



Future of foreign dividends

Background: Tax on dividend from specified foreign companies

It is imperative for Indian companies with outbound investment in a specified foreign company (i.e., a foreign company, where an Indian company holds 26 percent or more of the equity share value) to ponder over the recent amendment proposed by the Finance Bill 2022 (FB 2022).

We are well aware that there is a concessional dividend tax regime under section 115BBD, which taxes the dividend received by an Indian company from specified foreign companies at 15 percent.

As a refresher, to avoid administrative hassles of taxing dividend and granting refunds to individual shareholders, Dividend Distribution Tax (DDT) was levied on dividend distribution by companies and consequently, the income was exempt in the hands of the shareholders. DDT led to a cascading effect on taxes on dividend, especially in a multi-tier corporate structure and more exacerbated in case of the foreign subsidiaries.

Therefore, section 115BBD was introduced through the Finance Act, 2011 and taxed dividend income at 15 percent (plus applicable surcharge and cess) as opposed to the corporate tax

rate applicable to a company on the gross amount of dividends. If taxes were paid on foreign dividend under section 115BBD, then such dividend income was not subject to DDT at the time of onward distribution by the Indian shareholder company. This helped mitigate the cascading effect of taxes on dividend.

The above rate of tax under section 115BBD was aligned to the DDT rate of 15 percent. No expenditure in respect of such dividends were allowed under the Income-tax Act, 1961. Prior to this amendment, such dividends were taxed at an applicable corporate tax rate, subject to allowable deductions.

Proposed amendment in Finance Bill 2022

It is proposed that the concessional rate of tax of 15 percent on dividend from specified foreign companies shall not apply from FY2022-23 onwards.

Impact of the proposed amendment

The impact of the aforesaid budget proposal is that all dividends declared, distributed, or paid by the specified foreign companies shall be taxable per the normal tax rate applicable to such companies from FY2022-23 onwards.

Impact on companies with foreign subsidiaries

The above sunset clause is a call for swift action to explore the impact on Indian companies with specified foreign subsidiaries to evaluate implications around dividend repatriation to India.

There will be an impact in cases where:

01

The Indian shareholder is not eligible for deduction under section 80M¹, as the dividend payout by the Indian company may not be in the same year as the year of receipt of the foreign dividend and/or not to the extent of the foreign dividend received; and

02

The foreign taxes on dividend are lower than Indian taxes.

Comparison of tax costs if dividend is received from a specified foreign company in FY2021-22 or FY2022-23

Particulars	Tax on aforesaid dividend income from FY2022-23 onwards	Tax on aforesaid dividend income up to FY2021-22	Difference in the tax rate
Entities opting for concessional tax regime	25.17%	17.16%	8.01%
25% tax regime	29.12%	17.47%	11.65%
30% tax regime	34.94%	17.47%	17.47%

Areas for detailed examination

- 01** Simulation exercise to compute the tax liability on aforesaid foreign dividends pre and post the proposed amendment by Finance Bill, 2022
- 02** Claim of foreign tax credit on dividend received on or after 1 April 2022
- 03** Point of taxation of dividend, which is declared in FY2021-22 but paid in FY2022-23
- 04** The allowability of expenses against dividend is to be separately considered
- 05** Foreign jurisdiction rules relevant to dividend repatriation and to determine the distributable profits

Conclusion

Thus, the amendment warrants a closer examination of the dividend repatriation of Indian companies with outbound investment.

¹ Deduction from gross total income on inter corporate dividend, subject to specified conditions



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