115JB to provide that dividend income and expenses claimed in respect thereof to be added back or reduced from the net profit if such income is taxed at lower than MAT rate due to DTAA.

It should be noted that the dividend income shall be taxable in the hands of a foreign company in accordance with the provisions of the Act or relevant DTAA, whichever is more beneficial.

Advance tax liability on dividend income

If the shortfall in the advance tax instalment or the failure to pay the same on time is on account of dividend income, no interest under section 234C shall be charged provided the assessee has paid full tax in subsequent advance tax instalments. However, this benefit shall not be available in respect of the deemed dividend as referred to in Section 2(22)(e).

MCQ ON TAX TREATMENT OF DIVIDEND RECEIVED FROM COMPANY

Q1. Dividend received from an Indian company which has suffered dividend distribution tax is exempt from tax.

(a) True (b) False

Correct answer : (a)

Justification of correct answer :

Up to Assessment Year 2020-21, if a shareholder gets dividend from a domestic company then he shall not be liable to pay any tax on such dividend as it is exempt from tax under section 10(34) of the Act. However, in such cases, the domestic company is liable to pay a Dividend Distribution Tax (DDT) under section 115-O. The Finance Act, 2020 has abolished the DDT and move to the classical system of taxation wherein dividends are taxed in the hands of the investors.

Q2. Which section provides for deduction of tax at source on distribution or payment of dividend by an Indian Company?

(a) Section 194A (b) 193

(c) Section 194 (d) 194-O

Correct answer : (c)

Q3. Section 194 provides _____rate of deduction of tax on distribution or payment of dividend by an Indian Company?

(a) 5% (b) 10%

(c) 20% (d) 1%

Correct answer : (b)

Justification of correct answer :

Section 194 provides for deduction of tax at source on distribution or payment of dividend by an Indian Company. The rate for tax shall be 10% and liability to deduct TDS.

Q4. What is the threshold limit for deduction of tax at source on distribution or payment of dividend by an Indian Company?

(a) Rs. 2,500 (b) Rs. 10,000

(c) Rs. 5,000 (d) No limit

Correct answer : (c)

Justification of correct answer :

Section 194 provides for deduction of tax at source on distribution or payment of dividend by an Indian Company. The rate for tax shall be 10% and liability to deduct TDS shall arise if the amount of dividend distributed or paid to shareholder exceeds Rs. 5,000;

Q5. As per section 2(22), dividend does not include ______ _.

(a) Any distribution if such distribution entails the release of all or any part of the assets of the company to the extent of accumulated profits of the company

(b) Any distribution made on liquidation of accompany to the extent of accumulated profits of the company

(c) Any distribution on the reduction of capital of a company to the extent of accumulated profits of the company

(d) Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956

Correct answer: (d)

Justification of correct answer :

With effect from assessment year 2000-01,"dividend" does not include—

(i) any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956;

(ii) any distribution of shares made in accordance with the scheme of demerger by the resulting company to the shareholders of the demerged company whether or not there is a reduction of capital in the demerged company.

(iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off.

Thus, option (d) is the correct option.

Q6. Dividend received from a foreign company is charged to tax under the head ____ _.

(a) Profits and gains of business or profession (b) Capital gains

(c) Income from other sources (d) Income from salaries

Correct answer: (c)

Justification of correct answer :

Dividend received from a foreign company is charged to tax under the head "Income from other sources".

Thus, option (c) is the correct option.

Q7. Dividend received from domestic company will be included in the total income of the tax payer and will be charged to tax at _____ _____.

(a) 15%

(b) 20%

(c) 30%

(d) Normal rate of tax applicable to the assessee

Correct answer : (d)

Justification of correct answer :

Dividend received from domestic company will be included in the total income of the tax payer and will be charged to tax at the rates applicable to the taxpayer.

Thus, option (d) is the correct option.