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A CRITICAL EVALUATION OF CORPORATE DIVIDEND TAX

(WITH SPECIAL REFERENCE TO SHAREHOLDING PATTERN OF THIRTY COMPANIES OF BSE SENSEX)

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ABSTRACT

Since its introduction in 1997, the Corporate Dividend Tax (CDT) or Dividend Distribution Tax (DDT) is one of the biggest concerns for the Indian corporate world. The present paper is an attempt to focus on the positive and the negative impacts of this tax. This study also tries to find the existence of any significant relationship between the state revenue from this tax and the shareholding patterns of the corporate entities of the country. With special reference to the shareholding pattern of 30 companies of BSE Sensex, it is an attempt to make a critical evaluation of the present tax system and revenue generated from this. Present study also tries to provide relevant suggestions for a better alternative tax system.

KEYWORDS*: Corporate Dividend Tax (CDT), BSE, Shareholding Patterns, Indian Income Tax Act.*

Introduction

As a nonprofit organization Government of each and every country is committed to work for social welfare and economic development. This function of the Government requires a huge amount of funds and resources. To collect these required funds, both state and central Government imposed various types of taxes, duties, charges, rates and fines on the general public and others. So tax is a mandatory financial charge or some other type of levy imposed upon a taxpayer (an individual or other legal entity) by a Government organization in order to fund various public expenditures. In present age two types of taxes charged by the Government.If tax is levied directly on personal or corporate income or earnings, then it is a Direct Tax. If tax is levied on the price of the goods and services, then it is called an indirect tax. Following three main direct taxes are imposed by the Central Government of India:

- Income Tax: It is imposed on the taxable income of an individual and all other legal entities (except corporate entities) earned or received during a particular financial year.
- Corporate Tax: It is imposed on the taxable income or earnings or net profit of a corporate entity (Joint Stock Company) earned during a particular financial year.
- Corporate Dividend Tax or Dividend Distribution Tax: It is imposed on the amount of any type of dividend declared or paid or distributed by the company to its shareholders.

In this way companies are taxed doubly, first on the income or net profit of the company and the other on the dividend paid to its shareholders.

Review of Literature

Review of literature is a summary, discussion and critical analysis of work related to our research topic. There are many books, reports, articles; research papers etc are available on Dividend Tax and its effect on investors, companies and Government. Main findings from above review of literature are as under:

- Brennan (1970), Black (1976) and Modigliani (1982) argue that shareholders would prefer capital gains to dividend if the capital gains tax was lower. It means there is a negative relationship between dividend preferences of investors and dividend tax rates applicable to them.
- Pettit (1977) and Ramaswamy (1984) use British data on frequent changes in the tax rates to establish that tax changes do affect investors' value of dividends.

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- Collins and Kemsley (2000) argue that shareholders cannot avoid the dividend taxes as they are implicitly priced in share prices.
- Moser & Puckett (2009) utilize the changes in dividend tax laws to study the existence of dividend tax clienteles.
- Bhattacharyya S. (2016) concluded that a prudent tax policy can play a great role in the balancing of revenue and the growth of the economy.

Objective of the Study

- To evaluate the existing system of Corporate Dividend Tax (here referred as CDT).
- To find out the correlation between shareholding pattern and the state revenue from CDT (with special reference to 30 companies of BSE Sensex).
- To suggest a better alternative collection system of CDT in place of existing one.

Limitation of the Study

This research study has the following limitations:

- This research study is based on the following tax slabs for the assessment year 2017-18, applicable for the previous year (financial year) 2016-17.
    - Income Tax Rates: It is from 0% to 30%, (according to the taxable income of the taxpayers) + 10 % Surcharge (If applicable) + 3% Education Cess.
    - Corporate Tax Rates: It is 30%+7% or 12% Surcharge (whichever is applicable)+3% Education Cess.
    - CDT Rates: It is 15% + 12% surcharge + 3% Education Cess.
- ii. This research study is based on the secondary data available from Annual Reports of the companies, data available from BSE and Government revenue data.
- iii. This research study is based on shareholding pattern of 30 companies of BSE Sensex as on 30 the September 2017.

Research Design & Methodology

This research study is mainly based on secondary or published data. All information's are collected from books, newspapers, annual reports, company websites, factsheets etc.

