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Article

Dissecting Section 80M of the Income Tax Act - The known and the unknown

By **Bharathi Krishnaprasad and V. Baratwaj**

The Finance Bill 2020 (referred to as the **'Bill'**) proposed plethora of amendments in the Income Tax Act, 1961 (referred to as the **'Act'**) on different aspects. One such amendment was to relieve corporates from paying distribution tax on dividends (**'DDT'**) and going back to the old school ways of taxing such dividends in the hands of the shareholders.

Consequent to the abolishing of DDT, the Bill also proposed re-introduction of Section 80M of the Act which was omitted *vide* the Finance Act, 2003. This Article focusses on analysing the proposed Section 80M and understanding certain important intricacies in the same.

Section 80M provides deduction in respect of **inter-corporate dividends**. The proposed provisions are the same as the Section stood before its omission, making it a case of old wine in a new bottle! The benefits sought to be conferred by the proposed Section 80M are better explained in the following table:

Applicable to	Domestic Company[1]
Condition for deduction	Where Gross Total Income (GTI) of such company in any previous year includes income by way of dividends from any other **domestic company**
Quantification of deduction	Lower of the following: • Dividends received from any other domestic company • Dividends distributed by the assessee company on or before the **due date**
Meaning of 'due date'	One month prior to date of furnishing return of income under Section 139(1) of the Act
Bar on double deduction	Where deduction has been claimed under this section in any previous year, no deduction is allowed in respect of such amount already claimed in any other previous year

As explained above, the intent of the Section is to ensure that when a company has included dividends from a domestic company as part of its taxable income and has also distributed dividend to its shareholders, some benefit is provided to the company by presuming that such distribution is first made out of the dividends received and hence, allowing deduction to the company in respect of such distributions.

To the extent dividends are further distributed, the company is deemed to be a fiscally transparent entity through which the dividends pass and reach the hands of the ultimate shareholders[2], where they are sought to

[1] As per Section 2(22A) of the Act, Domestic Company means an Indian Company or any other company which, in respect of its income is 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.

[2] Consequent to scrapping of DDT, dividends are taxable in the hands of the shareholders

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be taxed. While it is a pre-condition that all the companies involved in the chain and distributing dividends must be domestic companies, there is no similar qualification as far as the shareholders to whom such distribution is made. As such, the ultimate beneficiary of the dividend could very well be a non-resident individual or a foreign corporate entity.

Difference in comparison to Section 115-O(1A)

As already stated, the provision has been inserted consequent to the removal of DDT. During the DDT regime, a similar benefit was available to the companies vide Section 115-O(1A) whereby certain dividends received by a domestic company were allowed to be reduced for determining the net amount on which DDT is to be paid by the company. However, there are certain important differences which are highlighted in the table below:

S. No	Section 80M	Section 115-O(1A)
1	Applicable to dividends received by a domestic company from any other **domestic company,** which may or may not be subsidiaries	Applicable to dividends received by a domestic company from its **subsidiaries**
2	Benefit is not available or restricted where the GTI is negative or is not sufficient to absorb the entire eligible deduction.	The benefit under this section is available even when the GTI of the company is negative.
3	Benefit is available only in respect of dividends received from domestic company	Benefit is available even in respect of dividends received from foreign subsidiaries

Availability of deduction in case the GTI is negative or insufficient

As discussed in the table above, deduction under Section 80M (being a deduction falling under Chapter VI-A of the Act) will not be available or will be restricted, in scenarios where the GTI is negative or insufficient[3], even though such company may have distributed sufficient dividends to its shareholders. In other words, any amount of deduction under this Section is available only when the GTI is positive.

Whether deduction is eligible for past distributions?

An interesting question that can arise is whether any distribution made in any earlier year can be claimed as deduction under Section 80M in any subsequent year, if no deduction for such distribution has been claimed earlier under this Section (for any reason). This aspect could be understood with the help of the following illustration:

Particulars	Year-1	Year-2
Dividends received by A Ltd from B Ltd. (both	100	150

[3] Second proviso to Section 123 of the Companies Act, 2013, states that in case of inadequacy or absence of profits, the company can declare dividends from its accumulated profits transferred to free reserves and subject to conditions prescribed in the Rules. The conditions are specified in Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014.

