Impact of Dividend Distribution Tax Policy on Small Investors

According to the provision of dividend distribution tax (DDT) introduced in 1996-97, the amount of dividend received in the hands of shareholders is exempt from tax. Companies need to reduce the amount of DDT from gross dividend amount decided by the company as an appropriation of profits. Companies can neither treat DDT as deductible expenditure similar to that of income tax paid nor issue TDS certificates to the shareholders. This provision has adversely affected the small investors and benefited the high net worth investors, institutional investors or promoters (the large category investors). Retail investors who are not liable to pay any income tax or those who are falling in the tax slab of 10% (DDT being 15%) are the ultimate losers whereas the large category investors in tax slabs 20% or 30% are highly benefited. Therefore, the need of the hour is an amendment of Section 115-O in order to remove the injustice done to small investors. Read on…

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Introduction

Some years back, in India, the dividend amount was taxable in the hands of dividend recipients. Most of the small investors were not having any tax liability but the corporate sector, high net worth investors (HNIs) and promoters (all of them termed as large category investors herein after) were falling in the highest-tax slabs. After some time, mainly the large category tax payers started requesting the Government to allow the income from dividends to be exempt from income tax in the hands of recipients. The Government accepted the demand but simultaneously introduced the dividend distribution tax (DDT) to be paid by the companies. The Government and the tax authorities clarified that the DDT to be paid by the companies will have to be an appropriation of profits and not expenditure deductable for income tax calculations of the company. Therefore, the amount to be paid as DDT is reduced out of the amount decided by the companies for payment of the dividend.

The DDT provision introduced in 1996-97 states that the companies cannot treat this tax payment as

deductible expenditure similar to the income tax paid by the companies in their profits. The companies have also been barred from issuing TDS certificates to the shareholders. Also, the recipients of dividend cannot treat this amount as a TDS, even though the tax has been paid by the company on their behalf (out of gross amount of dividend). The Government should accept one of the two options. Firstly, if DDT is the tax liability of the company, it should have been treated equal to the normal income tax liability of the company. Secondly, if that is not the case, it has to be treated as TDS by the company. By not doing both, the taxpayers who are not liable to pay any income tax or those who are falling in the tax slabs of 10% (DDT rates are 15%), are at a substantial loss due to payment of DDT. On the other side, the taxpayers in tax slabs of 20% or 30% are highly benefited as they pay only 15% tax on the dividend amount (in the form of DDT) instead of regular tax payable by them on their total taxable income.

When this provision was introduced, investors were very happy that their demand was easily accepted for making the amount of dividend received in their hands tax free. This provision of DDT has benefited the large category investors, Government (IT Department) and the company declaring dividend. The large category investors benefit on dividend received due to reduced tax liability from 30% to 15%. The Government has saved crores of rupees as administrative cost of Income Tax Department for verifying the tax payment, verifiability of tax returns for millions of taxpayers, etc. Also, the Government receives a single cheque of DDT amount from the concerned company without any hassle. The company is not at any loss, as it deducts the DDT from the gross dividend amount which actually belongs to the shareholders and also saves on paperwork and printing cost of TDS certificates.

The Government of India has a right to amend the existing provisions of the Income-tax Act based on the suggestions made by investors. But these amendments should not result in penalising any category of investors and more so the retail investors.

The Standing Committee Report on Direct Taxes Code, 2010 pointed out:

1. The provisions of DDT should bring equity.
2. The proposed taxation is not equitable as it provides huge concession to persons in the 30% tax bracket.
3. There should be some exemption from DDT for small investors for investment in shares.

