VISION: Journal of Indian Taxation
Vol. 8(1), Jan-Jun 2021, pp. 127-136
DOI: 10.17492/jpi.vision.v8i1.812107
www.journalpressindia.com/vjit

Abrogation of Section 115-O: Reinforcing the Classical System of Dividend Taxation

*Shivangi Pandey**

ABSTRACT

Dividend Distribution Tax, unlike other taxes, is one such tax structure whose incidence keeps on changing. When it was introduced in the year 1997, the shareholders' enjoyed the immunity of not facing the liability for the same. However, with the passage of economy, its incidence kept on shifting from company to shareholders'. With the announcement of Union Budget 2020-21, the finance minister proposed to reintroduce the vintage model, with a view to provide some relief to the corporate houses which were otherwise burdened with a bundle of taxes. Shift of incidence is not a novel step; however, the current situation of pandemic made this proposal's impact uncertain. Through this paper, the author strives to bring in picture the pros and cons of this proposal; how fair it would be for the shareholders'; whether the giant corporate houses would get an opportunity to avail the benefit of not paying DDT, irrespective of the pandemic; whether it would portray Indian taxation structure as a liberal one for the prospective foreign companies; and whether vintage model would provide assure success in 21st century.

Keywords: *Tax incidence;; Dividend; Shareholder; India.*

1.0 Introduction

Tax is a quintessential element of governance. The governmental authorities rely on us to provide us various services and amenities. Taxpayers range from a middle-class earner to a business tycoon, from a sole proprietorship to large MNCs. The shareholders are entitled to dividend, which is their share in the distributed profits (Aggarwal, 2014). However, paying this amount of dividend turned out to be an extra cost upon the corporate giants as they were supposed to pay tax on this dividend as well. This abrogated tax is known as Dividend Distribution Tax (DDT)

**Student, Symbiosis Law School, Hyderabad, Telangana, India.*
(E-mail:shivangip691@gmail.com)

(Ali, 2020). Anyways the corporations were burdened with high corporate tax; this along with DDT lead to less return on investment which consequently inflated the sufferings Indian companies (Shah, Desai & Changlani, 2018).

DDT gained popularity in recent times as the Union Budget for 2020-21 brought several tax amendments in order to simplify the tax structure, facilitate growth and ease of doing business. The Finance Minister made such proposals with a view to bring down the number of litigations as well. One of them is shifting back the incidence of DDT on investor and abolishing the age-old Dividend Distribution Tax (Govindekar, Sheth & Thakkar, 2020). This move was much awaited as it was hampering the very own 'Make in India' scheme as already the existing tax structure is too high for a corporate giant to flourish without any barrier. Also, DDT was a matter of concern with respect to future of Indian economy and the corporates.

This move of the government would also be beneficial for the economy as India would now become an attractive hub for the foreign investors. Prior to this declaration, the Indian Companies were supposed to pay DDT @ of 20.56% (this inclusive of DDT-15%, surcharge-12%, and health and education cess–4%), in addition to the tax payable on corporate profits.[1] The DDT chargeable in India was one of the prime disadvantages for our economy as the prospective investors were not ready to accept double taxation at the hands of government (Talreja, 2020). Such a system also promoted use of innovative yet injurious ways in order to evade dividends, consecutively circumventing payment of DDT. This hampered the rights of shareholders as their benefit was being neglected. Keeping all these problems in mind, the Indian Parliament took the step of abrogating Dividend Distribution Tax.

However, not every proposal is supported by pros; there is space for cons. Though the companies would be at a position to share their entire distributable profits with the shareholders, its impact on the dividend receivers would be unpredictable.[2] This move of Indian government has become a debatable topic for the other nations. The reason being, the foreign investors would be benefitted by it as they would now enjoy the levy of reduced dividend, provided they have entered into a favorable tax treaty with India.[3] Keeping aside the shortcomings, this proposal would provide the biggest relief from double taxation and would enable both the parties to make a considerable choice.

This relief measure has been applicable on the dividends which have been declared after April 1, 2020. Dividends would not form of a part of taxable income of assessee and would be charged under the head "income from other sources."[4] However, the drawback lies on its impact on the recipients; some categories of equity investors would enjoy the benefit of lower taxes on their dividend income, while some might literally end up paying through their nose.[5] The base of this research would primarily revolve around DDT; pre-Union Budget and post-Union Budget situation. This research would be useful for the future researchers as well as for the recipients who would now have to deal with another tax burden, apart from the various tax structure imposed upon them.

