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Chartered Accountants

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International Tax

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Bombay HC allows Treaty Benefits on Dividend Distribution Tax (DDT); Reverses Special Bench Ruling in Total Oil

Snapshot

In a pathbreaking judgment, the Bombay High Court has held that the Dividend Distribution Tax (DDT) rate under Section 115-O of the Income Tax Act can be restricted to the lower withholding tax rate prescribed under the Double Taxation Avoidance Agreement (DTAA).

The ruling explicitly reverses the position taken by the Mumbai ITAT Special Bench in Total Oil India Pvt Ltd[1], which had held that DTAA benefits were not applicable to DDT as it was a tax on the company and not the shareholder.

By prioritizing the "nature of income" over the "person on whom tax is levied," the Court concluded that DDT is essentially a tax on dividend income of the shareholder, merely collected from the company for administrative convenience.

The Court declared that retention of tax in excess of the DTAA rate would be contrary to Article 265 of the Constitution of India.

This decision opens a significant window for taxpayers already contending on the above issue to claim refunds for excess DDT paid in years prior to its abolition in 2020, challenging the Revenue's long-standing stance.

Background

The controversy regarding the applicability of DTAA rates to Dividend Distribution Tax (DDT) has been a highly litigious issue in India's international tax landscape. While taxpayers argued that DDT is essentially a tax on dividends covered under DTAA, the Revenue maintained that it is a tax on the company's distributed profits, independent of the shareholder, and thus outside the treaty's scope. This view was previously fortified by the Mumbai ITAT Special Bench ruling in Total Oil India Pvt Ltd, which denied DTAA benefits for DDT.

In the present case, the Taxpayer, Colorcon Asia Pvt. Ltd., a wholly owned subsidiary of Colorcon Limited, UK, distributed dividends during AYs 2016-17 to 2019-20 to Colorcon Limited, UK. The Taxpayer paid DDT at the rates specified under Section 115-O of the Act.

The Taxpayer approached the Board for Advance Rulings (BFAR), seeking a ruling on whether the DDT rate on dividends could be restricted to 10% as per Article 11 of the India-UK DTAA. The BFAR, relying on the ITAT Mumbai Special Bench's ruling in Total Oil (Supra), answered the questions in favour of revenue, holding that DDT squarely falls outside the scope of the DTAA and is a tax on the company, not the shareholder.

Aggrieved by the BFAR's ruling, the taxpayer filed a Writ Petition before the Bombay High Court.

Arguments by the Parties

Taxpayer's Argument

Substance of Tax

DDT is a tax on the dividend income of the shareholder, and not an independent tax on the distributing company. The incidence was merely shifted to the company for the 'Administrative convenience' of collection, but its core nature remains tax on dividend. Definition of income provided by Section 2(24) of the Act specifically includes Dividend and no amendment to said definition was made after introduction of Section 115-O.

Article 11 Focuses on Income

Article 11 of the India-UK DTAA restricts the tax on "dividends" to 10%. This restriction is based on the nature of the income (dividend), not the person who has discharged the tax.

Supremacy of DTAA (Section 90(2))

Since the DTAA provides for a lower rate (10%) which is more beneficial than the rate under Section 115-O (approx. 20.56%), the beneficial DTAA rate must prevail, as mandated by Section 90(2) of the Income Tax Act.

DDT is 'Tax' under the Act

DDT is an 'Additional tax' and falls under the definition of 'Tax' in Section 2(43), and its levy is traceable to the overall charging provisions of the Act (Section 4), which are subject to Section 90.

Unilateral Changes vs. Treaty

Allowing India to charge a rate higher than the treaty rate would defeat the objective of the DTAA (an "economic bargain") and violate international tax principles. Unilateral amendments to domestic law, like the introduction of a higher DDT rate, cannot alter or override the beneficial provisions agreed upon in the bilateral tax treaty.

DTAA Purpose & Foreign Tax Credit (Article 24)

If DDT is treated as a tax on the company, the non-resident shareholder is effectively denied the Foreign Tax Credit (FTC) in their home country (e.g., the UK) under the DTAA's Article 24 (Method for Elimination of Double Taxation). Interpreting DDT as a shareholder tax is necessary to give effect to the treaty's core objective: the prevention of double taxation.

Reliance on Precedent

The taxpayer relied on ruling of Delhi ITAT delivered in favour of taxpayer in case of Giesecke & Devrient (India) (P.) Ltd.[2]

Revenue's Arguments

Tax on Company's Distributed Profits

DDT is levied on the company's distributed profits, and not on the shareholder's income. Therefore, the non-resident shareholder is not the person being taxed, rendering the DTAA (Article 11) inapplicable. If the domestic company has to enter the domain of DTAA, the countries should have agreed specifically in the DTAA to that effect.