For the Analysis or interpretation of data, it is essential to use statistical and accounting methods or research tools. So following formulae applied for this purpose:

- **Shareholding Percentage**

  Formula: $\frac{\text{No.of shares held by investor group} * 100}{\text{Total No.of shares of Paid Up Capital of Company}}$

- **Effective Rate of CDT**

  Formula: $\frac{\text{Total CDT Payable} * 100}{\text{Dividend Payable}}$

- **Proposed State Revenue From Tax On Dividend (From Non Public):**

  Formula : $\frac{\text{Total Dividend Paid to Non Public} * (\text{Present Maximum Tax Rate})\ 30}{100}$

- **Proposed State Revenue From Tax On Dividend (From General Public):**

  Formula: $\frac{\text{Total Dividend Paid to General Public} * (\text{Present Minimum Tax Rate})\ 10}{100}$

CDT: Concept

According to Section 115-O of Indian Income Tax Act – " A domestic company has to pay tax at a specific rate on dividend distributed, declared or paid by it to its shareholders."In other words domestic company shall pay tax on all dividends, interim + final + deemed [except on those in the nature of loans advances mentioned u/s 2 (22) e of Company Act] declared distributed or paid by it. However some exemptions are introduced recently regarding the dividends received from the subsidiary companies. This Section 115-O was introduced in Income Tax Act by the Finance Bill 1997**.** So we can classify the taxability of dividend in following two periods:

- **Taxability of Dividend before Introduction of Section 115-O (Prior to 1997)**:
  - A domestic company was not required to pay tax on dividend declared, distributed or paid by it.
  - Dividend income was taxable in the hands of shareholders, so it was included in the Gross Total Income of the shareholders.
  - The shareholders were entitled to get deduction on account of dividend income from domestic company subject to a maximum limit u/s 80L (for non corporate assesses) and u/s 80M (for corporate assesses)
- **Existing CDT collection system after Introduction of Section 115-O (Post 1997):**
  - A domestic company is required to pay tax on dividend declared, distributed or paid by it.
  - Such dividend is not taxable (fully exempt) in the hand of shareholder. So for all the types of shareholders it is exempted u/s 10(34) of Income Tax Act.
  - Section 80M is withdrawn and section 80L is amended to exclude dividend income.

CDT: Brief Time Line

1997	CDT introduced through the Finance Bill with rate of 10%
2002	CDT removed, Dividend taxable on the hands of shareholders
2003	CDT re- introduced with rate of 12.5%
2207	CDT rate increased to 15%
2008	Insertions of CDT exemption rules
2012	Insertions of more CDT exemption rules.
2016	Some more amendments made in the section 115-O

CDT: Illustrative Computations:

A domestic company wants to pay Rs. 85 as dividend then the CDT Calculation will be as follows:

Dividend Payable **Rs. 85.00**

CDT @15% [Dividend Payable x 0.15/ (1-0.15)] Rs. 15.00
(+) Surcharge (@12% on Rs. 15) Rs. 01.80
(+) Education Cess [@3% on (Rs.15 + Rs. 1.8) Rs.00.504
= Total CDT payable on the Dividend of Rs. 85 Rs.17.304
So Effective Rate of CDT [Total CDT Payable x 100/Dividend Payable] 20.358%

CDT: Simple, Fast & Low Cost Collection- A Positive Effect

This was also the main purpose of the introduction of the CDT in 1997, According to the section 115-O this tax is payable by the company within 14 days of the declaration or distribution or payment of dividend. So the revenue collected through this tax is very easy, simple,fast and economical too for the central Government of India.

CDT: Overlooked Shareholding Pattern- A Major Negative Effect

In India there are more than 5,000 companies are listed on BSE & NSE, out of which more than 1,200 companies are paying dividend to its shareholders. In the maximum companies the promoters are major shareholders and the general public is in the form of minorities. Apart from these two main categories of the investors, there are some other categories also exists in the shareholding pattern of the Indian corporate entities. The shareholding pattern in all the companies is not identical; it is very from company to company. In case of the public sector undertaking, the Government of India is a major shareholder and minority shares are distributed between various categories of the investor, including the general public. On other hand the shareholding pattern of private sector companies is uneven. Following is the list of Main categories of the investors in both types of the companies:

- Promoters (Including Foreign Promoters)
- Foreign Institutional Investors. (FIIs)
- Domestic Institutional Investors (DIIs) or Financial Institutions (FIs)
- Mutual Funds & Non Banking Financial Companies (MFs &NBFCs)
- Other Corporate Entities(Others)
- General Public of Retail Individual Investors.(RII)