2.0 Repudiation of DDT – A Calculated Move or a Perilous Step?

The Union Budget 2020 had been a significant one as various leading light decisions were taken- instead of four slabs, seven slab taxation structure has been introduced; DDT has been abolished; and the requirements for determining residential status of assesses has been relaxed.[6] The prime focus has been towards the return of classical system of dividend taxation, wherein the burden has shifted back to the hands of recipients. In light of this proposal, copious opinions and views had arisen; some were of the view that investors' and shareholders rights are at stake, and some were of the opinion that this move is for their benefit only.

2.1 Advantageous move for foreign companies

The change is drastic as the ones who were initially exempted from paying taxes on a particular section of income, were now supposed to consider it as a part of their taxable income. This step has been taken keeping in mind the future of Indian economy. Apart from the domestic aids, various foreign investors' are responsible for the growth of our economy and thus this decision has been taken in their favour. Quite few countries have adopted this tax mechanism and the countries which have entered into tax treaty with India; initially they failed to provide credit to the underlying DDT which was being paid by the companies (Kumar & Kumar, 2020). Consistently, they were in demanding old tax regime as it would then allow them to take the advantage of tax rates prescribed in the tax treaties. Consequentially, double taxation would be eliminated as payment of such taxes would then enjoy the immunity of tax credit in the home country.

The rationale behind this step is to boost foreign investment in India. The government has also eased down the corporate tax rates and this proposal can be said to be like an icing on cake for the foreign investors'! The lesser the burden of tax on them, the bigger would be the investment in Indian subsidiaries and startups. Initially, Section 115-O of the Income Tax Act did not extend to the foreign companies. This created an obstacle as then they were burdened with excessive taxation structure. With this proposal, the government has also given strong rational to include such dividends as well as a deduction under Section 80M of the respective Act (Saraf, 2020).

2.2 Cascading effect

As per Section 115-O of the Act, an Indian domestic company is required to pay a DDT @ 15%, in addition to the surcharge and cess.[7] The subsidiary companies were subjected to deduction and after that on the whole amount DDT was calculated. After the announcement of abolition of DDT, the government has assured that another deduction under Section 80M of the act would be inserted in order to do away with the cascading effect of taxes, in this case, DDT. This would prevent the companies from facing multiple layers of tax and would promote the basic idea for which this proposal has been made. Cascading effect could be easily understood as a tax on another tax. For example, a consumer buys a product and is levied upon with a tax and along with it is forced to buy the product at an inflated rate. This is cascading effect and in order to rescue the consumers from this, the government came up with GST (Goods and Services Tax).

Overall, it can be said that this proposal has been a calculated move of the government. Initially, several times government has shifted the burden from investors' to companies and then back to investors'. However, this time the rationale behind this decision is worth pondering upon. It would not only be beneficial for the domestic subsidiaries but also for the foreign companies who have taken interest to contribute to India's economy but somewhere were forced to stay back due to numerous obstacles. By this proposal, the government has intended to clear the path for the foreign companies and plan for a better future of Indian economy.

3.0 Return of Vintage Model and 21st Century Indian Economy

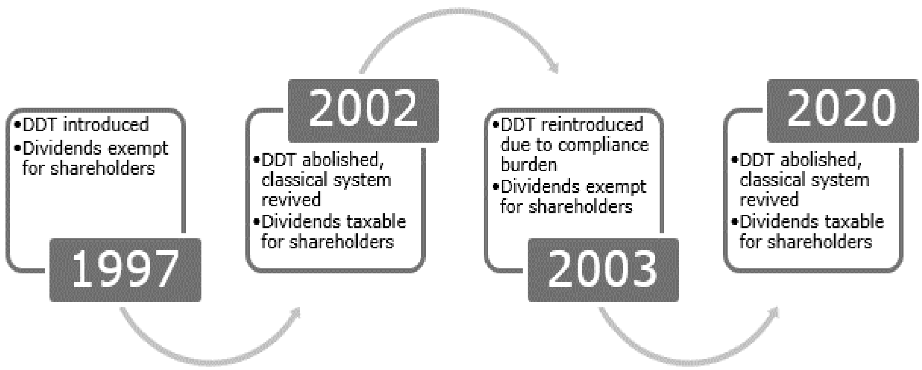
The author has emphasized upon the prior vintage model which had been in force for a long time. Prior to Union Budget 2020, the companies were supposed to bear the burden of DDT, in addition to the surcharge and cess. Due to abovementioned reasons, the government decided to return to the classical model of dividend taxation as that would prevent double taxation and cascading effect (Bhutani, 2003). Moreover, the abrogated regime acted as an obstacle in the movement of funds as well as in the treasury management within the corporate groups (Chaturvedi & Jain, 2020). Apart from paying the tax on distributed profits, the corporate giants had to bear the cost of transferring the funds to the respective shareholders'. This was even more burdensome for the companies which were involved in businesses like real estate, or power, where more of special vehicles were used for carrying on the business. All these extra costs prevented the growth of the overall economy.

