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TAX FLASH NEWS

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The Mumbai Tribunal refers an issue of eligibility of lower tax treaty rate on dividend over DDT rate to the Special Bench

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the ITAT or Tribunal) in the case of Total Oil India Pvt Ltd[1] (the taxpayer) dealt with the issue of eligibility of lower tax treaty rate on dividend for Dividend Distribution Tax (DDT) under Section 115-O of the Income-tax Act, 1961 (the Act). The Tribunal did not agree with the earlier decisions of the other benches of the Tribunal where the benefit of lower tax rate on dividend has been granted as against the DDT rate. The Tribunal, based on various observations, referred the matter to the President of the Tribunal to form a Special Bench to deal with this issue.

Facts of the case

The taxpayer, an Indian resident company, has some non-resident shareholders fiscally domiciled in France. During the Assessment Year 2016-17, the taxpayer paid Dividend Distribution Tax (DDT) under Section 115-O on payment of dividend to the non-resident shareholders.

The taxpayer claimed that since the shareholders of the taxpayer are entitled to the benefits of the tax treaty, DDT paid by the taxpayer, which is nothing but a tax on dividend income of the shareholders, cannot exceed the rate of tax provided under the tax treaty. In support of its claim, the taxpayer relied on a decision of the Delhi Tribunal in the case of Giesecke & Devrient India Pvt Ltd.[2] which has also been subsequently followed by several other benches of the Tribunal. Reference was also made to the decision of the Kolkata Tribunal in the case of Indian Oil Petronas Pvt Ltd.[3]

The tax department did not agree with the decisions relied on by the taxpayer. Accordingly, the tax department contended that this issue may be referred to a Special Bench of the Tribunal.

Tribunal's decision

The Tribunal relied on the decision of Supreme Court in the case of Paras Laminates Pvt Ltd.[4] wherein it was held that it is vital to the administration of justice that those exercising judicial power must have the necessary freedom to doubt the correctness of an earlier decision if and when subsequent proceedings bring to light what is perceived by them as an erroneous decision in the earlier case and in such circumstances, it is but natural and reasonable and indeed efficacious that the case is referred to a larger bench.

The President of Central Excise, Customs and Gold Control Tribunal (CEGAT), as it then was, accepted these recommendations, and the Supreme Court ultimately upheld the action of the President, CEGAT. There was no occasion for conflict of decisions of the coordinate benches, and yet, in the esteemed views of the Supreme Court, the recommendation for constitution of the special bench, as indeed the constitution of the special bench itself, was held to be in order.

In this view of the matter, the taxpayer's submission that President cannot constitute a Special Bench in the absence of conflict of opinions by the division benches is incorrect and untenable in law.

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[1] DCIT v. Total Oil India Pvt Ltd (ITA No. 6997/Mum/2019) – Taxsutra.com
Note: The Mumbai Tribunal has dealt with more than one issues in this decision. However, this flash news deals with the issue of eligibility of tax treaty benefits to the taxpayer who is a resident of India paying DDT under Section 115-O of the Act.
[2] Giesecke & Devrient India Pvt Ltd. v. ACIT [2020] 120 taxmann.com 338 (Del)
[3] DCIT v. Indian Oil Petronas Pvt Ltd [2021] 127 taxmann.com 389 (Kol)

[4] Union of India v. Paras Laminates Pvt Ltd [1990] 186 ITR 722 (SC)

It is for the President to take a considered call on whether or not it is a fit case for constitution of a Special Bench, but, in the event of his holding the view that it was indeed a fit case to constitute a Special Bench, he is not, denuded of the powers to do so on account of lack of conflict in the views of the division benches.

