

ASSESSMENT OF VARIOUS ENTITIES

AMENDMENTS BY THE FINANCE (No.2) ACT, 2014

- (a) Scheme for taxation of Real Estate Investment Trust (REIT) and Infrastructure Investment Trust (Invit) [New Chapter XII-FA – Section 115UA]

Effective from: A.Y.2015-16

Related amendment in sections: 2(42A), 10(23FC), 10(23FD), 10(38), 47(xvii), 49(2AC), 111A, 115A, 139(4E), 194A, 194LBA & 194LC

- (i) The SEBI has notified the final regulations relating to two new categories of investment vehicles namely, the Real Estate Investment Trust (REIT) & Infrastructure Investment Trust (Invit).
- (ii) The SEBI (Real Estate Investment Trusts) Regulations, 2014 (“REIT Regulations”) provide a framework for registration and regulation of Real Estate Investment Trusts (“REITs”).

Salient features of the REIT Regulations, as approved by the SEBI:

- (a) REITs shall be set up as a trust and registered with SEBI. It shall have parties such as Trustee, Sponsor(s) and Manager.
- (b) The trustee of a REIT shall be a SEBI registered debenture trustee who is not an associate of the Sponsor/manager.
- (c) REIT shall invest in commercial real estate assets, either directly or through special purpose vehicles (SPVs). In such SPVs, a REIT shall hold or propose to hold controlling interest and not less than 50% of the equity share capital or interest. Further, such SPVs shall hold not less than 80% of its assets directly in properties and shall not invest in other SPVs.
- (d) Once registered, the REIT shall raise funds through an initial offer. Subsequent raising of funds may be through follow-on offer, rights issue, qualified institutional placement, etc. The minimum subscription size for units of REIT shall be ₹ 2 lakhs.
- (e) Units of REITs shall be mandatorily listed on a recognized Stock Exchange and REIT shall make continuous disclosures in terms of the listing agreement. Trading lot for such units shall be ₹ 1 lakh.

- (f) For coming out with an initial offer, the value of the assets owned/proposed to be owned by REIT shall be of value not less than ₹ 500 crore. Further, minimum issue size for initial offer shall be ₹ 250 crore.
- (g) The Trustee shall generally have an overseeing role in the activity of the REIT. The manager shall assume operational responsibilities pertaining to the REIT.
- (h) A REIT may have multiple sponsors, not more than 3, subject to each holding at least 5% of the units of the REIT. Such sponsors shall collectively hold not less than 25% of the units of the REIT for a period of not less than 3 years from the date of listing. After 3 years, the sponsors, collectively, shall hold minimum 15% of the units of REIT, throughout the life of the REIT.
- (i) Not less than 80% of the value of the REIT assets shall be in completed and revenue generating properties.
- Upto 20% of the value of REIT assets shall be invested in following :
- (1) developmental properties;
 - (2) mortgage backed securities;
 - (3) listed/ unlisted debt of companies/body corporates in real estate sector;
 - (4) equity shares of companies listed on a recognized stock exchange in India which derive not less than 75% of their operating income from Real Estate activity;
 - (5) government securities;
 - (6) money market instruments or cash equivalents.
- However, investments in developmental properties shall be restricted to 10% of the value of the REIT assets
- (j) A REIT shall invest in at least 2 projects with not more than 60% of value of assets invested in one project.
- (k) REIT shall distribute not less than 90% of the net distributable cash flows, subject to applicable laws, to its investors, atleast on a half yearly basis.

- (iii) The SEBI (Infrastructure Investment Trusts) Regulations, 2014 (“InvIT Regulations”) provide a framework for registration and regulation of Infrastructure Investment Trusts (“InvITs”).

The salient features of the InvIT Regulations, as approved by SEBI:

- (a) InvITs shall be set up as a trust and registered with SEBI. It shall have parties such as Trustee, Sponsor(s), Investment Manager and Project Manager.
- (b) The trustee of an InvIT shall be a SEBI registered debenture trustee who is not an associate of the Sponsor/Manager.
- (c) InvITs shall invest in infrastructure projects, either directly or through SPV. In case of PPP projects, such investments shall only be through SPV.