Each activity which is undertaken affects the economy, either directly or indirectly. The extra costs which the companies had to bear, in addition to already paid DDT, surcharge and cess, led to the reduction in investment decisions as hardly any considerable amount used to be with companies (Sanghavi, 2019). Upon examining this situation, the government decided to do away with all the stones which were in creating an obstacle in building a clear road for better Indian economy.

3.1 DDT journey: Similar stance as 1997

This snapshot (Figure 1) would enable the readers to clearly understand the journey of DDT from 2017 to 2020. The situation which existed during 1997 and the current situation after the proposal in Union Budget 2020 are ironical. Under both the circumstances, initially shareholders' were exempted but later they are brought under the burden of dividend taxation structure. This step would be directly beneficial for Indian economy as it would open all the gates for the foreign investors' and foreign companies (Sharan, 2019). Without any excessive burden, they would freely invest in Indian economy, and would uplift the position of India on a global platform.

Figure 1: The Journey of DDT from 2017 to 2020



The 21st century Indian economy has witnessed various ups and downs. After the New Economic Policy of 1991, India opened gates for foreign players thus boosting the opportunities for economic growth. Then gradually DDT was introduced. In the 21st century, whole world faced the situation of recession around the year 2008 due to which several tax burdens were imposed on the individuals. Gradually, India could achieve a steady growth in the economy. The previous regime of DDT had indirectly affected the economic growth and thus this change became a necessity and a major requirement.

The current proposal would help the foreign investors' in availing the benefit of DDT tax credit which was initially unavailable at their home jurisdictions.[8] The first and foremost benefit would also be the rise in foreign investment in the Indian companies and startups. Many people consider that India has abundant talent, however, when it comes to give a platform to that talent, usually they don't get sufficient amenities to move ahead. Proposals like these would enable the interested parties to enter into Indian market without any hesitation and enjoy the fruits of Indian talent and capability.

Therefore, it can be stated that indeed, old is gold! The vintage model would prove to be beneficial for Indian market and would help in the upliftment of Indian economy as this what we look forward to.

4.0 Effect of Abrogation on the Rights of Investors' and Corporates

This proposal might seem to be cruel some for the investors' as from a long time; they were enjoying the exemption from payment of taxation on their dividend income. However, this change of hands is somewhere beneficial for the investors' as well. The resident and non-resident investors' are few of them. They are benefitted by the new proposal as the difference in their residential status would not cost them more and would also be covered under the deduction benefit under the direction of Income Tax Act.

For the foreign investors', it would simply minimize their tax cost of investment decisions in India and as mentioned earlier, would be benefitted by the tax credit scheme as well. However, the treaty benefits might prove to be more helpful here. For the domestic investors', the ones whose total income is less than 10 lakhs, they would stand a chance to utilize the deduction; however, the ones whose income is more than this stipulated amount, the obliteration of DDT would not bring any significant change (Safi, Vakharia & Ray, 2020).

The corporate giants on the other hand would definitely be benefitted by this proposal as they would be free from double taxation and cascading effect. They would stand a chance to declare more dividend which would in-turn benefit the investors' and shareholders' (Subramaniam, 2020). Many of the government schemes would be benefitted by this move as companies would be motivated to employ more capital towards the growth of India and its varied activities.