To that, the Government contended:

1. Before introduction of DDT on companies, TDS was to be deducted by the companies and dividend was taxable in the hands of recipients. Credit of TDS was allowed to shareholders.
2. In view of various administrative difficulties, DDT provision was introduced whereby tax is paid by the company out of the distributable surplus at the time of distribution of dividends and income by way of dividends received by the shareholders is treated as exempt from tax.
3. There cannot be a separate rate of DDT for small and large shareholders as the tax is being levied on the company and not on the shareholders.
4. Even if the rate is lowered in case of small shareholders, such shareholders are not benefited as all shareholders have to be paid dividend at same rates.
5. DDT (@15% in the hands of the company) need not end up in a concession for persons in 30% tax bracket. Even if the dividend was to be taxed in their hands, their net tax liability may end up less than 30% due to deduction of expenses like interest, etc., from their income.

Here, the objective is to identify the adverse impact on the retail investors, due to implementation of DDT.

Our Observations

Our study establishes the Government's contention that the DDT is payable by the companies and not by the shareholders and, then, that the large category shareholders may not necessarily be in tax bracket of 30% only, does not hold water.

We shall be establishing our point, in details mentioned below, as to how the provision of DDT has adversely affected the small investors and benefited the large category investors. In order to understand the impact of DDT on small investors, we consider four cases/companies, viz. Hero Motor Corp., Infosys Ltd, ONGC and Reliance Industries Limited.

The DDT provision introduced in 1996-97 states that the companies cannot treat this tax payment as deductible expenditure similar to the income tax paid by the companies in their profits. The companies have also been barred from issuing TDS certificates to the shareholders.

The average number of shares with the retail investors is so low that majority of them will not fall in the taxable category. Even if some of them fall in that category, that would be 10% tax slab. (Refer to Table nos. 1.1, 2.1, 4.1).

Calculations have been done for both categories of the retail investors and we find that in both cases they are losers. (Refer to Table nos. 1.2.1, 1.2.2, 2.2.1, 2.2.2, 3.1.1, 3.1.2, 4.2.1, 4.2.2)

In case of large category investors, average number of shares held by each institution and each promoter respectively is so large that there cannot be a case when the income tax bracket can be lesser than the 30% + surcharge + cess. (Refer to Table nos. 1.3, 1.4, 2.3, 2.4, 3.2, 3.3, 4.3, 4.4

Case 1: Hero Motor Corp

Table 1.1: Average Number of Shareholders under each category

Year	Total No. of retail share-holders	Total No. of shares with retail investors	Average No. of shares with retail investors	Total No. of insti-tutional share-holders	Total No. of shares with insti-tutional investors	Average No. of shares with institutional investors	Total No. of promot-ers	Total No. of shares with promoters	Average No. of shares with pro-moters
2009-10	56030	17mn	304	731	73mn	99864	68	110mn	1.62mn
2010-11	66239	20mn	302	611	76mn	124387	24	104mn	4.33mn
2011-12	68602	18mn	263	768	78mn	101563	17	104mn	6.12mn

Table 1.2.1: Retail Investors (under zero/exempt tax bracket)

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Retail Investors (under zero/exempt tax bracket)			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*0 (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	129	19	110	17mn	129*17*0=0	323mn	323mn
2010-11	122	28	94	20mn	122*20*0=0	560mn	560mn
2011-12	52	7	45	18mn	52*18*0=0	126mn	126mn

Table 1.2.2: Retail Investors (under 10.3 percent tax bracket)

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Retail Investors (under 10.3 percent tax bracket)			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*10.3% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	129	19	110	17mn	2193*10.3=226mn	323mn	97mn
2010-11	122	28	94	20mn	2440*10.3=251mn	560mn	309mn
2011-12	52	7	45	18mn	976*10.3=96mn	126mn	30mn

Table 1.3: Institutional Investors

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Institutional Investors			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*32.45% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	129	19	110	73mn	9417*32.45 =3056mn	1387mn	1669mn
2010-11	122	28	94	76mn	9272*32.45 =3009mn	2128mn	881mn
2011-12	52	7	45	78mn	4056*32.45 =1316mn	546mn	770mn

Table 1.4: Promoters

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Promoters			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*30.9% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	129	19	110	110mn	14190*30.9 = 4385mn	2090mn	2295mn
2010-11	122	28	94	104mn	12688*30.9 = 3921mn	2912mn	1009mn
2011-12	52	7	45	104mn	5408*30.9 =1671mn	728mn	943mn

Case 2: Infosys Ltd.

