INTERNATIONAL TAXATION ALERT

24 April 2023

Non-resident shareholders not eligible for lower rate for taxation of dividend prescribed in Tax Treaties where DDT is applicable

FACTS OF THE CASE

- Till 31st May, 1997, any dividend distributed by a domestic company was taxable in the hands of the shareholders and the said company was required to deduct tax at applicable rates under the applicable provisions. The shareholders were required to disclose the said income and claim credit for the tax deducted at source.

- In order to avoid above cumbersome process, Sec. 115-O of the Income Tax Act, 1961 ('Act') was introduced vide Finance Act, 1997 shifting the tax liability on dividends distributed from shareholders to companies distributing the dividend as 'additional tax' on distributed profits. The said provisions of Sec. 115-O had undergone changes over the period and was finally abolished vide Finance Act, 2020.

- The assessee, Total Oil India Private Limited, had declared/paid dividend during AY 2016-17 to its shareholders which inter-alia included dividend to its Non-resident shareholders which were tax residents of France.

- A cross objection was filed by the assessee before the Hon'ble Mumbai ITAT[1] wherein the assessee contended for the first time that DDT paid on such dividend could not exceed the rate at which such dividends would be taxed in the hands of shareholders under the Indo-French tax treaty. Reliance was placed on the decision of Hon'ble Delhi ITAT in the case of *Giesecke & Devrient India Pvt Ltd v. ACIT*[2] and Hon'ble Kolkata ITAT in case of *DCIT v. Indian Oil Petronas Pvt. Ltd*[3].

- The Division Bench of Hon'ble Mumbai

[1] DCIT v. Total Oil India (P.) Ltd. (2021) 127 taxmann.com 774 (Mumbai - Trib.)
[2] (2020) 120 taxmann.com 338 (Delhi - Trib.)
[3] (2021) 127 taxmann.com 389 (Kolkata - Trib.)

ITAT doubted the correctness of the decision of above Co-ordinate Benches on the reasoning that when taxes are paid by resident of India in respect of his own liability, then such taxation in India cannot be protected or influenced by a tax treaty provision, unless a specific provision exists in the related tax treaty which enables the extension of the treaty protection.

- In order to address these aspects in a holistic and comprehensive manner, ITAT referred the issue for consideration before the Special Bench.

- Further, the Revenue in the case of *Maruti Suzuki India Private Limited*[4] & *Gujarat Gas Co. Ltd.*[5] made an application for reference of a similar issue to the Special Bench.

- Hence, in the backdrop of above, a Special Bench was constituted by the Hon'ble President of Mumbai ITAT for addressing the aforesaid issue.

ISSUE BEFORE HON'BLE ITAT SPECIAL BENCH

Where dividend is declared, distributed or paid by a domestic company to a non-resident shareholder(s), which attracts additional income-tax (tax on distributed profits) referred to in Sec. 115-O, whether such additional income-tax payable by the domestic company shall be at the rate mentioned in Sec. 115-O or the rate of tax applicable to the non-resident shareholder(s) with reference to such dividend income?

DECISION OF HON'BLE MUMBAI ITAT SPECIAL BENCH

- Though dividend is income in the hands of the shareholder, its taxability need not necessarily be in the hands of the shareholder. The sovereign has the prerogative to tax dividend, either in the hands of the recipient of the dividend or otherwise;

- DDT is tax on 'distributed profits' and not a tax on 'dividend distributed'. The scheme of Chapter XII-D that contains Sec. 115-O is a complete code by itself for levy and collection of tax on distributed profits;

- DDT tax rate is 15% + grossing up u/s. 115-O and accordingly, domestic cos. paying DDT to NR shareholders claimed that rate of DDT has to be only at 10% based on lower limit tax rate on dividends under most of the tax treaties;

- Assessee's reliance on the decision of Hon'ble Apex Court in the case of *UOI v. Tata Tea Co. Ltd.*[6] was rejected with a remark that SC was not dealing with the nature of DDT as to whether it is a tax on the company or a tax on the shareholder and observes that it is well settled that a judicial precedent is only "*an authority for what it actually decides and not what may come to follow from some observations which find place therein*".

