TAXATION OF DOMESTIC COMPANIES UNDER THE INCOME TAX ACT, 1961: A DETAILED ANALYSIS OF THE PROVISIONS AND AMENDMENTS INSTITUTED FROM 2013 – 2017 AND THEIR CONSEQUENCE THEREFROM

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DOMESTIC COMPANY: DEFINITION AND SIGNIFICANT PROVISIONS AS TO TAXATION UNDER THE INCOME TAX ACT, 1961

The Domestic Company has been defined under the Section 21(22A), of the Income Tax Act, 1961, as given :

""domestic company" means an Indian company, or any other company which, in respect of its income liable to tax under this Act, has made the prescribed arrangements for the declaration and payment, within India, of the dividends (including dividends on preference shares) payable out of such income."[1]

Some of the provisions as to the taxation of the domestic companies, as defined above, as incorporated under the Income Tax Act, 1961, are explained as given :

Analysis Of The Rates Of Income Tax For The Assessment Year 2017-18 For A Domestic Company As Per Amendments To The Income Tax Act, 1961

Under the Amendments, the rates of income tax on domestic companies for the assessment year of 2017- 2018 has been elucidated as given:

[1] S.21(22A), Income Tax Act, 1961

(i) The rate of income tax for any domestic company, other than those companies referred to in the clauses (ii) and (iii) below is 30%,

(ii) The rate of income tax payable by a domestic company whose total turnover or gross receipt in the previous year 2014-15 does not exceed ` 5 crores is 29%.

(iii) Special rate of income tax in case of newly setup domestic companies engaged solely in the business of manufacture or production of article or thing [Section 115BA] is set at 25%.

Other stipulations include:

Surcharge : A surcharge at the rate of 7% shall be levied if the total income of the domestic company exceeds ` 1 crore but does not exceed `10 crore.

Further, as per the provisions, a surcharge at the rate of 12% shall be levied, in case the total income of the domestic company exceeds `10 crore.

Marginal Relief : The total amount payable as income-tax and surcharge on total income exceeding `1 crore, but not exceeding ` 10 crore, shall not exceed the total amount payable as income-tax on a total income of ` 1 crore, by more than the amount of income that exceeds `1 crore.

Further, the total amount payable as income-tax and surcharge on total income exceeding `10 crore, shall not exceed the total amount payable as income-tax and surcharge on a total income of `10 crore, by more than the amount of income that exceeds `10 crore.

Cess : The 'Education Cess' at the rate of 2%, and the 'Secondary and Higher Education Cess' at the rate of 1% on income tax, which is inclusive of surcharge, if applicable, shall be chargeable.

Provisions Under Section 34A Of The Income Tax Act, 1961:

The Section 34A of the Income Tax Act, 1961, deals with – 'Restriction on unabsorbed depreciation and unabsorbed investment allowance for limited period in case of certain domestic companies.'

[3] S.34A, Income Tax Act, 1961

As per the sub – section 1 of this section, while computing the profits and gains of the business of a domestic company pertaining to the previous year relevant to the assessment year commencing on the 1st day of April, 1992, and also in the case where effect is to be given to the unabsorbed depreciation allowance or unabsorbed investment allowance or both in relation to any previous year relevant to the assessment year commencing on or before the 1st day of April, 1991, the deduction shall be restricted on the ground of the given conditions[3]:

where it relates to depreciation allowance, should be added to the depreciation allowance for the previous year relevant to the assessment year commencing on the 1st day of April, 1993, and should be deemed to be part of that allowance. However, in those cases where there is no such allowance for that previous year, then that should be deemed to be the allowance for that previous year and so on for the succeeding previous years.

where it relates to investment allowance, should be carried forward to the assessment year commencing on the 1st day of April, 1993 and the balance of the investment allowance, if any, still outstanding shall be carried forward to the following assessment year.

However, in the case where the period of eight years has expired before the portion of such balance is adjusted, the said period shall be extended beyond eight years till such time the portion of the said balance is absorbed in the profits and gains of the business of the domestic company.

The other provisions as to taxation of a Domestic Company under the Income Tax Act, 1961, have been critically explained upon and analyzed in the subsequent sections.