- (d) An InvIT shall hold or propose to hold controlling interest and more than 50% of the equity share capital or interest in the underlying SPV, except where the same is not possible because of a regulatory requirement/ requirement emanating from the concession agreement. In such cases, sponsor shall enter into an agreement with the InvIT, to ensure that no decision taken by the sponsor, including voting decisions with respect to the SPV, are against the interest of the InvIT/ its unit holders.
- (e) Sponsor(s) of an InvIT shall, collectively, hold not less than 25% of the total units of the InvIT on post issue basis for a period of at least 3 years, except for the cases where a regulatory requirement/concession agreement requires the sponsor to hold a certain minimum percent in the underlying SPV. In such cases, the consolidated value of such sponsor holding in the underlying SPV and in the InvIT shall not be less than the value of 25% of the value of units of InvIT on post-issue basis.
- (f) The proposed holding of an InvIT in the underlying assets shall be not less than ₹ 500 crore and the offer size of the InvIT shall not be less than ₹ 250 crore at the time of initial offer of units.
- (g) An InvIT which proposes to invest at least 80% of the value of the assets in the completed and revenue generating infrastructure assets, shall :
- raise funds only through public issue of units.
 - have a minimum 25% public float and at least 20 investors.
 - have minimum subscription size and trading lot of ₹ 10 lakhs and ₹ 5 lakhs, respectively.
 - distribute not less than 90% of the net distributable cash flows, subject to applicable laws, to the investors, atleast on a half yearly basis.
 - through a valuer, undertake a full valuation on a yearly basis and updation of the same on a half yearly basis and declare NAV within 15 days from the date of such valuation/updation.
- (h) A publicly offered InvIT may invest the remaining 20% in under construction infrastructure projects and other permissible investments, as defined in the regulations. However, the investments in under construction infrastructure projects shall not be more than 10% of the value of the assets.
- (i) Listing shall be mandatory for both publicly offered and privately placed InvITs and InvIT shall make continuous disclosures in terms of the listing agreement.

(iv) The Finance (No.2) Act, 2014 has introduced a special taxation regime for providing the manner of taxability of –

- income in the hands of business trusts; and
- income distributed by such business trusts in the hands of the unit holders.

Section 2(13A) defines a business trust to mean a trust –

- registered as an Infrastructure Investment Trust (Invit) or a Real Estate Investment Trust (REIT);
- the units of which are required to be listed on a recognized stock exchange –
- in accordance with the regulations made under the SEBI Act, 1992; and
- notified by the Central Government in this behalf.

(v) New Chapter XII-FA, containing the special provisions relating to business trusts, has been inserted w.e.f. A.Y.2015-16. Section 115UA(1) provides that any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder, as it had been received by, or accrued to the business trust.

(vi) Section 10(23FC) exempts any income of a business trust by way of interest received or receivable from a Special Purpose Vehicle (SPV). Thus, the business trust enjoys a pass-through status in respect of interest received or receivable from a SPV.

SPV means an Indian company in which the business trust holds controlling interest and any specified percentage of shareholding or interest, as may be required by the regulations under which such trust is granted registration (not less than 50% as per the current REIT regulations).

(vii) The distributed income of the business trust, to the extent it comprises of interest referred to in section 10(23FC), is deemed to be the income of the unit holder in the previous year of distribution and subject to tax in the hands of the unit holder in that year. Accordingly, the business trust is required to deduct tax at source on interest component of income distributed to its unit holders.

(viii) Any distributed income referred to in section 115UA, to the extent it does not comprise of interest referred to in section 10(23FC), received by unit holders is exempt in their hands under section 10(23FD).

Example

A business trust receives income of ₹ 1 crore, comprising of ₹ 80 lakh interest from SPV and ₹ 20 lakh dividend from SPV. It distributes ₹ 90 lakh to its unit-holders. What are the tax implications?