- Reliance was placed on the decision of the Hon'ble Bombay High Court in the case of *Godrej & Boyce Mfg. Co. Ltd vs. DCIT*[7] wherein it was held that the legal characteristic of DDT is tax on a company paying the dividend and is chargeable to tax on its profits as a distinct taxable entity. The domestic company paying DDT does not do so on behalf of the shareholder. In terms of Sec. 10(33), dividend does not form part of total income in the hands of recipient shareholder. Thus, the Hon'ble Bombay High Court held that DDT was not a tax on income of the shareholder but was instead a tax on the company.

  Further on appeal before Hon'ble Supreme Court[8], the Apex Court observed that "*if the argument is that tax paid by the dividend paying company u/s 115-O is to be understood to be on behalf of recipient assessee, the provisions of Sec. 57 should enable the assessee to claim deduction of expenditure incurred to earn the income on which such tax is paid*" which is wholly incongruous in view of the provisions of

[4] ITA No.961/Del/2015
[5] ITA No. 123/Ahd/2012

[6] (2017) 398 ITR 260 (SC)
[7] (2010) 194 Taxman 203 (Bombay HC)
[8] (2017) 394 ITR 449 (SC)

Sec. 10(33).

Thus, on the argument made by the assessee that the Apex Court has reversed the decision of Hon'ble Bombay High Court, the Special Bench held that the Apex Court has taken a different basis to reach the same conclusion without diluting the reasoning of the Hon'ble Bombay High Court.

- Also, the Hon'ble Bombay HC in the case of *Small Industries Development Bank of India v. CBDT*[9] held that the charge u/s 115-O of the Act is on the company's profits which is declared, distributed or paid by way of dividend and not on income by way of dividend in shareholder's hands.

- Sec.115-O (3) & (4) states that the tax on distributed profits so paid by the company shall be treated as the final payment of tax. Further, no credit shall be claimed by the company or by any other person in respect of the amount of tax so paid and no deduction under any other provision of the Act shall be allowed to the company or a shareholder in respect of such amount which has been charged to tax. Thus, it clearly shows that shareholder does not enter the domain of DDT at all.

- Reliance was also placed on Hon'ble Madras High Court's ruling in *B.M. Amina Umma* v. ITO[10] which was approved by the Apex Court in *Balaji v. ITO*[11] *where it was held that "there is nothing in the fundamental concepts of income-tax even to prevent the imposition of the immediate and apparent incidence of the tax on a person other than the person whose income is to be assessed."* Hence, it was admitted by Special Bench that DDT is a tax on the distributed profits of a domestic company and is a tax on profits of the domestic company and not on the shareholder.

- Since DDT is a tax not on the shareholder but on the amount declared, distributed, paid as the case may be, by way of dividend and being a tax on income of the company, there is no double taxation of the same income for which recourse can be taken under DTAA.

- DTAA has to be looked from recipient taxability perspective. As dividend is paid by resident Indian Co. and DDT paid is a tax on its income, domestic company u/s.115O does not enter the domain of DTAA at all.

- In the Protocol to India-Hungary DTAA, the Contracting States have extended the Treaty protection to DDT wherein it has been specifically provided that when the Co. paying dividend is a resident of India, the tax on distributed profits shall be deemed to be taxed in the hands of shareholders and it shall not exceed 10% of gross amount of dividend. Referring to the same, it was held that wherever the Contracting States to a tax treaty intend to extend the treaty protection to the domestic company paying DDT, only then, the domestic company can claim benefit of the DTAA, if any.

- Based on the above, it was held that dividend payable by the domestic company shall be at the rate prescribed in Sec. 115-O instead of rate mentioned in DTAA.

COMMENTS

- Considering the stakes involved, the domestic cos. are likely to keep the matter alive and agitate the issue before respective High Courts & will attain finality before the Apex Court.

[9] (2021) 133 taxmann.com 158 (Bombay)
[10] 26 ITR 137 (Mad HC)
[11] 1962 AIR 123 (SC)

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