

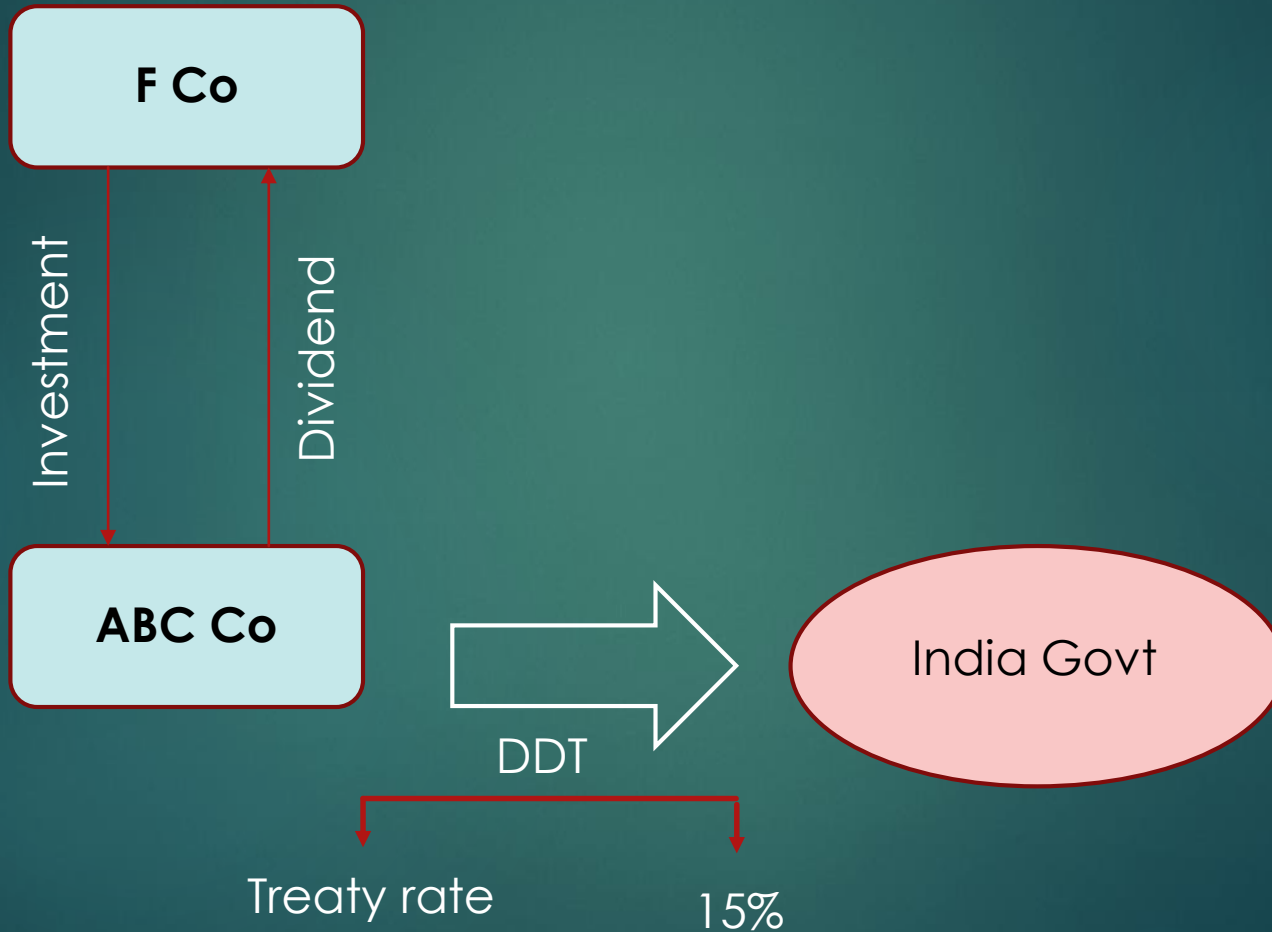
Case Studies on Corporate taxation

CHAMBER OF TAX CONSULTANTS

22.08.2019

DDT under tax treaties

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DDT under tax treaties

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DDT is a tax on company

- ▶ Literal reading of section 115-O – subsections (1) and (2)
- ▶ Sub-section (4) and (5) bars any credit or deduction
- ▶ Consequences of non-payment of DDT
- ▶ Finance Minister speech in 1997
- ▶ Co-existence of section 115O and 115BBDA
- ▶ Judicial precedents

DDT is a tax on company

Literal reading of section 115-O

- ▶ *(1) Notwithstanding anything contained in any other provision of this Act and subject to the provisions of this section, in addition to the income-tax chargeable in respect of the total income of a domestic company for any assessment year, any amount declared, distributed or paid by such company by way of dividends (whether interim or otherwise) on or after the 1st day of April, 2003, whether out of current or accumulated profits shall be charged to additional income-tax (hereafter referred to as tax on distributed profits) at the rate of fifteen per cent:*

DDT is a tax on company

Literal reading of section 115-O

- ▶ *(2) Notwithstanding that no income-tax is payable by a domestic company on its total income computed in accordance with the provisions of this Act, the tax on distributed profits under sub-section (1) shall be payable by such company.*

DDT is a tax on company

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Bar on any credit

- ▶ (4) The tax on distributed profits so paid by the company shall be treated as the final payment of tax in respect of the amount declared, distributed or paid as dividends and no further credit therefor shall be claimed by the company or **by any other person** in respect of the amount of tax so paid.
- ▶ (5) No deduction under any other provision of this Act shall be allowed to the company **or a shareholder** in respect of the amount which has been charged to tax under sub-section (1) or the tax thereon.

