CHAPTER 49
TAXATION OF DIVIDENDS

Sec 115BBD: Tax on certain Dividends received from Foreign Companies

Following conditions must be fulfilled for application of Sec 115BBD:

1. Benefit of Sec 115BBD is available only to the Indian Company.
2. Indian Company must hold at least 26% in nominal value of the equity share capital of the Specified foreign company.
3. Dividend received under sec 2(22)(e) shall not be covered.
4. No other expense shall be claimed by the Indian Company in respect of dividend received.
5. “Specified Foreign Company” means a foreign company in which Indian company holds 26% or more equity share capital.
6. If the above the conditions are fulfilled, then Dividend Income will be taxable at 15%.

Sec 10(34): Dividend referred to in Sec 115-O is exempt from tax in hands of shareholder. Also refer Sec 115BBDA

Sec 115-O(1): Tax on distributed profits of Domestic Companies

- Dividend Distribution tax is payable, by domestic company
- in addition to the income-tax.
- Any amount declared, distributed or paid
- by way of dividends (whether interim or otherwise),
- whether out of current or accumulated profits
- shall be charged to additional income-tax @ 15%. (15% plus surcharge @ 12% always plus 4% Health & Education cess always). Grossing up concept introduced by Finance Act, 2014 and this tax rate works out to be 20.56%. {NA for 2(22)(e)}

Notes:

1. DDT is payable even if no income tax is paid by the company.
2. DDT shall be **paid within 14 days** from the date of -
   (a) declaration; or
   (b) distribution; or
   (c) payment,
   of any dividend whichever is earliest.

3. Further **credit** of DDT paid is **not available** to company or shareholder.

4. DDT is **not** an allowable **deduction** under I.T. Act. *(Even in MAT it is disallowed)*

5. Dividend includes deemed dividend under sec 2(22)(a), (b), (c), (d) & (e). But for sec 2(22)(e) DDT rate will be **34.944%** without grossing up. *(FA 2018)*

6. **Foreign Company is not liable** to pay DDT.

7. As per Finance Act, 2016, there will be **no DDT** where specified Domestic Company *(SPV)* distributes dividend to Business Trust subject to some conditions. *(This is discussed in chapter of Business Trust)*

8. As per Finance Act, 2016
   - **No DDT** shall be chargeable
   - In respect of the total income of company, being a unit of an **International Financial Service Centre,**
     - Deriving income solely in convertible foreign exchange,
     - On any amount declared, distributed or paid by such company, by way of dividends (whether interim or otherwise)
     - On or after the 1st day of April 2017,
     - Out of its current income, *(or income accumulated as a unit of IFSC after 1st April 2017)*
     - Either in the hands of the company or the person receiving such dividend.
   - **Note 1:** The bold and underlined words are inserted by Finance Act (No.2) 2019.
   - **Note 2:** “Unit” means a unit established in an International Financial Service Centre, on or after the 1st April 2016;
Sec 115-O(1A): Reduction in Dividend Distribution Tax

Domestic Subsidiary Company (More than 50% equity capital held by Holding Company)

- Pays dividend
- And Subsidiary Company paid DDT under sec 115-O thereon, if it was payable.

Foreign Subsidiary Company (More than 50% equity capital held by Holding Company)

- Pays dividend
- Holding Company will pay the tax on such dividend under sec 115BBD.

Holding Company

While distributing/ declaring dividend, holding company is eligible to reduce the dividend received from Domestic Subsidiary Company as well Foreign subsidiary Company for the purpose of payment of DDT under sec 115-O(1).

Provided that the same amount of dividend shall not be taken into account for reduction more than once.

⇒ Note 1: Holding Company should hold more than 50% equity share capital of domestic subsidiary company and foreign subsidiary company.

⇒ Note 2:
Benefit of reduction of dividend is available on year to year basis i.e. dividend paid for one FY can be claimed in the same FY only. carry forward of benefit is not allowed. Further benefit can be available irrespective of the fact that the dividend is paid for different FYs.

Eg:

<table>
<thead>
<tr>
<th>Paid Div</th>
<th>Paid Div and DDT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company A (subsidiary)</td>
<td>Company B (Holding 60% Eq. shares of company A)</td>
</tr>
<tr>
<td>↓</td>
<td>↓</td>
</tr>
<tr>
<td>Paid final Dividend on 20/10/2016 for FY 2015</td>
<td>Declared and paid intrim dividend on 01/01/2017 for FY 2016 - 17</td>
</tr>
</tbody>
</table>
Note 3:

Subsidiary means only that subsidiary in which parent company holds more than 50% in equity share capital. Dividend received from other types of subsidiary i.e. subsidiaries having controlling composition of board etc. shall be not getting the benefit u/s 115-O (1A).

