

Direct Tax Alert

October 14, 2020



Delhi ITAT determines DDT on dividends to non-resident shareholder to be circumscribed by DTAA rates

Background

Until 1 April 2020, dividends declared, distributed or paid by an Indian company was subject to additional income-tax at the rate of 15% (exclusive of applicable surcharge and cess)¹ (referred to as 'Dividend Distribution Tax' or 'DDT') in the hands of such Indian company under section 115-O of the Income-tax Act, 1961 ('the Act').

The 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 Double Taxation Avoidance Agreement ('DTAA')].

Several DTAA's provided for taxation of dividends at a lower rate of tax (i.e. a rate lower than effective rate of 20.56%).

Having regard to the above, there has been a school of thought that DDT to be paid on the dividend distribution made to a non-resident shareholder should be restricted to the rate of tax

on dividends as set out in the relevant DTAA. However, there was no judicial precedence on the same till date.

Recently, the Delhi ITAT in the case of *Giesecke & Devrient [India] Pvt Ltd v The Addl. C.I.T.*² has upheld the view that DDT liability should be circumscribed by the rate specified in the DTAA. The facts and the ruling of the ITAT on the said issue has been covered in the subsequent paragraphs.

Brief Facts

Giesecke & Devrient [India] Pvt Ltd (Appellant) was a 100% subsidiary of Giesecke & Devrient GmbH, a German Company.

During Financial Year ('FY') 2012-13, Appellant had declared dividends to its German parent and discharged DDT at the rate specified in section 115-O of the Act (i.e. without reference to the rate mentioned in the DTAA between India and Germany).

¹ Effective DDT rate after grossing-up of the dividend amount for FY 2019-20 was 20.56%.

² ITA No. 7075/DEL/2017



The Appellant raised an additional ground of appeal before the ITAT with respect to extending the benefit of DTAA between India and Germany qua the rate of tax on payment of dividends to its German parent.

Decision

Admission of additional ground

While the income-tax authorities sought dismissal of the additional ground by contending that *inter alia* (a) the aspect was never raised before any lower authorities (b) it required verification of facts.

The ITAT however, relying on the jurisdictional Delhi High Court decision of Maruti Suzuki India Ltd³ admitted the additional ground for adjudication.

DDT is a tax on dividends

The ITAT on a perusal of the charging section of the Act and definition of the terms “Tax” and “Income” observed that:

- income-tax chargeable on total income of a person includes additional income-tax;
- ‘Tax’ would include DDT (being additional income-tax) within its ambit; and
- ‘Income’ includes dividends within its fold.

The ITAT, further observed that the Hon’ble Bombay High Court in the case of Godrej Boyce Manufacturing Company Limited⁴ had unequivocally held that DDT was a tax on the company and not on the shareholder.

Accordingly, the ITAT observed that while the liability to pay DDT is on the Indian company, DDT is a tax on the income and income includes dividends.

Legislative history of introduction and withdrawal of DDT

The ITAT perused the Memorandum to Finance Bills of 1997 and 2003 (i.e. Finance Bill vide which DDT was introduced and reintroduced) and observed that the reason for introduction of DDT was for administrative convenience i.e. collection of tax at a single point (Indian company) rather than a legal necessity. It further noted that for all

intents and purposes, DDT is a charge on dividends. It also noted that the burden of DDT falls on the shareholders rather than the company as the amount of dividend available for distribution to the shareholders stands reduced.

The ITAT further considered the Memorandum to Finance Bill 2020 and observed that as per the Finance Bill, the incidence of dividend tax is on the Indian company and not on shareholder where it should normally be, as the dividend is the income of the shareholder, and not that of the Indian company.

The ITAT after a conjoint reading of the Memorandum to Finance Bills concluded that DDT was levied for administrative convenience and its withdrawal was done considering that levy was across the board at a flat rate, irrespective of rate at which the shareholder is otherwise taxed.

Applicability of DTAA to DDT liability

The ITAT observed that the income of a non-resident is to be determined having regard to the provisions of the DTAA i.e. the Act or the DTAA, whichever is more beneficial should be applied.

As per the ITAT order, the fact that the liability to pay the DDT is cast on Indian company would not be relevant while considering the applicability of rates of dividend tax set out in the DTAA.

It was noted that while the DTAA between India and Germany was notified in November 1996 i.e. prior to introduction of DDT in FY 1997-98. The ITAT, relying on the Jurisdictional Delhi High Court’s decision in the case of New Skies Satellite⁵ (which dealt in detail and had concluded that the amendments made in the Act/ domestic law cannot override the provisions of the DTAA) concluded that the tax rates mentioned in the DTAA will prevail over the tax rates mentioned in the Act. Thus, the ITAT held that DDT levied by the appellant should not exceed 10% i.e. the rate specified in Article 10 of the India-Germany DTAA.

The ITAT however remanded the matter to the Assessing Officer for limited purpose of verifying that German parent was not carrying on business in India through a permanent establishment (‘PE’)

³ WP(C) 1324/2019, order dated 16 December 2019

⁴ 328 ITR 181

⁵ 382 ITR 114



and shareholding in the Indian company is effectively connected to such PE.

Dhruva Comments

This is one of the first judgments which has dealt with the issue of interplay of DTAA and DDT liability on merits. The decision reaffirms two critical aspects:

- DDT rate should be restricted to the rate specified in the respective DTAA
- Claim for DDT refund can be made by Indian companies before Appellate authorities

It is important to note the fact that DTAA with Germany was signed prior to introduction of DDT played a significant role in conclusion reached by ITAT. Several of India's vital DTAA (e.g. Mauritius, Singapore, Netherlands etc) have been entered into prior to introduction of DDT and Indian companies with shareholders domiciled in such countries are likely to benefit from this decision.

The decision will aid Indian companies to make a similar claim before Assessing Officers and Appellate Authorities for the past years. Given the potential ramifications, the decision is likely to be challenged by the Revenue authorities.



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