What's New
News Flash

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CBDT issues circular on taxation of dividends issued by foreign companies deriving value substantially from India

The Central Board of Direct Taxes (CBDT) has issued a circular[1] dated 26 March 2015 that deals with the controversial question as to whether dividends paid by a foreign company would be taxable in India under Explanation 5 to section 9(1)(i) of the Income-tax Act, 1961 (the Act), if the shares of the foreign company derive their value substantially from the assets situated in India. The CBDT has accepted that such an extended application of the provisions of the Act may result in (an unintended) taxation of dividend income declared by a foreign company outside India.

This may cause 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 Finance Act, 2012.

The CBDT has stated that the purpose of the amendment of section 9(1)(i) of the Act was to tax gains having economic nexus with India. It is stated that since the declaration of dividend by a foreign company outside India does not have the effect of transfer of any underlying assets located in India, the said dividends 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, even if the shares derive their value substantially from assets situated in India.

The takeaway

This circular may be useful where dividends are paid by offshore funds to their investors/ limited partners.

[1] Circular No. 4/ 2015 [F. No. 500/17/2015-FT&TR-IV]

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