Sec 115-O(1B): Grossing up of Dividend Analysis

Tax rate as per sec 115-O(1) on dividends is 15%. As per Finance Act, 2014 this rate shall in all cases be increased by surcharge of 12% and Health & education cess of 4% regardless of what is the total income / dividend distributed by the company. (NA for 2(22)(e))

The effective tax rate for payment of DDT as per sec 115-O(1) shall be as under:

- Tax rate 15%
- Add: 12% Surcharge 1.8%
- Add: 4% Education Cess 0.672%
- Total tax rate 17.472%

Calculation of DDT Rate after grossing up (NA for 2(22)(e)):
TAXATION OF DIVIDENDS

Sec 115BBDA: Tax on certain dividends received from Domestic Companies
(Inserted by Finance Act, 2016)

1. This sec shall apply to a dividend received from Domestic Company by any resident assessee other than:
   - Domestic Company;
   - Certain Fund, Trust, Institution registered u/s 10(23C)/12A/12AA.

Sec is also not applicable where a non resident receives dividend exceeding Rs. 10 lacs.

2. This sec shall apply where the total dividends received by the specific assessee from all companies taken together, exceeds Rs. 10 lacs during the previous year.

3. The amount of aforementioned dividends shall be taxed @ 10% (plus surcharge if applicable and cess)

4. No deduction in respect of any expenditure or allowance or setoff of loss shall be allowed to the assessee under any provision of the Act in computing the income by way of dividends.

5. Dividends shall include deemed dividend except u/s 2(22)(e).

6. It may be noted that company shall pay DDT u/s 115-O on the dividend which is getting taxed u/s 115BBDA in the hands of shareholders.

Deemed Dividend

1) Sec 2(22) (a) to 2(22)(d)
Under these secs, the company will pay Dividend Distribution Tax u/s 115-O. Such dividend will be exempt in the hands of the shareholder u/s 10(34) subject to 115BBDA.

2) Sec 2(22)(e)
In this case, company will pay DDT @ 30% plus 12% Surcharge (Always) & 4% Health & Education Cess (Without Grossup). Then such Dividend will be exempt in the hands of Shareholders u/s 10(34). Sec 115BBDA will not be applicable.
Sec 2(22)(a): Distribution of Assets by company.

(1) Dividend includes *any distribution of assets* by company to its shareholders to the extent company possesses accumulated profits, whether capitalised or not.

(2) *Fair Market Value of the asset* on the date of distribution will be considered to compute deemed dividend.

<table>
<thead>
<tr>
<th>Balance Sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Capital</td>
</tr>
<tr>
<td>(includes bonus Shares of Rs. 50,000)</td>
</tr>
<tr>
<td>Issued out of reserves)</td>
</tr>
<tr>
<td>Reserves</td>
</tr>
</tbody>
</table>

The Company distributes assets of Rs. 200,000 to shareholders. The FMV of the assets on the date of distribution is as follows:

<table>
<thead>
<tr>
<th>Case</th>
<th>MV of Assets</th>
<th>Deemed dividend u/s 2(22)(a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Rs. 150,000</td>
<td>Rs. 150,000</td>
</tr>
<tr>
<td>II</td>
<td>Rs. 250,000</td>
<td>Rs. 250,000</td>
</tr>
<tr>
<td>III</td>
<td>Rs. 300,000</td>
<td>Rs. 300,000</td>
</tr>
<tr>
<td>IV</td>
<td>Rs. 400,000</td>
<td>Rs. 300,000</td>
</tr>
</tbody>
</table>

The deemed dividend u/s 2(22)(a) is exempt in the hands of shareholders u/s 10(34) subject to sec 115BBDA. The company shall be liable to pay DDT u/s 115-0.

Sec 2(22)(b):

Dividend includes:

(1) Any distribution to its SHs by way of debentures or debenture stock or deposit certificate with or without interest.

(2) Any Distribution of bonus shares to its preference shareholders (not to equity shareholders)
to the extent to which company possesses accumulated profits whether capitalised or not.

Q1

Balance Sheet

<table>
<thead>
<tr>
<th></th>
<th>Equity Capital</th>
<th>Cash</th>
<th>350,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>(includes bonus)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shares of Rs. 50000</td>
<td></td>
<td>Assets</td>
<td>200,000</td>
</tr>
<tr>
<td>issued out of reserves</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pref. Sh. Capital</td>
<td>100,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserves</td>
<td>300,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The company issued bonus shares to all shareholders in the ratio of 1:1.

Ans: Bonus shares allotted to equity shareholders does not amount to deemed dividend u/s 2(22)(b). Whereas bonus shares allotted to preference SHs amount to deemed dividend.

