KPMG

Tax Flash News

25 April 2023

Domestic company cannot apply a lower rate prevailing under tax treaty over DDT rate while paying dividends to non-resident shareholders

Executive Summary

Until 31 March 2020, dividends declared, distributed or paid by a domestic company were subject to Dividend Distribution Tax (DDT) at 15 per cent in the hands of the company under Section 115-O of the Income-tax Act, 1961 (the Act). Several tax treaties provided for taxation of dividends at a lower rate of tax than DDT. Thus, in cases where dividend is distributed to non-resident shareholders, the companies have been claiming that DDT should be restricted to the rate of tax on dividends as per the relevant tax treaty. While some benches of the Income-tax Appellate Tribunal (the Tribunal) held that the DDT rate should be restricted to the rate specified in the respective tax treaty, the Mumbai Tribunal did not agree with these decisions and referred the matter to the President of the Tribunal for forming a Special Bench to deal with this issue.

Recently, the Special Bench of the Mumbai Tribunal (Special Bench) in the case of Total Oil India Pvt Ltd[1] (Total Oil) held that DDT is a tax on the profits of the domestic company and not on the shareholder. Thus, DDT payable by the domestic company to non-resident shareholders shall be at the rate specified under Section 115-O of the Act and not at the rate under the dividend article of the tax treaty.

Facts of the case

- Total Oil, an Indian company, paid dividend to its shareholders, including a French shareholder. It contended that DDT on such dividend should not exceed the tax rate on dividends under the India-France tax treaty. In this regard, reliance was placed on the decisions of the Delhi Tribunal in the case of Giesecke & Devrient India Pvt Ltd[2] and the Kolkata Tribunal in the case of Indian Oil Petronas Pvt. Ltd.[3], wherein it was held that DDT is a levy on the dividend distributed and accordingly, the DDT rate should be restricted to the rate of tax on dividend under the tax treaty in case of non-resident shareholders.

- However, the Division Bench of the Mumbai Tribunal, doubting the correctness of the aforesaid favourable decisions of the co-ordinate benches on various grounds, placed the matter before the President of the Tribunal, requesting for constitution of a Special Bench so that all the aspects relating to this issue could be considered in a holistic and comprehensive manner.

- Further, the tax department also made an application for reference of a similar issue to the Special Bench in the case of Maruti Suzuki India Private Limited[4]. Similar request was also made in the case of Gujarat Gas Co. Ltd.[5]

Special Bench decision

- Section 115-O is a code by itself as regards levy and collection of tax on distributed profits. The non-obstante clause in Section 115-O is an indication that the charge under the said section is independent and divorced from the concept of 'total income' under the Act.

[1] DCIT v. Total Oil India Pvt. Ltd. (ITA No.6997/Mum/2019) – Taxsutra.com

[2] Giesecke & Devrient India Pvt Ltd. ACIT [2020] 120 taxmann.com 338 (Del)
[3] DCIT v. Indian Oil Petronas Pvt. Ltd [2021] 189 ITD 490 (Kol)
[4] Maruti Suzuki India Private Limited v. DCIT (ITA No. 961/Del/2015) (Del)
[5] Gujarat Gas Co. Ltd. v. JCIT (ITA No. 123/Ahd/2012) (Ahd)

- The argument that in the case of Tata Tea Co. Ltd.[6], the Supreme Court has laid down the principle that DDT is a tax in the hands of the shareholder is devoid of merit. The Supreme Court was not dealing with the nature of DDT, as to whether it is a tax on the company or a tax on the shareholder, but was evaluating the issue of constitutional validity of Section 115-O. Therefore, the said decision does not support the case of Total Oil.

- The Bombay High Court, in the case of Godrej & Boyce[7], while dealing with the issue of Section 14A disallowance, held that DDT is not paid by the company on behalf of the shareholders and the company does not act as an agent of the shareholder while paying tax under Section 115-O. Thus, DDT was not a tax on the income of the shareholder but was instead, a tax on the company.

- The matter reached the Supreme Court[8] and while pronouncing its decision, the aspect which weighed with the Supreme Court was that DDT was not a payment on behalf of the shareholder. The Supreme Court has taken a different basis to reach the same conclusion but without diluting the reasoning of the Bombay High Court that DDT was not a tax paid by the domestic company on behalf of the shareholder. Therefore, the argument that DDT is paid on behalf of the shareholder and has to be regarded as payment of liability of the shareholder, discharged by the domestic company paying DDT, does not flow from the ratio laid down by the Supreme Court in the case of Godrej & Boyce.

- Even the Bombay High Court decision of Small Industries Development Bank of India[9] indicates that the charge under Section 115-O is on the company's profits and not on income in the hands of the shareholder.

- Unlike the provisions of TDS and TCS that specifically provide that such payments are on behalf of the payee, DDT provisions do not mention the same. This is an indication that DDT is a charge on the profits of the company and not a tax paid on behalf of the shareholder by the domestic company.

- Since DDT is not a tax not on the shareholder but a tax on the income of the domestic company, there is no double taxation of the same income. Further, for invocation of tax treaty, the first condition is that the non-resident should be taxed in India. DDT is a tax on the income of the domestic company and not a tax paid on behalf of the shareholder. Hence, the domestic company does not enter the domain of tax treaty at all.

- There is no specific extension of tax treaty rate to DDT under India France tax treaty, unlike in the protocol to the India-Hungary tax treaty, which specifically provides that when the company paying dividends is a resident of India, the tax on distributed profits shall be deemed to be taxed in the hands of the shareholders and it shall not exceed 10 per cent of the gross amount of the dividend. Further, tax treaty protection cannot be extended to the domestic company and it cannot claim the benefit of the Dividend Article.

- For the above reasons, it was held that where dividend is declared, distributed, or paid by a domestic company to a non-resident shareholder, DDT payable by the domestic company shall be at the rate mentioned in Section 115-O and not at the tax treaty rate. However, if both the tax treaty countries intend to extend the treaty protection to the domestic company paying DDT, then the domestic company can claim the benefit of the tax treaty.

Our comments

This is an important decision wherein the Special Bench of the Tribunal, not agreeing with the favourable view of the division benches, has held that DDT cannot be restricted to the dividend tax rate under the tax treaty. Since the levy of DDT under Section 115-O is not applicable from 1 April 2020, the relevance of this decision would be for years prior thereto where the companies may have claimed refund of the excess DDT over tax treaty rate. It would also be interesting to see how the High Courts will deal with this issue when this matter comes up before them.

---

[6] Union of India v. Tata Tea Co Ltd [2017] 398 ITR 260 (SC)
[7] Godrej & Boyce Co. Ltd. v. DCIT [2010] 194 Taxman 203 (Bom)
[8] Godrej & Boyce Mfg Co Ltd v. DCIT [2017] 394 ITR 449 (SC)
[9] Small Industries Development Bank of India (SIDBI) v. CBDT [2021] 133 taxmann.com 158 (Bom)

KPMG in India addresses:

Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2, Serilingampally
Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
2nd Floor, Block T2 (B Wing),
Lodha Excellus, Apollo Mills Compound, N M
Joshi Marg, Mahalaxmi, Mumbai- 400011
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

---

30 years and beyond

https://kpmg.com/in/en/home/social

kpmg.com/in/en/home/social