Table 2.1: Average Number of Shareholders under each category

Year	Total No. of retail share-holders	Total No. of shares with retail investors	Average No. of shares with retail investors	Total No. of insti-tutional share-holders	Total No. of shares with insti-tutional investors	Average No. of shares with institutional investors	Total No. of promot-ers	Total No. of shares with promoters	Average No. of shares with pro-moters
2009-10	380483	121mn	318	1213	254mn	209398	19	92mn	4.84mn
2010-11	415222	122mn	294	1381	259mn	187545	19	92mn	4.84mn
2011-12	458648	86mn	188	1471	319mn	216859	19	92mn	4.84mn

Table 2.2.1: Retail Investors (under zero/exempt tax bracket)

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Retail Investors (under zero/exempt tax bracket)			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*0 (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	35.6	5.1	30.5	121mn	35.6*121*0 =0	617mn	617mn
2010-11	73.3	12.1	61.2	122mn	73.3*122*0=0	1476mn	1476mn
2011-12	54	8.8	45.2	86mn	54*86*0=0	757mn	757mn

Table 2.2.2: Retail Investors (under 10.3 per cent tax bracket)

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Retail Investors (under 10.3 per cent tax bracket)			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*10.3% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	35.6	5.1	30.5	121mn	4308*10.3 =444mn	617mn	173mn
2010-11	73.3	12.1	61.2	122mn	8943*10.3= 921mn	1476mn	555mn
2011-12	54	8.8	45.2	86mn	4644*10.3= 478mn	757mn	279mn

Table 2.3: Institutional Investors

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Institutional Investors			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*32.45% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	35.6	5.1	30.5	254mn	9042*32.45 =2934	1295mn	1639mn
2010-11	73.3	12.1	61.2	259mn	18985*32.45 = 6161mn	3134mn	3027mn
2011-12	54	8.8	45.2	319mn	17226*32.45 =5590	2807mn	2783mn

Table 2.4: Promoters

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Promoters			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*30.9% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	35.6	5.1	30.5	92mn	3275*30.9 =1012mn	469mn	543mn
2010-11	73.3	12.1	61.2	92mn	6744*30.9 =2084mn	1113mn	971mn
2011-12	54	8.8	45.2	92mn	4968*30.9 = 1535mn	810mn	725mn

Case 3: ONGC[1]

Table 3.1.1: Retail Investors (under zero/exempt tax bracket)

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Retail Investors (under zero/exempt tax bracket)			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*0 (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	38.41	5.43	32.98	294mn	11293*0= 0	1596mn	1596mn
2010-11	10.18	1.42	8.76	1180mn	12012*0=0	1676mn	1676mn
2011-12	8.65	1.54	7.11	1182mn	10224*0=0	1820mn	1820mn

Table 3.1.2: Retail Investors (under 10.3 per cent tax bracket)

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Retail Investors (under 10.3 per cent tax bracket)			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*10.3% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	38.41	5.43	32.98	294mn	11293*10.3= 1163mn	1596mn	433mn
2010-11	10.18	1.42	8.76	1180mn	12012*10.3=1237mn	1676mn	439mn
2011-12	8.65	1.54	7.11	1182mn	10224*10.3=1053mn	1820mn	767mn

Table 3.2: Institutional Investors

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Institutional Investors			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*32.45% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	38.41	5.43	32.98	259mn	9948*32.45 =3228mn	1406mn	1822mn
2010-11	10.18	1.42	8.76	1032mn	10506*32.45 =3409mn	1465mn	1944mn
2011-12	8.65	1.54	7.11	1450mn	12543*32.45 =4070mn	2233mn	1837mn