Answer

The proportion of interest and dividend income in the hands of each unit holder would be in the ratio of 8:2. For example, in the case of a unit holder to whom income of ₹ 5 lakh is distributed, ₹ 4 lakh would constitute interest income and ₹ 1 lakh dividend income. Tax has to be deducted by the business trust on interest component of income distributed to unit holders, since the business trust enjoys a pass-through status in respect of such income and the same is taxable in the hands of the unit holder. However, dividend income is exempt both in the hands of the business trust and in the hands of the unit holder, since the SPV would have paid dividend distribution tax under section 115-O on the same.

- (ix) Any person responsible for making payment of distributed income on behalf of the business trust to a unit holder is required to furnish a statement to the unit holder and the prescribed authority within the prescribed time.
- The statement should be in the prescribed form and manner. It should contain the particulars of the nature of income paid during the previous year as well as the other details as may be prescribed [Section 115UA (4)].
- (x) Under section 139(4E), a business trust is mandatorily required to furnish a return of its income or loss in every previous year. All the provisions of the Income-tax Act, 1961 would apply as if it were a return required to be furnished under section 139(1).
- (xi) The scheme of taxability of income in the hands of the business trust, unit holders, sponsors etc. is briefed in the table given hereunder –

	Transaction	Section	Tax and TDS implications ³
(1)	Transfer of listed units of the business trust by the unit holders	2(42A) 10(38) 111A	<u>Tax implications in the hands of unit holders:</u> ➤ STT leviable on trading of listed units on a recognized stock exchange; ➤ The period of holding of units of business trust to qualify as “long-term capital assets” is “more than 36 months”; ➤ Long-term capital gains would be exempt in the hands of the unit-holders; ➤ Short-term capital gains would be subject to concessional rate of tax@15% (plus surcharge, if applicable, and cess@3%).
(2)	Exchange of shares in SPV by sponsor for units of Business Trust	47(xvii) 10(38) & 111A	<u>Tax implications in the hands of the sponsor:</u> ➤ Such exchange is not treated as a transfer. Hence, taxability of capital gains on such transfer deferred to the time of disposal of units by the sponsor; ➤ However, both exemption under section 10(38) and the concessional rates of tax given under section 111A would not be available to the sponsor at the time of disposal of units. Therefore, long-term capital gains would be taxable@20% and short-term capital gains would be subject to the normal rates of tax in the hands of the sponsor.

	49(2AC)	➤ For computing capital gains in the hands of the sponsor, cost of acquisition of units would be deemed to be the cost of acquisition of shares to the sponsor; ➤ For computing capital gains in the hands of the sponsor, the period of holding of units to include the period of holding of shares for determining whether the capital gains is long-term or short-term.
	2(42A)	
(3)	Interest income of business trust from SPV	<u>Tax implications in the hands of the business trust & unit holders and TDS implications in the hands of the SPV & business trust:</u> ➤ Pass-through status for interest received by business trust from SPV: ▪ Interest income is not taxable in the hands of the business trust; and ▪ SPV is not required to deduct tax at source on interest paid to business trust. ➤ Tax consequences on distribution of such income by the business trust to the unit-holders: ▪ Interest income taxable in the hands of the unit holders – ○ @5%, in case of unit holders, being non-corporate non-residents or foreign companies; and ○ at normal rates of tax, in case of resident unit holders. ▪ Business trust to deduct tax at source on interest component of income distributed to unit holders: ○ @5%, in case of unit holders, being non-corporate non-residents or foreign companies; and ○ @10%, in case of resident unit holders.
	10(23FC) 194A(3)(xi)	
	115A(1) (iiac)	
	194LBA	

³ TDS provisions are applicable with effect from 1st October, 2014. The other tax implications are in relation to A.Y.2015-16.