Therefore, overall it can be said that this proposal is a double-edged sword for both the parties. They would not be allies but would work hand-in-hand to boost the Indian economy. Tax is something where individuals employ their capital and seek to experience the benefits out of that capital employed. Abrogation of DDT is a positive step for the nation as whole.

5.0 Turn of Plates: A Boon or a Bane During Pandemic?

Proposals come and go; what matters is the situation in which it is made. When the Union Budget 2020 was declared, no one had imagined the state for which it was being drafted. From March 2020, the whole of India was subjected to the situation posed by pandemic and all were forced to lock themselves and their activities for the benefit of human kind. Literally everything shutdown for a minimum period of two months and so did the economic activities.

Almost all aspects have been affected and are now striving to return to their original position. The proposal of abrogating DDT was somewhere beneficial for the corporate giants as they are now free from one burden, the burden of paying heavy tax on distributed profits (Talereja, 2013). The companies already had to shut down their operations during the peak time of pandemic and due to which they could not accumulate sufficient funds to pay heavy corporate tax and DDT. This proposal is a kind of “boon” for them due to these reasons.

However, the situation for the investors’ is still complex. During the pandemic, investors’ already had accumulated funds as no investment decision could be taken during the lockdown period. Given the current situation, they might not face the difficulty to pay the DDT and this situation might be a boon for them as well.

Overall, it can be said that turn of plates would be more effective for the corporate giants, given the situation posed by COVID-19. They might not be able to declare more dividend because of shut down of operations but would be in a position to save themselves from the heavy tax burden.

6.0 Conclusion

Dividend distribution tax was more of a necessity when it was declared by the government. Gradually, the government kept shifting its burden from recipients to corporate giants. Initially, no reasonable points were mentioned by the government to take such a decision, but given the situation prior to Union Budget 2020, the tax burden on the companies was more than being in the state of excessive. It was apparent that most of the income of corporate giants gushed out in form of taxes, surcharges and cess. The minimum amount which used to be left in their hands was again subject to division amongst the existing owners. This way, even the foreign investors' took a step back from being a part of Indian economy. Keeping such drawbacks in mind, the government took the decision of stepping back and shifted the burden of DDT on the investors'. They still enjoy deductions and now proposals have been made to extend these deductions to the foreign investors' as well. So overall, this proposal is definitely a much needed one for the Indian economy and this research is open for the further researchers to elucidate upon.

Endnotes

1. CORPORATE SERVICES.COM, https://www.corporateservices.com/india-dividend-distribution-tax-eliminated-2020/ (last visited Oct 27, 2020).
2. Aarati Krishnan, *Dividend tax change: Who gains, who loses*, THE HINDU BUSINESS LINE (Feb 07, 2020) https://www.thehindubusinessline.com/opinion/columns/aarati-krishnan/dividend-tax-change-who-gains-who-loses/article30764201.ece#.
3. Pieter de Ridder, *India Withdraws Divided Distribution Tax*, MAYER BROWN (Feb 18, 2020) https://www.mayerbrown.com/en/perspectives-events/publications/2020/02/india-withdraws-dividend-distribution-tax.
4. Arpan Chaturvedi and Rohit jain, *Budget 2020: Government Abolishes Dividend Distribution Tax*, BLOOMBERG QUINT (Feb 01, 2020, 1:31 PM) https://www.bloombergquint.com/business/budget-2020-government-abolishes-dividend-distribution-tax.
5. *Dividend Distribution Tax: Will abolished DDY benefit you if your income is high?*, FINANCIAL EXPRESS (May 01, 2020, 1:15 PM) https://www.financialexpress.com/money/income-tax/dividend-distribution-tax-will-abolished-ddt-benefit-you-if-your-income-is-high/1945349/.
6. Ashwini Kumar Sharma, *Three tax changes to keep in mind in the new financial year*, LIVE MINT (Mar 31, 2020, 10:01 PM) https://www.livemint.com/money/personal-finance/three-tax-changes-to-keep-in-mind-in-the-new-financial-year-11585671771376.html
7. Section 115-O, The Income Tax Act, 1961, Acts of Parliament.
8. Supra note 12.