:: Deemed dividend = Rs. 100,000

Sec 2(22)(d):

Dividend includes any distribution to its shareholders on reduction of its capital to the extent to which the company possesses accumulated profit whether capitalised or not.

(1)

Balance Sheet

<table>
<thead>
<tr>
<th></th>
<th>Equity Capital</th>
<th>Assets</th>
<th>300,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>(includes bonus)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shares of Rs. 50,000</td>
<td></td>
<td>P/L (Dr Balance)</td>
<td>100,000</td>
</tr>
<tr>
<td>issued out of reserves)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditors</td>
<td>200,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The company reduces share capital by Rs. 100,000 by setting off the debit balance of P/L A/C.

Ans: There is no deemed dividend u/s 2(22)(d) since to company has no accumulated profits and there is not distribution of assets to SHs.
### Balance Sheet

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Capital</td>
<td>200,000</td>
<td>Cash</td>
<td>250,000</td>
</tr>
<tr>
<td>(includes bonus shares</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>of Rs. 50,000 issued</td>
<td></td>
<td>P/L (Dr Balance)</td>
<td>150,000</td>
</tr>
<tr>
<td>out of reserves)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserves</td>
<td>200,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The company reduces the share capital by Rs. 150,000 by giving cash to the shareholders.

$\rightarrow$ Rs. 100,000 is the deemed dividend u/s 2(22)(d) and the same shall be liable to tax u/s 115-O.

### Sec 2(22)(c): Liquidation of Companies

<table>
<thead>
<tr>
<th>Company</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
</tr>
</tbody>
</table>

- **Company** sells the assets & distributes money to SHs then Co. is liable for CG.
- **If Co. distributes assets then such transfer is exempt u/s 46(1).**
- **However, such distribution of assets on liquidation amounts to deemed dividend u/s 2(22)(c).**
  - [to the extent Company possesses accumulated profits]

**Step 1 - Amt received in money**
- (+) FMV of assets received

**Step 2 - Amount assessed as DD u/s 2(2)(c)**

**Step 3 - Step 1(-) Step (2)**

**Step 4 - CG = FVC**
- (-) Exp (XX)
- NVC XXX
- of shares
- (-) COA/ICOA (XX)
- LTCG/STCG XX

**Note:**

The **period subsequent** to the date on which company goes into liquidation shall **not be considered** to determine the period of holding.

**Q.** What will be the COA of the assets received by the shareholders on liquidation?
As per **Sec 55**, the COA of such assets will be **FMV** of the asset on the date of distribution.

**Q.** Mr. X purchased 2000 shares of A Ltd on 01/01/2012 for Rs. 20,000. The company A Ltd goes into liquidation on 30/06/2019 and be receives the following on 02/03/2020.

1) Cash = Rs. 25,000
2) Machinery (BV - Rs. 40,000, FMV - Rs. 60,000)

As on 30/06/2019, the accumulated profits of the company were Rs. 150,000. Mr. X holds 20% shares of A Ltd. Others shareholders of the company also received cash and machinery as above proportionately.

You are also given that Mr. X sells this machinery on 31/03/2020 at Rs. 100,000. The company had acquired this machinery on 01/01/2005 for Rs. 40,000.

**Answer:**

As per **sec 46(1)**, no capital gains shall arise in the hands of the company on distribution of assets to shareholders on liquidation.

Deemed dividend u/s **115-O** in AY 2020 - 21 = Rs.30,000 per shareholder

(150,000 x 20%)

For each shareholder, deemed dividend of Rs.30,000 in exempt u/s **10(34)**. The capital gains implication will be as follows:

**AY 2020 - 21**

**On shares in liquidating company**

<table>
<thead>
<tr>
<th>Sale Proceeds</th>
<th>L.T</th>
</tr>
</thead>
<tbody>
<tr>
<td>POH - 01/01/2012 to 29/06/2019</td>
<td>LT</td>
</tr>
<tr>
<td>FMV of machinery</td>
<td>60,000</td>
</tr>
<tr>
<td>Add: Cash Received</td>
<td>25,000</td>
</tr>
<tr>
<td>Less: Deemed dividend u/s 2(22)(c)</td>
<td>(30,000)</td>
</tr>
<tr>
<td>NVC / FVC</td>
<td>55,000</td>
</tr>
<tr>
<td>(-) ICOA → 20,000 x</td>
<td></td>
</tr>
<tr>
<td><strong>LTCG</strong></td>
<td></td>
</tr>
</tbody>
</table>

**On Sale of machinery**

| POH : 02/03/2019 to 30/03/2020 | ST |
| FVC | 100,000 |
TAXATION OF DIVIDENDS

(-) COA

<table>
<thead>
<tr>
<th>STCG</th>
</tr>
</thead>
<tbody>
<tr>
<td>40,000</td>
</tr>
</tbody>
</table>

Sec 2(22)(e): Loans and Advances by a Closely held Company
Deemed as Dividend.