SECTION 115BA: TAX ON INCOME OF CERTAIN DOMESTIC COMPANIES

Amendments to Section 115BA under the Finance Act, 2016- A Critical Analysis:

The amendments were brought about to the Section 115BA by the Finance Act, 2016, with effect from Assessment Year 2017-18.[4]

Certain domestic companies given option to be taxed at the special rate of 25% [Section 115BA(1)] :

For the purpose of extending relief tie the domestic companies which are newly set up, and which tend to be engaged only in the business pertaining to the manufacture or production of article or thing, the Section 115BA has been inserted in the Income Tax Act 1962, which extends the option to domestic company to pay tax @25% for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2017.[5] However, such a benefit, as has been incorporated in the section, can be available only subject to the given conditions specified under the Section 115BA(2) :

(a) the company has been set-up and registered on or after 1 -3-2016;

(b) the company is not engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it; and

(c) the total income of the company has been computed,—

without any deduction under the provisions of –

i. section 10AA (relating to special economic zone), or benefit of accelerated depreciation/additional depreciation under section 32(1)(iia), or
ii. benefit of investment allowance under section 32AC or under section 32AD, or
iii. deduction under section 33AB (tea/coffee/rubber development account), or
iv. section 33ABA (site restoration fund), or
v. section 35(1)(ii), (iia), (iii) section 35(2AA), section 35(2AB) (relating to scientific research/social research), or
vi. section 35AC (expenditure on eligible projects and scheme), or
vii. section 35 AD (deduction on account of capital expenditure on specified business), or
viii. section 35CCC (agricultural extension project), or
ix. section 35CCD (skill development project), or

[4]Finance Act,2016

[5] S.115BA, Income Tax Act, 1961

x. any provisions of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" other than the provisions of section 80JJAA;(2) Specified conditions for opting provisions of section 115BA(1) [Section 115BA(2)]

Provisions under Section 115BA(3):

Under section, the provision states that the loss referred to in section 115BA(2)(c)(ii) shall be deemed to have been already given full effect to and no further deduction for such loss shall be allowed for any subsequent year.[6]

Section not to apply unless the option is exercised in the prescribed manner on or before due date specified under section 139(1) [Section 115BA(4)] :

As per this Section, the section shall not apply unless the person exercises the option, in the prescribed manner, which shall also be on or before the due date specified under section 139(1).[7] The Section 139(1) further provided the duration for the purpose of furnishing the first of the returns of which, is required for the person to furnish, in accordance to the provisions of the Act.[8] However, the Proviso to the section specifies that, if the option has been already exercised for any previous year, then the same cannot be subsequently withdrawn for the same or any other previous year.

Provided that once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.

SECTION 115BBDA: TAX ON CERTAIN DIVIDENDS RECEIVED FROM DOMESTIC COMPANIES

Critical Analysis of the Provisions under Section 115BBDA of the Income Tax Act, 1961:

[6] S.115BA(3)

[7] S.115BA(4)

[8] S.139(1)

The Section 115BBDA of the Income Tax Act, 1961, has the title – 'Tax on certain dividends received from domestic companies.'

As per this section, notwithstanding anything contained in this Act, where the total income of an assessee, being:

i. an individual,
ii. a Hindu undivided family, or,
iii. a firm

who or which is resident in India, includes any income in aggregate exceeding ten lakh rupees, and such being there by way of dividends declared, distributed or paid by a domestic company or companies, then in that case, the income-tax payable shall be the aggregate of —

(a) the amount of income-tax calculated on the income by way of such dividends in aggregate exceeding ten lakh rupees, at the rate of ten per cent; and

(b) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of income by way of dividends.

Further, as per the sub – section (2) of this section, that has been stipulated that no deduction shall be allowed to the assessee, under any provision of this Act, in respect of any expenditure or allowance or set off of loss, in the computation of the income by way of dividends referred to in clause (a) of sub-section (1) of the section 115BBDA.[9]

Also, the Explanation (b) to this section, defines a *"specified assessee"*[10] as:

a person other than,—

(i) a domestic company; or

(ii) a fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10; or

[9]S.115BBDA(2)

[10]Explanation (b), S.115BBDA

(iii) a trust or institution registered under section 12A or section 12AA.

