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DIRECT ALERT

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Bombay High Court rules dividend tax rate provided under DTAA overrides the dividend distribution tax provisions

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The Bombay High Court held[1] that the taxpayer is entitled to concessional tax rate on dividend as per Article 11 of the India-United Kingdom ("UK") Double Taxation Avoidance Agreement ("DTAA"), superseding the Dividend Distribution Tax ("DDT") provisions. A landmark ruling emphasizing the supremacy of DTAA over the Income-tax Act, 1961 ("the Act").

Background:

- Colorcon Asia Pvt. Ltd. ("Colorcon India" or "the taxpayer") was a wholly owned subsidiary of Colorcon Limited, United Kingdom ("Colorcon UK"). Colorcon UK was a tax resident of UK with a valid Tax Residency Certificate. The taxpayer paid dividend to Colorcon UK during Assessment Years ("AYs") 2016-17 to 2019-20. The taxpayer consequently paid DDT thereon at the rate specified under section 115-O of the Act. The taxpayer filed an application before the Board for Advance Ruling ("BFAR") seeking an advance ruling on whether Colorcon India would be entitled to restrict the tax rate on dividends distributed to Colorcon UK at 10 per cent under Article 11 of the India-UK DTAA.

- The BFAR held that the dividend tax rate prescribed under Article 11 of India-UK DTAA shall not restrict the tax rate of DDT. Following the decision of Mumbai Income Tax Appellate Tribunal ("ITAT") Special Bench in DCIT v. Total Oil Private Limited[2], the BFAR held observed that DDT does not fall within "Taxes covered" under Article 2 of India –UK DTAA and thus the same is outside the scope of DTAA between India and UK.

- Aggrieved by this, the taxpayer filed an appeal before the Bombay High Court ("Bombay HC") against the BFAR ruling. The contentions of the taxpayer, tax authorities and the decision of Bombay HC are summarised below.

Issue under consideration:

- Whether DDT paid by taxpayer is to be governed by DTAA or to be dealt with only in accordance with section 115-O of the Act?

Taxpayer"s contention:

- DDT is nothing but tax on dividend (which is income of the shareholder) whose incidence has been shifted to the distributing company as per the provisions of section 115-O of the Act introduced by the Finance Act, 1997. There is no change in its substantive concept or definition, and the shifting has occurred for "administrative convenience" only. Reliance was placed on the Supreme Court"s decision of **UOI v. Tata Tea**[3] which held that DDT is tax paid on dividend itself.

- DDT is an "Additional tax" covered by the definition of "tax" as defined in section 2(43) of the Act, which falls within the ambit of charging section 4 of the Act. Section 4 of the Act operates subject to other provisions of the Act including section 90. Consequently, the taxpayer argued that the provisions of the DTAA would operate even if

[1] *TS-1623-HC-2025(BOM)*
[2] *TS-197-ITAT 2023(Mum)*
[3] *[2017] 398 ITR 260 (SC)*

inconsistent with the provision of the Act as per Section 90 supported by various jurisprudence.[4]

- The taxpayer argued that being resident in India, it is eligible to seek relief under Article 1 of the India-UK DTAA. It was further argued that Article 2 of the DTAA has enlisted the taxes covered and it covers "Income Tax" including any surcharge thereon under the definition of "Tax" for the purpose of "Taxes covered in India". Article 2 also provides that the DTAA to apply to any identical or substantially similar tax in addition to or in place of tax.

- Furthermore, the taxpayer also contended that it satisfies all the conditions provided in Article 11 for restricting the tax rate on dividend to 10%, viz.,
  - **Payment** – the payment must be "dividend" as defined in Article 11(3);
  - **Payer** - Such dividend has been paid by a resident of India;
  - **Payee** – should be paid to a resident of UK; and
  - **Beneficial ownership** - Dividend shall be taxable at 10%, if the recipient is the beneficial owner of the dividend (Colorcon UK admittedly was the beneficial owner of dividend)

- Any unilateral change made in the Act over the years merely in relation to the incidence of tax cannot alter or overwrite the beneficial provision of the DTAA. Reliance was placed on the Supreme Court decision in the case of **Engineering Analysis Centre of Excellence (P) Ltd. v. CIT**[5].

