FICCI Suggests Replacement of DDT with Withholding Tax

DDT ON FOREIGN SHAREHOLDERS RAISES COST OF DOING BUSINESS IN INDIA

NEW DELHI, June 26, 2010. The cost of doing business in India could come down if the Dividend Distribution Tax (DDT) on foreign shareholders is replaced by a withholding tax as under the current system, foreign shareholders are unable to claim credit in the home country for DDT paid in India, resulting in a higher effective tax rate. This, according to FICCI, tantamounts to imposing an additional business cost for doing business in India.

FICCI has therefore pleaded for a '**split kind of system**' whereby DDT is levied on domestic shareholders and withholding tax on foreign shareholders. Else, it has suggested that an option be made available to the shareholders to choose between the DDT and the withholding tax.

The suggestion being tax neutral would not result in a revenue loss to the exchequer.

Further, DDT on domestic shareholders is seen by industry as a surrogate tax paid on behalf of the shareholders. Its cascading effect in multilayered corporate entities and high tax rate of 15% is seen as a major irritant in corporate financial restructuring and engineering.

Section 115-O dealing with tax on distributed profits of domestic companies, provides that any amount declared, distributed or paid by any domestic company by way of dividends shall be charged to additional income tax – called Dividend Distribution Tax (DDT) at the base rate of 15%.

Dividends are distributed out of after tax profits, tax having been already paid by the respective companies, and thus DDT tantamounts to double taxation, which must be avoided. FICCI has suggested that at least, the DDT rate of 15% should be reduced to 10% as was the position prior to 2003.

More importantly, the cascading impact of DDT needs to be avoided. While the Finance Act 2008 did initiate steps to mitigate its impact by providing that domestic holding company will not have to pay DDT on dividends paid to its shareholders to the extent it received dividends from its subsidiary company on which DDT has been paid by the subsidiary, inter-alia providing that the benefit will not be available if the holding company is itself a subsidiary of another company. In other words, the reduction benefit is available only up to one level. It has been further clarified that for this purpose, a company shall be said to be subsidiary of another if such other company holds more than half the nominal value of equity share capital of the company. Also that the same amount of dividend shall not be taken into account for reduction more than once.

FICCI has noted that while this was a welcome initiative, it has mitigated the cascading effect of DDT only partially. The restriction of benefit of reduction only up to one level has not gone far enough. Multi-layered corporate subsidiaries are key to corporate financial restructuring and engineering. In this perspective, FICCI has stressed that the reduction benefit should be extended up to the last level of this chain. The amount of dividend on which DDT has been paid at the first level should be allowed to be reduced in the hands of each subsequent level of holding-subsidiary relationship. Also, that investment companies which do not necessarily hold subsidiaries and invest in various companies in the open market should be eligible for such reduction on further distribution of the dividend amount on which DDT has already been paid.

FICCI feels that the ideal solution of the problem would be the revival of section 80M which we had till 31st March 2004 in our Income Tax Act. Under this section, where the gross total income of a domestic company, in any previous year, included any income by way of dividend from another domestic company, a deduction was allowed in computing the total income of such domestic company of an amount equal to so much of the amount of income by way of dividends from another domestic company as did not exceed the amount of dividend distributed by the first mentioned domestic company.

That apart, the benefit of the said deduction will not be available to a holding company in India, which is a “subsidiary” of foreign company. Dividend remittance from overseas subsidiary and associate should be exempted from Indian income tax if the same is already taxed in the source country.