[6]The Section 15BBDA provides for the rationalization of the taxation of Dividend income.

As per the provisions enshrined under the Section 10(34), of the Income Tax Act,1961, dividend which suffer dividend distribution tax (DDT) under section 115-O is exempt in the hands of the shareholder.[11] Under the section 115-O, however, the dividends are taxed at the rate of fifteen percent only, at the time of distribution, in the hands of company declaring dividends.[12]

The stipulations pertaining to the section can be elucidated by way of an example:

Example explaining the Section:

For instance, if a company 'A' undertake the distribution dividends in the form of shares, to its shareholders, of its wholly owned subsidiary company 'B', which is at the face value of Rs. 100 each, while the market value is Rs.150 per share, then the liability to tax on the part of the company would be relied on the basis of the market value of the share.

However, for the purpose of this, such stands as an immaterial consideration in case the shares are of such a nature that they cannot be divided for the purpose of being utilized towards the tax deductible at source. Thereby, the liability of the company towards the payment of the distribution tax is not in any manner reduced or affected because if the fact that, the dividend in question has been paid in kind, or that such was calculated in a basis which is distinguished from what the income tax law stipulates.

Constituents under the term 'Dividend': Analysis of the Definitions as per Section 115BBDA and Section 2(22)

The term 'dividend' has been defined under the Explanation (a) to Section 115BBDA, as :

[11] S.10(34)

[12]S.115-O

[13]Explanation (a), **S.** 115BBDA

"dividend" shall have the meaning assigned to it in clause (22) of section 2 but shall not include sub-clause (e) thereof "[13]

According to the definition in the Income-tax Act, 'Dividend' includes the following items:

Accumulated Profits :

The 'accumulated profits' amounts to any distribution by a company, of its capitalized or non - capitalized accumulated profits.

Further, if such distribution includes the release by the company of or all part of its assets to its shareholders, then the current profits would be a part of the accumulated profits, but the subsidy on Capital Account cannot be regarded as accumulated profits, as per the decision in the case of CIT v. Rajasthan Wires (P) Ltd. (2003) 130 Taxman 93 DP (Mag.).[14]

***Bonus**:*

A bonus, as per the sections, is any distribution by company of it's debenture, debenture stock, or deposit certificates, which maybe in any form and also with or without interest, to its shareholders.

Bonus also includes the distribution by such company of shares by way of bonus, to it's preference shareholders, to the extent to which the company possesses accumulated profits, which may or may not be capitalized.

***Liquidation**:*

Any distribution made by a company to its shareholders on its liquidation, to the extent to which such distribution is attributable to the accumulated profits of the company immediately before its liquidation, which may or may not be capitalized.

Share Capital Reduction:

Share Capital Reduction is termed as any distribution by a company, to its shareholders, on the reduction of its share capital.

Substantial Interest:

Such includes any payment made by a company, in which the public are not substantially interest of any sum whether representing a part of the assets of the company or otherwise made after the 31st day of May, 1987.

Such a payment maybe by way of advance or loan to a shareholder, who is a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without right to participate in profits), and must be holding not less than ten per cent of the voting power.

The payment may also be made to any concern, in which such shareholder is a member or a partner, and in which he has a substantial interest (hereinafter in this clause referred to as the said concern).

However, that will also include any payment by any such company on behalf of or for the benefit of the shareholder, who has a substantial interest in the company, and such a payment shall be made to the extent to which the company possesses accumulated profits.

Amendment to Section 115BBDA under the Finance Act, 2016: Detailed Analysis of the Amended Provisions:

The amendment has been given effect for the Assessment Year of 2017-18.

Dividend in aggregate exceeding ` 10,00,000 received by certain persons to be taxed at the special rate of 10% [Section 115BBDA(1)]:

The sub – section 1 provides that, notwithstanding anything contained in this Act, if the total income of an assessee, who is - an individual, Hindu undivided family or a firm, resident in India – includes any income, which exceeds` 10,00,000, in aggregate, by way of dividends declared, distributed or paid by a domestic company, then in that case, the income-tax payable shall be the aggregate of—

(a) the amount of income-tax calculated on the income by way of such dividends in aggregate exceeding ` 10,00,000, @ 10%; and

(b) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of income by way of dividends.[15]

Further, as per the amendment, no deduction to be allowed from dividend taxable at special rate under section 115BBDA(1).

