CHAPTER

3 Section 8: Income from Dividends - Year of taxability

3.1 General

3.1.1 Section 8 of the Act (Dividend Income) – According to section *8(a)*, any dividend declared or distributed or paid within the meaning of sub-clauses *(a)*, *(b)*, *(c)*, *(d)*, *(e)* of section 2(22) is deemed to be the income of the previous year in which such dividend is *declared, distributed or paid as* the case may be. As per *section 8(b)*, any *interim dividend* declared by the company shall be deemed to be the income in the previous year in which it is *unconditionally made available to the member who is entitled* thereto.

3.1.2 This section states that for the purposes of inclusion in the total income of an assessee, any dividend declared by a company or distributed or paid by it shall be deemed to be the income of the previous year in which it is so declared, distributed or paid.

3.1.3 Section 8 of the Act decides the previous year for taxing real and deemed dividend. It is part of computation machinery. This is not a charging section. This can be gauged by the words "for the purposes of including in the total income..." which shows that this section is a part of the computation mechanism.

3.2 Year of chargeability

3.2.1 Many a times dividend is declared in year one but distributed and paid in the succeeding year. The reasons for this could be timing difference between date of declaration and date of payment, for certain reasons. Declaration could have occurred before 31st March of the financial year, but distribution is made in the subsequent year in accordance with cash flow. Or, the declaration may have taken place but special permissions required from other statutory bodies, may not have been obtained during the year; e.g. Reserve Bank of India permission (required earlier) in case of payments to non-resident shareholders outside India.

3.2.2 Hence, from the above, the year of taxability could be different from the year in which dividend is actually paid. But a declaration of dividend which is conditional and does not create an enforceable obligation to pay does not amount to a declaration within the meaning of this section. Therefore, such dividend is not taxable until the condition is fulfilled.

3.2.3 It was held in the case of *Mafatlal Gagalbhai & Co. (P.) Ltd. v. CIT* [193 ITR 188]/[1991] 58 Taxman 150 (Bom.) that if during the previous year in which dividend is declared, certain events occur due to which either the declaration of dividend is cancelled or the amount of dividend is to be treated as loan or payment of a part of capital, or if due to operation of law during the previous year, the declaration of dividend is to be treated as inoperative and invalid, then the declaration shall be treated as ineffective.

3.2.4 Clause *(b)* of section 8 of the Act makes the interim dividend taxable as the income of the year in which it is 'unconditionally made available' to the shareholder. In the case of *J. Dalmia v. CIT* [53 ITR 83] (SC), the Honorable Supreme Court held that a mere resolution of the directors resolving to pay a certain amount as interim dividend does not create a debt enforceable against a company, and the interim dividend is taxable as the income of the year in which the dividend warrant is actually issued.

Dividend is taxable in all case as 'Income from other sources' u/s 56 of the Act. In the case of all other heads of income, the character of income determines the head of taxability, but dividend is mandatorily taxed under the head "Income from other sources". Even if the dividend has business character (for e.g., dividend in the hands of a share trader), it would still be taxed under the head "Income from other sources".

3.3 Issues

3.3.1 The Income Tax Department over the years has tried to treat the year of declaration of dividends as the year in which the dividend should be taxed. This issue was dealt with in the case of *Pfizer Corporation v. CIT* [180 CTR Bom 319], 2003 [259 ITR 391] (Bom.)/ [2003] 129 ITR 459 (Bom.) on 30th November, 2002 by Honorable Bombay High Court.

3.3.2 The moot question in this case was whether the Tribunal was right in holding that the final dividend income accrued to the assessee on the date of declaration even though the Reserve Bank of India had not granted permission under the Foreign Exchange Regulation Act, 1973.

3.3.3 The assessee was a shareholder in the Indian subsidiary of Pfizer Limited. On 31st July, 1975, Pfizer Limited declared final dividend amounting to ₹ 50.40 lakhs. Out of that amount, ₹ 25.20 lakhs stood remitted on 3rd September, 1976, pursuant to the approval granted by the RBI under the FERA (The Foreign Exchange Regulation Act, 1973). Similarly, on 31st May, 1976, Pfizer Limited declared final dividend of ₹ 79.80 lakhs, out of which ₹ 29.40 lakhs were remitted on 22nd July, 1977. According to the Department, income accrued to the assessee during the AY 1976-77 amounting to ₹ 25.20 lakhs as Pfizer Limited declared final dividend on 31st July, 1975, whereas, according to the assessee, that income accrued to the assessee during the AY 1977-78 as the remittance was permitted by the RBI on 3rd September, 1976, i.e., during the AY 1977-78. Similarly, according to the Department, dividend income accrued to the assessee during the AY 1977-78 as the final dividend was declared by Pfizer Limited on 31st May, 1976, whereas, according to the assessee, the dividend income of ₹ 29.40 lakhs accrued to it during the AY 1978-79 as the remittance was permitted by the RBI only on 22nd July, 1977.

3.3.4 It was argued by the assessee that declaration of final dividend did not create legal obligation in the company to pay the assessee. Section 5(2)(*b*) of the Act determined the income to be taxable in India when the right to receive dividend vested in the assessee. The taxability only arose in the year in which RBI approved the payment to be issued to the non-resident shareholders and not the year in which dividend was declared.

The principle that emerges is that a declaration which is subject to a regulatory statute, will result in a taxing event only when the regulation is complied with. A mere declaration without a vesting cannot result in taxability.