The reasons for doubting the correctness of the decisions of the co-ordinate benches, on the DDT rate being restricted by the treaty provision dealing with taxation of dividends in the hands of the shareholders, are as follows:

- The Supreme Court in the case of Godrej & Boyce Mfg Co Ltd[5] observed that the fact that Section 10(3) and Section 115-O brought in together, deleted and reintroduced in a composite manner does not assist the taxpayer. Further if tax paid by the dividend paying company under Section 115-O is to be understood to be on behalf of the recipient taxpayer, the provisions of Section 57 should enable the taxpayer 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 Section 10(33).

- The payment of DDT under Section 115-O does not discharge the tax liability of the shareholders. It is a liability of the company and discharged by the company. Whatever be the conceptual foundation of such a tax, it is not a tax paid by, or on behalf of, the shareholder. Therefore, DDT cannot be treated as a tax on behalf of the recipient of dividends, i.e. the shareholders. In the case of Giesecke & Devrient India Pvt Ltd, the division bench did not have any occasion to deal with this judicial precedent from the Supreme Court.

- The stand of the taxpayer that in the light of the subsequent decision of the Supreme Court in the case of Tata Tea Co Ltd.[6] one has to proceed on the basis that dividends received by the shareholders are taxed as income in the hands of the shareholders, is incorrect. The Tata Tea Co Ltd decisions does not overrule, or even remotely deal with, the specific decision of the Supreme Court in the case of Godrej & Boyce Mfg Co Ltd. The inferences drawn on the basis of Tata Tea decision are thus misplaced.

- Under the scheme of the tax treaties, no tax credits are envisaged in the hands of the shareholders in respect of DDT paid by the company in which shares are held. DDT thus cannot be equated with a tax paid by, or on behalf of, a shareholder in receipt of such a dividend. Infact, the payment of DDT does not, in any manner, prejudice the foreign shareholder, and any reduction in the dividend distribution tax does not, in any manner, act to the benefit of the foreign shareholder resident in the treaty partner jurisdiction. This taxability is wholly tax-neutral vis-à-vis foreign resident shareholder and the treaty protection, when given in respect of DDT, can only benefit the domestic company concerned. The treaty protection thus sought goes well beyond the purpose of the tax treaties.

- The Delhi High Court's decision in the case of New Skies Satellite BV[7] does lay down the principle that an amendment in the domestic law will not influence the interpretation of that expression in the tax treaty, and there is absolutely no doubt on that proposition. However, that proposition cannot support the interpretation, as is canvassed by the coordinate benches, that even when tax burden is shifted from a resident of the tax treaty partner jurisdiction to resident of another jurisdiction, the tax burden on the another person, who is not eligible for tax treaty benefits anyway, will nevertheless be subjected to the same level of tax treaty protection. Such a proposition does not even find mention in any tax treaty literature, and therefore, extending the tax treaty protection to the company paying dividends, in respect of DDT, appears to be a solitary decision of its kind, anywhere in the world.

- In the case of Volkswagen of South Africa (Pty) Ltd[8], the South African High Court has observed that a similar DDT, known as Secondary Tax on Companies (STC) paid on the distribution of dividends, is a tax on 'a company declaring the dividends and not on dividends'.

- While the views so expressed by a foreign judicial body do not bind the Tribunal, or, for that purpose, any judicial body in India, these views at least suggest that this school of thought reflected in the said decision deserves to examined in a fair, judicious and open-minded manner.

- Wherever the Contracting States to a tax treaty intended to extend the treaty protection to the DDT, it has been so specifically provided in the tax treaty itself. For example, in India-Hungry tax treaty it is specifically provided, in the protocol to that 'When the company paying the 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 dividend'. In the absence of such a provision in other tax treaties, it cannot be inferred on the basis of a rather aggressively creative process of interpretation of tax treaties.