(4)	Interest payments to non-resident lenders on ECBs by the business trust	194LC	<u>TDS implications in the hands of business trust:</u> ➤ TDS@5% on interest payments to non-resident lenders on ECBs by the business trust [Such interest would attract tax in the hands of the non-resident lenders@5% as per section 115A]. ➤ The above concessional rate of TDS is applicable to moneys borrowed by the business trust in foreign currency from a source outside India, with the approval of the Central Government – (a) Under a loan agreement at any time before 1.7.2017; (b) By way of issue of long-term bonds at any time on or after 1.10.2014 but before 1.7.2017.
(5)	Dividend received by the business trust from SPV	115-O & 10(34) 10(23FD)	<u>Tax implications in the hands of the SPVs, business trust and unit holders:</u> ➤ Since the SPV would be subject to dividend distribution tax u/s 115-O, the dividend received by the business trust would be exempt in its hands; ➤ The dividend component of income distributed by the trust to unit holders will also be exempt from tax in the hands of unit holders.
(6)	Capital gains on disposal of assets by the Business Trust	115UA(2)	<u>Tax implications in the hands of the Business Trust and Unit holders:</u> ➤ Capital gains is chargeable at the applicable rates in the hands of the Business Trust: ▪ In case of long-term capital gains, the provisions of section 112 would apply; ▪ In case of short-term capital gains on sale of listed shares, the provisions of section 111A would apply; ▪ Short-term capital gains, other than the gains subject to tax under section 111A, would be subject to maximum marginal rate.

		10(23FD)	➤ If such capital gains are further distributed to unit-holders, the component attributable to capital gains would be exempt in the hands of the unit holders.
(7)	Income of business trust [Other interest dividend from SPV and capital gains subject to tax under section 112 / 111A]	115UA(2) 10(23FD)	<u>Tax implication in the hands of the Business Trust and Unit holders:</u> ➤ Any other income of the trust is chargeable to tax at the maximum marginal rate (i.e., @33.99%). ➤ Such income distributed to unit holders would be exempt in their hands.

Example

A REIT gives particulars of its income for the P.Y.2014-15:

- (1) Interest income from SPV – ₹ 5 crore;
- (2) Dividend income from SPV – ₹ 3 crore;
- (3) Short-term capital gains on sale of listed shares of SPV – ₹ 2 crore;
- (4) Short-term capital gains on sale of developmental properties – ₹ 1 crore
- (5) Interest received from investments in unlisted debentures of real estate companies – ₹ 10 lakh;

Discuss the tax consequences of the above income earned by the REIT in the hands of the REIT and the unit holders, assuming that the REIT has distributed ₹ 10 crore to the unit holders in the P.Y.2014-15.

Answer

S. No.	Nature of Income	Tax treatment
(1)	Interest income of ₹ 5 crore from SPV	No tax liability in the hands of REIT due to pass-through status enjoyed by it in respect of interest income from SPV. Therefore, SPV is not required to deduct tax at source on interest payment to REIT. However, the REIT has to deduct tax at source – - @10%, on interest component of income distributed to resident unit holders; and - @5%, on interest component of income distributed to non-corporate non-resident unit holders and foreign companies.

		Interest component of income distributed to unit holders is taxable in the hands of the unit holders – @5%, in case of unit holders, being non-corporate non-residents or foreign companies; and at normal rates of tax, in case of resident unit holders. The interest component of income received from the business trust in the hands of each unit-holder would be determined in the proportion 5/11.1.
(2)	Dividend income of ₹ 3 crore from SPV	No tax liability in the hands of REIT since dividend is subject to dividend distribution tax under section 115-O in the hands of the SPV. No tax liability on the dividend component of income distributed to unit holders.
(3)	Short-term capital gains of ₹ 2 crore on sale of listed shares of SPV	REIT is liable to pay tax@15% under section 111A in respect of such short-term capital gains. No tax liability on the capital gain component of income distributed to unit holders.
(4)	Short-term capital gains of ₹ 1 crore on sale of developmental properties	Taxable at maximum marginal rate of 33.99% in the hands of the REIT. No tax liability on the capital gain component of income distributed to unit holders.
(5)	Interest of ₹ 10 lakh received in respect of investment in unlisted debentures of real estate companies	Such interest is taxable@33.99%, being the maximum marginal rate, in the hands of the business trust. No tax liability on the interest component of income distributed to unit holders.