Provisions under Section 115BBDA(2):

This section provides that no deduction to the assessee, under any provision of this Act, with respect to any expenditure or allowance or set off of loss shall be allowed in computing the income by way of dividends referred to in section 115BBDA(1)(a).[16]

CHAPTER XII D: SPECIAL PROVISIONS RELATING TO TAX ON DISTRIBUTED PROFITS OF DOMESTIC COMPANIES

Detailed and Systematic Analysis of the Provisions of Chapter XII D

Section 115 – O : Detailed Analysis of the Provisions Stipulated

Section 115-O (1) : Under the sub – section 1 of the Section 15-O, the amounts declared, distributed or paid on or after 1.4.2003 by a domestic company by way of dividends are charged to additional income-tax at the flat rate of 15%, in addition to normal income tax chargeable on the income of the company. Dividend received from domestic companies on or after 1.4.03 are exempt in the hands of shareholders :[17]

A further analysis of the sub – clauses to the aforementioned section stipulates the given:

Section 115-O(1A) : The Section provides the relief from what is regarded as double taxation of dividends, through the removal of the cascading effect caused by dividend distribution tax as part of a multi – tier structure. A holding company which receives dividend from its

[15] S. S.115BBDA(1)

[16] S.115BBDA(2)

[17] S.Section 115-O(1)

subsidiary company can reduce the same from dividends declared, distributed or paid by such a subsidiary company. For the purpose of this section, a holding company is designated as that company which holds more than 50% of the nominal value of equity shares of the subsidiary. However, certain conditions have been provided under the section for the availing of the benefit:

where such subsidiary is a domestic company, the subsidiary should have paid the dividend distribution tax, as payable on such dividend; and

where such subsidiary is a foreign company, the tax is payable by the domestic company under section 115BBD on such dividend.[18]

Section 115-O (1B) : The Section provides that for the purposes of determining the tax on distributed profits payable in accordance with the section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115-O(1), be equal to the net distributed profits.[19]

Other Key Provisions of Section 115 – O:

Section 115-O (3): Under this, the company shall have the liability to pay the tax in the distributed profits which shall be to the credit of the Central Government, and within fourteen days from the date of:

i. Declaration of any dividend; or
ii. Distribution of any dividend; or
iii. Payment of any dividend

whichever is earliest.

However, no deduction under any other provision of this Act shall be allowed to the company or a shareholder in respect of the amount which has been charged to dividend distribution tax.

[18] S.115-O(1A)

[19] S.115-O (1B)

Furthermore, with respect to the provision of this section, Surcharge @ 10% and Education Cess and SHEC @ 3% would also be levied on this 15% Dividend Distribution Tax.[20]

Section 115-O (4) : As per the section Section 115-O (4), that has been stipulated that the tax on distributed profits so paid by the company shall be treated as the final payment of tax in respect of the amount declared, distributed or paid as dividends and no further credit therefore shall be claimed by the company or by any other person in respect of the amount of tax so paid.[21]

Section 115-O (5) : The Section 115-O (5) provides that there shall be No deduction under any of the provisions of the Income-tax Act, 1961 to the shareholder with respect to the dividend income.[22]

ANALYSIS OF THE OTHER SIGNIFICANT PROVISIONS UNDER CHAPTER XII D

The detailed analysis of the other sections comprised under the Chapter is given as under:

Provisions under Section 115P:

The Section 115P of the Income Tax Act deals with the 'Interest payable for non-payment of tax by domestic companies.' As per the section, if there is the officer of a domestic company and such a company fails to pay the whole or any part of the tax on distributed profits, which have been referred to in :

sub-section (1) of section 115-O,

And within such time as allowed under sub-section (3) of that section 115-O

[20] S.115-O (3)

[21] S.115-O (4)

[22] S.115-O (5)

,then in that case, he or it shall be liable to pay simple interest at the rate of one per cent for every month or part thereof. Such an interest shall be payable on the amount of such tax for the period beginning on the date immediately after the last date, on which such tax was payable, and ending with the date on which the tax is actually paid.[23]

Provisions under Section 115Q :

The Section 115Q of the Income Tax Act, 1961, has the title – 'When company is deemed to be in default.' The Section includes the stipulation that in case of any principal officer of a domestic company, and the company does not pay tax on distributed profits in accordance with the provisions of section 115-O, then, he or it shall be deemed to be an assessee in default.

