Section 80M – Maximizing Deduction for Dividend Distributed Across two Financial Years

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Over the last few years, rates of taxes on companies have constantly been brought down. Simultaneously, tax exemptions and deductions have also been significantly reduced. Section 80M of the Income Tax Act, 1961 (“IT Act) is one of the very few tax deductions still available. The section, aimed at avoiding cascading effect of tax on dividend at each stage of its distribution, provides a deduction for dividend received, to extent it is re-distributed. This article attempts to highlight certain aspects of how companies should plan their dividend distribution so as to ensure that they do not lose out on the eligible exemption.

Historical Background of Section 80M:

Analogous provision was initially introduced way back in 1961, as Section 99, which exempted dividend income from levy of super tax. Vide Finance Act, 1965, Section 99 was omitted and a new Section 85A was introduced for providing a partial rebate of tax on the dividend income. In the year 1967, Section 85A was omitted and Section 80M was introduced as part of the newly inserted Chapter VI -A of the Act.

Section 80M as introduced, provided a blanket deduction on dividend income at specified percentages. A significant amendment was made vide Finance Act, 1990 to quantity the deduction available on dividend income with reference to the quantum of dividend distributed. Subsequently, as the law evolved in the manner in which dividend income itself was taxed, necessary amendments were also made to Section 80M.

In 2003, Section 80M was omitted, since dividend was exempted in the hands of the shareholder, and subjected to tax in the hands of the company distributing the dividend (“Dividend Distribution Tax”).

The Section was reintroduced vide Finance Act, 2020 when the tax liability for dividends was shifted back to the shareholders, and Dividend Distribution Tax was omitted.

Section 80M in its present form:

As it presently stands, deduction under Section 80M is available upon fulfilment of the following conditions:

a. The Assessee should be in receipt of income in the nature of dividend, which is includable in the total income of the Assessee – dividend here would have its ordinary meaning, and would not extent to items artificially treated as dividend.

b. The Assessee must have distributed dividend to its shareholders, on or before the “due date” – being a date falling one month before the due date for filing of return of income for the respective year.

c. The Assessee must not have claimed deduction for the dividend distributed in any other previous year.

One of the crucial conditions of claim of deduction under the Section on which this article seeks to emphasize on, is the meaning of “due date” specified the Section. to Section 80M.

While the section seeks to grant deduction to the dividend received, the computation of the quantum of deduction is linked to the dividend actually distributed. The computation mechanism however does not require a correlation between the dividend received and the dividend distributed. The distinction between a deduction linked to income, but capped to a particular extent, vis-à-vis a deduction lined to income applied for a specific purpose, is often lost sight off. Section 80M is a deduction falling in the first class, often classified as falling in the second class by tax payers and administrators. This has been explained in the following examples:

Example 1 – A Ltd receives dividend of Rs. 10 Crores on 30 April 2023 from its subsidiary. Assume that the dividend was donated to the Prime Minster Relief Fund immediately. Assume that A Ltd had business surplus of Rs. 50 Crores during the period between April 2023 and September 2023, Interim dividend of Rs. 30 Crores was declared on 15 December 2023 out of the surplus earned during the year. Here, though the dividend received was used for non-business purposes, and dividend distributed to shareholders were out of business profits. A Ltd will still be eligible for deduction under Section 80M. The section does not require a correlation between dividend received and dividend distributed. The deduction is provided for the dividend received, but computed based on the dividend distributed, and not linked to the dividend distributed.

Example 2 – B Ltd receives dividend of Rs. 10 Crores on 30 April 2023 from its subsidiary. Assume that the dividend was donated to the Prime Minster Relief Fund immediately. Assume that A Ltd had business deficit of Rs. 5 Crores during the period between April 2023 and September 2023, however, it had “surplus in profit and loss account” of Rs. 100 Crores. It declared interim dividend of Rs. 30 Croes on 15 December 2023, out of the surplus in the profit and loss account. Here, though the dividend was distributed out of previous years’ profits, A Ltd will still be eligible for deduction under Section 80M, for the reasons mentioned in the earlier example.

The Delhi High Court in *CIT v. Delhi Tourism & Transportation and Development Corporation Ltd* emphasizes this point. The Hon’ble Court held that under Section 80M, emphasis was on the word “distribution” and not on the “period” to which the dividend paid related to. The Court concluded that for claiming deduction under Section 80M, it is not a condition precedent that dividend received and distributed must relate to the same assessment year. Furthermore, the Hon’ble Madras High Court in case of CIT v. Titan Industries held that even though the dividend declared pertains to a period before the introduction of Section 80M, as long as the dividend is distributed before the due date defined in Section 80M, deduction will be available to the assessee. These judgments clearly support the reasoning for availability of deduction in both the examples above.

Example 3 – C Ltd received Rs.10 Crores as dividend during the Financial Year (‘FY’) 2022 -23, and generated business surplus of Rs 40 Crores during the year. It had distributed final dividend of Rs.30 Crores in July 2023. C Ltd can claim deduction under Section 80M to the extent of Rs.10 Crores in the tax return for FY 2022-23.

Subsequently, in FY 2023-24, assume C Ltd receives dividend of Rs.15 Crores, however no dividend was distributed after its last distribution in July 2023. In such a case, the dividend distributed in July 2023, to the extent that it is not already considered in computing the deduction under Section 80M for the FY 2022-23 (being Rs. 20 Crore), can be considered for the purposes of determining the deduction under Section 80M for FY 2023-24. When the claim for deduction under Section 80M for FY 2023-24 is computed, all the requirements of the Section would be fulfilled in relation to the divided of Rs 15 Crores received during the FY 2023-24. In this example therefore, Rs. 15 Crores, can be considered for determining deduction under Section 80M for FY 2023-24.

The illustrations provided above are not purely academic, but arise in many practical cases.