
APPLICABILITY OF DTAA RATES TO DIVIDEND DISTRIBUTION TAX UNDER SECTION 115-O: A PRE-2020 ANALYSIS

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Introduction

Dividend as derived from its etymological origin ‘dividendum’ means the share of profits of a Company that a Corporate Entity chooses to give to its shareholders. The Finance Act, 2020 has transferred the burden of taxation as regards dividends from Company to the shareholders of the Company from 01.04.2020 onwards. However, prior to the said date, pursuant to Section 115-O of the Income-tax Act, 1961 (“**IT Act**” or “**the Act**”), the Companies were being taxed for dividend distribution, instead of the investors/shareholders. This Article delves into the aspects of whether the rate of tax under the standard stipulation of the Double Taxation Avoidance Agreements (“**DTAA**”) can be made applicable instead of the Dividend Distribution Tax (“**DDT**”) as mentioned above.

I. Treatment of Dividend in Domestic Law

(i) Outline

Section 2(22) of the IT Act gives an enumerative but not an exhaustive definition of what amounts to a ‘dividend’. The section construes the term dividend in a wide sense as elaborated by the apex court in a catena of judgments². Therefore, for the list of things as laid out in Section 2(22) of the IT Act, there is a liability to deduct tax at source and attract an additional tax liability under section 115-O of the Act. The Dividend Distribution Tax has to be paid in addition to the total income tax liability of the company. It is a tax on dividend (interim or otherwise) declared, distributed or paid by the company out of either current or accumulated profits³. The

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²Hari Prasad Jayantilal & Co. Ltd. v. V.S. Gupta, ITO (1966) 59 itr 794 (SC); CIT v. Dalmia Investment Co. Ltd. (1964) 52 ITR 567

³Section 115-O (3) of the Income Tax Act 1961

aforesaid tax at the rate of 15% excluding surcharge and cess must be paid by the company within 14 days of incidence of tax⁴. However, it is pertinent to mention that Section 10(34) of the Act, provides for exclusion of dividend income at the behest of investor thereby the tax liability lies at the hand of the Company under Section 115-O of the Act.

(ii) Non-Obstante Clause

Furthermore, the provision *i.e.* Section 115-O (1) commences with the following phrase-

“Notwithstanding anything contained in any other provision of this Act and subject to the provisions of this section”

which compels the sub issue relevant for the object of this Article, i.e. whether the scope of that non obstante clause will have an overriding effect on Section 90(2) of the IT Act as well. In one of the cases, ITAT Bangalore⁵ has answered the issue in negation by taking a view that when inconsistent, the Double Taxation Avoidance Agreement will have a primacy over the Income Tax Act despite the presence of a non-obstante clause.

II. Legislative Intent of Dividend Distribution Tax

Recently ITAT Delhi in a similar case⁶ pertaining to the primacy of applicability of rate of tax of Dividends in IT Act vis-à-vis DTAA, assessed the scope of taxation of dividend while analyzing whether the incidence of tax should lie with shareholder or the company. It held that the Finance Act, 1997 which brought in the provision of Section 115-O of the IT Act legislated with the intent of administrative convenience for the Revenue rather than legal necessity. The object was to levy tax at a single entity for the incidence of dividend distribution rather than on multiple entities i.e. the shareholders of the company for the receipt of Dividend income. The ITAT order further assessed the aspects of source and residence-based taxation to further state that the charging sections in Income-tax Act, 1961 i.e. Section 4 and 5 are subject to the considerations of Section 90 which is an enabling provision for DTAA's and also deal with tax computation favouring the assessee. The ITAT order went on to uphold the applicability of rate of tax pursuant to DTAA on the ground that since the assessee was relying upon the India-Germany treaty which predates the legislation itself therefore the taxation of dividend

⁴Ibid r/w sub- section (1) of Section 115-O of the Income Tax Act 1961

⁵ DCIT v. Bharath Fritz Werner Ltd., IT(IT)A No. 1360/Bang/2019

⁶ Giesecke & Devrient [India] Pvt Ltd. v. The Addl. C.I.T, ITA No. 7075/DEL/2017

distribution should be as per the DTAA.

III. Overriding Effect of DTAA

(i) Legislative Mandate

(a) Section 90(2) IT Act:

Sub-Section (1) of the said section is an enabling provision for the Central Government, which provides it with the statutory permit to enter into bilateral agreements/ treaties with the foreign countries with the object of avoiding double taxation over the same incidence. However, the operative phrase used in the sub section (2) of the same provision is that the Act shall apply to the extent that they are more 'beneficial to that assessee'. Therefore, in case the rate of taxation on dividend distribution is lesser in comparison to the one that is levied under the IT Act then in that case pursuant to Section 90(2), the treaty may prevail over the statutory provisions.

