Dividend Tax Saving

For resident individual shareholders

Background:

Up to FY 2019-20, if a shareholder gets dividend from a domestic company then he shall not be liable to pay any tax on such dividend as it is exempt from tax under section 10(34) of the Act. However, in such cases, the domestic company was liable to pay a Dividend Distribution Tax (DDT) under section 115-O.

The Finance Act, 2020 has abolished the DDT and has moved to the classical system of taxation, wherein **dividends are taxed in the hands of investors**. So, **dividend** received from **mutual funds** held is also **taxable** in the hands of investors. Also, dividend received from foreign companies is taxable in the hands of shareholders at their **slab rate.**

The **final dividend** including deemed dividend shall be taxable in the year in which it is declared, distributed or paid by the company, whichever is earlier. Whereas, **interim dividend** is chargeable to tax on receipt basis.

Hence, it now becomes pertinent for investors' to be aware of the various ways through which this tax can be planned and reduced.

(a) Deductions for Trader/ Investor: *(Based on the nature of dealing with securities, quantum of deductions varies)*

Dividend from shares earned by a **trader** is taxable under Profits and Gains from Business or Profession head. Hence, he can claim the **deductions of all those expenditures** which have been incurred to earn that dividend income such as collection charges, interest on loan etc.

But, on the other hand, the dividend received by an **investor is taxed under Income from Other Sources head**. Hence, he can claim deduction of only **interest expenditure** which has been incurred to earn that dividend income to the extent of **20%** of total dividend income. No deduction shall be allowed for any other expenses, including commission or remuneration paid to a banker or any other person for the purpose of realising such dividend.

(b) 15G/H for TDS:

As per the Section **194**, which shall be applicable to dividend distributed, declared or paid on or after 01-04-2020, an Indian company shall deduct tax at the rate of 10% from dividend distributed to the resident shareholders if the aggregate amount of dividend distributed or paid during the financial year to a shareholder **exceeds Rs. 5,000**. (Concessional rate of 7.50 % for the period 14th May 2020 to 31st March 2021 as per Press Release of CBDT dated 13th May, 2020)

The same rates of TDS are also applicable for **mutual funds**, as per section **194K**.

Declaration under **Form 15G/ 15H** can be filed by the individual, for **nil deduction of TDS**, if the total dividend income does not exceed the maximum exemption limit and tax on the estimated total income for the financial year in which such income is to be included is nil. *(15G- for non-senior citizens & 15H- for senior citizens)*

(c) SWP as against Dividend Payout:

Systematic Withdrawal Plans (SWPs) is the **reverse of** Systematic Investment Plan (**SIP)**, wherein a fixed amount is redeemed every month out of the investment specified. SWPs can be set up in growth mutual funds. So, every month when we redeem, **some units of the mutual fund held would be sold**. In times when the NAV of the mutual fund is high, selling lesser number of units would get the same amount. On the other hand, when the NAV of the mutual fund is low, selling more units would get the fixed monthly amount.

Where, earning a **fixed income on a regular basis** is the goal, SWP can be set-up in a debt or equity oriented- growth fund, to avoid dividend payout schemes. SWPs are taxed under Capital Gains head, and the corresponding tax on capital gains are generally lower, if dividends are to be taxed at the highest slab rate. Whereas, the only exception being sale of debt-oriented mutual funds before 3 years from the date of investment as it is taxed at slab rate.

Moreover, the **frequency** of withdrawals and the **quantum** of withdrawal (a fixed amount or only the capital appreciation) can be decided by the investor. Capital reduction/ erosion is not a worry as the scheme is a growth scheme. So, the redemptions have to planned in a way that they are lesser than or equal to the returns generated by the growth scheme, leaving the capital stable.

(d) STP as against Dividend Reinvestment:

Systematic Transfer Plan (STP) is like SWP, but the redemption proceeds are not transferred to bank account, but **reinvested** in some other scheme. Where, regular income is not the goal but **rebalancing the portfolio** and managing risk by strike a balance between debt and equities, by moving investments from equities to debts and vice versa. The taxation of STPs is also similar to SWPs as both are redemptions.

Conclusion:

For dividend received from shares from companies only interest expenditure deduction is available, if applicable. For mutual funds investment, option (c) and (d) can be weighed with regard to other factors including transaction costs, loads and brokerages. If the investor falls in a lower tax slab rate, he/ she need not worry about dividends getting taxed in the hands of investors. Also, for investors with nil tax on estimated total income can avoid TDS deduction by submitting Form 15G/H.

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