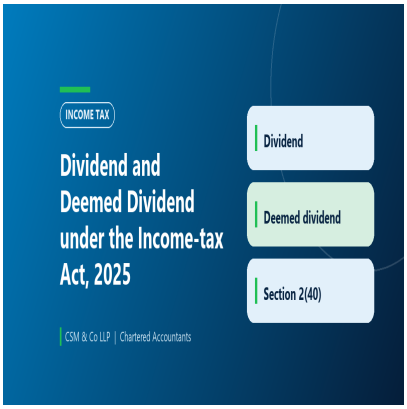

Dividend and Deemed Dividend under the Income-tax Act, 2025: Meaning, Tax, TDS and Section 2(40) (Tax Year 2026-27)

Description

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Quick summary

- Dividend is taxed in the shareholder's hands as income from other sources (section 92(2)(a)) at the normal rates, and no expense, including interest, can be deducted against it from 01/04/2026 (section 93(2) as substituted by Finance Act 2026).
- The Act's meaning of dividend (section 2(40)) is wider than the cash dividend a company declares: it includes distribution of accumulated profits, debentures, payments on liquidation or capital reduction, and loans or advances by a closely held company to a shareholder with 10% or more voting power, or to a concern in which that shareholder has a substantial interest (deemed dividend).
- From 01/04/2026 a payment by a company on buy-back of its own shares is no longer within the dividend definition; it is dealt with under the capital gains provisions.
- A domestic company deducts TDS of 10% on dividend (section 393(1), Table Sl. No. 7); there is no deduction from an individual's dividend paid by a mode other than cash if the total in the year does not exceed ?10,000 (section 393(4)).

A dividend is a share of a company's profits paid to its shareholders. For tax, the Income-tax Act, 2025 (in force from 01/04/2026) uses a wider meaning in **section 2(40)** and then taxes it as **income from other sources** under **section 92(2)(a)**. The old Dividend Distribution Tax was abolished long ago, so the tax is on the shareholder.

What counts as dividend (section 2(40))

Dividend includes:

1. Any distribution by a company of **accumulated profits**, whether capitalised or not, that releases assets of the company to its shareholders.
2. A distribution of **debentures, debenture-stock or deposit certificates** to shareholders, and a distribution of **bonus shares to preference shareholders**, to the extent of accumulated profits.
3. A distribution on **liquidation**, to the extent attributable to accumulated profits just before liquidation.

4. A distribution on **reduction of capital**, to the extent of accumulated profits.
5. **Deemed dividend (section 2(40)(e))**, described next.

“Accumulated profits” includes all profits of the company up to the date of the distribution or payment (up to liquidation in case 3). For an amalgamated company, the accumulated profits of the amalgamating company on the date of amalgamation are added.

Buy-back is no longer dividend

Before 01/04/2026, sub-clause (f) treated a payment by a company on the purchase of its own shares as dividend. Finance Act 2026 **omitted** it. A buy-back is now taxed as a transfer under the capital gains provisions (section 69 of the 2025 Act as amended, which also has a higher tax for promoters).

Deemed dividend: loans to shareholders

If a company **in which the public is not substantially interested** (a closely held company) pays any sum, to the extent it has accumulated profits, as:

- an **advance or loan to a shareholder** who is the beneficial owner of shares carrying **at least 10% of the voting power** (not shares with a fixed rate of dividend); or
- an **advance or loan to a concern** (a HUF, firm, association of persons, body of individuals or company) in which that shareholder is a member or partner and has a **substantial interest**; or
- a payment **on behalf of, or for the individual benefit of**, such a shareholder,

the amount is treated as dividend. A person has a substantial interest in a concern other than a company if beneficially entitled to **20% or more of its income** at any time in the tax year (section 2(40), explanation (D)).

Example. X Pvt Ltd (closely held) has accumulated profits of ?40 lakh. It lends ?25 lakh to Mr S, who holds 12% of the voting power. The ?25 lakh is treated as dividend in Mr S’s hands because the loan is within the accumulated profits. Had the loan been ?60 lakh, only ?40 lakh would be deemed dividend.

What is not dividend

- A loan or advance in the **ordinary course of business**, where lending money is a substantial part of the company’s business.
- A dividend paid by the company that is **set off** against an earlier amount already treated as deemed dividend, to that extent.
- A distribution of shares by the **resulting company in a demerger**.
- Certain advances or loans between two group entities, where one is an IFSC finance company or finance unit, the other is located outside India, and the parent is listed outside India in a country notified by the Central Government.
- A distribution on liquidation or capital reduction in respect of shares issued for full cash consideration where the holder cannot take part in surplus assets on liquidation.