(b) Dividends received by Indian companies from specified foreign companies to be entitled to concessional rate of tax without restriction of benefit to a particular assessment year(s) [Section 115BBD]

Effective from: A.Y.2015-16

- (i) Dividends received by Indian companies from **specified foreign companies** are subject to a concessional tax rate of 15% on gross dividend (in the sense, that no expenditure would be allowable in respect of such dividend) as against the normal tax rate of 30% on net dividend. This is provided for under section 115BBD,

- inserted by the Finance Act, 2011 and applicable for A.Y.2012-13. The benefit of this concessional rate under section 115BBD was extended to the A.Y.2013-14 by the Finance Act, 2012 and A.Y.2014-15 by the Finance Act, 2013.
- (ii) The Finance (No.2) Act, 2014 has now extended the benefit of concessional rate of taxation@15% on gross dividend received by Indian companies from specified foreign companies without limiting it to a particular assessment year, in order to encourage Indian companies to repatriate foreign dividends into the country.
- (iii) Accordingly, for A.Y.2015-16 and subsequent assessment years, the gross dividend received by Indian companies from specified foreign companies would be subject to tax at the rate of 15%.
- (iv) **Specified foreign company** means a foreign company in which the Indian company holds 26% or more in nominal value of the equity share capital of the company.
- (v) Therefore, this concessional rate would not be applicable in respect of dividend received from a foreign company in which the holding of the Indian company is less than 26% of the nominal value of the equity share capital.
- (vi) Accordingly, if the total income of an Indian company, includes income by way of dividend declared, distributed or paid by a specified foreign company, the income tax payable would be the aggregate of –
- (a) Income-tax @15% on gross dividend from such specified foreign company; and
- (b) Income-tax with which the Indian company would have been chargeable had its total income been reduced by such dividend.
- (c) Assessee claiming investment linked tax deduction under section 35AD covered within the ambit of AMT [Section 115JC]**
- Effective from: A.Y.2015-16**
- (i) At present, only assessee claiming profit linked tax deduction under Chapter VI-A [Sections 80-IA, 80-IAB, 80-IB, etc.] or exemption under section 10AA fall within the purview of Alternate Minimum Tax (AMT) under section 115JC.
- (ii) The existing provisions of section 115JC provide that where the regular income tax payable by a person, other than a company, for a previous year is less than the alternate minimum tax for such previous year, the person would be required to pay income tax at the rate of 18.5% on its adjusted total income.
- (iii) The total income shall be increased by deductions claimed under Part C of Chapter VI-A [Sections 80-IA, 80-IAB, 80-IB etc.] and deduction claimed under section 10AA to arrive at the adjusted total income.
- (iv) The investment linked deduction for specified business has been provided under section 35AD in lieu of profit linked deductions, which have the effect of diverting profits from the taxable sector to the tax-free sector.
- (v) The profit linked deductions under sections 80-IA, 80-IAB, 80-IB etc. are already

being subject to AMT. However, so far, investment-linked deduction under section 35AD was not subject to AMT.

- (vi) In order to remove this inconsistency and bring the investment linked deduction claimed under section 35AD within the scope of AMT, section 115JC has been amended to provide that total income shall be increased by the deduction claimed under section 35AD, as reduced by the depreciation allowable under section 32, as if no deduction under section 35AD was allowed in respect of the asset for which such deduction is claimed.

Example

Mr.X, carrying on the business of operating a warehousing facility for storage of sugar, has a total income of ₹ 80 lakh. In computing the total income, he had claimed deduction under section 35AD to the tune of ₹ 70 lakh on investment in building (on 1.4.2014) for operating the warehousing facility for storage of sugar. Compute his tax liability for A.Y.2015-16.