1) Dividend includes any loan or advance given by a closely held company to a
shareholder (beneficial owner) not holding less than 10% of voting power, then
it shall be deemed as dividend in the hands of the shareholder.

2) Dividend includes any loan or advance given by a closely held company to Any
concern in which such shareholder is a member or a partner and in which he has
substantial interest (20%), then it is deemed as dividend in the hands of the
concern.

The above dividends will be taxable to the extent the company possesses
accumulated profits.

Make Chart here

Notes:

1) The following conditions are to be satisfied on the date on which loan or
advance is given to shareholder of the concern by a closely held company in order
to attract Sec 2(22)(e):
   (a) Beneficial owner of shares holding 10% or more voting power.
   (b) Member or Partner in the concern.

2) Concern means HUF / Firm / Company / AOP / BOI.
3) A person shall be deemed to have substantial interest in a concern if he is at
anytime during the PY, beneficiary entitled to not less than 20% of income of
such concern.

4) Accumulated profits shall be considered up to the date on which loan / advance
is given to shareholder / concern.

5) The fact that the loan was repaid will not make any difference in applicability
of sec 2(22)(e).

6) Since deemed dividend u/s 2(22)(e) is taxable in the hands of shareholder, ∴
Company will deduct TDS on it u/s 194. (Amended by Finance Act 2018)

7) For the purpose of sec 2(22)(e), Accumulated profits gets reduced by the
amount of deemed dividend even if no adjustment is made in the Books of
Accounts.

Illustration:

1) HUF through its karta is a shareholder in a private limited company and holds
12% shares in the company. The company has accumulated profits of Rs. 10 lacs.
The company gives a loan of Rs. 2 lacs to Mr. X in his individual capacity and Rs.
350,000 to HUF.

→ Rs. 350,000 is deemed dividend u/s 2(22)(e) since HUF is the beneficial owner
of 12% shares in the company and thus the said dividend is subject to DDT u/s
115-O on which DDT @ 34.944% shall be payable by Company.
There will be no deemed dividend u/s 2(22)(e) in case of Mr. X since he is not
the beneficial owner of the shares.

As per sec 2(22), dividend shall not include the following;

(1) Any dividend paid by a company which is set off by the company against the loan
which has been deemed as dividend u/s 2(22)(e).

Case 1: On 01/04/2020, Co gives a loan of Rs. 1,00,000 to SH Mr. X
(25%) → Deemed dividend u/s 2(22)(e) on 30/04/2020, Co. declares dividend
- Mr X - Rs. 10,000 which is adjusted against the loan of Rs. 100,000.

Ans: Rs. 100,000 is deemed dividend u/s 2(22)(e) w.r.to Mr. X for AY 2021 - 22. The
actual dividend of Rs. 10,000 which has been set off against loan shall not be
considered as dividend for the company. Even though the company will pay dividend of Rs. 40,000 to all SHs, it will pay DDT on Rs. 30,000 @ __________ (Total dividend payable - Dividend set off)

**Case 2:** The Company on 01/04/2020 gives a loan of Rs. 1,00,000 to Mr. X who holds 25% shares. The company declares dividends on 30/04/2020. Dividend of Rs. 10,000 is paid to Mr. X.

**Ans:** Rs. 100,000 is deemed dividend w.r.t Mr. X for AY 2021 - 22. The actual dividend of Rs. 10,000 will not be reduced from Rs. 40,000 now and the company will pay DDT on Rs. 40,000 @ ________.

(2) As per **Sec 2(22)**, any advance or loan made to a shareholder or a concern in the ordinary course of business where money lending is _substantial part of_ the company is _not defined_.

**Illustration:**
A company is in the business of money lending as well as manufacturing. More than 50% of the PGBP comprises of Income from Money lending business. The company has accumulated profits of Rs. 200,000 on 01/04/2020 and it gives a loan of Rs. 100,000 to shareholder who holds 15% shares in the company. In the following cases:

(1) At no interest.
(2) At 4% interest whereas normally company lends to other borrowers @ 18% pa.
(3) At 18% p.a.

**Ans:** In case (1) and (2), Rs. 100,000 will be deemed dividend u/s **2(22)(e)** w.r.t Mr. X for AY 2021 - 22.

In case (3) there is no deemed dividend w.r.t Mr. X as the money is lend by the company in the ordinary course of business and money lending forms substantial part of the business of the company.

**ALL THE BEST**