How dividend is taxed

- **Head:** income from other sources (section 92(2)(a)).
- **Rate:** the normal rates on the shareholder’s total income. There is no separate flat rate for a resident.
- **When:** a dividend is the income of the tax year in which it is declared, distributed or paid; an interim dividend is the income of the year in which it is unconditionally made available to the shareholder entitled to it (section 7(2)).

- **Deductions:** none. Section 93(2), as substituted by Finance Act 2026, says no deduction is allowed against dividend income or income from units of specified mutual funds and UTI units. Earlier, interest expense up to 20% of the dividend was allowed. Section 93(1)(a), which allows commission paid for realising interest on securities, no longer mentions dividend either.

TDS on dividend

A domestic company deducts **10%** of any dividend (including on preference shares) **before paying** it, and the table shows no threshold (section 393(1), Table Sl. No. 7). No tax is deducted in these cases (section 393(4), Table Sl. No. 10):

- dividend paid to LIC, GIC and the other specified insurance bodies, and to other notified persons; and
- dividend to an **individual shareholder** paid by a mode other than cash, if the total dividend paid or likely to be paid in the tax year does not exceed **?10,000**.

A shareholder who qualifies can give the declaration allowed under section 393(6) in the cases listed there. The TDS is credited against your tax, so claim it in the return using your tax statement.

Practical points

1. **Loans from your own company.** A shareholder-director who borrows from a closely held company should check the 10% voting power test and accumulated profits before drawing the money, because the loan can become taxable dividend.
2. **Review buy-back plans.** Since 01/04/2026 they are taxed as capital gains.
3. **Financing shares by borrowing.** The interest is no longer deductible against dividend income. Whether it can be claimed anywhere else was not examined for this post.
4. **Foreign and non-resident dividends** have separate rates and treaty rules and are not covered here.

How CSM & Co LLP can help

We advise closely held companies on loans to shareholders and directors, reporting of dividend income and TDS compliance on dividend. Please reach out to our team and we will be happy to assist.

Frequently asked questions

What is deemed dividend?

Deemed dividend arises when a company in which the public is not substantially interested pays money, to the extent of its accumulated profits, as a loan or advance to a shareholder who is the beneficial owner of shares carrying 10% or more of the voting power, or to a concern in which that shareholder is a member or partner and has a substantial interest, or pays on behalf of or for the individual benefit of such a shareholder (section 2(40)(e)). The amount is taxed as the shareholder's dividend income.

What does "substantial interest" mean for a concern that is not a company?

A person has a substantial interest in a concern, other than a company, if at any time in the tax year the person is beneficially entitled to not less than 20% of the income of the concern (section 2(40),

explanation (D)).

Which loans are not deemed dividend?

An advance or loan made to a shareholder or the concern by a company in the ordinary course of its business, where lending money is a substantial part of the company's business; a dividend that is set off against an amount earlier treated as deemed dividend; a distribution of shares by the resulting company in a demerger; and certain loans between group entities involving an IFSC finance company or finance unit and a foreign-listed group (section 2(40), exclusions (i) to (v)).

Is the company's buy-back payment still a dividend?

No, from 01/04/2026. The sub-clause that treated a payment by a company on purchase of its own shares as dividend was omitted by Finance Act 2026. Buy-back proceeds are taxed under the capital gains provisions (see section 69).

Can I deduct interest paid on a loan used to buy shares?

No. Section 93(2), as substituted by Finance Act 2026, allows no deduction against dividend income or income from units of specified mutual funds and UTI units. Earlier, interest up to 20% of the dividend could be deducted.

Is there TDS on dividend?

Yes. A domestic company deducts 10% before paying any dividend (section 393(1), Table Sl. No. 7), with no threshold in the table. The deduction is not made on an individual shareholder's dividend if it is paid by a mode other than cash and the total during the tax year does not exceed ?10,000, and for certain shareholders such as LIC, GIC and other specified institutions (section 393(4), Table Sl. No. 10).

Official sources

- Income Tax Department: Income-tax Act, 2025 (sections 2(40), 92, 93, 393)

Related reading

- Interest for Late Return and Advance Tax Default under the Income-tax Act, 2025: Sections 423, 424, 425 and 411 (Tax Year 2026-27)
- Decoding the Direct Tax Landscape: Budget 2025 Insights
- DTAA and Foreign Tax Credit under the Income-tax Act, 2025: Sections 159 and 160, Forms 41 to 44 and Rule 76 (Tax Year 2026-27)

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