



Tax Insights

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DDT being a tax on distributed profits not eligible for beneficial DTAA rate – Special bench, Mumbai of the Tribunal

In brief

In a recent ruling¹, the Special bench, Mumbai of the Income-tax Appellate Tribunal (Tribunal), held that dividend distribution tax (DDT) under section 115-O of the Income-tax Act, 1961 (the Act) is an additional tax levied on the company and not on the shareholder. Accordingly, benefit of the lower tax rate as per the relevant Double Taxation Avoidance Agreements (DTAA) for taxation of dividend will not be available in case of non-resident shareholders. However, the Tribunal observed that lower tax rate benefits can be extended to non-resident shareholders of only those countries where such DTAA protection has been specifically agreed upon.

In detail

Facts

- The taxpayer, an Indian company, declared and paid dividend during the year under consideration.
- One of the shareholders of the taxpayer was a non-resident (tax resident of France).
- As per the erstwhile provisions on dividend taxation, the Indian company is required to pay additional income-tax on any amount declared, distributed or paid by way of dividend under section 115-O of the Act at the prescribed rate on the distributed profits.
- The taxpayer raised an additional ground before the Tribunal that the rate at which tax under section 115-O of the Act has to be paid on the dividend cannot be more than that prescribed under the DTAA between India and France for taxing dividends in the hands of the non-resident shareholder.
- Reliance was placed by the taxpayer on coordinate bench rulings² wherein the Tribunals had held the following:
 - DDT is levied on dividend distributed by the payer company which is 'additional tax' and is covered under the definition of 'tax' as defined under the Act. Hence, it is subject to the charging section under

¹ ITA No. 6997/MUM/2019 dated 20 April 2023 along with other clubbed appeals and interveners

² Giesecke & Devrient India Private Limited v. ACIT [2020] 120 taxmann.com 338 (Delhi ITAT); DCIT v. Indian Oil Petronas Private Limited [2021] 189 ITD 490 (Kolkata ITAT)

the Act, and consequentially eligible for the applicability of section 90 of the Act.

- Payment of DDT under section 115-O of the Act by the domestic company was for and on behalf of the shareholder and in discharge of the shareholder's liability to pay tax on the dividend distributed.
- The Division bench, Mumbai of the Tribunal doubted the correctness of the decisions on the aforesaid cases and referred the matter to the Special bench for consideration.

Issue before the Special bench of the Tribunal

- Where the 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 section 115-O of the Act, whether such additional income-tax payable by the domestic company will be at the rate mentioned in section 115-O of the Act or the rate of tax applicable to the non-resident shareholder(s) with reference to such dividend income?

Revenue's contentions

- The Revenue submitted that a bare perusal of section 115-O of the Act shows that it overrides the charging provisions of section 4 of the Act. Section 115-O of the Act is a separate charging section, and hence, it takes no support from section 4 of the Act.
- The Revenue further submitted that the charge under section 115-O of the Act is on the distributable profits of the company and not on dividend and that it is not a procedural section but a charging section.
- Relying on the decision of the Supreme Court³, the Revenue submitted that the additional tax levied under the section is on the distributable profits of the company.
- Reliance was placed by the Revenue on the decision of the jurisdictional High Court⁴, wherein it was categorically held that the charge under section 115-O of the Act is on the company's profits; more specifically, it is on that part of the profits which is declared, distributed or paid by way of dividend. Thus, it is not on income by way of dividend in the shareholder's hands.
- Statutory incidence of tax levy, once complete, leaves no scope of interment. Once the tax is levied on a particular specie of profits of the company, then no scope is left for an argument that the tax so levied is in fact paid by the company either on behalf of the shareholders or is in fact being paid on the dividend income of the shareholders.
- The tax levied under section 115-O of the Act, both in law and in time, precedes the actual accrual as it gets crystallised at an earlier stage of declaration on dividends. At the declaration stage, when charge under section 115-O of the Act crystallises, the key element of crystallisation of levy under section 4 of the Act is missing. Thus, the Revenue submitted that the assertion that tax under section 115-O of the Act is on the dividend income of shareholders is untenable.

Taxpayer's contentions

- The genesis of the charge for additional income-tax under section 115-O of the Act on the profits declared, distributed and paid by way of dividends can be traced to and is within the ambit of the charging provisions of section 4 of the Act. The term 'tax', as defined under section 2(43) of the Act, would also cover additional income-tax levied under section 115-O(2) of the Act.
- Charge of additional income-tax under section 115-O of the Act referred to as tax on distributed profits is income by way of dividend, which forms part of the income of the shareholders. By a combined reading of the different provisions, it is evident that the legislature itself unequivocally construed the levy of tax under section 115-O of the Act as a charge on income by way of the dividend declared, distributed and paid by the company.
- Section 115-O of the Act is not a tax on corporate profits, but a tax levied on the amount declared, distributed or paid by a company by way of dividend, whether interim or otherwise.

