

CASE STUDY (01 JAN)-INCOME TAX ACT, 1961

QUESTION *Can dividend distribution tax under Section 115-O of Income-tax Act, 1961 be levied in respect of the dividend declared out of agricultural income?*

FACTS OF THE CASE: *The petitioner is a tea company engaged in cultivating and processing tea in its factory for marketing. The cultivation of tea is an agricultural process while the processing of tea in the factory is an industrial process. The petitioners contend that when the company distributes dividend, it is taxed under Section 115-O. The tax on dividend declared by it in this case is nothing but a tax on agricultural income. The legislative competence for taxing agricultural income lies with the State Government and not the Central Government.*

ISSUE: *Can dividend distribution tax be levied on dividend income of a tea company under section 115-O?*

SUPREME COURT'S OBSERVATIONS: *As per entry 82 of List I the Union Parliament has the competence to tax "income other than agricultural income." Section 115-O pertains to additional tax at the stage of distribution of dividend by domestic company which is covered by entry 82 in List I.*

When dividend is declared to be distributed and paid to a company's shareholders it is not impressed with character of the source of its income. The Court relied on Mrs. Bacha F Guzdar v. CIT AIR 1955 SC 74 which looked into the nature of the dividend income in the hands of the shareholders. Dividend is derived from the investment made in the company's shares and the foundation rests on the contractual relations between the company and the shareholder.

Dividend is not 'revenue derived from land' and hence cannot be termed as agricultural income in the hands of a shareholder.

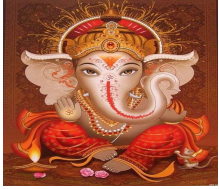
Hence, despite the petitioner's company being involved in agricultural activities, in the shareholder's hands, the income is only dividend and not agricultural income.

The Calcutta High Court had upheld *the vires of section 115-O but put a qualification that additional tax levied under section 115-O shall be only to the extent of 40% which is the taxable income of the tea company.*

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The Supreme Court overturned this cap placed by the Calcutta High Court. Section 115-O is within the competence of the Parliament and hence, no limits can be placed on the same.

Supreme Court's Decision: *When dividend is declared to be distributed and paid to a company's shareholders, it is not impressed with character of the source of its income. Section 115-O is within the competence of the Union Parliament and therefore dividend distribution tax can be levied in respect of the entire dividend declared and distributed by a tea company.*

PLEASE NOTE THAT – *from Budget 2020 the Dividend Distribution Tax (DDT) has been abolished not tax on dividend will be taxable in the hand of investors and companies are required to deduct TDS is applicable at a rate of 5% for dividend income exceeding Rs. 5,000 in a financial year. Therefore, the company distributing the dividend will deduct the TDS on the dividends paid to the shareholders.*

a). Income by way of dividend in excess of Rs 10 lakh would be chargeable at the rate of 10% for individuals, Hindu Undivided Family (HUF) or partnership firms and private trusts.

b). When a holding company receives dividend from its subsidiary company (both being domestic companies), then when the holding company distributes dividend, the amount of dividend liable for DDT will be equal to:- Dividend declared/distributed/paid during the year (less) Dividend received by holding company during the year (subject to certain conditions)

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