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Dear Readers,

Greetings for the season!

In this edition, we bring you to quite a few interesting articles.

The article on 'All About Dividends & Tax' deals with the budget proposal on changes pertaining to DDT and consequential amendments and impact thereon.

The second part of article on "GST implications on development of plots" deals with liability of developer and landowner qua their sales to respective customers and impact of credit thereof definitely would be an interesting read.

I hope that you will have good time reading this edition and please do share your feedback. I will also urge clients to mail us topics or issues on which you want us to deliberate in our future editions, so that we can contribute to the same.

Thanking You,

Suresh Babu S
Chairman &Managing Partner

DIRECT TAXATION

ALL ABOUT DIVIDENDS AND TAX

Contributed by CA Suresh Babu S & CA Sri Harsha |

One of the significant issues that caught everyone's attention in the recent budget was the amendment to Section 115-O of IT Act[1] which deals with dividend distribution tax (for brevity 'DDT'), wherein the effect of amendment is that the domestic companies need not pay such DDT for any amount declared, distributed or paid by way of dividends post 31st March 20. In this article, we would detail the various issues which gets touched upon as a consequence to such amendment.

Pre-Budget Position – Taxability:

Prior to amendment, Section 115-O used to state that any domestic companies which declare, distribute or pay any amounts by way of dividends, the same would be subjected to an additional tax of 15%[2] (plus surcharge and cess) on the dividend declared. The said DDT is in addition to the normal income tax payable by the company.

Since the company is subjected to pay such DDT, the said dividend was exempted in the hands of share holders by virtue of Section 10(34) of IT Act. However, the said exemption is not provided for certain dividends which are regulated by Section 115BBDA with effect from 01.04.17. Vide said section, a 'specified assessee 'is subjected to an additional tax of 10% (plus surcharge and cess) on dividend income which is received exceeding Rs 10 lakhs. The definition of 'specified assessee' excludes a domestic company or fund or institution or other similar kinds referred in certain sub-clauses of Section 10(23C) or trust registered under Section 12A and 12AA.

Hence, individual shareholders who are in receipt of dividends exceeding Rs 10 lakhs (whether from one or more domestic companies) in a year, were subjected to an additional tax at the rate of 10% (plus surcharge and cess) apart from the company paying the DDT.

Post Budget Position – Taxability:

As discussed earlier, the budget has amended Section 115-O to state that the domestic company is not obliged to pay DDT for the dividends declared post 31st March 20. Since the domestic company is not under obligation to pay such DDT, the exemption in the hands of shareholder or additional tax paid by specified assessee is also amended.

Hence, the position for the dividends declared post 31st March 20 would be that they will be taxable in the hands of shareholders with the omission of tax at company's level. The shareholders would be required to pay tax at rates applicable (based on their total income) plus surcharge and cess. Since the entire dividend is taxable in the hands of shareholder, the significance of Section 115BBDA is lost and accordingly the said section is also proposed to be omitted for dividends declared post 31st March 20.

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[1]Income Tax Act, 1961

[2]In cases of dividends which are in the nature specified vide Section 2(22)(e), the rate of tax is 30%.

Tax Deduction at Source:

Prior to the budget, since the DDT was paid at company's level and exempted in the hands of shareholder (except in the case of specified assessee), there was no withholding obligation under Section 194 for payments of dividend which are in the nature mentioned vide Section 115-O made to Indian shareholders. Further, the dividends paid to non-resident not being a company or foreign company, the dividends are not subjected to any withholding obligation. Section 195 which deals with withholding obligations for payments made to non-resident not being a company or foreign company also excludes dividends in the nature of Section 115-O from such withholding requirements.

However, post budget the current situation will be subjected to change. The amendment in Section 194 states that the domestic company liable to pay dividend to resident Indian shareholder is liable to deduct tax at rate of 10% if the pay-out is more than INR 5,000. Further, the domestic company paying dividends to non-resident shareholders or foreign company would now be subjected to withholding obligations qua Section 195. The rate of withholding from the perspective of domestic law would be 20% in terms of provisions of Section 115A, since the reference to the dividends in nature of Section 115-O is omitted. However, the shareholder resident outside India can take the beneficial rate, if provided in DTAA[3] subject to other conditions specified therein.