³ CIT v. Elphistone Spg. & Wvg. Mills Co. Limited [1960] 40 ITR 142 (SC)

⁴ Small Industries Development Bank of India v. CBDT [2021] 133 taxmann.com 158 (Bombay)

- Legislative competence to enact section 115-O as part of the Act could only be upheld if the same is construed to be in the nature of tax on income by way of dividend; otherwise, the levy would be unconstitutional, failing the test of legislative competence.
- Where two countries have agreed for the taxation of the dividend income in the source state at a lower rate, then the charge of a higher tax by way of introducing a different mechanism for collecting tax on such dividend income would be contrary to the principle of DTAA override as enshrined in Articles 26 and 27 of the Vienna Convention.
- Machinery provision for the collection of tax does not change the nature of tax. The nomenclature given to levy tax under section 115-O of the Act, tax on distributed profits, is in fact tax on the dividend income of the shareholders. It is not tax on the income of the company. The machinery adopted for the collection of tax or shifting the incidence of tax from shareholders to the company cannot be determinative of the nature of tax.
- Enactment of sub-section (3) to section 115-O of the Act clearly depicts that DDT is the liability of the domestic company but on the dividend income of the shareholders.
- The taxpayer further contended that complete protection to the non-resident shareholders from the provisions of the Act in the India-Hungary DTAA should also be extended to the domestic company paying dividend to non-resident shareholders of other countries as well.

Tribunal's observations and ruling

The Tribunal analysed various aspects of the contentions raised by respective parties and held the following.

Meaning of the word 'dividend'

- Dividend means the portion of the profit received by the shareholder from the company's net profit, which is legally available for distribution among the members. Therefore, dividend is a return on the share capital subscribed for and paid to its shareholders by a company.
- If dividend is the share of profits declared as distributable among the shareholders, it does not mean that the character of the profits distributed by the company as dividend retains the same character when it reaches the hands of the shareholders.

Section 115-O of the Act

- Section 115-O of the Act creates a charge of additional income-tax on the amount declared, distributed or paid by a domestic company by way of dividend. Thus, it is a tax on 'distributed profits' and not a tax on 'dividend distributed'.
- The non-obstante clause in section 115-O of the Act indicates that the charge under the said section is independent and divorced from the concept of 'total income' under the Act.

Nature of DDT: Is it a tax on the company or the shareholder?

- Relying on the principle laid down by the Supreme Court⁵ and the jurisdictional High Court⁶, the Tribunal held that DDT is neither a payment on behalf of the shareholder nor it is to be regarded as payment of liability of the shareholder discharged by the domestic company paying DDT.

Therefore, the charge under section 115-O of the Act is on the company's profits and not income in the hands of the shareholder.

- Since the DDT is treated as final payment of tax under section 115-O of the Act in respect of the dividend declared, distributed or paid and no further credit or deduction can be claimed by the company or any person under any other provisions of the Act; this proves that shareholder does not enter in the domain of DDT at all.

⁵ Godrej & Boyce Mfg. Co. Limited v. DCIT (394 ITR 449) (SC) wherein the Supreme Court in the context of section 14A of the Act held that section 14A of the Act would apply to dividend income on which tax is payable under section 115-O of the Act.

⁶ Small Industries Development Bank of India v. CBDT (133 taxmann.com 158) wherein the Bombay High Court held that the liability to pay additional tax as per section 115-O of the Act is irrespective of whether the recipient has received dividend as income, which is chargeable to tax or not.

- Relying on the decision of the Madras High Court⁷, the Tribunal observed 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.

Applicability of DTAA

- The Tribunal observed that DTAA should be looked at from the recipient's taxability perspective. Since DDT is paid by a domestic company resident in India, it is a tax on its income and not tax paid on behalf of the shareholder. Therefore, such domestic company does not enter the domain of DTAA at all.
- If the domestic company has to enter the domain of the DTAA, the countries should have agreed specifically to that effect in the DTAA. The Tribunal made a reference in this regard in the protocol to the India-Hungary DTAA, where the contracting states have extended the DTAA protection to the DDT. In such cases, the Tribunal held that the domestic company can claim the benefit of lower tax rate as per the DTAA, if any.

The takeaways

- This is an important ruling wherein the Special bench, Mumbai of the Tribunal has put to rest the ongoing controversy on the DDT issue. The Tribunal, in the present case, has emphasised that DDT is an additional income-tax on the company's profits and not on income in the hands of the shareholder; hence, the lower rate of tax on dividends as per the DTAA of the shareholder will not apply. As such, the domestic company does not enter the domain of DTAA at all.
- Moreover, the Special bench also held that a DTAA benefit for lower tax rate, if any, on DDT can be extended to contracting states wherein the same has been specifically agreed to by the respective parties to the DTAA, e.g. the India-Hungary DTAA.
- Indian companies who have claimed a refund of excess DDT paid *vis-à-vis* the beneficial DTAA rates are likely to be impacted by this ruling.

⁷ B.M. Amin Umma v. ITO 26 ITR 137 (Madras)

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