India; France; Japan; Hungary

Indian Court Denies Treaty Benefit on Dividend Tax Paid by Indian Companies to Non-resident Shareholders, Absent Specific Provision Under Treaty

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On 20 April 2023, a special bench of the Mumbai Tribunal, in the case of *DCIT* v. *Total Oil India Pvt. Ltd.* (ITA NO.6997/MUM/2019), ruled that where dividend is declared, distributed or paid by a domestic company to a non-resident shareholder(s), which attracts dividend distribution tax (DDT) as per section 115-O of the Income tax Act, 1961 (Act), such DDT payable by the domestic company shall be at the rate mentioned in Section 115-O and not at the tax rate applicable to the non-resident shareholder(s) as per the relevant tax treaty (DTAA). Details of the decision are summarized below.

In a bunch of appeals considered together, the taxpayers paid/declared dividend to non-resident shareholders (being tax residents of France and Japan) for multiple tax years. However, considering that non-resident shareholders are entitled to the benefit of DTAA, the taxpayers paid DDT at the DTAA rate (as it was more beneficial than the rate under domestic law).

The tax authority argued that section 115-O is an independent section. Further, DDT is payable by the company declaring/distributing dividend and the said company was not eligible for benefits under DTAA.

The Mumbai Tribunal ruled in favour of the tax authority and held as follows:

- Section 115-O is a complete code in itself in so far as levy and collection of tax on distributed profits. The non-obstante clause in the section indicates that the charge under the said section is independent and divorced from the concept of "total income" under the Act.
- DDT paid under section 115-O is a charge to tax on the profits of the company and not a charge in the hands of the shareholder or tax paid on behalf of the shareholder by the domestic company.
- DDT is paid by the domestic company resident in India. It is a tax on its income and not tax paid on behalf of the shareholder. In such circumstances, the domestic company does not enter the domain of DTAA at all.
- If domestic company has to enter the domain of DTAA, the countries should have agreed specifically in the DTAA to that effect. In the DTAA between India and Hungary, the Contracting States have extended the treaty protection to DDT. It has been specifically provided in the protocol to the Indo Hungarian Tax Treaty that, 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% of the gross amount of dividend.
- Thus, wherever the Contracting States to a tax treaty intend to extend the treaty protection to the domestic company paying DDT, only then, the domestic company can claim benefit of the DTAA, if any.

Note: Currently, DDT under section 115-O has been abolished and dividends are taxed in the hands of shareholders at the rates applicable to them.

The full text of the decision pronounced by the Mumbai Income Tax Appellate Tribunal is available here (as a PDF).

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