Government likely to abolish dividend distribution tax in upcoming Budget

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The government is likely to abolish dividend distribution tax (DDT) in the upcoming Budget and may instead tax the shareholders receiving dividends, in a bid to help improve investor sentiment by addressing the multiplicity of taxes and bring down the effective tax rates for companies. The move will need changes in Section 115 (O) of the Income-tax Act.

DDT is levied on dividends that a company pays its shareholders out of its profits. It is currently charged at the rate of 20.55 per cent, including a surcharge and education cess. “The idea is to move to the classical way of taxation where tax is imposed on the person getting the dividend. The Budget will address the issue of the multiplicity of taxation for companies,” said a person in the know.

It will also help domestic investors because they can claim credit for DDT while paying income tax, or refund if their tax liability is nil. The proposed measure is in line with the recommendations made by the panel on direct tax overhaul, chaired by former Central Board of Direct Taxes member Akhilesh Ranjan. The panel recommended doing away with DDT, but retaining the much-detested long-term capital gains (LTCG) tax and securities transaction tax (STT).

Finance Minister Nirmala Sitharaman had, in the winter session of Parliament, called DDT a ‘regressive measure’. DDT results in the cascading of taxes because companies pay dividends out of their profits already taxed. DDT becomes a cost for foreign shareholders, who find it difficult to avail of foreign tax credits (in home country for taxes paid overseas) because they do not directly pay it.

Budget logoThe government collects around Rs 60,000 crore from DDT each year. Moving to the classical method of taxing dividends will not affect collections.

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DDT was brought in for administrative convenience to recover tax at the dividend distributing company stage to minimise the efforts and resources of collecting tax at the shareholder stage. Dividends are also taxable at a concessional rate of 10 per cent in the hands of shareholders if they receive more than Rs 10 lakh a year.

Pallavi Joshi Bakhru, group head taxation, Vedanta, said the endeavour in the current economic environment should be to put more disposable income in the hands of shareholders to spur consumption and would make more money available to companies to reinvest back into the business for expansion and upgrade.

Amit Maheshwari, managing partner at Ashok Maheshwary & LLP, said that removing DDT had been a longstanding demand of industry as this led to triple taxation and increased the tax cost for investors in general. "Overseas investors are not able to take credit of DDT in their home country and this adds to their tax cost. This also makes India incompetitive vis-à-vis other countries." He said that shifting the taxation of dividend to the recipient would enable MNCs to utilise the double taxation avoidance agreements with India more effectively to reduce the tax paid on dividends and also claim credit of that in the home country.

Features of dividend distribution tax

- Provisions of DDT were introduced by the Finance Act, 1997
- DDT was brought in for administrative convenience to recover tax at company stage
- It minimises the efforts and resources of collecting tax at shareholder level
- DDT is levied at the rate of 15% on the gross amount of dividend in accordance with Section 115 (O), and 20.55% including cess and surcharge
- The tax has proved to be a burden for companies
- There is no credit mechanism for foreign shareholders