

# kcmFlash

International Tax

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## DDT finally makes it to DTAA after a journey of 20 years *Indian Tax Tribunal rules in Taxpayer's favour, applies "Substance over Form"!*

### Snapshot

In a time span of more than 20 years, India finally gets its first ruling <sup>1</sup> on the much debated and sought after topic of applicability of Tax Treaty benefits on Dividend Distribution Tax (DDT). Delhi Bench of ITAT has held in favour of Taxpayer by upholding the fundamental principle of DDT being in the nature of a "tax on income".

Interestingly, the Bench has also upheld supremacy of Tax Treaty over provisions of section 115-O notwithstanding that DDT is a tax levied in the hands of the company and not in the hands of the shareholder.

This Ruling will be extremely relevant for Taxpayers who have either filed additional grounds or claimed refund of excess DDT or have matters pending at appellate forums wherein they may now seek to raise additional ground for claiming Tax Treaty Benefit for rate of DDT.

### Facts of the Case

The Taxpayer was a wholly owned subsidiary of Giesecke & Devrient GmbH ('parent'). During Assessment Year 2013-14, the Taxpayer had paid dividend to its parent after depositing DDT as per the provisions of section 115-O of the Income-tax Act, 1961 ('the Act') without considering the provisions of the Double Taxation Avoidance Agreement (DTAA) between India and Germany (India-Germany DTAA).

During the course of appellate proceedings at Income-tax Appellate Tribunal (ITAT) – Delhi Bench, the Taxpayer raised the following additional grounds seeking refund for DDT paid in excess of the maximum rate of tax prescribed as per India-Germany DTAA:

- a. The Tax Officer had not extended benefits of India-Germany DTAA in terms of rate to be applied on dividends paid to shareholder;
- b. The Tax Officer did not consider that dividend income was that of the non-resident shareholder governed by provisions of India-Germany DTAA
- c. On a combined reading of section 10(34) and section 90(2), it was income of the non-resident and such income could not have been subjected to a rate in excess of rate prescribed under the India-Germany DTAA

<sup>1</sup> Giesecke & Devrient [India] Pvt Ltd. v. Addl CIT [ITA No. 7075/Del/2017]

- d. Only legitimate tax could have been retained as per provisions of section 237 of the Act read with Article 265 of the Constitution of India.

### Revenue's contentions

Revenue contended that the additional grounds were not to be admitted on the following counts:

- a. The issue was neither ever taken before the Tax Officer nor before the Dispute Resolution Panel ('DRP').
- b. Issues raised vide additional grounds were not mere legal issues but also required verification of facts.

### ITAT's Observations and Ruling

#### On admissibility of additional grounds

Delhi Bench of ITAT allowed the additional grounds considering the following:

- a. A similar matter was raised as an additional ground before the Delhi Bench in the case of Maruti Suzuki India Limited <sup>2</sup> and the Bench had admitted the additional ground. Revenue had preferred a Writ Petition <sup>3</sup> to the High Court which was dismissed
- b. The matter was a purely legal issue

#### On merits

The Bench made the following observations on the matter:

- (i) Section 115-O provided for levy of "additional income tax" on profits declared / distributed
- (ii) Genesis of section 115-O could be traced to the charging provisions of section 4 of the Act which covered within its purview "additional-

income tax" which was the tax under section 115-O

- (iii) Section 2(24) of the Act defined "income" to include dividends.
- (iv) Definition of "Tax" under section 2(43) would cover additional income tax levied under section 115-O

In addition to the fundamental observations, the Bench also made the following observations:

- a. Considering the decision of Bombay High Court in the case of Godrej & Boyce Manufacturing Company Limited <sup>4</sup>, the Bench held that DDT was a 'tax on the company' and 'not on the shareholder'.
- b. While DDT might have been a tax on the payer company, it would still retain the character of being a tax on income (the definition of which includes dividend).
- c. Particulars of DDT were to be disclosed at various places in Tax Return, Tax Audit Report, etc. and there were no separate provisions for adjudication / collection / recovery of DDT in default
- d. The Bench also referred to Memorandums explaining provisions of Finance Bill 1997, 2003 and 2020 and held that dividend was an income in the hands of the shareholder, however, merely from a procedural / administrative consideration, the levy was on the company during the DDT regime
- e. From the perspective of economic consideration, the burden of DDT effectively fell upon the shareholders rather than the company as the amount of distributed profits