Bombay Stock Exchange is one of the oldest Stock Exchange in the Asia and world's 11th largest stock exchange. It was established in 1875. The basic stock price indices of this exchange are known as In the BSE Sensex, which was launch in1986. This includes weighted market price of 30 large caps, blue chip companies representing all the major sectors of the economy. Let'sdiscuss the shareholding pattern of sample of 30 companies of BSE Sensex and their tax liability with the help of Table 01& 02:

Table 1

Shareholding Pattern (In %) of 30 Companies of BSE Sensex (As on 30th September, 2017)

S. No.	Company	Promoters	FIIs	DIIs	MFs & NBFCs	Others	RII
1.	Adani Ports	61.92	23.52	06.51	03.55	01.93	02.57
2.	Asian Paints	52.79	-------	23.50	02.17	08.65	12.89
3.	Axis Bank	28.76	48.24	01.65	06.89	07.99	06.47
4.	Bajaj Auto	49.30	17.44	06.84	01.83	09.64	15.95
5.	Bharti Airtel	67.14	16.16	06.87	03.42	05.75	00.66
6.	Cipla	36.73	17.67	08.39	09.80	07.28	20.13
7.	Coal India	78.86	06.40	09.84	01.64	01.17	02.08
8.	Dr. Reddy's Lab.	26.74	32.40	05.77	04.78	21.97	08.34
9.	HDFC Bank	21.20	34.35	02.50	08.05	25.28	08.62
10.	Hero Motocorp	34.64	42.94	06.66	04.82	04.70	06.24
11.	HUL	67.20	13.26	03.88	01.78	01.97	11.91
12.	HDFC	-------	77.55	07.23	04.13	02.39	08.70
13.	ICICI Bank	-------	34.94	39.99.	15.34	03.96	05.77
14.	Infosys	12.75	38.31	12.47	08.33	18.24	09.90
15.	ITC	-------	20.04	31.94	03.98	34.57	09.47
16.	Kotak Mahindra Bank	33.61	36.84	03.04	05.43	10.54	10.54
17.	L & T	---------	17.27	28.86	11.58	20.78	21.51
18.	Lupin Lab.	46.70	31.87	03.75	05.39	02.75	09.54
19.	M & M	25.27	34.51	19.36	06.00	07.51	07.35
20.	Maruti Suzuki	56.21	25.03	05.50	06.28	04.08	02.90
21.	NTPC	69.74	10.43	13.92	03.09	01.07	01.75
22.	ONGC	68.93	06.02	10.30	01.17	11.81'	01.77
23.	Power Grid	57.90	25.66	03.46	06.20	03.67	03.11
24.	Reliance Industries	45.00	19.48	14.22	02.74	09.20	09.36
25.	Sun Pharma	54.39	21.28	06.85	05.36	05.07	07.05
26.	SBI	61.77	09.33	10.17	08.29	04.30	06.14
27.	TCS	73.75	16.73	04.55	00.72	00.48	03.77
28.	Tata Motors	34.73	23.24	10.52	04.82	20.48	06.21
29.	Tata Steel	31.35	14.02	18.22	12.49	04.08	19.84
30.	Wipro	73.25	10.19	04.52	02.52	03.93	05.59
	Average Holdings	**42.35**	**24.67**	**9.81**	**05.52**	**08.95**	**08.70**

Source: Economic Times

Analysis

On going through the above table it is clearly visible that in all the 30 companies the holding of general public is very less and major shareholders are non public. Maximum holding of the general public is in L& T Ltd, while it is minimum in Bharti Airtel Ltd. In summarized form we can observe that average general public holding is only 8.70%, while average non public holding is 91.3%.

Table 02

Tax Slab of Different Categories of Shareholders (As Per the Tax Rates for the Assessment Year 2017-18)

S. No.	CATEGORY OF SHAREHOLDERS	TAX SLAB
1.	**NON PUBLIC:** • Promoters (Including Foreign Promoters) • Foreign Institutional Investors. (FIIs) • Domestic Institutional Investors (DIIs) or Financial Institutions (FIs) • Mutual Munds & Non Banking Financial Companies(MFs & NBFCs) • Other Corporate Entities.(Others)	30%Tax +07 or 12% Surcharge + 3% Education Cess
2.	**GENERAL PUBLIC:** or Retail Individual Investors.(RIIs)	0% to 30% (According to Taxable Income) + 10% |Surcharge(IfApplicable) + 3% Education Cess.