However, such a person shall be regarded as an assessee in default only in respect of the amount of tax payable by him or it.

Furthermore, as per this section, all the provisions of this Act for the collection and recovery of income-tax shall apply.[24]

Amendment Under The Finance Act, 2014 : Critical Analysis:

The Finance Act, 2014, has amended the Section 115-O. The Amendment, thereby, stipulates that, the dividends shall be required to be grossed up for the purpose of payment of Dividend Distribution Tax.[25]

This amendment has been explained as given :

Example explaining the Amendment

Prior to the amendment as has been brought about, if the amount of Dividend that was paid was at Rs. 100, then the Dividend Distribution Tax as levied and paid with respect to such an amount of Dividend was Rs. 100.

[23]S. 115P

[24] S.115Q

[25]S.Finance Act, 2014

However, subsequently, after the incorporation if the Amendment, the provision that has been enshrined provides, that, if the amount paid or distributed by a company is Rs. 100, the DDT, under the amended provision would be as given :

Dividend (Net Amt of Dividend)		=	Rs. 100
Increase by	(100*0.15)	=	Rs. 17.65
	(1-0.15)		
Dividend (Gross Amt)		=	Rs. 100
DDT @ 15% of Rs. 100		=	Rs. 17.65

Thereby, such can be adequately inferred from the explanation as specified, that after the incorporation of the amendment to the Act as has been elucidated, the amount to be paid as the Dividend Distribution Tax has escalated.

Analysis of the Insertion of the Section 115-0(7) Through the Finance Bill, 2017 : Exemption from Dividend Distribution Tax (DDT) on distribution made by a SPV to Business Trust [W.e.f. 1-6-2016]:

The Section 115-O (7) was incorporated through the Finance Bill, 2017, with effect from 1st June, 2016.[26]

In order to rationalize the taxation regime for business trusts (REITs and Invits) and their investors, the Act has provided a special dispensation and exemption from levy of dividend distribution tax.

The sub-section (7) to section 115-0 stipulates that :

[26] Finance Bill, 2017

[27] S.115-O (7)

For the purpose of ensuring and there achieve a due rationalization of ten taxation regime for business trust (REITS and Invite), and their investors, the Act further provided for a special dispensation and exemption from the levy of dividend distribution tax by the virtue of the insertion of the section 115-9 under the Act. The amended section has the provision, elucidated upon as given[27] –

Tax on Distributed Profits : Under this, there shall be no more tax charged on distributed profits with regard to any amount as maybe declared, paid or distributed by the specified domestic company, which maybe by way of dividend (interim or otherwise) to a business trust, out if it's own current income, on or after the date as is specified.

Non – Applicability of the Section : However, with regard to the amendment, the provisions of the section has not been made applicable to any amount which is declared, paid or distributed by a specified domestic company, which maybe at any time, by way of dividends (interim or otherwise) out if it's own accumulated profits and current profits up to the date as maybe specified.

Exemption with respect to Dividends paid out of Current Income : Thereby, the exemption from the levy of DDT would only stand as regards to the dividends of current income after the date when the business trust acquires the shareholding in the specified domestic company. The dividends paid out of accumulated and current profits upto this date shall be liable for levy of DDT as and when any dividend out of these profits is distributed by the company either to the business trust or any other shareholder.

Further, the Explanation clause to this sections sets the definitions as regards to "specified domestic company" and "specified date" give as :

(a) Meaning of 'Specified domestic company'[28] :The 'specified domestic company' has been defined as – "a domestic company in which a business trust has become the holder of whole of the nominal value of equity share capital of the company (excluding the equity share capital

[28]Explanation (a),S.115-O (7)

[29]Explanation (b), S. 115-O (7)

required to be held mandatorily by any other person in accordance with any law for the time being in force or any directions of Government or any regulatory authority, or equity share capital held by any Government or Government body)"

(b) Meaning of 'Specified date'[29] : The 'specified date' refers to "the date of acquisition by the business trust of such holding as is referred to in clause (a)."