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Particulars	Year-1	Year-2
are domestic companies)		
Dividends distributed by A Ltd.	80	50
GTI	(1000)	1000
Deduction under Section 80M	0 (since GTI of A Ltd is negative)	50? or 130 (i.e.50+80)? Where 80 represents dividend distributed in Year 1, but which could not be claimed as deduction under 80M in Year 1

On plain reading of the provisions under Section 80M of the Act, it can be observed that deduction is available in respect of dividends distributed by a domestic company **on or before the due date**. The deduction is neither qualified by the words **'distribution made during the previous year'** nor the Section is worded similar to a provision like that of Section 43B[4]. Further, there is only a bar on double deduction, i.e., an amount distributed as dividend and claimed as deduction under Section 80M in any previous year, cannot be claimed again as deduction in any subsequent year. There is no bar as long as it can be demonstrated that the dividend though distributed in a prior year, was never claimed as deduction previously.

Therefore, it can be argued that as long as the dividends constitute distributions made on or before the specified due date (irrespective of the year in which they are made) and as long as the said distributions are not claimed as deduction earlier, benefit under Section 80M, going strictly by the language of the provision, cannot be denied. In our view, *prima facie,* there seems to be no bar for claiming deduction of Rs. 80 in Year 2 along with Rs. 50 (i.e. total deduction of Rs.130 in Year 2). However, a point to ponder is, would this interpretation go in tandem with the intention behind introducing Section 80M? Like so many other issues, it may also end up in courts.

Whether deduction is to be claimed on gross or net dividend income?

Another relevant question that can arise is whether deduction under Section 80M is to be computed considering gross dividend income or net dividend income (gross dividend income less allowable deductions). The implication is that in case the deduction is allowed only in respect of net dividends, the deduction under Section 80M would be comparatively lower.

Interestingly, the Act earlier contained a specific Section 80AA which addressed this point that the deduction under Section 80M was to be made considering net dividends and not gross dividends. This Section was omitted consequent to introduction of DDT for the first time from 1st June 1997. With bidding adieu to DDT, the Bill, however, does not propose to introduce any provision similar to that of Section 80AA. Given this, would lack of a specific provision stipulate that deduction is to be allowed against net dividend income lend substance to a stand that such a deduction is to be claimed against gross dividend income?

The authors are of the view that the wordings of Section 80M read with Section 80AB[5] are clear

[4] Section 43B permits certain deductions only in the year in which payment is actually made, however, relaxes the condition by permitting deduction even when such payments are made on or before the due date for filing return of income.

[5] Section 80AB provides that where any deduction is to be computed with reference to any income included in the GTI, the amount of income as computed in accordance with the provisions of this Act shall be deemed to be income included in the GTI.

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enough to lead to an interpretation that deduction is to be computed with reference to net dividend income, after deducting expenses, even in the absence of a specific provision like that of erstwhile Section 80AA. However, there are chances that there could be litigations on this aspect in the future.

To conclude, though the proposed beneficial provisions may seem simple and unambiguous, there are chances for disputes in future on certain aspects, some of which are highlighted in the article.

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Circular

Vivad Se Vishwas Scheme – Modifications and clarifications

Certain amendments were introduced in the Direct Tax Vivad Se Vishwas Bill, 2020 to impart greater flexibility and clarity in its application. Notable among the amendments were that changes in the meaning of 'appellant' to mean person whose appeal, writ or SLP is pending and those where time limit to file appeal against the order of various appellate forums or Court has not expired, partial relief of paying only 50% of tax in case assessee has a favourable ruling on the issue, simplified calculation of tax to be paid to mean tax which would have been paid had the order in appeal been confirmed, extension of the Scheme to search cases where disputed tax not exceed Rs. 5 crores and also refund of tax paid in excess of amount payable under the Scheme.

Additionally, by way of Circular 7/2020 dated 4-3-2020, a number of clarifications have been issued in respect of the Scheme. The salient points are:

- The benefit of the scheme can be availed even where no appeal is pending but the case is pending in arbitration.
- Matters pending before AAR are not eligible.
- Writ filed against reopening of assessment is not covered under the scheme.
- An applicant cannot choose one or two issues out of an appeal and settle the dispute in part.
- Appeals for which the due date of filing had not expired as on 31-1-2020 are also eligible under the scheme.
- Credit of taxes paid earlier will be available against the disputed tax.
- In case an issue had been settled in favour of an assessee by the Supreme Court, the issue need not be settled through the scheme. If the said issue is part of other issues, then tax on the issue may be taken as nil.
- No appeal can be filed against tax determined as payable under the scheme.
- Once declaration has been made under the Scheme, in case is not paid citing financial difficulty, the declaration will become null and void.

