DIVIDEND TAXATION IN INDIA:

FROM DDT TO SHAREHOLDER-LEVEL TAXATION

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For more than two decades, India followed a unique system of taxing dividends. Instead of taxing shareholders, the Income-tax Act imposed a Dividend Distribution Tax (DDT) on companies declaring dividends. This made dividends largely tax-free in the hands of investors.

India's experiment with Dividend Distribution Tax (DDT) began in 1997, when it was introduced by Jaswant Singh, then Finance Minister, through the Finance Act, 1997. The objective was simplicity: instead of tracking and taxing millions of shareholders, the tax burden was shifted to companies declaring dividends. Dividends were made tax-free in the hands of investors, while companies paid DDT at a prescribed rate.

However, this regime created distortions:

- Domestic investors escaped tax
- Foreign investors were taxed twice
- Companies bore a heavy tax cost

Over time, however, the tax evolved from a simplification tool into a significant fiscal burden. With successive rate hikes, gross-up provisions, and surcharges, the effective DDT rate rose to over 20%, making India one of the most heavily taxing jurisdictions globally on distributed corporate profits. By contrast, most OECD countries taxed dividends in shareholders' hands, often at concessional rates with treaty relief.

The inequities of the regime became increasingly apparent - particularly for foreign investors, who could not claim treaty credit for DDT paid by Indian companies, leading to economic double taxation. Recognising these distortions, the DDT framework was partially diluted by Arun Jaitley in 2016 through an additional tax on high-income resident shareholders, signalling the beginning of the end for DDT.

The then Government data showed:

- DDT collections were company-centric, not investor-centric
- Large, cash-rich companies bore the tax
- High-income shareholders often escaped tax completely

To plug this gap:

- Finance Act 2016 (FM Arun Jaitley) introduced:
    - Additional 10% tax on dividends above ₹10 lakh for resident individuals

This was a clear policy signal that DDT was no longer equitable - it taxed companies, not capacity to pay.

The final shift came in Budget 2020, presented by Nirmala Sitharaman, when DDT was abolished with effect from FY 2020–21. India aligned itself with globally accepted norms by taxing dividends in the hands of shareholders, enabling treaty relief, improving foreign investor confidence, and restoring neutrality between retained and distributed profits. It would be safe to say that this wasn't just a tax change - it was a signal to global capital markets.

Policy reviews before Budget 2020 noted that:

- Foreign Portfolio Investors (FPIs) and PE funds consistently raised concerns that:
    - DDT was not creditable under DTAAs
    - India's dividend policy reduced post-tax returns
- This made India less attractive compared to:
    - Singapore
    - Netherlands
    - Mauritius

      (all of which follow shareholder-level dividend taxation)

This concern was explicitly acknowledged in Budget discussions leading up to FY 2020–21.

Hence the Indian taxation system aligned now with global best practices, and we moved in line with OECD-consistent practice. Since then, dividends are taxed in the hands of the recipient, not the company.

NATURE OF DIVIDEND INCOME UNDER CURRENT LAW:

1. Head of Income

Under Section 56(2)(i), dividend is taxable under the head "Income from Other Sources"

It applies to dividend income earned on shares, mutual funds from Indian and Foreign companies.

Note: If shares are held as stock-in-trade, dividend can still be offered under business income by some taxpayers (depends on facts + consistency).

2. Rate of Tax

Dividend is taxed at the normal tax rate applicable to the Assessee as under:

Type of Assessee	Tax rate
Resident individual	Slab rate
Company	Corporate tax rate
Firm / LLP	30%
NRI / Foreign company	20% or DTAA rate

The above rates are exclusive of any surcharge/cess.

<u>Special Provisions of Taxation : Sections 115A, 115AC, 115AD, 115E</u>

Although dividends are normally taxed at slab rates, certain categories enjoy special rates:

(a) Section 115A – Non-Residents

Dividends received by Foreign companies and NRIs : taxable at 20% (plus surcharge and cess), unless DTAA provides a lower rate.

(b) Section 115AC – Global Depository Receipts (GDRs) Holders

Applies to Non-resident individuals and Foreign companies on dividends from Global Depository Receipts of Indian companies : Tax rate: 10%

(c) Section 115AD – Foreign Institutional Investors (FIIs)

Dividends earned by FPIs from investments in Indian securities are taxable at a concessional rate of 20%. This is levied on a gross basis, without allowing any deduction for expenses. The tax is ordinarily collected through tax deduction at source under section 195, and where applicable, FPIs may also claim the benefit of a lower rate under an applicable DTAA.

(d) Section 115E – NRIs

Dividends from Indian companies received by NRIs are taxed at 20% (without deduction of expenses).

3. Tax Deduction at Source (TDS) on Dividends

Since dividends are taxable, payers must deduct tax at source.

(a) Section 194 – For Resident Shareholders

TDS @ 10%

- Applicable only if dividend exceeds ₹10,000 in a year
- Deducted at the time of payment or credit, whichever is earlier

(b) Section 195 – For NRIs and Foreign Companies

TDS at:

- Rate prescribed under the Act (20% or 30%), or
- Lower rate under DTAA

whichever is beneficial to the taxpayer. It is to be noted that no minimum threshold applies.

4. Deductions from dividend Income : Section 57 of the I.T. Act

It provides for deductions from income taxable under the head "Income from Other Sources." In respect of dividend income, only interest on money borrowed for the purpose of making the investment in shares is allowed as a deduction. However, this deduction is restricted to a maximum of 20% of the dividend income included in the total income.

No other expenses such as brokerage, commission, salary, or portfolio management fees are allowed. The objective of this provision is to prevent excessive expense claims while allowing genuine interest costs incurred to earn dividend income.

5. DTAA and Taxation of Dividends

Under India's Double Taxation Avoidance Agreements (DTAAs), dividends paid by an Indian company to a non-resident shareholder are generally taxable in India as the source country, but at a concessional rate prescribed under the applicable treaty. Most Indian tax treaties, broadly based on the Organisation for Economic Co-operation and Development Model Convention, cap India's taxing rights on dividends at rates typically ranging between 5% and 15%, subject to conditions such as beneficial ownership and minimum shareholding thresholds in certain cases.

Following the abolition of the Dividend Distribution Tax (DDT), DTAA provisions have become fully operative for dividend income. Since dividends are now taxed in the hands of shareholders, non-resident investors and NRIs can claim treaty benefits either through lower withholding tax in India or by availing foreign tax credit in their country of residence for Indian taxes paid. This shift has eliminated the economic double taxation that existed under the DDT regime and has enhanced tax certainty and post-tax returns for foreign investors, thereby aligning India's dividend taxation framework with internationally accepted practices.

DTAA relief for dividends is available only where the recipient qualifies as a beneficial owner and complies with treaty documentation requirements such as furnishing a Tax Residency Certificate.

CONCLUSION

The abolition of the Dividend Distribution Tax (DDT) has fundamentally reshaped the taxation of dividend income in India.

By shifting the tax burden from companies to shareholders, dividends are now taxed like any other income - at applicable slab or treaty rates, subject to tax deduction at source, and with the benefit of Double Taxation Avoidance Agreements where available.

This framework promotes greater tax equity by taxing investors according to their individual capacity, encourages foreign investment by offering clarity and treaty-based relief, and brings India's dividend taxation in line with internationally accepted principles.

At the same time, the new regime increases both the tax liability and compliance obligations for high-income investors, making it essential to engage in informed tax planning through the use of DTAA benefits, allowable expense deductions, and efficient investment structuring to optimise the overall tax outcome.
