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TAX FLASH NEWS

7 May 2021

In case of non-resident shareholders, beneficial tax treaty rate will apply for dividend distribution tax

Recently, the Kolkata Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Indian Oil Petronas Pvt. Ltd.[1] (the taxpayer) dealt with the issue of applicability of tax rate in the case of dividend paid to a non-resident shareholder as per the India-Malaysia Tax-treaty (the treaty) for the purpose of Dividend Distribution Tax (DDT) under Section 115-O of the Income-tax Act, 1961 (the Act). The Tribunal observed that the rate specified in the tax treaty would apply to dividend distributed by a company to non-resident shareholders and not the DDT rate prescribed under Section 115-O.

Facts of the case

The taxpayer is engaged in the business of manufacturing, trading and bottling of liquefied petroleum gas (LPG). During the Assessment Year 2013-14 and 2014-15, the taxpayer paid dividend to a Malaysia based entity. During the appellate proceedings, the taxpayer raised additional ground and contended that the DDT payable under Section 115-O should be at the beneficial rate prescribed under the tax treaty.

The Assessing Officer (AO) held that the taxpayer is liable to pay tax as per the provisions of Section 115-O instead of beneficial tax rate provided under the tax treaty. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Tribunal's decision

Relevant provisions of the Act

In the instant case, the dividend income should be chargeable to tax in the hands of the shareholders as per the provisions of Section 4. However, for administrative convenience, the incidence of tax is shifted to the resident company paying dividend income. The company being the person responsible for distributing dividend to the non-resident shareholders, the rate of tax to be paid on such dividend income would be governed by the tax rate specified in the tax treaty (being more beneficial) and not the rate specified in Section 115-O.

As per the provisions of the Act, DDT is a tax on dividend income and not on undistributed profits of the company. Undistributed profits of a company are still the profits of the company. They constitute the income of the company. Until the company declares dividend, no portion of these profits can become the income of the shareholders. Reference was made to the decision of Madras High Court in the case of C W Spencer[2].

As per the aforesaid principle, the dividend income would constitute income in the hands of the shareholders and would be chargeable to tax under Section 4. As per the provisions of Section 4 of the Act, the income tax including the additional income tax should be charged at the rate specified in the Act or tax treaty, whichever is more beneficial to the taxpayer.

In the instant case, the dividend, being an income in the hands of non-resident shareholders in respect of which the incidence of tax is borne by the resident company paying dividend. The rate of tax as specified in the tax treaty, being more beneficial to the taxpayer, would apply over the rate specified in Section 115-O.

Decisions of Tata Tea and Godrej & Boyce Manufacturing Co

The Supreme Court in the case of Tata Tea Limited[3] had held that DDT is leviable on the entire amount of dividend, even if it is distributed partly out of agricultural income. The Supreme Court referred to its earlier decision in the case of Bacha Guzdar[4] to hold that dividend distributed by a company is not impressed

[1] DDIT v. Indian Oil Petronas Pvt. Ltd. (ITA No. 1884 & 1885/Kol/2019) – Taxsutra.com

[2] C W Spencer v. ITO [1957] 37 ITR 107 (Mad)
[3] Union of India v. Tata Tea Co. Ltd. [2017] 398 ITR 260 (SC)
[4] Bacha Guzdar v. CIT [1955] 27 ITR 1 (SC)

with the character of its own income. Thus, the levy of DDT by the Parliament on the entirety of the dividend, even if distributed wholly or partly out of agricultural income, is valid under the Constitution of India.

The dividend is still taxable as income, though the incidence of tax has shifted from the shareholder, to the company paying the dividend. Once the Supreme Court has held that dividend connotes income, the logical conclusion is that as per Section 4, the said income should be chargeable to tax in the hands of the person earning such income.

The Supreme Court in the case of Godrej & Boyce Manufacturing Co.[5] had held that dividend income was taxable, albeit in the hands of the payer company and not in the hands of the recipient.

When in both the decisions, Supreme Court had held that dividend income is taxable, the conclusion is that taxability of an income has to be considered from the perspective of the recipient, since the term 'income' can only have a logical relevance qua the recipient of a certain sum of money or its equivalent and not the payer thereof. The term 'income' cannot be reconciled qua the payer.

It may be a different matter altogether that the incidence of tax on 'dividend income' has been fixed on the payer of dividend under the relevant scheme of the Act. However, the fact remains that the dividend income is taxed in the form of DDT under Section 115-O, which can only be autopsied for the purposes of calculating the rate of tax thereon from the perspective of the recipient shareholder, though the quantum of tax, once decided, is to be borne by the payer of dividend. Thus, though optically appearing to run counter to the subsequent ruling in the case of Tata Tea, the earlier ruling in the case of Godrej Boyce does not actually or in substance, convey any contrary or contradictory view, as expressed by the Supreme Court in the case of Tata Tea in the context of the issue on hand.