Inter-Corporate Dividends:

Prior to budget, Section 115-O used to provide provisions for dealing with cascading effect of taxes. The said section provides that the domestic company will be allowed to reduce the dividends received from subsidiary domestic company, if the subsidiary domestic company has paid DDT when it declared such dividends. In case of foreign subsidiary company, the dividend is allowed to be reduced, if the holding company has paid tax on such dividend under Section 115BBD on such dividend. This is required because, in absence of this, the tax would have been paid twice on the same dividend.

Post budget, since dividends distributed are excluded from taxability under Section 115-O, a new section has been proposed in terms of Section 80M, wherein it states that a company receiving dividend from another domestic company, the dividend received by the first mentioned company shall be excluded from the gross total income if such first company declares divided on or before the due date for filing the return. This is required because, in absence of this, the dividends declared by company B and received by company A would be subjected to tax in the hands of company A and when company A further declares dividend, the same would be subjected to tax again in the hands of shareholder. Section 80M ensures that such dividend would not be subjected to tax twice and accordingly states that dividends would not be included in company A, if such company A further declares dividend before filing of the return.

However, the amendment did not cover instances where the dividend is declared by foreign company and received by company A (in example supra) and further distributed to shareholders of company A. Hence, to this extent the company A would have to pay dividend under Section 115BBD and shareholders receiving, will have to pay again. An amendment to remove this anomaly is need of the hour in order to avoid double tax on the same dividend assuming the same is declared prior to filing of the return. The new

[3] Section 90(2) allows the non-resident (not being a company) or foreign company chose provisions of DTAA or domestic law which are more beneficial to them.

Section 80M, however, removed the earlier restriction of exclusion of dividends received from subsidiary alone and extended to any domestic company. Further, the company receiving dividend from another company, which was earlier exempted under the provisions of Section 10(34)and not required to be added in the total income and accordingly not subjected to payment of minimum alternative tax (for brevity 'MAT'), will be subjected to MAT now.

Deduction of Expenses:

Prior to budget, since the dividends are exempted in the hands of shareholders and such income not being included in total income, any claim of expenditure relating to earning of such income was not allowed by tax authorities virtue of provisions of Section 14A. The said section states that no expenditure would be allowed in relation to such income which does not form part of total income. Basis such provisions, the tax authorities used to contend that any expenditure (majorly interest which is paid for raising funds to purchase shares of other company) will not be allowed to be claimed since such expenditure is in relation to the dividend (exempt income). The contention of the taxpayer that the shares of the other company were purchased with an intention to gain/retain control and since the dominant intention is not to earn dividend (exempt income) but to gain/retain control, such interest paid shall not be treated as expenditure in relation to earn dividend (exempt income). Another contention which was put forward by taxpayer is that the interest paid is to buy the shares and sell them, whenever there is a profit and not with an intention to earn dividend and hence the expenditure of interest should be allowed since the activity of the taxpayer is business and not investments. As long as the activity is the trading of shares and not an investment, the provisions of Section 14A should not be applicable was strongly contested by the taxpayer.

The Honourable Supreme Court had occasion to deal with the above two contentions put forth by taxpayers in the matter of Maxopp Investment Limited vs Commissioner of Income Tax, New Delhi and Principal Commissioner of Income Tax -I vs DB Corp Limited[4] , wherein it was held that the theory of dominant nature does not stand the test of Section 14A and accordingly held that interest expenditure incurred for acquiring shares for gaining/retaining control is not allowable as expenditure. The reason quoted by the Honourable Court is that, the taxpayer is aware at the time of the investment that he may generate dividend and, in such case, the entire dividend will be earned by taxpayer alone, which is not the case when the shares are held as trade.

However, as far as the contention that the shares are purchased for trading and not as investments, the Honourable Supreme Court in the same matter held that, interest expenditure incurred for acquiring shares for the purposes of trading is allowable and the provisions of Section 14A would not be applicable despite the fact that the such holding of shares for trading purposes would yield certain dividend (exempt income) incidentally. This is because the taxpayer would not know at the time of investment whether such shares would yield him dividend or not, since the main purpose being to liquidate shares when the price goes up.