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[5] Godrej & Boyce Mfg Co Ltd Vs DCIT [2017] 394 ITR 449 (SC),
[6] Union of India v. Tata Tea Co Ltd [2017] 398 ITR 260 (SC)

[7] DIT v. New Skies Satellite BV[1] [2016] 382 ITR 114 (Del)
[8] Volkswagen of South Africa (Pty) Ltd v. Commissioner of South African Revenue Service (Case no. 24201/2007; www.ibfd.org database)

- A tax treaty protects taxation of income in the hands of residents of the treaty partner jurisdictions in the other treaty partner jurisdiction. Therefore, in order to seek treaty protection of an income in India under the India-France tax treaty, the person seeking such treaty protection has to be a resident of France. When the taxes are paid by the resident of India, in respect of its own liability in India, such taxation in India, cannot be protected or influenced by a tax treaty provision, unless a specific provision exists in the related tax treaty enabling extension of the treaty protection.

- Tax treaty is in the nature of self-imposed limitations of a State's inherent right to tax, and these tax treaties divide tax sources, taxable objects amongst themselves. Inherent in the self-imposed restrictions imposed by the tax treaty is the fact that outside of the limitations imposed by the tax treaty, the State is free to levy taxes as per its own policy choices. DDT, not being a tax paid by or on behalf of a resident of treaty partner jurisdiction, cannot thus be curtailed by a tax treaty provision.

- Accordingly, the Tribunal held that it is a fit case for the constitution of a Special Bench, consisting of three or more Members, so that all the aspects relating to this issue can be considered in a holistic and comprehensive manner. It is a macro issue that touches upon the tax liability of virtually every company which has residents of a tax treaty partner jurisdiction as shareholders and has substantial revenue implications.

- The question referred by the Tribunal to Special Bench is whether the protection granted by the tax treaties in respect of taxation of dividend in the source jurisdiction, can be extended, even in the absence of a specific treaty provision to that effect, to DDT under Section 115-O in the hands of a domestic company.

Our comments

Till 1 April 2020, dividends declared, distributed or paid by an Indian company was subject to DDT at the rate of 15 per cent in the hands of such Indian company under Section 115-O of the Act. DDT was discharged by the Indian company at the aforesaid rate irrespective of whether the shareholder was a resident or a non-resident who may be a tax resident of country with which India has entered into a tax treaty.

Several tax treaties provide for taxation of dividends at a lower rate of tax than the DDT rate. Thus, taxpayers have been claiming that DDT paid on the distribution of dividend to a non-resident shareholder should be restricted to the rate of tax on dividends as set out in the relevant tax treaty.

In October 2020, the Delhi Tribunal in the case of Giesecke & Devrient [India] Pvt Ltd held that DDT rate should be restricted to the rate specified in the respective tax treaty. Subsequently, following Delhi Tribunal's decision, the Kolkata Tribunal in the case of Indian Oil Petronas Pvt Ltd held the decision favour of the taxpayer.

However, the Mumbai Tribunal in the present case did not agree with the above-referred benches of Tribunal and referred the matter to the Special Bench consisting of three or more Members. The Tribunal has given some important observations while referring the matter to the Special Bench. According to Tribunal, the Supreme Court's decision of Tata Tea Co Ltd does not overrule, or even remotely deal with, the specific decision of the Supreme Court in the case of Godrej & Boyce Mfg Co Ltd. Thus the inferences drawn by various benches of Tribunal on the basis of Tata Tea decision are misplaced.

The Tribunal while referring to the South African High Court's decision observed that it is a tax on 'a company declaring the dividends and not on dividends'.

It is important to note that under the India-Hungry tax treaty it is specifically provided that when the company paying the dividend is a resident of India the tax on distributed profits shall be deemed to be taxed in the hands of the shareholders. However, the present case dealt with the India-France tax treaty which does not contain such clause. Thus it is important to analyse the dividend article of various Indian tax treaties to determine the benefit of tax treaty against DDT.

It would be interesting to see when the President of the Tribunal will approve to form the Special Bench to deal with this issue and how the Special Bench will deal with this issue considering the Supreme Court decisions and various Tribunal decisions in favour of taxpayers.

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