Answer

Particulars	₹ in lakh
Tax liability under the normal provisions of the Income-tax Act, 1961	22.25
Add: Education cess and SHEC@3%	0.67
Total tax liability	22.92
Adjusted Total Income	
Total Income	80.00
Add: Deduction under section 35AD	70.00
Less: Depreciation under section 32 [10% of ₹ 70 lakh]	7.00
Adjusted Total Income	143.00
AMT@18.5%	26.46
Add: Surcharge@10% (since adjusted total income > ₹ 100 lakh)	2.64
Add: Education cess and SHEC@3%	29.10
Tax liability under section 115JC	0.87
	29.97
Since the regular income-tax payable is less than the AMT payable, the adjusted total income of ₹ 143 lakhs shall be deemed to be the total income of Mr.X and tax is payable@18.5% thereof plus surcharge@10% and cess@3%. Therefore, the tax liability is ₹ 29.97 lakhs.	

AMT Credit to be carried forward under section 115JD	
Tax liability under section 115JC	29.97
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	22.92
	7.05

- (d) Credit for AMT to be available even in a year when the adjusted total income is not more than ₹ 20 lakh and there is no claim for deduction under section 10AA or Chapter VI-A or section 35AD [Section 115JEE]

Effective from: A.Y.2015-16

- (i) As per section 115JEE(1), the provisions of Chapter-XII BA shall be applicable to any person who has claimed a profit-linked deduction under Chapter VI-A or a deduction under section 10AA. Section 115JEE(2) provides that the Chapter shall not be applicable to an individual or an HUF or an association of persons or a body of individuals (whether incorporated or not) or an artificial juridical person if the adjusted total income does not exceed ₹ 20 lakh.

- (ii) This provision has created genuine hardship in claim of credit of alternate minimum tax under section 115JD in an assessment year where the adjusted total income is not more than ₹ 20 lakh or there is no claim of any deduction under section 10AA or Chapter VI-A under the heading "Deductions in respect of certain incomes".

- (iii) In order to enable an assessee who has paid alternate minimum tax in any earlier previous year to claim credit of the same, in any subsequent year, sub-section (3) has been inserted in section 115JEE to provide that the credit for tax paid under section 115JC shall be allowed in accordance with the provisions of section 115JD, notwithstanding the conditions mentioned in sub-section (1) or (2) of section 115JEE.

- (iv) Hence, even if the assessee has not claimed any deduction under section 10AA or section 35AD or Chapter VI-A in any previous year and the adjusted total income of that year does not exceed ₹ 20 lakh, it would still be entitled to set-off his brought forward AMT credit in that year.

- (e) Dividend and income distribution tax leviable on gross dividend / income and not on the net dividend / income distributed to shareholders and unit holders [Section 115-O & 115R]

Effective from: 1st October, 2014

- (i) Under section 115-O, a domestic company is liable for payment of additional income-tax @15% on any amount declared, distributed or paid by way of dividends to its shareholders.
- (ii) This tax on distributed profits is the final tax in respect of the amount declared, distributed or paid as dividends and no credit in respect of it can be claimed by the company or the shareholder.
- (iii) Likewise, under section 115R, additional income-tax is levied in respect of income distributed by the mutual funds to its investors at the specified rates.

Answer

(iv) In the earlier tax regime when dividends were taxable in the hands of the shareholder, the gross amount of dividend representing the distributable surplus was taxable, and the tax on this amount was paid by the shareholder at the applicable rate depending on the slab of income he fell into.

(v) However, with effect from 1st June, 1997, Chapter XII-D was inserted by the Finance Act, 1997 to levy additional income-tax at a flat rate of 10% on distributed profits of domestic companies. Currently, additional income-tax is being levied at the rate of 15%. However, these rates have so far been applied on the amount paid as dividend (i.e., on the net amount distributed by the company instead of the gross amount including the distribution tax payable by the company).

(vi) Therefore, the additional income-tax under both sections 115-O and 115-R is currently being computed with reference to the net amount distributed.

(vii) On account of the difference in the base of the income distributed or the dividend on which the distribution tax is calculated, the effective tax rate is lower than the rate provided in the respective sections.

(viii) With a view to ensure that tax is levied on the correct base, the amount of distributable income and the dividends which are actually received by the unit holder of mutual fund or shareholders of the domestic company have to be grossed up for the purpose of computing additional income-tax.