Post budget, the entire issue of applicability of Section 14A would not arise, since the dividend is no longer exempted in the hands of shareholder. Hence, it appears that the expenditure incurred in relation to earning such dividend income gets completely allowed. However, that would have been the case, if

[4] 2018 (3) TMI 805- Supreme Court

there was no amendment to Section 57. The said amendment states that there shall be no deduction against dividend income except interest, with a maximum cap of 20% of such dividend income.
With the above amendment in place the situation would be those taxpayers who would be purchasing shares of other company for gain/retain of control and earn dividend income incidentally and claim full interest, the tax authorities would place reliance on Honourable Supreme Court judgement in the matter of Maxopp Investment Limited (supra) and reject that the intention of acquisition is not relevant and accordingly try to restrict the interest expenditure to the extent of 20% of dividend income. However, those taxpayers who continue to hold shares with an intention to trade and not for the purposes of investment can claim entire deduction of interest under Section 36(1)(iii), since such dividend will be taxable under the head profits and gains from business or profession.

Dividend vs Buy-Back:

The company would be having multiple ways to remunerate the shareholders. The dividend method is sorted as there would not be any reduction in the share capital as compared to other ways namely buy-back and others. However, the company can choose a tax efficient model to remunerate its shareholders. Hence, it is required that a closely held company do the tax impact in possible methods namely, dividend pay-out or buy-back, and choose to implement such method which entails low tax outflow (at both company and shareholders level). However, there might be a potential litigation from the tax authorities by invoking provisions of General Anti-Avoidance Rule (for brevity 'GAAR').

The provisions of GAAR gives power to tax authorities to declare an arrangement to be an impermissible avoidance arrangement if the main purpose of the arrangement its to obtain tax benefit and such arrangement lacks commercial substance. The applicability of GAAR would trigger if the tax benefit is more than INR 3 Crore. Hence, the tax authorities might test the buy-back arrangement over the dividend pay-out, if the tax benefit[5] in buy-back option is more than INR 3 Crore.

However, the taxpayer can substantiate the existence of commercial substance and prove that the arrangement of buy-back is not to mainly obtain the tax benefit and accordingly be out of the ambit of GAAR. The said view also garners support from the Example 12 of Expert Committee Report on GAAR, where it was stated that, whether to pay dividend to its shareholder, or buy back its shares or issue bonus shares out of accumulated reserves is a business choice of a company and further at which point of time a company makes such a choice is its strategic policy decision and such decisions cannot be question under GAAR. However, such a suggestion is not considered by the Government when it has released the Circular dealing with FAQs. Hence, the implementation of the arrangement may be questioned by the tax authorities.

This could be a potential issue going forward, because of the tax impact the dividends method may result in when compared with the buy-back method. In buy-back method, the company has to pay tax at rate of 20% on distributed income and the said income is exempted in the hands of shareholder. Whereas in the case of dividend, the same is not taxable at the company level and taxable in the hands of shareholder at the applicable rates, current highest being more than 40%. Hence, on a collective basis, the tax outflow

[5] FAQ 14 vide Circular 7/2017 has clarified that 'tax benefit' has to be calculated qua arrangement and the limit of INR 3 Crores cannot be read in respect of a single tax payer.

would be higher in dividend method declared post 31st March 20. This makes the company to opt for buy-back method rather than dividend method, if the company is fine with alteration in the share capital. Hence, the potential test under GAAR is going to come in near future.

Conclusion:

The above are certain aspects which we wanted to discuss in this piece. Undoubtedly, there would be many more issues which requires a re-look and re-consideration. Any further thoughts on this can be shared with us at **suresh@sbsandco.com** and **harsha@sbsandco.com**

GST

GST IMPLICATIONS ON DEVELOPMENT OF PLOTS

Contributed by CA Sri Harsha & CA Manindar

Introduction:

This article is a continuation to our article in previous edition. In the previous article, we took up to deal the tax implications on development of plots, wherein, we have identified four transactions which are common to any development agreement:

Transaction I - Transfer of Development Rights (TDR) by landowner to developer
Transaction II - Construction Services provided by developer to landowner
Transaction III - Sale of Plots allotted to his share by developer
Transaction IV - Sale of Plots allotted to his shared by landowner

The tax implications on Transaction I and Transaction II are dealt in the previous article. Now, in this article, we wish to deal with tax implications on Transaction III and Transaction IV and conclude with our comments.