Grossing up principle

On perusal of Section 195A it indicates that in the present case the incidence of tax on dividend income is borne by the company paying dividend income by virtue of statute and not by way of any agreement and as such, the rigor of Section 195A would not be applicable. Even if the payment is to be grossed up, the rate specified in tax treaty (if more favourable) would apply to gross up the said payment. Thus, in conclusion, the rate of tax payable on dividend distributed to non-resident shareholders would depend upon the relevant Article of the tax treaty, subject to the fulfilment of the specified conditions.

Remanded back

The Delhi Tribunal in the case of Giesecke & Devrient (India) Pvt. Ltd.[6] held that the rate specified in the tax treaty would be applicable to dividend distributed by a company to non-resident shareholders and not the rate specified in Section 115-O. However, the issue was set aside and sent to the AO to verify the claim. The Kolkata Tribunal in the case of Reckitt Benkiser (I) Pvt. Ltd.[7] had set aside the above issue and sent it to the AO without adjudication after admitting the additional ground taken up by the company.

In view of the above and as the relevant Article of the tax treaty have to be examined, the Tribunal set aside this matter to the file of the AO for fresh adjudication in accordance with law after admitting the claim of the taxpayer.

Our comments

Till 31 March 2020, dividends declared, distributed or paid by an Indian company were subject to DDT at the rate of 15 per cent (exclusive of applicable surcharge and cess) under Section 115-O.

Whether DDT is a tax leviable on the dividend paying company or is a tax leviable on the shareholder and is merely a mechanism of collecting the same through the company for administrative convenience has been a matter of debate from a long time.

The Delhi Tribunal in the case of Giesecke & Devrient [India] Pvt Ltd held that DDT is nothing but a tax on shareholders which was collected through the dividend paying companies, in order to avoid the administrative inconvenience of requiring the company to identify each shareholder and deduct tax at source (TDS). Since ultimately DDT is a tax on shareholders and not on the company, the shareholders are entitled to apply the provisions of the India-Germany tax treaty or the Act, whichever is more beneficial to them.

Similarly, the Delhi Tribunal in the case of Maruti Suzuki India Ltd[8] relying on the decision of Tata Tea Co. Limited accepted additional grounds raised by the taxpayer to restrict the rate of DDT levied on dividend distributed by taxpayer to its overseas holding company at 10 per cent as per Article 10 of India-Japan tax treaty. However, eligibility of tax treaty benefit is yet to be decided by the Tribunal in this decision.

Recently, the Mumbai Tribunal while dealing with a similar issue in the case of ITD Cementation India Ltd.[9] set aside the additional ground raised by the taxpayer on the issue of refund of excess DDT paid by taxpayer as per Section 115-O, instead of 15 per cent as per India-Thailand tax treaty. The Tribunal relied on the decision of Van Oord India Pvt Ltd.[10]. The issues was remitted back to the file of the AO to examine the same in the light of decision of the Supreme Court in the case of Tata Tea Company Ltd. and Godrej and Boyce Manufacturing Company Ltd.

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[5] Godrej & Boyce Manufacturing Company Ltd. v. DCIT [2017] 394 ITR 449 (SC)

[6] Giesecke & Devrient (India) Pvt. Ltd. v. Addl. CIT (ITA No. 7075/Del/2017)
[7] Reckitt Benkiser (I) Pvt. Ltd. v. DCIT (ITA No. 404/Kol/2015)
[8] Pr. CIT v. Maruti Suzuki Limited (ITA No. 961/DEL/2015)
[9] ITD Cementation India ltd. v. DCIT [ITA No. 5869 & 5870/Mum/2018]
[10] Van Oord India Pvt Ltd. v. DCIT [2019] 111 taxmann.com 480 (Mum)

In the present case, the Tribunal has discussed the Supreme Court decisions in the case of Tata Tea Company Ltd. and Godrej and Boyce Manufacturing Company Ltd and observed that the rate specified in the tax treaty would be applicable to dividend distributed by a company to non-resident shareholders and not the rate specified under Section 115-O.

In view of these decisions, the taxpayer may analyse dividend article of various Indian tax treaties to determine applicable tax treaty rate. Further one needs to consider the applicability of MFN clause available under some of the Indian tax treaties[11] which provide a beneficial tax rate with respect to dividend income.

It is important to note that the Finance Act 2020 has abolished dividend distribution tax and the incidence of tax has been shifted to investors with effect from 1 April 2020. Now domestic companies are required to deduct tax at source while paying dividend to shareholders. Even under the current regime, subject to fulfillment of certain conditions, the taxpayer will be eligible for tax treaty rate as against the TDS rate prescribed under the Act for dividend income.

[11] The Netherlands, France, Switzerland, Sweden and Hungary tax treaties

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