- The also taxpayer relied upon the decision of Delhi ITAT in **Giesecke & Devrient (India) (P.) Ltd. v. ACIT**[6] in support of its contention that the DDT rate is subject to tax rate provided under the DTAA.

Revenue"s contention:

- As per section 115-O of the Act, it is evident that the incidence as well as charge in respect of DDT is only on the domestic company that declares, distributes, or has paid the dividend.

- DDT is an "additional income tax" on the domestic company and cannot be construed to mean as "tax" in the hands of non-resident shareholder earning dividend income. Reliance was placed on the Supreme court"s decision in the case of **Godrej and Boyce Manufacturing Company Limited v. DCIT**[7].

- The India-UK DTAA is silent and do not contemplate DDT as a tax on shareholders similar to Indo-Hungary DTAA which specifically provides in the protocol that tax on distributed profits shall be deemed to taxes in the hands of the shareholders.[8]

- Since there are no further terms or mutual agreement settling the mode of application of the limitations imposed in Article 11 by the DTAA itself, it cannot be held that rate of tax provided under Article 11(2)(b) of DTAA will supersede rate provided by section 115-O.

- Under the scheme of tax treaties, no tax credit is envisaged in the hands of shareholders in respect of DDT payable and thus it cannot be equated with a tax paid by or on behalf of the shareholder.

Bombay HC"s ruling:

- The DDT qualifies as an "additional tax" under Section 2(43) of the Act and thus falls within the ambit of the charging provision in Section 4, making it eligible for relief under section 90 pursuant to the applicable DTAA. The Court further emphasized that a DTAA, being a mutual agreement between countries, must be given full effect, and unilateral domestic amendments cannot override or diminish the relief provided under the treaty.

- Since the taxpayer satisfies all the conditions provided in Article 11 of the DTAA, DDT is squarely covered under Article 11 of the DTAA. Further, on a plain reading of Article 11, it is evident that the person

[4] *UOI v. Azadi Bachao Andolan [263 ITR 706 (SC); Sanofi Pasteur Holding SA v. Dept. of revenue [2013] 354 UTR 316 (AP)*
[5] *[2021] 432 ITR 471 (SC)*
[6] *TS-522-ITAT-2020(DEL)*
[7] *TS-176-SC-2017*
[8] *Protocol: With reference to Article 10, 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.*

on whom the tax on dividend is levied is an irrelevant and extraneous consideration for its application.

- The Bombay HC distinguished the Supreme Court decision in the case of Godrej & Boyce (supra) by noting that the Supreme Court was dealing with disallowance under section 14A of the Act, which is completely different context. The Bombay HC also observed that the decision of Total Oil India (P) Ltd. (supra) was also not well founded.

- Basis the above, the Bombay HC held that the DDT paid by Colorcon India would be governed by Article 11 of the India-UK DTAA and consequently, the dividend income shall be subject to a concessional tax rate of 10% in India.

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For any queries in relation to this tax alert, please feel free to reach out.

DHRUVA INSIGHT

This landmark ruling by the Bombay High Court gives a major relief. For almost two decades, Indian companies distributing dividends to foreign shareholders paid DDT at an effective rate of about 20% even when India's DTAAs with countries like the UK, USA, Singapore, Netherlands, and Germany limited India's taxing rights on dividends to just 10% or 15%. The decision now provides much-needed clarity, ruling that DTAA benefits can't be denied simply because India collects the tax from the domestic company rather than directly from the shareholder.

In reaching this conclusion, the Bombay High Court has reinforced a key principle: India's international DTAA obligations take precedence over domestic tax collection mechanisms if they are beneficial to the taxpayer including Indian resident.

It will be interesting to see how judiciary responds to DTAAs, which were signed after the DDT regime was introduced. Equally, it would be worth examining the extent to which the principles laid down by the Bombay High Court can be extrapolated to other transaction where the statutory liability to pay tax has been shifted from non-resident taxpayers to domestic company.

In many situations, companies may not have litigated this issue and therefore, may feel left out. This decision may offer opportunities to such companies to claim benefit of the DTAA. This may require an appropriate strategy and thought process to be evolved.

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