Source: Indian Income Tax Act 1961.

Analysis

On going through the above table we can observe that all the major shareholders(non public) of the companies are liable to pay tax at the maximum rate with surcharge and cess. On other hand the minority shareholder general public is liable to pay tax according to their taxable income. Now with the help of the above two tables we can discuss the relationship between the CDT and the shareholding pattern of the companies. As we already explained through an illustrative calculation, the existing effective flat CDT Rate is 20.358%. It is payable by the company ignoring the tax liability of above explained category of shareholder.

Let's take an illustration of two companies from BSE senxex:

- **Infosys Ltd.** – In the financial year 2015-16 and 2016-17 paid total CDT of Rs. 2,199 Crore on total dividend of Rs. 11,485 Crore. According to the shareholding pattern of the company 90.1% shares held by non public and rest by the public. So out of this total dividend,90.1 %, paid to the non public shareholders, who arecapable to pay the maximum tax of 30% and above.
- **TCS Ltd.** – In the financial year 2015-16 and 2016-17 paid total CDT of Rs. 3,433.16 Crore on total dividend of Rs. 17,733.38 Crore. According to the shareholding pattern of the company 96.23% shares held by non public and rest by the public. So out of this total dividend,96.23 %, paid to the non public shareholders,who are capable to pay the maximum tax of 30% and above.

With the help of above illustration we can notice that CDT is charged by the Government at a flat rate of 20.358%, ignoring the shareholding pattern or tax payment capacity of assesses. As we know, in all the companies majority shareholder belongs to maximum tax slab, so they are in position to pay higher taxes on their dividend income.Only 20.358% CDT collected from these is not justified.

Overlooked shareholding pattern creates following other negative impacts also:

- **Loss of State Revenue from CDT:** From the above analysis it is observe that by imposition of the CDT, Government collected around 20 % tax from the non public shareholders, which are eligible to pay tax more than 30%. So it is direct loss of revenue to the Government from this source.
- **Regressive Tax System:** High Net worth Individuals (HNIs) and corporate entities (Non Public Shareholders) are capable to pay higher taxes, but less tax charged from them. On other side Retail Individuals Investors (general public shareholders) are under different lower tax slab, but more tax charged from them. It means CDT is not charged according to the tax payment capacity of both type of shareholders.. So charging flat 20.358% CDT also leads to a regressive tax system, which is also against the principles of the equity and taxation.
- **Undue Advantages to the HNIs &Corporate Entities**: The existing CDT collection system is giving unnecessary benefit to only this category of the investors. They are paying higher tax on their all other incomes, but on dividend income they are paying tax at the less rate through CDT.
- **Double Taxation:** According to the present tax structure in India, a company firstly pays the corporate tax and then the CDT. It leads to double taxation because the dividend is paid out of the net divisible profits of the company on which corporate tax has already been paid. It also show the negative impact on the cash flow of the company and its earning capacity. This is just like an extra burden on all the corporate entities.
- **Reduction in Dividends:** All the domestic companies are required to pay the CDT from their own funds, so to arrange the required funds they are intended to reduce the normal rates or amount of shareholder's dividend. In this way the return to the shareholders also decreased.

So there is a direct and close relationship exists between the shareholding pattern and the State revenue from CDT, because the shareholding pattern is the main determinant of the amount collected from the tax on dividend income. We can say that overlooking the shareholding pattern is just like ignoring the tax payment capacity of the tax payers. That's why there are only few positives of the CDT, but the negatives are so many. Any tax imposed by any type of Government without assessing the capacity of tax payers is not an example of good tax at all.

Withdrawal of CDT: Suggestion to Remove Negative Effects

As we discussed in the previous point ignoring the shareholding pattern is the major negative effect of the CDT. Once we try to develop a proper system of collection of the dividend tax after considering the shareholding pattern of the corporate entities, then all the negative impacts of existing system will automatically removed. Let's look at the back ground of the introduction of the CDT in 1997. At that time in India few companies are listed and equity culture is in primary stage. Only few categories of investors registered with tax authorities and the SEBI, that was also not in a systematic manner. The use of technology is limited in the field of corporate affairs as well as in tax collection procedure. So the Government was finding it very difficult to collect the tax on the dividend income of shareholders. But now the economic scenario is totally changed and now Indian stock market and corporate sector is one of the well organized and regulated markets under the regulations of SEBI, finance ministry and ministry of corporate affairs. In these 20 years (from 1997 to 2017) we built a strong financial infrastructure with following basic points:

- All the categories of the shareholders are duly registered with SEBI, because every participant of the secondary and primary market has to register it self compulsory with SEBI.
- All the categories of the shareholders are duly registered with Income Tax Authorities through the PAN Card.
- All the information and data are available regarding each and every category of the shareholders and dividend paying companies through the electronic mode to all the concern authorities.
- Now all the financial transactions (for example payment of dividend, filing the tax return, Tax Deduction at Source, share transfer etc.), which are related with corporate sector is taking place on the electronic mode, which is very easy, time saving and transparent in all the terms.
- Due to the use of the electronic platform, now none of the shareholder is in a position to avoid any type of tax imposed by the Government. Due to the use of this platform, cost of collection of corporate related taxes is significantly decreased.

In short, now Indian corporate sector is ready for the withdrawal of the CDT and to charge the tax on dividend income in the hands of the shareholders, which was in practice before the introduction of CDT. This proposed change l surely not only increase in the state revenue, but it will leads to a progressive tax structure on the dividend income. Let's compare the state revenue as per the existing CDT and as per the proposed Taxability of the Dividend in the hand of the shareholders with the help of table 03:

Table 03

Existing& Proposed State Revenue From Tax on Dividend (On the Basis of 30 Companies of BSE Sensex) (For the F.Y. 2015-16 & 2016-17) (In Rs. Crores)

S. No.	Company	Total Dividend Paid	Existing Revenue from CDT	Proposed Revenue from taxability of the dividend in the hand of the shareholder		
				Non Public (@ 30%)	General Public (Minimum@ 10%)	Total
1.	Adani Ports	497.02	101.19	145.27	01.28	146.55
2.	Asian Paints	1,481.95	299.47	387.28	19.10	406.38
3.	Axis Bank	2,388.94	423.1	670.31	15.46	685.77
4.	Bajaj Auto	1,736.2	353.44	437.78	27.69	465.47
5.	BhartiAirtel	943.3	75.9	281.12	00.62	281.74
6.	Cipla	354.26	32.70	84.88	07.13	92.01
7.	Coal India	29,659.6	864.71	8712.80	61.69	8774.49
8.	Dr. Reddy's Lab.	775.8	69.3	213.33	06.47	219.80
9.	HDFC Bank	5,220.62	1,062.81	1,431,18	45.00	1,476.18
10.	Hero Motocorp	3,175.09	646.38	893.09	19.81	912.90
11.	HUL	7,033.25	1,370.25	1,858.68	08.38	1,867.06
12.	HDFC	3,164.96	461.42.	866.88	27.53	894.41
13.	ICICI Bank	4,371.42	419.37	1,235.76	25.22	1,260.98
14.	Infosys	11,485	2,199	3,104.39	113.70	3,218.09
15.	ITC	13,680.24	2,726	3,718.29	128.59	3,846.88
16.	KotakMah. Bank	91.91	18.02	24.67	00.97	25.64
17.	L & T)	3006.15	676.85	707.86	64.66	772.52
18.	Lupin Lab.	676.18	137.72	183.50	6.45	189.95
19.	M & M	1,466.23	216.57	407.54	10.78	418.32
20.	Maruti Suzuki	2,114.6	430.4	615.98	06.13	622.11
21.	NTPC	4,914.1	996.36	1,448.43	08.60	1,457.03

22.	ONGC	15,399,9	3,105.13	4,538.20	27.26	4,565.46
23.	Power Grid	1,531.65	331.23	445.20	04.76	449.96
24.	Reliance Industries	6,350	1,266	1,726.69	59.44	1,786.13
25.	Sun Pharma	481.36	14.94	134.22	03.39	137.61
26.	SBI	4,126.88	640.89	1,162.05	25.34	1,187.39
27.	TCS	17,733.38	3,433.16	5,119.45	66.85	5,186.30
28.	Tata Motors	122	24	34.33	00.76	35.09
29.	Tata Steel	1,820.04	204.95	437.68	36.11	473.79
30.	Wipro	2,211.4	457.08	626.33	12.36	638.69
	TOTAL	**1,32,613.53**	**22,596.92**	**41,653.10**	**841.53**	**42,494.70**

Source: Revenue from existing CDT – Annual Reports of the companies and Proposed Revenue – own computations are on the basis of present tax slabs.(Note:All the surcharges and the cess are ignored for the calculation of Proposed Revenue)