Dividend Exempt in Shareholder's Hands

Since the dividend income was exempt for the shareholder under Section 10(34), the DTAA rate application is redundant, as there is no taxable income in the shareholder's hands to be subject to a concessional rate.

DDT Not a 'Covered Tax' (India-Hungary Reference)

DDT is an additional domestic levy and is not specifically enumerated as a "tax covered" under the DTAA. Unlike the treaties like the India-Hungary DTAA, India – UK DTAA does not specifically include DDT in its scope, thus allowing the domestic rate to apply.

Reliance on Precedent

The Revenue relied heavily on the ITAT Mumbai Special Bench ruling in Total Oil (Supra) to assert that the DTAA benefits cannot be extended to DDT.

Reliance on Article 1

The Revenue argued that a tax treaty protects taxation of income in the hands of residents of the treaty partner jurisdictions in the other treaty partner jurisdiction. However, in the present case, the Taxpayer being resident of India cannot seek relief under India – UK DTAA as per Article 1 of DTAA.

Findings of the Hon'ble High Court

The Hon'ble HC after detailed analysis of the definitions of income, tax and dividend provided u/s 2(24), 2(43) and 2(22) of the ITA respectively and legislative history of amendments made over period of time in section 115-O of the ITA, agreed with the observations of Delhi ITAT in Giesecke case (supra) and delivered its judgment in favor of the taxpayer addressing various crucial issues as covered below:

True Nature of DDT (Substance over Form)

The Court ruled that from a combined reading of Section 115-O and 10(34), along with the legislative history of the amendment in section 115-O, it is evident that the shifting of DDT incidence to the company (the "alchemy of Section 115-O") was purely for administrative convenience and did not change the substantive nature of the levy. DDT is fundamentally a tax on dividend income of the shareholder; this is supported by the fact that DDT is payable even if the company has a loss and company cannot claim credit of the DDT paid against its tax payable (if any).

Income tax includes DDT thus covered in both Act and DTAA

DDT is an "additional tax" covered under the definition of 'Tax' in Section 2(43) and is covered by the Charging Section 4. Since DDT is an 'Income Tax' as per the provisions of the Act, it definitely falls within ambit of Article 2 of DTAA as income tax includes surcharge and dividend and Article 2 (2) clearly apply to any identical or substantially similar tax in addition to or in place of tax.

DDT is a charge on shareholder's income

Section 4 of the Act levies income-tax, including additional income tax, in respect of the 'total income' of every person. Thus, it is the earning of the 'income' that attracts the charge. 'Income' has been defined under Section 2(24) of the Act to include 'dividend'. The declaration, distribution or payment of dividend by company cannot in any manner be regarded as 'income ' of the company distributing the dividend. Payment of DDT by company in fact reduces the cash flow in hands of shareholders which proves that DDT is a charge on shareholder's income.

Four Elements Triggering Article 11

The application of Article 11 (India-UK DTAA) is triggered by four elements, all of which were found to be satisfied:

- The payment must be a dividend as defined in Article 11(3).
- The dividend must be paid by a resident of one state (India).
- The dividend must be paid to a resident of the other state (UK).
- The tax rate cannot exceed 10 per cent if the dividend is beneficially owned by the resident of the other state.

Irrelevance of Tax Incidence

The Court emphasized that for Article 11, the person on whom the tax is levied (the company) is an "irrelevant and extraneous consideration." The Article focuses on the nature of income (dividend) and the person who is beneficial owner of the Dividend which is UK resident in the present case.

Supremacy of DTAA

Section 4 of the Act is subject to provisions of the Act, thus making it subservient to Section 90 which requires beneficial treatment to prevail. Therefore, the DTAA must override the domestic law (Section 115-O) when the treaty provisions are more beneficial (Section 90(2)) as has also been asserted by Apex court in case of Azadi Bachao Andolan and Engineering Analysis.

Treaty Interpretation Principles

The Court held that treaties must be interpreted liberally, in good faith, and according to the Vienna Convention on Law of Treaties (VCLT) Article 31 (Azadi Bachao Andolan[3] and Engineering Analysis[4]). Treaties are an "economic bargain" between nations, and unilateral amendments to domestic law cannot alter or defeat the treaty's purpose.

Constitutional Violation

Collecting and retaining DDT in excess of the 10% limit stipulated by the DTAA is "erroneous and contrary to law," violating Article 265 of the Constitution (no tax shall be levied or collected except by authority of law).