CHAPTER XIIDA : SPECIAL PROVISIONS RELATING TO TAX ON DISTRIBUTED INCOME OF DOMESTIC COMPANY FOR BUY-BACK OF SHARES

The Finance Bill of 2013, caused the incorporation of a new chapter under the Income Tax Act, 1961, under the title -"Special provisions relating to tax on distributed income of domestic company for buy back of shares". The Chapter comprises of three sections – Sec. 115QA, Sec. 115QB and Sec. 115QC.

Detailed Analysis of the Provisions Of Chapter XIIDA:

Provisions under Section 115QA :

The Section 115QA is the charging section which authorizes the levy of the additional tax.

The Explanation (i) provides the definition of the term "buy-back", as that which means the :

"purchase by a company of its own shares in accordance with the provisions of [any law for the time being in force relating to companies]"[30]

Further, the Explanation (ii) of the Section provides the definition to the term "distributed income" meaning :

[30] Explanation (i), S.115QA

[31]Explanation (ii), S.115QA

"the consideration paid by the company on buy-back of shares as reduced by [the amount, which was received by the company for issue of such shares, determined in the manner as may be prescribed]."[31]

Provisions under Section 115QB :

The Section 115QB of the Income Tax Act, 1961, deals with, 'Interest payable for non-payment of tax by company. As per the section, if there is the officer of a domestic company and such a company fails to pay the whole or any part of the tax on distributed income, which have been referred to in:

sub-section (1) of section 115-O,

And within such time as allowed under sub-section (3) of that section 115-O

Then, in the case, he or it shall be liable to pay simple interest at the rate of one per cent for every month or part thereof, on the amount of such tax.

Such a simple interest, shall, thereby, be payable for the period beginning on the date immediately after the last date on which such tax was payable, and ending with the date on which the tax is actually paid.[32]

Provisions under Section 115QC :

The Section 115QC of the Income Tax Act, 1961, deals with – 'When company is deemed to be assessee in default.' As per the Section, if there is any principal officer of a domestic company and the company does not pay tax on distributed income in accordance with the provisions of section 115QA, then, in that case, he or it shall be deemed to be an assessee in default.[33]

However, such would be the assesse in default only in respect of the amount of tax payable by him or it.

[32] S.115QB

[33] S.115QC

Also, for the purpose of this section, all the provisions of this Act for the collection and recovery of income-tax shall apply.

Elucidation on the Cases to which this Chapter shall not be Applicable:

Some of the instances where this chapter shall not apply include:

Where the shares have been purchased by the virtue of the scheme under the sections 391 to 394 of the 1956 Act – such a buy back would not qualify as one under the section 77A, and hence, its taxability will continue to be governed by the section 46A.

Where the shares have been cancelled pursuant the provisions of reduction of capital under the section 77 read with section 100 of the 1956 Act – then that also does not qualify as a buy back under the section 77A. The amount so received, to the extent of accumulated profits will be taxed as dividend under the section 2(22)(d) of the Act.

Where the shares bought back tend to be those of an unlimited company – as unlimited 54 companies are not governed by section 77 and hence are able to reduce its capital independent of any requirements of section 77A of the 1956 Act;

Where the shares bought back are those of a foreign company – the normal capital gains provisions read with get tax treaty provisions shall operate to govern the taxation of such buy backs.

Where the shares bought back are those of a listed company or redemption of presence shares at a premium – this will operate to be charged as capital gains pursuant to the decision if the Supreme Court in the case of Anarkali Conversion34 of preference shares into equity or equity into preference – such conversion is generally treated as "transfer" for tax purposes and hence liable to capital gains tax.

