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TAX TRIBUNAL 'DOUBTS' THE APPLICATION OF TAX TREATY BENEFIT TO DIVIDEND DISTRIBUTION TAX

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The Mumbai Bench of the Income Tax Appellate Tribunal (Tribunal) in the case of Deputy CIT v. Total Oil India Private Limited (ITA No. 6997/Mum/2019) (Taxpayer) has expressed 'doubts' over the correctness of certain decisions rendered by co-ordinate benches of the Tribunal (see our earlier Ergo published on 21 October 2020) on the issue of tax treaty applicability to dividend distribution tax (DDT). In those decisions, it was held that in relation to dividends paid to non-resident shareholders, the rate of DDT payable by an Indian company should not exceed the tax rate specified for dividend income in the applicable tax treaty between India and the country of tax residence of the non-resident shareholder. Having expressed doubts over the correctness of those decisions, the Tribunal has requested the President of the Tribunal to constitute a 'Special Bench' (comprising three or more Tribunal members) to adjudicate on this issue.

BACKGROUND

Until 31 March 2020, dividend income was exempt *inter alia* in the hands of non-resident shareholders and the company paying the dividends was required to pay additional corporate tax in the form of DDT at an effective and flat rate of ~21%, without having any regard to the tax rate applicable to the shareholders. From 1 April 2020, the DDT regime has been abolished and dividends are taxable in the shareholders' hands. The policy objective of introduction of DDT in the year 1997 was to ensure administrative convenience by having a single point of tax collection.

Since DDT was payable by Indian companies and not the non-resident shareholders (for whom dividend income was exempt), the issue of applicability or relevance of beneficial rates under tax treaties was doubtful. When this issue came up for consideration before the Delhi bench of the Tribunal last year, it ruled in favour of the taxpayer and held that the DDT rate should be restricted by the rate specified for dividend income under the applicable tax treaty (our Ergo analysing the decision of the Delhi bench of the Tribunal can be accessed here). The ruling of the Delhi bench of the Tribunal was subsequently followed in a ruling given by the Kolkata bench of the Tribunal.

In the recent case, the year in question was 2015-16 and the Taxpayer had distributed dividends to its shareholders, some of whom were residents of France. The Taxpayer had filed an additional cross-objection during the ongoing appellate proceedings before the Tribunal, claiming that the rate of DDT should not exceed the rate specified in the India – France tax treaty.

TRIBUNAL ORDER

The Mumbai bench of the Tribunal admitted the cross-objection filed by the Taxpayer and thereafter, expressed doubt on the correctness of the aforesaid decisions given by co-ordinate benches of the Tribunal. It gave the following key reasons / perspectives on why it doubted the correctness of those earlier decisions –

- <u>DDT should be considered as a tax on the company and not shareholders, hence treaty protection for resident company not available in the absence of a specific provision</u>

  The Tribunal reasoned that DDT should be considered as a tax liability of the dividend-paying company and is discharged by such company. In this regard, the Tribunal placed reliance on the Supreme Court ruling in Godrej & Boyce Manufacturing Company Limited v. DCIT [(2017) 394 ITR 449 (SC)], where the Supreme Court had observed that DDT cannot be equated to a tax being paid on behalf of the recipient shareholder. The Tribunal further added that in a situation where tax is considered as being paid by an India-resident company in respect of its own liability in India, such taxation in India cannot be protected or influenced by a tax treaty provision (which is extended to non-residents) unless a specific provision exists in the tax treaty.

- <u>Where intended, tax treaty provisions specifically provide for treaty application to taxes like DDT</u>

  The Tribunal observed that wherever the contracting states to a tax treaty intended to extend the treaty protection to DDT, it has been specifically so provided in the tax treaty itself. The India-Hungry Tax Treaty was cited as an example, where the protocol to the tax treaty specifically states that tax on distributed profits of an Indian resident company paying dividends shall be deemed to be taxed in the hands of the shareholders, and that it shall not exceed 10% of the gross amount of dividend. The Tribunal held that in the absence of such a provision in other tax treaties, it cannot be inferred that DDT rate should be restricted by the applicable tax treaty provision.

- <u>No tax credit for shareholders</u>

  The Tribunal noted that tax treaties do not envisage any tax credits in the hands of the shareholders in respect of DDT paid by the company in which shares are held. The Tribunal reasoned that in such a case, DDT cannot be equated with a tax paid by or on behalf of a shareholder.

- <u>Foreign jurisprudence on taxes like DDT</u>

  In terms of foreign jurisprudence on taxes similar to DDT, the Tribunal cited the ruling of the South African High Court in Volkswagen of South Africa (Pty) Ltd v Commissioner of South African Revenue Service (Case no. 24201/2007). The South African High Court ruling involved a tax similar to the DDT known as secondary tax on companies (STC) paid on the distribution of dividends. In that case, it was held that STC is a tax on "a company declaring the dividends and not on dividends". The Tribunal observed that while the views expressed by a foreign judicial body are not binding on any judicial body in India, their views deserve to be examined in a fair and open-minded manner.

After setting out reasons for doubting the correctness of earlier decisions, the Mumbai bench of the Tribunal referred the issue for consideration of a Special Bench (consisting of three or more Tribunal members). The specific question raised for consideration of the Special Bench has been framed as follows:

> "*Whether the protection granted by the tax treaties under section 90 of the Income Tax Act 1961, in respect of taxation of dividend in the source*

> *jurisdiction, can be extended, even in the absence of a specific treaty provision to that effect, to the dividend distribution tax under section 115-O in the hands of a domestic company?"*

The above reference as well as constitution of the Special Bench is subject to approval and any modifications by the President of the Tribunal.

COMMENTS

A Special Bench of the Tribunal is generally constituted if contrary views are given by different benches of the Tribunal on the same issue. The ruling of a Special Bench is binding on all benches of the Tribunal on the issue adjudicated by the Special Bench.

In this recent ruling, while the Tribunal did not pass any definitive ruling contrary to the one from the earlier benches of the Tribunal, the Tribunal relied on the Supreme Court's ruling in Union of India v Paras Laminates Private Limited [(1990) 186 ITR 722 (SC)] to justify reference of the case to a Special Bench. In the aforesaid ruling, the Supreme Court had held that if a judicial body perceived the decision in an earlier case to be erroneous, it was reasonable and efficacious to refer the case to a larger bench.

Given the nature of the issue involved where several legal principles are relevant and some support the taxpayer while some support the revenue, a timely reference to a Special Bench (instead of pronouncing a contradicting ruling or waiting for the High Court / Supreme Court to settle the debate), is surely a constructive step. Unless the order of a Special Bench is overturned by the High Court / Supreme Court or the law is amended, it is a binding precedent.

Also, considering that there are differing views among the adjudicating authorities, taxpayers that have claimed / intend to claim a refund of DDT paid in the past (i.e., DDT in excess of the tax rate for dividend in the applicable tax treaty) may reevaluate their position going forward.

The next step to be watched closely is whether a Special Bench is constituted to adjudicate on the issue and if so, how the Special Bench rules thereon. Nonetheless, as indicated earlier, readers should note that the issue *per se* is relevant only for tax liability of the years prior to 2020-21.

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