<sup>2</sup> 961 / Del / 2014

<sup>3</sup> WP(C) 1324/2019

<sup>4</sup> 328 ITR 81

available for shareholder stood reduced to the extent of DDT levied

- f. Sections 4 (genesis of DDT, as mentioned above) and 5 were "subject to provisions of the Act" which would also include section 90. Taking into consideration the judgment by AP High Court in case of Vishakapatnam Port Trust <sup>5</sup>, the Bench held that sections 4 and 5 were subject to DTAA. Further, the Bench also relied upon the judgments by Calcutta High Court in the case of CIT v. Devi Ashmore India Ltd <sup>6</sup> and Supreme Court in the case of Union of India v. Azadi Bachao Andolan <sup>7</sup> to hold that the provisions of DTAA would prevail to the extent of inconsistency with the provisions of the Act
- g. Date of notification of India-Germany DTAA (November 29, 1996) was very relevant and that the DTAA was entered into before introduction of section 115-O which was introduced vide Finance Bill 1997. In this regard, the Bench observed that Delhi HC had in the case of New Skies Satellites <sup>8</sup> held that an amendment to the domestic law could not imply an amendment to the DTAA and that a party could not unilaterally alter the terms of a DTAA.

Based on the aforesaid observations, the Bench ruled that:

- (i) Generally accepted principles relating to interpretation of treaties in light of elimination of double taxation, did not bar application of DTAA to DDT. The Bench further held that liability of DDT under the Act falling upon the company was not relevant while considering applicability of rates of dividend tax set out in the DTAA's

- (ii) Article 10 of India-Germany DTAA clearly mentioned that dividends beneficially owned by a resident should not be charged to tax at a rate exceeding 10% of the gross amount of the dividend and the tax rates specified in the DTAA in respect of Dividends must prevail over DDT

The Bench accordingly allowed the grounds of the Taxpayer and restored the matter back to the Tax Officer for verification of the fact of existence of a Permanent Establishment ('PE') in India.

### KCM Note

DDT was first introduced in 1997 and was reintroduced in 2003. After almost 20 years since its introduction, this is India's first ruling on the much debated and discussed topic of allowability of DTAA benefits in case of DDT which effectively was being levied on companies distributing dividends. The prevalent view across the industry was that DTAA benefits would not be available in case of DDT as DDT was a tax on Company distributing the dividends and not on the shareholder and accordingly, the Indian company paying dividends was not eligible to take recourse to DTAA's.

Post Supreme Court's decision in the case of Tata Tea Co. Ltd. <sup>9</sup> which while upholding the constitutional validity of section 115-O held that DDT was a tax on income, quite a few taxpayers started using the argument to put forth a claim of applying DTAA provisions to DDT. It is worth noting that it was in *IFA Cahiers 2016* that **Mr. Arpit Jain, Partner at KCM** had contributed on the Topic "The Notion of Tax and elimination of double taxation or double non-taxation" wherein based on his research and practical experience since 2008 on the topic, he had categorically observed that there was a good chance of treating DDT as a "tax on income" and thereby being eligible for DTAA benefits.

<sup>5</sup> 144 ITR 146

<sup>7</sup> 263 ITR 706

<sup>6</sup> 190 ITR 626

<sup>8</sup> 382 ITR 114

<sup>9</sup> 398 ITR 260

While this is a welcome ruling, it would have been better had it been more reasoned and could have covered the aspects of basic principles of reading a treaty, for example, while a DTAA provides for distributive rights, it does not mandate in whose hand should the income be taxed, especially in context of Article 10 – Dividends. Further, reference to Delhi High Court ruling in the case of Skies Satellites seems uncalled for as it could raise a brow as to whether the ruling could be equally relevant in cases where DTAA's are signed after introduction of DDT. We will have to wait and see how the Revenue takes up the matter with higher appellate authorities.

As mentioned earlier, over the past few years, the matter had garnered attention amongst the tax

practitioners and a ruling was desperately awaited. While the Ruling may not have a long term value as far as future is concerned considering that DDT has now been replaced by the classical system of taxing dividends, it would surely open up avenues for Taxpayers who have tax returns yet to be filed / revised, or have matters pending before appellate authorities wherein the aspect of refund of DDT could now be raised as an additional ground. The Taxpayers should ensure that they have necessary documents to claim a Treaty benefits, viz. Proof of Beneficial Ownership, Tax Residency Certificate, No PE, etc.

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