Amendment to Section 115QA under the Finance Bill, 2013: A Critical Analysis

Objectives and Implications of the Amendment:

The objective pertaining to the very incorporation of the Amendment, as has been specified, has been elucidated as part of the explanatory memorandum. The Explanatory Memorandum explains the reason for this enactment in the following words:

"Unlisted Companies, as part of tax avoidance scheme, are resorting to buy back of shares instead of payment of dividends in order to avoid payment of tax by way of DDT particularly where the capital gains arising to the shareholders are either not chargeable to tax or are taxable at lower rate. In order to curb such practice it is proposed to amend the Act…"

The consideration that was at the reception of the share holder on the buy back of shares by the company, was not regarded under the category of dividend, but rather was deemed as capital gains under the section 46A. The memorandum has explicitly stated and elucidated that the unlisted companies, are part of a tax avoidance scheme, are voluntarily taking to the buy back of shares in place of the payment of dividends, so as to avoid the payment of tax by the means of DDT, particularly in those cases where the capital gains that arise to shareholders are either not chargeable to tax, or are subject to taxation hut only at a lower rate.

The amendment has, thereby, attempted to successfully curb the illicit practice undertaken in lieu of ensuring a proper functioning within the taxation regime as has been established. The Chapter XIIDA comprises of the provisions, by the virtue of which, the consideration extended by the company for the purchase of it's own unlisted shares, which is actually in excess of the sum received by the company at the time of the issue of such shares, will be further charged to an additional tax at the rate if 20%in the hands of the company. It is further stated therein that the additional income tax shall stand as final in the similar way as the dividend distribution tax. Thereby, the income arising to the shareholder with regard to such buy back shall be exempt where the company is liable to pay additional tax.

Example explaining the Amendment:

Furthermore, the amendment has been incorporated so as to attain the curbing of the avoidance of dividend distribution tax under the Section 115-O.

For instance, supposing that there is an unlisted company which had disposable reserves of 200 ' in it's hands, and which was available for distributing as dividend. Further, supposing that the company was proposing to distribute '20 as dividend. In such a case, the company would he liable to pay DDT u/s 115-O @ 15% on this ` 20 i.e. ` 3.

Thereby , so as to avoid this DDT of ‘3, the company may buy- back some of the company’s own shares of face value of ` 100 issued by it at par at ` 120.

Now with regard to the definition of the term ‘dividend’, as specified in the section 2(22) of the Income Tax Act, 1861, a payment made by a company on purchase of its own shares from its shareholder, in accordance with the provisions of section 77A of the Companies Act, 1956, is specifically excluded from the meaning of ‘dividend’. Thereby, consequently, the company would not be under the obligation to extend a payment of ` 3 as DDT in the buy back of its shares.

Thereby, in the hands of the shareholder, under the section 46A of the Income Tax Act, 1961, the amount of ’20 would be payable as capital gains. And so, if the gains is long term then it would be further entitled to concessional tax treatment. Thus, such becomes a case where the DDT is avoided by the company in the guise of a buy back transaction of shares. The amendment has, thereby, attempted to address the loopholes established by the virtue of the measure of subjecting the amount of the escaped dividend of ’20 by a new additional tax of 20% {in comparison to DDT of 15%}.

Limitations Introduced by the Amendments:

Erroneous Assumption Guiding the Amendments:

Pertaining to the amendments incorporated with respect to the aforementioned Chapter, such becomes rather significant to note that, the amendments have indeed derived foundation in the erroneous assumption which states that every buy back at the gain of the shareholder causes an of DDT. The amendments have been incorporated on the basis of a false assumption that the company indulging the buy - back necessarily has distributable surplus in it’s hands for declaring dividend. However, such does not stand to be true.

Thereby, there might be a case wherein a company does not have disposable surplus in hand for dividend distribution and yet such a company indulges in buy back of it’s own shares which are financed out of a prior issues of shares belonging to a different category altogether. The buy back may, however, also involve a gain to the shareholder concerned in the buy back procedure. However, the payment of gain does not stand financed by the company from any free reserves, but from fresh capital.

For instance, with respect to a company which may which to buy back some of it's shares{Type A} issued at its face value of ` 10 at a buy back price of ` 30. Such a company, further, has no disposable surplus at it's helm for the purpose of dividend distribution. It finances the buy back by a prior issue of another category of shares {Type B} of say face value ` 100. Such stands permissive because the types of shares in such a case are different - one has face value of ` 10 and another has face value of ` 100. Now, with regard to the provision of the Section 115QA[35], the gain of '29 of the shareholder is further regarded as a 'distributed income' and additional tax is levied on the same at the hands of the company, even though in such a case there was no advance of DDT.[15]

Such might there amount to an unintended damage that the provision may inflict.