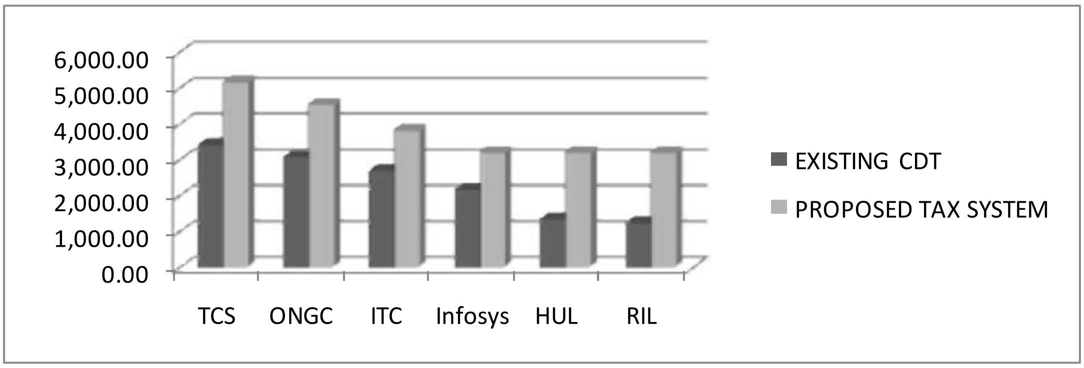
Comparative Analysis

On going through the above comparative table it is observe that there is a huge difference between the revenue from existing CDT and proposed taxability of the dividend. The shareholding pattern in almost all the listed corporate entities in the country is same as in the above 30 companies, which means the majority of shareholders are belongs to non public category, which are capable to pay higher taxes. So the state revenue will show an increase of at least 88.05% if this model of tax be adopted. The above table is based on the assumed average tax rate of 10% from the general public. Proposed revenue may be change in case of the 0% or 20% tax rates applies on that. We can analysis this change as under:

Total Revenue from Proposed Taxability of the Dividend (In different cases):

CASE 01:	**(In Rs. Crore)**
From Non public (@30%)	41,653.10
+ General Public (@ 0%)	00.00
Total State Revenue:	**41,653.1**
Increase in state revenue over Present CDT:	**84.33%**
CASE 02:	
From Non public (@30%)	41,653.10
+ General Public (Minimum @ 10%)	841.53
Total State Revenue:	**42,494.70**
Increase in state revenue over Present CDT:	**88.05%**
CASE 03:	
From Non public (@30%)	41,653.10
+ General Public (Average @ 20%)	1,683.06
Total State Revenue:	**43,336.16**
Increase in state revenue over Present CDT:	**91.78%**

Existing & Proposed State Revenue From Tax on Dividend (Top 6 Companies out of 30 Companies of BSE Sensex)(for the F.Y. 2015-16 & 2016-17) (In Rs. Crores)



In all the above cases the total proposed revenue is more than the existing CDT and the tax collected from the general public is very less than the collection from non public. We can suggest that the

Government can adopt any method to collect the tax on the dividend income of the respective shareholders. An advisory or guidelines can also be issued for the same. Central Government can use any of the following options to collect the tax in at easy fast and economical way:

- TDS can be made at different rates on the dividend income of the all shareholders, just like the TDS on the interest income of the debenture holders.
- TDS can be made at single maximum tax rate on the dividend income of the Non Public Shareholders and no TDS will be applicable on the general public.
- TDS can be made at single maximum tax rate on the dividend income, which is over a specific limited amount of the Non Public Shareholders and no TDS will be applicable on the dividend income which is less than the specific amount..
- Government can make dividend income exempted up to the certain limited amount, especially for the Retail Individual Investors.
- Section 80L and 80M can alsobe re- introduced.

Conclusion

The present tax policy of CDT means taxing the dividends on thehands of the company has actually increased the burden on the corporate **s**ector and significantly decreased the Government revenue. It actually goes against the present globalization policies of India, further leading to inefficient economic growth. Now it's justified to charge tax on the dividend income on the hands of the shareholders and let them pay the tax according to their tax bracket or payment capacity. In present digital world I-T department have an easy check on all types of shareholder of all the companies in India. A specific limit can be fixed and the small or retail shareholders falling below such limit can be exempted from such tax. In other words shareholders with larger shareholdingsin the company should be taxed at a higher rate on their income. It will increase the state revenue and also leads to a equity based progressive tax system for our developing economy.

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