CHAPTER 3

Presentation of dividend distribution tax

This article aims to:

Explain the manner of presentation of dividend distribution tax under Ind AS.

Introduction

One of the most common methods of distributing profits to shareholders is by way of declaring dividends (both interim and final). Dividend is an income for shareholders and as per Section 115-O of the Income Tax Act, 1961 (IT Act), a company declaring dividend has to discharge a Dividend Distribution Tax ('DDT') of 15 per cent on the amounts distributed as dividends.

Indian Accounting Standard (Ind AS) 12, *Income Taxes* prescribes the accounting for the income tax consequences of dividends i.e. DDT.

An issue was raised to the International Accounting Standards Board (IASB) whether the income tax consequences of payments on financial instruments classified as equity should be recognised in profit or loss or in equity. To resolve the issue, IASB amended International Accounting Standard (IAS) 12, *Income Taxes* and consequently, the Ministry of Corporate Affairs amended Ind AS 12 and amendments are applicable for accounting periods beginning on or after 1 April 2019.

Accounting guidance

Ind AS 32, *Financial Instruments: Presentation* provides guidance regarding classification of a financial instrument as a financial liability or an equity instrument. This classification determines whether dividend relating to that instrument is recognised as income or expense in the statement of profit and loss.

Thus, dividend relating to a financial liability or a component that is a financial liability would be recognised as an expense in the statement of profit and loss. On the other hand, distributions to holders of an equity instrument should be recognised directly in equity.

The recent Ind AS 12 amendment requires entities to 'recognise the income tax consequences of dividends in profit or loss, Other Comprehensive Income (OCI) or equity according to where the entity originally recognised those past transactions or events'.

Before amendment to Ind AS 12, the requirement regarding income tax consequences of dividends was ambiguous. It was not clear whether the requirements of paragraph 52B of Ind AS 12 before amendment apply only in the circumstances described in paragraph 52A - for example, when there are different tax rates for distributed and undistributed profits or whether those requirements apply as long as payments on financial instruments classified as equity are distributions of profit.

The amendment, therefore, clarifies that all income tax consequences of dividends (including payments on financial instruments classified as equity) are recognised consistently with the transactions that generated the distributable profits – i.e. in profit or loss, OCI or equity.

Presentation of DDT

Ind AS 12 (amended) requires companies to recognise DDT in the same place where the underlying transaction or event was recognised. Therefore, as a first step, companies need to analyse the terms and conditions of the financial instruments issued by them to determine if such instruments should be classified as liability or equity in accordance with the guidance provided under Ind AS 32. The classification of financial instruments is likely to involve significant judgement.

On 17 September 2019, the Accounting Standards Board (ASB) of the ICAI also released a Frequently Asked Question (FAQ) and clarified the presentation of DDT as DDT is a unique feature of India tax regime. The ASB referred to paragraph 65A of Ind AS 12 which is reproduced below: ***'when an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. In many jurisdictions, this amount is referred to as a withholding tax. Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividends'.*** The term 'withholding tax' is neither defined in the IT Act nor under Ind AS.

As per the ASB, withholding tax is only an example of tax collection mechanism envisaged by Ind AS 12. Therefore, ASB concluded that the standard does recognise possibility of other tax collection mechanisms, which have to be interpreted keeping in mind the substance and underlying intent of tax laws of the country. Accordingly, the ASB considered following two indicators to evaluate whether DDT is a portion of tax paid by company on behalf of its shareholders:

1. **Dividend received with an imputed tax credit:** As per the ASB, dividend is received by the shareholders in India with an imputed tax credit i.e. it will not be charged to further tax by the taxation authorities in the hands of shareholders. Therefore, DDT is covered by situation of paragraph 65A as per ASB.

   Further, it is of the view that in India, dividends are not taxable in the hands of shareholders as DDT is paid by the company that paid the dividend. According to ASB, had there been no DDT mechanism, dividend would have been taxable in the hands of recipients (though dividend exceeding specified limit has been made taxable under Section 115BBDA of the IT Act through Finance Act, 2016 with effect from 1 April 2017). In such a situation also, the tax applicable is at a lower rate in view of the fact that tax on dividend has already been collected in the form of DDT.

2. **Receipt of net/full amount of dividend declared and 'grossing up' of DDT:** As per ASB, in India, the amount of dividend is grossed up by the company for computation of DDT and shareholders receive a net amount of the dividend after deducting tax.

   It highlighted that DDT mechanism was introduced to replace the mechanism of Tax Deduction at Source (TDS) (commonly referred to as withholding tax) primarily to reduce the operational difficulties involved in that tax collection structure. Also, the Finance Act, 2014 brought the concept of 'grossing up' of base amount used for computing DDT. As per ASB, the intention behind introduction of grossing up was to bring the tax base equivalent to the tax base on which tax would have been collected if the dividends were taxable in the hands of shareholders.

   Based on the above, the ASB concluded that DDT is a portion of the dividends paid to taxation authorities on behalf of its shareholders. Therefore, DDT in substance is payment by the company on behalf of the shareholders and thus, will be covered under paragraph 65A of the IT Act.

With respect to presentation of the DDT, the ASB is of the view that the relevant guidance is in paragraph 61A of Ind AS 12. Para 61A states that 'current tax and deferred tax shall be recognised outside profit or loss if the tax relates to items that are recognised, in the same or a different period, outside profit or loss.

Accordingly, the ASB clarified that the presentation of DDT paid on dividends should be consistent with the presentation of the transaction that creates those income tax consequences, as follows:

a. **Dividend charged to statement of profit and loss:** Charge DDT to the statement of profit and loss.

b. **Dividend recognised in statement of changes in equity:** Recognise DDT in the statement of changes in equity.