No Nexus of the Provision with Availability of Disposal Surplus for Dividend Distribution :

Such stands possible that the additional tax under the Section 115QA maybe levied on a buy – back transaction even when there tends to be no disposable surplus at the hands of the company to distribute dividend. In that case, with respect to the amendment of the section 115QA, there operates no nexus pertaining to the provision with the availability of disposal surplus for dividend distribution at the hands of the company.[16]

The Supreme Court of India , in Punjab Distilling Industries Ltd. v. CIT [36], considered the constitutional validity pertaining to the provisions under the section 22[6A][d] of the 1922 Income-tax Act, which are, in effect, the same as its counterpart provisions in section 2[22][e] of the 1961 Act.

The Apex Court held that the deemed dividend provisions with respect to the share capital reduction are not ultra vires the Government of India, 1935, because such is permissible for the Legislature to formulate the law to prevent the evasion of tax, and hence the law provided for under the aforementioned section is one such law. The provision of the Section 2[6A] [d][37]

[35] S.115QA

[36][1965] 57 ITR 1 {SC}

[37]S.2[6A] [d]

was valid even though the share capital reduction operates as being permissible under the Company law. The provision was required to serve the purpose comprising of the case of the circumvention dividend tax by not paying normal dividend out of the accumulated profits at hand, but rather choosing to pay the shareholder otherwise, by the virtue of return of share capital in the guise of share capital reduction undertaken in that respect.

Dearth of Constitutional Validity:

There is a grave doubt that exists pertaining to the constitutional validity as can be afforded to tax on such buy back. The title of the Chapter is "Special Provisions Relating to Tax on Distributed Income of Domestic Company for Buy-Back of Shares". Indeed, however, in all the cases the tax on the amount paid as buy back may not qualify as a tax on "distributed income" of the domestic company, and thereby, to that extent, the title tend to be misleading.

Elimination of the Possibility of Set Off Of Losses:

Prior to the amendment as has been instituted, the shareholder earning capital gains on buy - back was capable to set off the loss suffered by him under the head 'capital gains', against the buy back. However, with regard to the amendment, such is not a f as to the ground that the company shall not permit any set off of such losses. Thereby, in that occasion, even though the tax may come to be designated as " additional income tax" in the hands of the company, the company would not be afforded with the ability to set off any losses that might incurred in the course of its business against the "distributed income".

Such a conception, however, reinforces the ideology that this does not amount to a tax imposed on income on any ground. Such is because the income stands exempted at the hands of the shareholder, and thereby, with regard to the Section 14A,17 the shareholder will be incapacitated in claiming any deduction with respect to expenses that may have been incurred at his helm with respect to the transfer of shares.39

[39]S.14A

INFERENCE

The Income Tax Act, 1981, has incorporated several provisions as to the domestic companies. While the Section 115BA provides for the tax on their incomes, the Section 15BBDA, on the other hand, stipulates the taxes as are applicable upon certain dividends received from the domestic companies.

Further, the Chapters XIIDA and XIID include detailed provisions pertaining to the taxation of domestic companies. Under the Chapter XIIDA, the three sections i.e. Sec. 115QA – 11QC, provide a detailed explanations and understanding of the buy – back of shares. Furthermore, the Chapter XIID stipulates the conditions on which the taxes on the distributed profits of domestic companies shall be applicable through the three sections comprised in the Chapter, i.e. Sec. 115-O – Sec. 115-Q.

Further, by the means of the Finance Bill, 2013, amendments were incorporated under the section 15QA, however, such include several lacunae which have not been adequately addressed so far, as the constitutional validity of the same has been questioned in several cases.

However, in the course of the years between 2013-17, several provisions haven been instituted, as have ben elaborated above in the preceding sections, which have broadened the scheme for a just taxation mechanism for the domestic companies, under the Income Tax Act, 1861.