(ix) Consequently, new sub-section (1B) has been inserted in section 115-O to provide that for the purposes of determining the tax on distributed profits payable in accordance with the section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115-O(1), be equal to the net distributed profits.

(x) Likewise, new sub-section (2A) has been inserted in section 115R to provide that for the purposes of determining the additional income-tax payable in accordance with section 115R(2), the amount of distributed income shall be increased to such amount as would, after reduction of the additional income-tax on such increased amount at the rate specified in section 115R(2), be equal to the amount of income distributed by the Mutual Fund.

Example

X Ltd., a domestic company, has distributed on 1/11/2014, dividend of ₹ 230 lakh to its shareholders. On 1/10/2014, X Ltd. has received dividend of ₹ 60 lakh from its domestic subsidiary company Y Ltd., on which Y Ltd. has paid dividend distribution tax under section 115-O. Compute the additional income-tax payable by X Ltd. under section 115-O.

Particulars	₹ in lakh
Dividend distributed by X Ltd.	230
Less: Dividend received from subsidiary Y Ltd.	60
Net distributed profits	170
Add: Increase for the purpose of grossing up of dividend	30
	$\left\{ \frac{15}{(100-15)} \times 170 \right\}^4$
Gross dividend	200
Additional income-tax payable by X Ltd. u/s 115-O [15% of ₹ 200 lakh]	30.00
Add: Surcharge@10%	3.00
	33.00
Add: Education cess@2% and SHEC@1%	0.99
	33.99

SIGNIFICANT NOTIFICATIONS/CIRCULARS

1. Clarification regarding scope of additional income-tax on distributed income under section 115R [Circular No. 6/2014, dated 11.2.2014]

Section 115R provides for levy of additional tax on distributed income to unit holders. Some Assessing Officers have taken a view that mutual funds/specified companies are required to pay additional income-tax under section 115R not only on income distributed by way of dividend but also on payments made at the time of redemption/repurchase of units as well as at the time of allotment of bonus units to existing investors.

On these issues, the CBDT has clarified the following –

- Section 115R(2) requires payment of additional income-tax at the rates prescribed thereunder in respect of any amount distributed by a specified company or a mutual fund to its unit holders. The income so distributed by such entities constitutes dividend paid to the unit holders and is liable to tax thereunder. However, **redemption of units or repurchase of units would not attract levy of tax under**

⁴ As per new sub-section (1B) of section 115-O, for the purpose of grossing up, the rate specified in sub-section (1) has to be considered. The rate specified in sub-section (1) is 15%. Further, in the example given in the *Explanatory Memorandum* to the Finance (No.2) Bill, 2014, grossing up has been done at the rate of 15%.

However, it is also possible to take a view that grossing up should be done at the rate of 16.995% (that is, 15% plus surcharge@10% plus education cess and SHEC@3%), which is the effective rate of dividend distribution tax.

section 115R(2) as such income is not in the nature of income "distributed" to the unit holders and hence, lies outside the purview of this section.

- (ii) Further, the income so distributed by the mutual fund or the specified company is specifically exempt from tax under section 10(35) in the hands of the recipient unit holders. As per the proviso to section 10(35), exemption of income thereunder is not applicable to those cases where transfer of units take place. The recipient of income is, therefore, liable to pay capital gains tax, if applicable, as per the relevant provisions of the Act, on transfer of such units.
- (iii) Also, since issue of bonus units is not akin to distribution of income by way of dividend, the same would not be subject to additional income tax under section 115R. This inference can be drawn from the provisions of section 55, prescribing "cost of acquisition" of bonus shares as Nil for the purposes of computation of capital gains tax.

Thus, in view of the above position, the CBDT has, in exercise of its powers under section 119, clarified that additional income-tax under section 115R(2) is to be levied on income distributed by way of dividend to unit-holders of mutual fund or specified companies. Further, it is specifically clarified that receipts from redemption/repurchase of units or allotment of additional units by way of bonus units would **not** be subject to levy of additional income-tax thereunder.