ICAI: PRESENTATION OF DIVIDEND AND DIVIDEND DISTRIBUTION TAX

Question: What is the presentation requirement as per Ind AS in India for dividend and dividend distribution tax thereon?

Response:

Presentation of Dividend

The paragraphs 35 and 36 of Ind AS 32, *Financial Instruments: Presentation,* reproduced hereunder relate to recognition of dividend declared on financial instruments.

''35 Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be recognised by the entity directly in equity. Transaction costs of an equity transaction shall be accounted for as a deduction from equity.

36 The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Thus, dividend payments on shares wholly recognised as liabilities are recognised as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognised in profit or loss, whereas redemptions or refinancings of equity instruments are recognised as changes in equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.''''

In view of the above, if a financial instrument is classified as debt, the dividend or interest paid thereon is in the nature of interest which is recognised in profit or loss. Dividend or interest paid on a financial instrument which is classified as equity, should be recognised in the Statement of Changes in Equity.

Amendment in Ind AS 12 effective from accounting periods beginning on or after 1st April, 2019

Paragraph 52B of Ind AS 12, *Income Taxes*, has been deleted in order to clarify whether the tax consequences of dividends should be presented in Statement of Profit and Loss or Other Comprehensive Income (OCI) or in the Statement of Changes in Equity (SOCIE). Paragraph 52B has been deleted and replaced with Paragraph 57A which has been rephrased suitably. Relevant paragraphs are as follows:

Paragraph 52A: "*In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In*

these circumstances, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits."

~~Paragraph 52B: "*In the circumstances described in paragraph 52A, the income tax consequences of dividends are recognised when a liability to pay the dividend is recognised. The income tax consequences of dividends are more directly linked to past transactions or events than to distributions to owners. Therefore, the income tax consequences of dividends are recognised in profit or loss for the period as required by paragraph 58 except to the extent that the income tax consequences of dividends arise from the circumstances described in paragraph 58(a) and (b).*"~~

Paragraph 57A: *"An entity shall recognise the income tax consequences of dividends as defined in IFRS 9 when it recognises a liability to pay a dividend. The income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity shall recognise the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events."*

Primarily, in the rephrased paragraph 57A, 1st part of 1st sentence of old paragraph 52B has been deleted to remove the link between differential tax rate structures of Paragraph 52A and presentation of tax consequences of dividend mentioned in paragraph 52B.

Presentation of Dividend Distribution Tax:

In the context of above-mentioned amendment to Ind AS 12, a need has arisen to clarify the presentation of dividend distribution tax (DDT), which is a unique feature of India Tax Regime. In respect of presentation of DDT, paid as per Income Tax Act, 1961, it is important to bear in mind the provisions of paragraph 65A of Ind AS 12 reproduced below:

"65A 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."

Paragraph 65A would apply where an entity pays a portion of the dividends to taxation authorities on behalf of shareholders. In this regard, it may be noted that while paragraph 65A uses the term „withholding tax", however, this term has not been defined anywhere in the Standard nor there is any definition under the Income Tax Act. Further, withholding tax is only an example of tax collection mechanism envisaged by the Standard. Therefore, the standard does recognize 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.

Consideration and evaluation of following indicators would be relevant to ascertain whether DDT is a portion of the tax paid by company on behalf of its shareholders, is evaluated: **A. Whether the dividend has been received with an imputed tax credit.**

In India, the dividend is received by the shareholders with an imputed tax credit in the sense that it will not be charged to further tax by the taxation authorities in the hands of shareholders, implying that DDT is covered by situation of paragraph 65A.
In India, dividends are not taxable in the hands of shareholders considering that DDT is paid by the company that distributed the dividend. Had there been no DDT mechanism, dividends received would have been taxable in the hands of recipients, though recently it has been made taxable if the amount of dividend exceeds specified limits. In this situation also, tax rate applicable is at lower rate in view of the fact that tax on dividend has already been collected in the form of DDT.

B. Receipt of net/full amount of dividend declared and 'Grossing up' of DDT by the Finance Act, 2014

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. This implies that DDT is a tax paid by company on behalf of its shareholders.

It is pertinent to note that DDT mechanism was introduced to replace the mechanism of tax deduction at source, commonly referred to as withholding tax primarily to reduce the operational difficulties involved in that tax collection structure.

Importantly, in the year 2014, Finance Act had brought in the concept of „grossing up" of base amount used for computing DDT. The intention behind this 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.

The above lead to inference that DDT is a portion of the dividends paid to Taxation Authorities on behalf of its Shareholders.

Therefore, in view of the above, DDT in substance, is payment by the company on behalf of shareholders and, therefore, covered by paragraph 65A. Further, following paragraph of Ind AS 12 is relevant with regard to the presentation of dividend distribution tax paid:

''61A 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. Therefore, current tax and deferred tax that relates to items that are recognised, in the same or a different period:

(a) in other comprehensive income, shall be recognised in other comprehensive income.

(b) directly in equity, shall be recognised directly in equity.''

In view of the above, presentation of DDT paid on the dividends should be consistent with the presentation of the transaction that creates those income tax consequences. Therefore, DDT should be recognised in profit or loss if the dividend/interest itself is recognised in profit or

loss. If the dividend is recognized in equity, the presentation of DDT should be consistent with the presentation of dividend, i.e., to be recognized in equity.

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