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## Budget 2018 – Blocking the defamed route to avoid DDT/CDT payment



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### Introduction

Amongst various other proposals, not finding spot in Mr. Jaitley's Budget Speech was one such proposal which is surely going to pinch a few corporate houses going in for amalgamation/ merger or such other restructuring.

As a professional, we are always advised that *"it's better to read everything of something and something of everything."* Going by this, we sat down at peace to go through Memorandum and Finance Bill of 2018 to know what exactly is in store for everyone and in search of a few silent proposals having significant impact.

Its seen as a practice in India, that the Ruling Party in their budget speech, immediately before Election Year, tend to blow their own horns rather than putting forward the changes brought about. This necessitates studying the Memorandum in depth even more.

One such proposed amendment which grabbed our attention was the one significantly broadening the definition of "Accumulated Profits" to include accumulated profits of the amalgamating company in the profits or losses of amalgamated company.

Another eye-catching proposal which corporates should look out for relates to widening the scope of DDT by taking into its ambit deemed dividend on loan to beneficial shareholder and that too not at the prevailing rate of DDT (15%) but higher rate of 30%.

What is surprising to note here is that the Indian Economic Survey of 2013-14 recommended phasing out DDT as it was considered to be undesirable in public finance schemes. Also, it would be apt to quote here the words of our Finance Minister from his budget speech of 2016 Budget on levying tax on dividend in hands of the shareholders. According to him, DDT *"perceived to distort the fairness and progressive nature of taxes"*.

Without going much in history now, let us discuss the budget proposal on DDT in detail one by one –

## **Widening the definition of "Accumulated Profits"**

1. As per the earlier provisions of deemed dividend u/s 2(22)(d), profits of the company up to the date of distribution or payment or liquidation were included in the definition of Accumulated profits.

This led to situations wherein corporate houses started adopting amalgamation route to stray away from payment of tax on deemed dividend. The amalgamation route served to be benefit of the companies in the flowing manner -

To start with, let us understand the 2 main methods of accounting for amalgamations as per AS 14 –

- a. The Pooling of Interest Method – The assets, liabilities and **reserves** of the transferor company are recorded by the transferee company at their existing carrying amounts
- b. The Purchase Method – The transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation

Now, if the amalgamation is an 'amalgamation in the nature of purchase', the identity of the **reserves**, other than the statutory reserves is not preserved. The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company.

The Income Tax Act charges DDT on the amount paid to shareholder on reduction of share capital to the extent of accumulated profits of the company (whether capitalized or not).

In order to avoid this DDT, certain unlisted companies, mainly multinationals were resorting to Purchase Method of Amalgamation wherein a profit-making company with huge Accumulated Profits was amalgamated with a company having significantly lower profits or even losses, without recording/accounting for the accumulated profits of the transferor company.

Now, it is proposed to add an explanation, widening the definition of accumulated profits by including accumulated profits of the amalgamating company as on the date of amalgamation in the accumulated profits/losses of amalgamated company. This will keep the reserves/accumulated profits the same as before amalgamation. And would leave no scope for the corporates to avoid paying DDT on their accumulated profits.

## **Inclusion of Deemed Dividend - Loan to Beneficial Shareholders within the ambit of DDT**

2. Presently, DDT at the rate of 15% is applicable on dividend declared, distributed or paid by a company and certain other instances where a transaction is deemed as dividend. One such transaction is of advancing loan/advances to shareholders which is deemed to be dividend on account of distribution of Accumulated Profits as loan rather than as dividend. Such transaction is presently subject to applicable tax rates and not covered by DDT. Which means the same was taxable in the hands of the shareholders and not at company level.

In order to bring certainty in taxation and collection of such tax and also to reduce litigations in the hands of shareholders, Budget 2018 has proposed to bring the above deemed dividend on account of loan to beneficial shareholder within the ambit of DDT from April 1, 2018.

Further, it is proposed that such dividend will not be taxable at the existing rate of DDT i.e. 15% but at 30% (without grossing up). This will lead to shifting the burden of collection and litigation to the company

providing loans/advances to shareholders.

## **Conclusion**

On a positive side, no doubt, the government has more or less has fulfilled its promise made back in 2016 of reducing the corporate tax rate to 25% but they now seem to be coming up with techniques to tax the corporates in new ways. This tends to reduce or even nullify the lower tax benefits.

Corporate tax rate of 25% for companies having turnover less than 250crores will surely be benefiting 99% of the assessee however widening the scope of DDT will definitely be pinching lot of corporates.

With foreign investments and collaborations kicking in, the government should have given thought to encourage M&A in India by rolling out positive proposals as the need of the hour is. Thus, widening the ambit of accumulated profits will surely be discouraging a few genuine multinational corporates going in for amalgamation.

Although, the exact impact of above proposal scan be known in near future only, however, it can be said that Indian corporate houses going in for amalgamation/merger need to pull up their socks as the road ahead seems to be rocky.

The government, we all should remember, if gives us one, takes back five.

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