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Ratio Decidendi

Associated Enterprises - Loans from two group entities cannot be aggregated to determine 51% threshold for deeming them as AEs

The revenue department contended that two group entities which had common directors had advanced loans which was in excess of 51% of the book value of assets and hence the appellant herein was an Associated Enterprise as per Section 92A(2)(c) of the Income Tax Act. The ITAT however held that when looked at individually, neither of the two concerns alleged to be AEs had advanced sums which exceeded 51% of the book value. Moreover, the appellant had made certain advances during the course of business for rendering ship management services and they could not be treated as loan. Thus, the appellant was held not an AE. [*Sovereign Safeship Management Pvt. Ltd.* v. *ITO* - ITA No. 2070/Mum/2016, Order dated 5-3-2020, ITAT, Mumbai]

Though situations for reduction/ waiver of interest are exhaustive, Courts under writ jurisdiction can go beyond it

The Petitioner had filed a writ petition before the High Court challenging the order passed by the Chief CIT rejecting its request for waiver of interest under Section 234A, 234B and 234C of Income Tax Act, 1961, in terms of CBDT Notification dated 26-6-2006 bearing reference No.400/29/2002-IT(B). The Petitioner had prayed for waiver of interest on the ground that at the time of assessment proceedings, the Company was directed to be wound up *vide* Court order, and therefore the Company was under a legal disability. The Chief CIT however rejected such application of the Petitioner holding that the case of the Petitioner did not fall within any of the circumstances specified in the Notification. From a perusal of the Notification, the Court upheld the order passed by the Chief CIT. It however also held that the Petitioner is entitled for a relief *dehors* the Notification and exercised such power under its writ jurisdiction. [*Tvl. Sanmac Motor Finance Ltd.* v. *Chief CIT* - Writ Petition No. 12500/2010, decided on 10-2-2020, Madras High Court]

Subsequent change in legal position cannot be a ground to reopen assessment after four years

The Petitioner had filed a writ petition challenging the initiation of reassessment proceedings after the expiry of four years from the end of the relevant assessment year. The opening of the assessment was based on a subsequent decision of the Supreme Court, which altered the legal position existing at the time of regular assessment. The Court held that since there was no allegation in the reasons recorded by the AO as to the failure on the part of the Petitioner to disclose fully and truly material facts necessary for its assessment, which is pre-requisite for reopening the assessment as per the Proviso to section 147, the re-assessment proceedings are to be quashed. [*Calcutta Club Ltd.* v. *ITO* - [2020] 114 taxmann.com 560 (Calcutta)]

Reduction of share capital amounts to transfer under Section 2(47), provided consideration has been paid thereof

The Assessee, a foreign tax resident, made investment in the shares of its wholly owned Indian subsidiary. During the concerned

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assessment year, the Indian subsidiary undertook a share capital reduction pursuant to Court's approval. Under the scheme, certain shares held by the Assessee were cancelled and consideration was paid thereof. A part of such consideration was appropriated by the Assessee towards sale consideration of the shares and capital loss on account of indexation benefit was claimed. The AO rejected the claim of the Assessee holding that there was no transfer under Section 2(47). Subsequently, the proposed disallowance was also affirmed by the DRP by relying on *Bennett Coleman & Co. Ltd v. ACIT* (133 ITD 1).

On appeal, the Tribunal held that the reduction of capital had resulted in 'extinguishment of rights in shares' and the definition of 'transfer' under Section 2(47) includes 'extinguishment of any rights' in a capital asset. Reliance in this regard was placed on *CIT v. Grace Collis* [248 ITR 323 (SC)]. The Tribunal further distinguished *Bennett Coleman* and held that no consideration was paid by the company to its shareholders in the facts of that case. [*Carestream Health Inc.* v. *Dy. CIT* – Order dated 6-2-2020 in ITA No. 826/Mum/2016, ITAT Mumbai]

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