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DIRECT TAX - CIRCULAR UPDATE

Taxation of dividend declared by foreign company is outside the ambit of Section 9 of the Income tax Act, 1961 ("the Act")

The CBDT has issued a clarificatory Circular (Circular no. 4/2015 dated March 26, 2015) which deals with the controversial question as to whether dividends paid by a foreign company outside India would be taxable in India if the shares derive their value substantially from assets situated in India.

The Explanatory Memorandum to Finance Act, 2012 (F.A 2012) clearly provided that the amendment to section 9(1)(i) of the Act made by F.A. 2012 was to reiterate the legislative intent in respect of taxation of income accruing or arising through indirect transfer of a capital asset situated in India. But the extended application of the provisions of explanation may result in taxation of dividend income declared by a foreign company outside India. This may cause unintended double taxation and would be contrary to the generally accepted principles of source rule as well as the object and purpose of the amendment made by the F.A. 2012 Act.

The CBDT Circular clarifies that Explanation 5 would be applicable in relation to deeming any income arising outside India from transfer of share or interest which has the effect of

transferring directly or indirectly the underlying assets located in India, as income accruing or arising in India. However, declaration of dividend by such a foreign company outside India does not have the effect of transfer of any underlying assets located in India.

Therefore to provide certainty in law, the CBDT has clarified that the dividends declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would NOT BE DEEMED to be income accruing or arising in India by virtue of the provisions of Explanation 5 to section 9 (1) (i) of the Act.

KNAV Comments:

The CBDT clarification is a good move as it will result in a settled rule of taxation. The Government has reiterated its assurance towards bringing tax certainty and provide an investor friendly environment with a non-adversarial tax regime to boost investments in economy.

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