References

Aggarwal, S. (2014). *Dividend Distribution Tax to be paid after grossing up of 'Dividend Distributed'*, 51 taxmann.com 157 (Article). Retrieved from

[https://www.taxmann.com/research/search?searchData=Dividend%20Distribution%20Tax%20to%20be%20paid%20after%20grossing%20up%20of%20%E2%80%98Dividend%20Distributed%E2%80%99]

Ali, K. (2020). *Dividend Distribution Tax (DDT)- A complete journey*, 114 taxmann.com 630 (Article). Retrieved from [https://www.taxmann.com/research/direct-tax-laws/top-story/105010000000017438/dividend-distribution-tax-ddt-a-complete-journey]

Bhutani, M. (2003). *How India's New Dividend Distribution System Works*, International Tax Review, 16-20 Retrieved from [https://www.internationaltaxreview.com/article/b1fbzfhw47v6wm/how-indias-new-dividend-distribution-system-works]

Chaturvedi, A., & Jain, R. (2020). *Return of the "classical system" of dividend taxation in Union Budget 2020*, 114 taxmann.com 125 (Article). Retrieved from [https://www.taxmann.com/research/direct-tax-laws/top-story/105010000000017346/return-of-the-%E2%80%9Cclassical-system%E2%80%9D-of-dividend-taxation-in-union-budget-2020-experts-opinion]

Govindekar, N., & S., D. (2020). *Abolition of DDT- You win some You lose some!!*, 114 taxmann.com 207 (Article). Retrioeved from [https://www.taxmann.com/research/search?searchData=Abolition%20of%20DDT%20You%20win%20some%20You%20lose%20some!!]

Kumar, S., & Kumar, B. (2020). *Taxability of dividends in the hands of shareholders – A half-baked solution?*, 114 taxmann.com 433 (Article). Retrieved from [https://www.taxmann.com/research/direct-tax-laws/top- -story/105010000000017444/taxability-of-dividends-in-the-hands-of-shareholders %E2%80%93-a-half-baked-solution]

Safi, A., Vakharia, K. & Ray, K. (2020). *Taxation of dividends – Change of hands!*, 114 taxmann.com 209 (Article). Retrieved from [https://www.taxmann.com/research/search?searchData=Taxation%20of%20dividends%20%E2%80%93%20Change%20of%20hands!]

Sanghavi, D. (2019). *The Curious Case of the Indian Dividend Distribution Tax-Inverse Split- rates on Corporate Profits? Or a Source-agnostic Levy?,* Kluwer International Tax Blog. Retrieved from [http://kluwertaxblog.com/2019/08/22/the-curious-case-of-the-indian-dividend-distribution-tax-inverse-split-rates-on-corporate-profits-or-a-source-agnostic-levy/

Saraf, A. & S., B. (2020). *Impact of abolition of Dividend Distribution Tax (DDT)*, 114 taxmann.com 361 (Article). Retrived from [https://www.taxmann.com/research/search?searchData=Impact%20of%20abolition%20of%20Dividend%20Distribution%20Tax%20(DDT)]

Shah, Y. G., Desai, V., & Changlani, S. (2018). *Dividend Distribution Tax – A Double-Edged Sword*, 89 taxmann.com 362 (Article). Retrieved from [https://www.taxmann.com/research/direct-tax-laws/top-story/105010000000015129/dividend-distribution-tax-%E2%80%93-a-double-edged-sword]

Sharan, S. (2019). *Cross Jurisdictional Study: Dividend Distribution Tax vis-à-vis Treaty Tax provisions*, 104 taxmann.com 375 (Article). Retrieved from [https://www.taxmann.com/research/search?searchData=Cross%20Jurisdictional%20Study:%20Dividend%20Distribution%20Tax%20vis-%C3%A0 vis%20Treaty%20Tax%20provisions]

Subramaniam, M. (2020). *Budget Breaking - DDT Goes Out*, 114 taxmann.com 13 (Article). Retrieved from [https://www.taxmann.com/research/direct-tax-laws/top-story/222330000000020126/budget-breaking-ddt-goes-out]

Talereja, A. (2013). *Changing Tax Reforms in India*, National Law School of India Review, *24*(2), 75-88.

Talreja, A., Shah, A. (2020). *Abolition of DDT: Has the aim missed the game?*, 114 taxmann.com 366 (Article). Retrieved from [https://www.taxmann.com/research/direct-tax-laws/top-story/105010000000017409/abolition-of-ddt-has-the-aim-missed-the-game]