

Taxation of dividend

Change in dividend taxation regime under Finance Act, 2020

May 2020



With effect from 1 April 2020, the erstwhile dividend distribution tax (DDT) has been abolished and the dividend income is now taxable in the hands of shareholders.

The Finance Act, 2020 has brought about a significant amendment in the taxation of dividend by abolishing the imposition of DDT. Under the erstwhile DDT regime, taxes on dividend were to be paid by the dividend distributing company at the rate of 20.56 per cent and the dividend income was exempt from taxation in the hands of shareholders.

The classical system of taxation of dividend in the hands of shareholders has now been reintroduced. With effect from 1 April 2020, dividend is taxable in the hands of shareholders and companies declaring dividend are required to withhold taxes thereon.

Snapshot of change in the dividend tax regime

Applicability

- DDT abolished
- Dividend income taxable in the hands of shareholder at applicable tax rates.

Withholding tax requirement

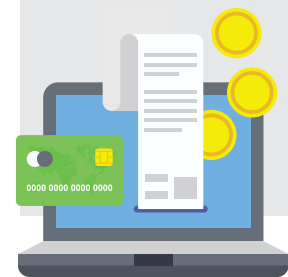
- 10 per cent for resident shareholders (reduced to 7.5 per cent in case dividend is paid or credited during the period from 14 May 2020 to 31 March 2021)
- 20 per cent (plus surcharge and cess) or treaty rate, whichever is lower, in case of non-residents, except in case of Foreign Portfolio Investors.

Removal of cascading effect

- Dividend received by a domestic company allowed as deduction from its gross total income
- Deduction allowed to the extent that such dividend is distributed by the domestic company up to one month prior to the due date of filing of income tax return.

Deductibility of expenses

- Only interest expense allowable as deduction against dividend income subject to cap of 20 per cent of dividend income received by resident shareholders.





Challenges

- Significant withholding tax compliance for dividend distributing companies
- Satisfaction of treaty entitlement conditions, including tax residency, beneficial ownership and other anti-abuse provisions
- Computational challenges around interplay of deduction under section 80M and interest allowance under section 57
- Tax return filing obligation for shareholders.

Opportunities

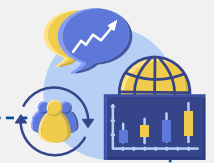


- Better cash flow for dividend distributing company
- Overall reduction in repatriation cost of dividend payable to non-resident shareholders
- Tax credit may be available in home country for non-resident shareholders.

Key facets of transition to the new dividend tax regime

Non-resident shareholders

- Determine eligibility under treaty based on the following.
 - Tax residency status
 - Beneficial ownership test and substance requirements
 - Availability of benefit under most favoured nation clause
- Principal purpose test under multilateral instruments
- Interplay of general anti-avoidance rules
- Threshold and period of shareholding
- Withholding tax rate for foreign portfolio investors.



Listed companies

- Set process for withholding tax compliance in case of listed companies
- Mapping of shareholders on record date
- Develop standard formats for obtaining declaration and maintaining other documentation
- Manage shareholders' expectation to limit the withholding tax as per treaty rates
- Changes in IT system
- Liaising with registrars/share transfer agents
- Filing of Form 15CA/15CB.



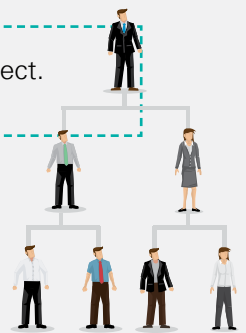
Closely held promoter-driven companies

- Comparison of Limited Liability Partnership (LLP) vs. company structure
- Trade-off between lower corporate tax rate and dividend taxation.



Multi-tier structures

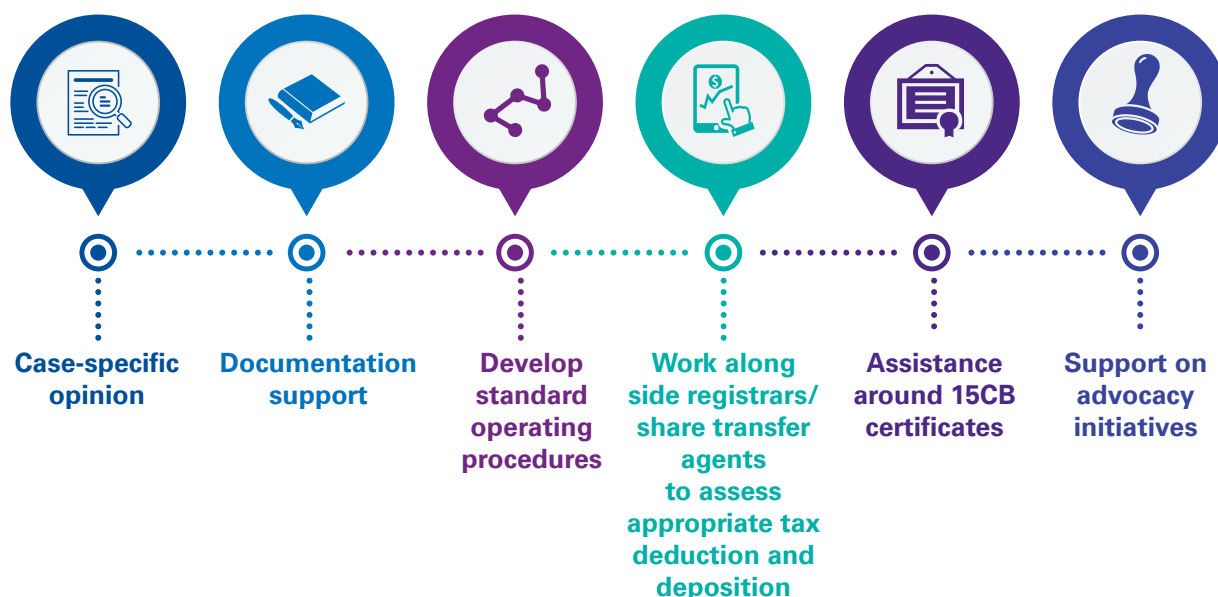
- Evaluate timing for dividend distribution in case of multi-tier structures
- Leveraging elimination of cascading effect.



KPMG in India's approach and methodology

Identification	Assessment	Implementation	Compliance
<ul style="list-style-type: none"> • Mapping of different classes of shareholders, including corporates, individuals, Alternate Investment Fund (AIF), Real Estate Investment Trust (REIT)/ Infrastructure Investment Trust (INVT) and American Depository Receipt (ADR)/Global Depository Receipt (GDR) holders • Ascertaining their residency status, treaty entitlement, etc. 	<ul style="list-style-type: none"> • Mapping the withholding tax rates applicable for resident and non-resident shareholders • Highlighting the relevant factors for non-resident shareholders to claim treaty benefit • Advising on the appropriate withholding tax rate for non-resident shareholders depending on the treaty conditions and the documentation provided by shareholders • Advising on ring-fencing of potential exposure on account of withholding tax obligations. 	<ul style="list-style-type: none"> • Assist in developing standard operating procedures laying down the withholding tax process • Assist in identifying the documentation requirement confirming fulfillment of all applicable conditions • Assist in preparing sample declarations to be obtained from non-resident shareholders before granting treaty benefits. 	<ul style="list-style-type: none"> • Assistance in compliance with withholding tax obligations, including facilitating issue of Form 15CB, filing of withholding tax statements, issue of withholding tax certificates, etc. • Liaising with registrar and transfer agents.

While the nature and areas of assistance would be customised to your specific requirements, KPMG in India's tax service offerings include the following.



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