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

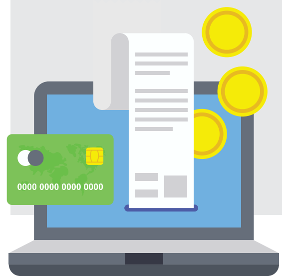
- 10 per cent for resident shareholders (reduced to 7.5 per cent in case dividend is paid or credited during the period from 14 May 2020 to 31 March 2021)
- 20 per cent (plus surcharge and cess) or treaty rate, whichever is lower, in case of non-residents, except in case of Foreign Portfolio Investors.

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

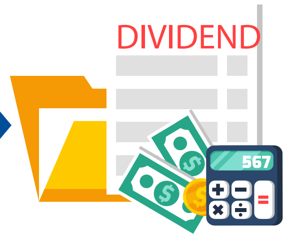
- Only interest expense allowable as deduction against dividend income subject to cap of 20 per cent of dividend income received by resident shareholders.



Challenges

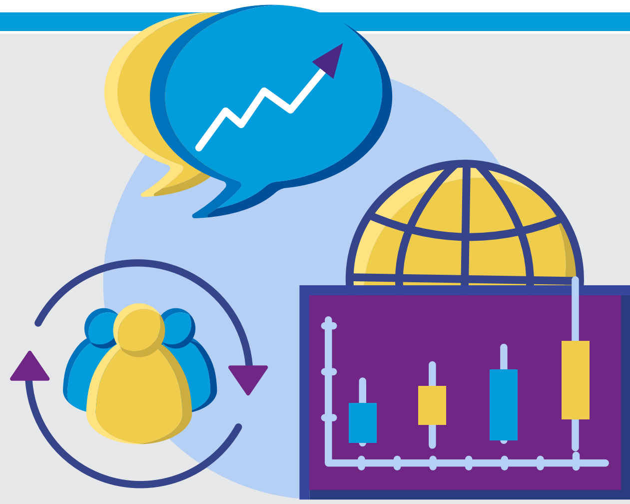
- Satisfaction of treaty entitlement conditions, including tax residency, beneficial ownership and other anti-abuse provisions
- Tax return filing obligation for shareholders
- Cash flow challenge where the tax is deducted at a higher rate as compared to the treaty rate

Opportunities



- Higher distributable surplus available for shareholders
- Flexibility to claim treaty benefits in eligible cases
- 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 considerations for non-resident shareholders



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Evaluation of dividend as an effective repatriation tool

2

Examining availability of treaty benefit for lowering the tax rate on dividend income

3

Explore option of obtaining lower withholding tax certificate from revenue authorities

4

Identifying compliance requirements - obtaining tax registration, return filing, etc.

5

Examination of availability of tax credit in home country of the non-resident shareholder

KPMG in India's approach and methodology

Identification	Assessment	Implementation	Compliance
• Mapping India investments • Understanding shareholding and investment structure.	• Determine eligibility under the 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 • Factoring in special regimes laid down for foreign portfolio investors/ business trusts or American Depository Receipt (ADR) / Global Depository Receipt (GDR) holders.	• Assist in identifying the documentation requirement to be maintained confirming fulfillment of all applicable conditions • Review of declarations, if any, to be provided by non-resident shareholders to the dividend distributing company to claim treaty benefits.	• Assistance in obtaining tax registration number in India • Assistance in preparation and filing of income tax return in India • Assistance with obtaining refunds, if any.

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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