Table 3.3: Promoters

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Promoters			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*30.9% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	38.41	5.43	32.98	1586mn	60918*30.9 = 18824mn	8612mn	10212mn
2010-11	10.18	1.42	8.76	6342mn	64562*30.9 = 19950mn	9006mn	10944mn
2011-12	8.65	1.54	7.11	5922mn	51225*30.9 =15828mn	9120mn	6708mn

[1] *We are unable to gather the information on the total number of shareholders in the retail, institutional and promoter categories. Thus, average number of shareholders in each of these categories could not be calculated.*

Case 4: Reliance Industries Limited

Table 4.1: Average Number of Shareholders under each category

Year	Total No. of retail share-holders	Total No. of shares with retail investors	Average No. of shares with retail investors	Total No. of insti-tutional share-holders	Total No. of shares with insti-tutional investors	Average No. of shares with institutional investors	Total No. of promot-ers	Total No. of shares with promoters	Average No. of shares with pro-moters
2009-10	3559853	762mn	214	2252	924mn	410302	41	1464mn	35.7mn
2010-11	3519740	755mn	215	2309	932mn	403638	68	1464mn	21.53mn
2011-12	3406044	770mn	226	2125	925mn	435294	62	1464mn	23.61mn

Table 4.2.1: Retail Investors (under zero/exempt tax bracket)

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Retail Investors (under zero/exempt tax bracket)			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*0 (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	7.70	1.10	6.60	762mn	7.70*762mn*0 = 0	838mn	838mn
2010-11	8.80	1.22	7.58	755mn	8.80*755mn*0 = 0	921mn	921mn
2011-12	9.31	1.39	7.92	770mn	9.31*770mn*0 = 0	1070mn	1070 mn

Table 4.2.2: Retail Investors (under 10.3 per cent tax bracket)

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Retail Investors (under 10.3 per cent tax bracket)			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*10.3% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	7.70	1.10	6.60	762mn	5867*10.3 = 604mn	838mn	234mn
2010-11	8.80	1.22	7.58	755mn	6644*10.3 = 684mn	921mn	237mn
2011-12	9.31	1.39	7.92	770mn	7169*10.3 = 738mn	1070mn	332mn

Table 4.3: Institutional Investors

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Institutional Investors			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*32.45% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	7.70	1.10	6.60	924mn	7115*32.45 = 2309mn	1016mn	1293mn
2010-11	8.80	1.22	7.58	932mn	8202*32.45 = 2662mn	1137mn	1525mn
2011-12	9.31	1.39	7.92	925mn	8612*32.45 = 2795mn	1286mn	1509mn

Table 4.4: Promoters

Year (1)	Gross Dividend Per share (2)	DDT per share (3)	Net Dividend per share (4)	Promoters			
				Number of shares (5)	Gross dividend *Normal tax rate =(2)*(5)*30.9% (6)	DDT =(3)*(5) (7)	Net Loss =(6)-(7) (8)
2009-10	7.70	1.10	6.60	1464mn	11273*30.9= 3483mn	1610mn	1873mn
2010-11	8.80	1.22	7.58	1464mn	12883*30.9= 3981mn	1786mn	2195mn
2011-12	9.31	1.39	7.92	1464mn	13630*30.9= 4212mn	2035mn	2177mn

This clearly implies that DDT exempt in the hands of small investors is not a boon to them. They are ultimately losing their amount of dividend to the tax authorities which could have been with them if the DDT was not introduced. By paying DDT, the large category investors are the ultimate beneficiaries of this provision.

A consolidated view of all the four cases is presented in Annexure 1 of Table 5.

Conclusions and Recommendations

Contentions of the Government for introducing the DDT are not justified. Most of the small investors are not falling in the taxable category. Even if a few are in the taxable category, they are in the 10% bracket. As against this, all the large category investors come under 30% tax bracket Therefore, small investors are losing due to introduction of DDT directly deducted and paid by the companies to the Income Tax Department. On the contrary, large category investors are benefited heavily due to the DDT provisions.