Rejection of Precedent and Constitutional Validity

The ITAT Mumbai Special Bench in Total Oil erred by ignoring the Supreme Court's clear position in Tata Tea[5], which held that DDT is a tax on dividend income. Once the Hon'ble Supreme Court has held that dividend connotes ' income ', the natural corollary is that as per section 4, the said income should be chargeable to tax in hands of person earning such income. Interpreting DDT as a tax on the company's income would render Section 115-O unconstitutional as it would fall outside the scope of Entry 82 of the Constitution (tax on income). Further, Hon'ble Bombay High court held reliance of Special Bench in Total Oil (Supra) on ruling Godrej & Boyce[6] as erroneous on ground of distinguishment of facts of both the cases.

KCM Comments

It is noteworthy that Hon'ble ITAT, Mumbai Bench, while adjudicating the issue, primarily relied upon the decision in *Godrej & Boyce* (supra) and, in doing so, appears to have overlooked the binding decision of the Hon'ble Supreme Court in *Tata Tea* (supra). In contrast, the Hon'ble High Court, while deciding the matter, placed substantial reliance on the ratio laid down in Tata Tea, wherein it was unequivocally held that Dividend Distribution Tax constitutes a tax on dividend income. Furthermore, the Hon'ble High Court expressly distinguished the judgment in *Godrej & Boyce* (supra) on the premise that it pertained to the disallowance mechanism under section 14A of the Act and therefore had no direct relevance to the issue under consideration. Hence, the reliance placed by the Revenue on *Godrej & Boyce* was held to be misconceived and unsustainable.

This ruling is a paradigm shift in the jurisprudence of Dividend Distribution Tax. For years, the Total Oil Special Bench decision stood as a barrier for foreign investors seeking treaty benefits on DDT. The Bombay HC has now effectively dismantled that barrier, validating the view that the "economic substance" of the tax (being on the shareholder) supersedes the "legal form" of collection (from the company).

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Much like the Supreme Court's approach in recent PE rulings, this judgment applies a "substance over form" approach to the interpretation of DTAAs. It recognizes that merely shifting the compliance obligation to the payer (company) does not strip the income (dividend) of its treaty protection.

Although DDT was abolished by the Finance Act, 2020 (w.e.f. April 1, 2020), this ruling is of immense significance for open litigations and potential refund claims for financial years prior to 2020-21. Companies that paid DDT at ~20% while their foreign shareholders were eligible for lower treaty rates (5%, 10%, or 15%) may now have a fortified legal basis to claim refunds.

Case Law References & Citations

1. *ITAT Special Bench in Deputy Commissioner of Income Tax vs. Total Oil India (P) Ltd [2023] 149 taxmann.com 332 (Mumbai - Trib.) (SB)*
2. *Delhi Bench of ITAT in case of Giesecke & Devrient (India) (P.) Ltd. Vs. Additional Commissioner of Income Tax, Special Range-4, New Delhi [2020] 120 taxmann.com 338 (Delhi-Trib.)*
3. *Union of India vs. Azadi Bachao Andolan 2003[263 ITR 706 (SC)]*
4. *Engineering Analysis Centre of Excellence (P) Ltd. vs. CIT [2021 432 ITR 471]*
5. *Union of India vs. Tata Tea Company Limited [2017] 85 taxmann.com 346 (SC)*
6. *Godrej and Boyce Manufacturing Company Limited vs. DCIT [2017] 81 taxmann.com 111 (SC)*

For further analysis and discussion, you may please reach out to us.

Locations

Ahmedabad
Arpit Jain
Level 11, Tower B,
Ratnaakar Nine Square,
Vastrapur,
Ahmedabad - 380 015

Phone: + 91 79 4910 2200
arpit.jain@kcmehta.com

Bengaluru
Dhaval Trivedi
4/1, Rudra Chambers, First Floor, 4th Main, B/W 8th & 9th Cross Road, Malleshwaram,
Bengaluru - 560 003

Phone: +91 80 2356 1880
dhaval.trivedi@kcmehta.com

Mumbai
Bhadresh Vyas
315, The Summit Business Bay,
Nr. WEH Metro Station,
Gundavali, Andheri East,
Mumbai – 400 069

Phone: +91 22 2612 5834
bhadresh.vyas@kcmehta.com

Vadodara
Milin Mehta
Meghdhanush,
Race Course,
Vadodara - 390 007

Phone: +91 265 2440 400
milin.mehta@kcmehta.com

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