(b) Double Taxation avoidance:

Every country taxes entities in their territories on the basis of various parameters, such as source, residence, presence of a permanent establishment, place of effective management etc. However, the very intent of Chapter IX of the IT Act is to avoid taxation of an entity, twice, based upon the same incidence of taxation. The law is settled that the time of accrual of DDT shall be at the date of remittance of such dividend⁷, however, if the laws of the foreign country are also aligned in a manner to make this remittance or distribution a taxable event then the Corporate Entity shall become liable to taxation on the same aspect or incidence in two different jurisdictions. Therefore, statutory force is given to the standard stipulations laid out in the DTAA upon consensus of both the countries to evade the foreseeable impediment. In accordance with the above, primacy has been given to the applicability of the provisions of Double Taxation Avoidance Agreement over the IT Act in the interest of equity.

(c) Central Board of Direct Taxes Circular⁸:

A circular titled "*Conflict between the provisions of the Income-Tax Act, 1961 and the*

⁷Pfizer Corporation v. CIT (2003) 259 ITR 391

⁸ Circular : No. 333 [F. No. 506/42/81-FTD] dated 2-4-1982

provisions of the Double Taxation Avoidance Agreement – Clarification” was issued by the Central Board of Direct Taxes on 2nd April 1982. The circular clearly elicits the legislative intent of the department, that in the case of any inconsistency between the specific provisions of DTAA and the general provisions of the IT Act, the DTAA shall have the overriding effect. Article 10 pursuant to the OECD or the UN Model, both specifically stipulate for the computation of tax as regards Dividend, which when read with Section 90 of the IT Act, as has been mentioned in the second paragraph of the Circular itself, supports applicability of DTAA over Section 115-O. Therefore, the provision makes it essential for the assessee to be given the benefit of the agreement as the Circular is binding on all Income Tax Authorities and has also been upheld by the Courts⁹.

(ii) Judicial Consensus: DTAA v. IT Act

The Hon’ble Apex Court in catena of judgments¹⁰ has upheld and reiterated this settled position of law, that the provisions of DTAA, for the benefit of the assessee prevails over the provisions of the Income Tax Act. The Supreme Court has held that irrespective of whether the treaty treats the fiscal domicile in one state or the other, the DTAA will prevail over provisions of Income Tax Act on account of being a part of the Taxation Policy of the Central Government pursuant to Section 90¹¹. High Courts have also widely held that the provisions of the DTAA will be applicable instead of the IT Act. The Andhra Pradesh High Court held that Section 4 and 5 of the IT Act have been made ‘*subject to the provisions of the Act*’ which will most certainly include Section 90 which by necessary implication would mean that the basis of charge of income tax is also dependent upon the provision of the DTAA¹². In another case¹³, the High Court held that the DTAA provisions effectuated are non-derogable and the amendments to the IT Act unless with a non obstante clause will not override the DTAA. In addition, the Karnataka High Court held¹⁴ that in a DTAA if there is a recognition that the power of taxation lies with the other country then the Central Government loses its right under Section 4 and 5 of the Act to levy tax. In furtherance, the Delhi High Court has time and again curtailed the scope of the tax liability of the assessee under the Income Tax Act if the computation of tax under the DTAA

⁹ CIT v. Davy Ashmore India Ltd. [1991] 190 ITR 626 (Cal)

¹⁰ Union of India (UOI) and Ors. vs. Azadi Bachao Andolan and Ors., (2004) 10 SCC 1; Commissioner

¹¹ Ibid

¹² CIT v. Visakhapatnam Port Trust, [1983]144ITR146(AP)

¹³ Sanofi Pasteur Holding SA Vs Department of Revenue [2013] 354 ITR 316 (AP)

¹⁴ CIT v. R.M. Muthaiah, [1993] 202 ITR 508 (KAR)

was benefitting the assessee¹⁵. ITAT Bangalore held in a relatively recent case that the tax deduction at the rate of 20% under section 206 AA will not be applicable if the benefit of DTAA is available to the assessee¹⁶.

IV. Conclusion

In accordance with the essence and intent of Section 90(2) of the Income Tax Act as substantiated with the help of the judgments mentioned above, it is evident that the DTAA provisions instead of the IT Act provisions, can be made applicable for the purpose of computing tax liability in the present case. Furthermore, the ITAT Delhi bench's judgment which not only affirms the above view but also outlines the intent and reasons for the legislation and the amendment of the Dividend Distribution Tax, vindicates the issue with a view which is more 'beneficial to assessee'.

¹⁵ DIT Vs New Skies Satellite BE [2016] 382 ITR 114 (Del); Danisco India P. Ltd Vs Union of India [2018] 404 ITR 539 (Del)

¹⁶ Dy.CIT (IT) Vs Infosys BPO Ltd. IT (IT) A No. 4/Bang/2014