We shall be establishing our point, in details mentioned below, as to how the provision of DDT has adversely affected the small investors and benefited the large category investors. In order to understand the impact of DDT on small investors, we consider four cases/companies, viz. Hero Motor Corp., Infosys Ltd, ONGC and Reliance Industries Limited.

These large category investors should be taxed for their dividend receipts as per their tax bracket applicable for their total income (inclusive of dividend receipts) and not at the rate of DDT.

Moreover, it is not proper to say that the DDT is not paid by the shareholders and is paid by the companies. If DDT is a tax liability of the company, it should not be deducted out of gross amount of dividend, as a part of appropriation of profits. Instead, it should be treated as expenditure deductable similar to normal income tax. As per the procedure followed by the companies, gross dividend amount, after reduction of DDT, is paid as dividend to the shareholders. This means that the deduction of DDT is reducing the eligibility of shareholders for dividend equal to DDT. In reality, the dividend recipients pay tax by receiving less amount of dividend, which they would have received had DDT was not reduced by the company.

Furthermore, after the introduction of DDT (1996-97), a lot of changes have taken place due to introduction of technology by the Government, SEBI, Companies and Income Tax Department. The technological changes such as mandatory dematerialization of investment in shares, making PAN card mandatory for financial transactions, online filing of tax returns, online payment of dividend by the company direct to the bank account of investors and online transfer of tax collections by the banks on same day to the Government are already in use. With these changes, the argument of administrative difficulties and expenditure, which was one of the causes to introduce DDT, has lost its relevance.

Therefore, the need of the hour is an urgent amendment in the "Section 115-O" of the Income-tax Act. The companies should be liable to issue the TDS certificates to shareholders for the amount of DDT. This will remove the injustice being done to the small shareholders at the cost of the large category investors. The shareholders of all categories will be able to get the refund of the amount which is more than their tax liability after taking into account their other income also, if any. It will also remove the anomaly of heavy benefits to the large category investors as they will have to pay the difference between DDT and the actual tax liability as per their taxable Income inclusive of dividend. This amendment will not result in any administrative problems as mentioned above.

Table 5; Amount of Loss or Profit to different category of Shareholders due to Dividend Distribution Tax (DDT) Annexure I

Company	Type of investors		Particulars		Loss — (in Millions)			Profit — (in Millions)		
			No. of Investors		2009-10	2010-11	2011-12	2009-10	2010-11	2011-12
Hero Motor Corp.		**2009-10**	**2010-11**	**2011-12**						
	Retail									
	0% Tax Bracket	56030	66239	68602	323	560	126			
	10.3% Tax Bracket	56030	66239	68602	97	309	30			
	Institutional									
	32.45 Tax Bracket	731	611	768				1669	881	770
	Promoters									
	30.9 Tax Bracket	68	24	17				2295	1009	943
Infosys Ltd.										
	Retail									
	0% Tax Bracket	380483	415222	458648	617	1476	757			
	10.3% Tax Bracket	380483	415222	458648	173	555	279			
	Institutional									
	32.45 Tax Bracket	1213	1381	1471				1639	3027	2783
	Promoters									
	30.9 Tax Bracket	19	19	19				543	971	725
ONGC										
	Retail	Numbers not available								
	0% Tax Bracket				1596	1676	1820			
	10.3% Tax Bracket				433	439	767			
	Institutional	Numbers not available								
	32.45 Tax Bracket							1822	1944	1837
	Promoters	Numbers not available								
	30.9 Tax Bracket							10212	10944	6708
RIL Ltd.										
	Retail									
	0% Tax Bracket	3559853	3519740	3406044	838	921	1070			
	10.3% Tax Bracket	3559853	3519740	3406044	234	237	332			
	Institutional									
	32.45 Tax Bracket	2252	2309	2125				1293	1525	1509
	Promoters									
	30.9 Tax Bracket	41	68	62				1873	2195	2177

Note: For retail investors, same number of shareholders has been taken for calculations at 0% and 10.3% tax brackets to show that they suffer loss in both situations. ■