Sale of Plots allotted to his share by developer:
(Transaction – III)

Schedule III of the CT Act[1] provides for a list of transactions which are neither supply of goods nor supply of services. Transaction by way of sale of land is covered under entry 5 of schedule III of the CT Act which implies that the sale of land is excluded from the meaning and scope of supply.

In view of the above entry, transactions by way of sale of land get excluded from the ambit of supply. The developed plots are nothing but land. Hence, the transactions of sale of plots by developer would be out of the ambit of definition of 'supply' and accordingly no tax obligation exists. The payment of stamp duty on the entire consideration received from the customer also proves that the intent of the developer and customer is to deal in land and customer is not interested in taking services from the developer.

However, if the developer chose to pay stamp duty only on part of the consideration, stating that, the remaining is towards development charges, then there might arise a situation where in there is a potential scope for litigation. The tax authorities may state that since the stamp duty was not paid on the entire consideration, the intention among the developer and customer is not to deal in land alone but also for availing certain services from the developer and accordingly demand tax on the entire amounts received from customers at applicable rates.

However, the act of tax authorities demanding tax on the entire consideration is questionable, in absence of support from the provisions. Entry 5(b) of Schedule II states that construction of complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where entire consideration has been received after issuance of completion certificate, where required, by competent authority or after its first occupation, whichever is earlier as supply of service.

[1]Central Goods & Services Tax Act, 2017

Whether the said entry can be said to be applicable for plots also would be the question. Since the said entry deals with complex, building, civil structure or part thereof, whether a plot would fall under any of the above to make the plot also fit in Entry 5(b) of Schedule II?

In our view, an isolated plot which is subject matter of discussion may not fit in the description of complex, building or civil structure and accordingly would be out of the ambit of Entry 5(b). Further, assuming that plot is kind of civil structure or part thereof, since there would not be any issuance of completion certificate for plots, we can conclude that plots were never envisaged in this entry and accordingly, the collection of development charges may not fit under Entry 5(b).

However, the said activity may still be considered as 'works contract' for the customer and accordingly the development charges alone may be subjected to tax at the residuary rate of 18% applicable for 'works contracts'. In our view, the demand of tax only on development charges would be more appropriate in law instead of tax on entire amount received from customer [assuming if the activity of plots also falls under Entry 5(b)].

Further, there would also be situations where advances have been received from the customer, but sale deeds were not entered. Such transactions would also be treated of sale of land, if the developer pays stamp duty on the entire value of consideration received from customers. If the developer has not discharged stamp duty on the entire consideration, then the tax implications as stated earlier would equally applicable. Only question that would arise, is at what point of time should developer discharge tax on the development services, since advance received is both towards land and development services. In our view, apportionment of advances first towards development services would be least litigative.

As far as credit is concerned, if the developer is paying stamp duty on the entire consideration, the tax paid on goods and input services will not be eligible since the output is neither a supply of goods nor services. However, if the developer is paying stamp duty on part of the consideration and paying tax on development charges, the tax paid on goods and input services can be availed.

Sale of Plots allotted to his share by landowner:
(Transaction – IV)

The tax implications in the hands of landowner are not much different from the developer. The entire discussion stated above would equally applicable here. In the previous article, while dealing with transaction of construction services provided by developer to landowner (Transaction II), we have stated that the tax has to be paid on such services. Since, that would be only the major credit, the eligibility of the same would depend upon whether the landowner pays stamp duty on the entire consideration or he choses to pay tax on development charges as discussed for developer.

Conclusion:

From this article and previous one, it is evident that there are certain issues which needs to be settled by intervention by CBIC to avoid any litigation.

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