Frequently Asked Questions (FAQs) regarding Dividend Distribution Tax

This FAQ on Dividend Distribution Tax has been issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI). The purpose of this FAQ is to illustrate and to assist in clarifying the requirements regarding treatment of Dividend Distribution Tax

Question: What are the presentation requirements as per Ind AS for dividend and dividend distribution tax thereon, if an entity has issued certain financial instruments that are classified as debt as per the provisions of Ind AS 32, *Financial Instruments: Presentation*? What would be the presentation requirements in this regard, if the financial instruments issued are classified as equity or if these are compound financial instruments and bifurcated into debt and equity?

Response:

With regard to the recognition of dividend declared on financial instruments, paragraphs 35 and 36 of Ind AS 32 reproduced hereunder may be noted:

‘‘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 charged to 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. In case of a compound financial instrument, the dividend or interest allocated to debt portion shall be charged to profit or loss and the portion of dividend or interest pertaining to equity shall be recognised in Statement of Changes in Equity.

With regard to the income tax consequences of dividend, paragraphs 52A and 52B of Ind AS 12, *Income Taxes,* provide as under:

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.

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 52A deals with the aspect where 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. However, as per paragraph 52B, income tax consequences of dividends are to be presented in profit or loss where it is linked to past transactions and events recognised. The ASB is of the view that in India the rate of income tax for company on taxable income does not change if a company distributes dividend. In India, the dividend distribution tax is a tax that is computed on the basis of the amount of dividend distributed to shareholders rather than based on the amount of profits earned and it arises at the point of time when the profits are distributed. Therefore, Indian scenario is different from the income tax consequences in other jurisdictions, which are covered by paragraph 52A of Ind AS 12.

In this context, following paragraph 65A of Ind AS 12, *Income Taxes,* as reproduced below may also be noted:

"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."

In India, dividends are not taxable in the hands of shareholders considering that DDT is paid by the company that paid the dividend. Had there been no DDT mechanism, dividend would have been taxable in the hands of recipients, though recently it has been made taxable if the amount of dividend exceeds a specified limit. Therefore, in view of paragraph 65A, DDT is, in substance, of the nature of withholding tax. Therefore, the Board is of the view that the nature of payment of DDT in India is not similar to the scenario covered under the current paragraph 52A. Accordingly, the following paragraph of Ind AS 12, *Income Taxes* 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 charged to profit or loss if the dividend itself is charged to profit or loss. If the dividend is recognised in equity, the presentation of DDT should be consistent with the presentation of the dividend, i.e., to be recognised in equity. Accordingly, in case of combined financial instruments, bifurcated into debt and equity, the portion of DDT related to dividend/interest to the debt component should be recognised in profit or loss and that related to equity component should be recognised in equity.