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Consequence of non-compliance with DDT

- ▶ Interest at 1% every month (or part of a month) on DDT from the due date to actual date of payment – 115P
- ▶ Principal officer or company shall be deemed to be assessee in default – 115Q
- ▶ Penalty equal to the amount of tax – 271C
- ▶ Imprisonment for a term of 3 months to 7 years – 276B

DDT is a tax on company

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Finance Minister speech in 1997 Budget (Para 100 and 101)

- ▶ *Another area of vigorous debate over many years relates to the issue of tax on dividends. I wish to end this debate. Hence, I propose to abolish tax on dividends in the hands of the shareholder.*
- ▶ *Some companies distribute exorbitant dividends. Ideally, they should retain the bulk of their profits and plough them into fresh investments. I intend to reward companies who invest in future growth. Hence, I propose to levy a tax on distributed profits at the moderate rate of 10 per cent on the amount so distributed. This tax shall be an incidence on the company and shall not be passed on to the shareholder.*

DDT is a tax on company

Co-existence of section 115-O and 115BBDA

- ▶ Tax on distributed profits of domestic companies – 115-O
- ▶ Tax on certain dividends received from domestic companies – 115BBDA
- ▶ *Liability to tax is shifting based on the quantum of dividends distributed to a specified assessee.*

DDT is a tax on company

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Judicial precedents

- ▶ *So far as the species of dividend income on which tax is payable under section 115-O of the Act is concerned, the earning of the said dividend is tax free in the hands of the assessee and not includible in the total income of the said assessee*
- ▶ *if the argument is that tax paid by the dividend paying company under section 115-O is to be understood to be on behalf of the recipient assessee, the provisions of section 57 should enable the assessee to claim deduction of expenditure incurred to earn the income on which such tax is paid. Such a position in law would be wholly incongruous in view of section 10(33) of the Act.*

Godrej & Boyce Manufacturing Co Ltd v DCIT [2017] 394 ITR 449 (SC)

History of dividend taxation

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- ▶ There was double taxation both at the company and shareholder level. So an attempt was made to neutralize double taxation.
- ▶ Income tax was deemed to be paid on behalf of the shareholder and a credit was allowed to the shareholder for the taxes paid at the company level.
- ▶ This was referred to as 'grossing up' of dividends. This was in vogue since 1916.
- ▶ There was gap in tax on distributed and undistributed profits. There were administrative hurdles.
- ▶ There was debate around whether the company is a separate legal entity or an agent of the shareholder?
- ▶ Grossing up was abolished in the year 1959-60.

History of dividend taxation

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- ▶ **Penal tax** on dividends paid in excess of net profits was introduced around 1948. The objective was to restrict dividend payment.
- ▶ It was an additional levy of income tax
- ▶ $\text{Excess} = \text{equity dividends} + \text{preference dividends} (-) \text{current profits} (-) \text{deductions/ exemptions} (-) \text{income tax and super tax paid by the company}$
- ▶ Penal tax was abolished in 1956.
- ▶ **Excess dividend tax** was introduced. It was inserted to encourage corporate savings and make private sector companies self sufficient in financing their investment.
- ▶ The statutory limit for dividend was revamped by making the base paid-up capital employed [and not profits].

History of dividend taxation

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- ▶ The base was held to be erroneous. Cash rich companies with minimal paid-up capital were restrained from declaring dividends.
- ▶ It was found to be discriminatory as every industry has its own capital requirement.
- ▶ Excess dividend tax was abolished in 1960.
- ▶ The desire to discourage dissipation of resources to pay high dividends was still lingering. **In 1964-65, Dividend tax was introduced.** The objective was however doubted. The retention may not automatically result in investment.
- ▶ Dividend tax was abolished in 1968.
- ▶ Parallely Bonus shares tax was also collected.

- ▶ **104.** (1) *Subject to the provisions of sub-section (2) and of sections 105, 106 and 107, where the Income-tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividends by any company within the twelve months immediately following the expiry of that previous year are less than the statutory percentage of the distributable income of the company of that previous year, the Income-tax Officer shall make an order in writing that the company shall, apart from the sum determined as payable by it on the basis of the assessment under section 143 or section 144, be liable to pay super-tax at the rate of—*

History of dividend taxation

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- ▶ Qua dividend recipient – they were subject to tax on income

Corporate recipients

- ▶ Inter-corporate dividends initially received no relief
- ▶ Minimal rebate to new undertakings engaged in certain industries were given
- ▶ Dividends from subsidiary were taxed at lower rates

Individuals

- ▶ TDS on dividend income
- ▶ Sentiments prevailing then: those who earn by sweat and toil should be taxed at lower rate as compared to those earning through property or investment.

History of dividend taxation

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- ▶ **Upto 1997-98** dividends were taxable in the hands of shareholders and TDS was deducted on such payments
- ▶ **Finance Act 1997** – wef AY 1998-99 section 10(33) was inserted – dividends were exempt in the hands of shareholders
- ▶ **Finance Act 2002** – wef AY 2003-04 section 10(33) was omitted
- ▶ **Finance Act 2003** – wef AY 2004-05 section 10(34) was inserted

DDT is a tax on shareholder

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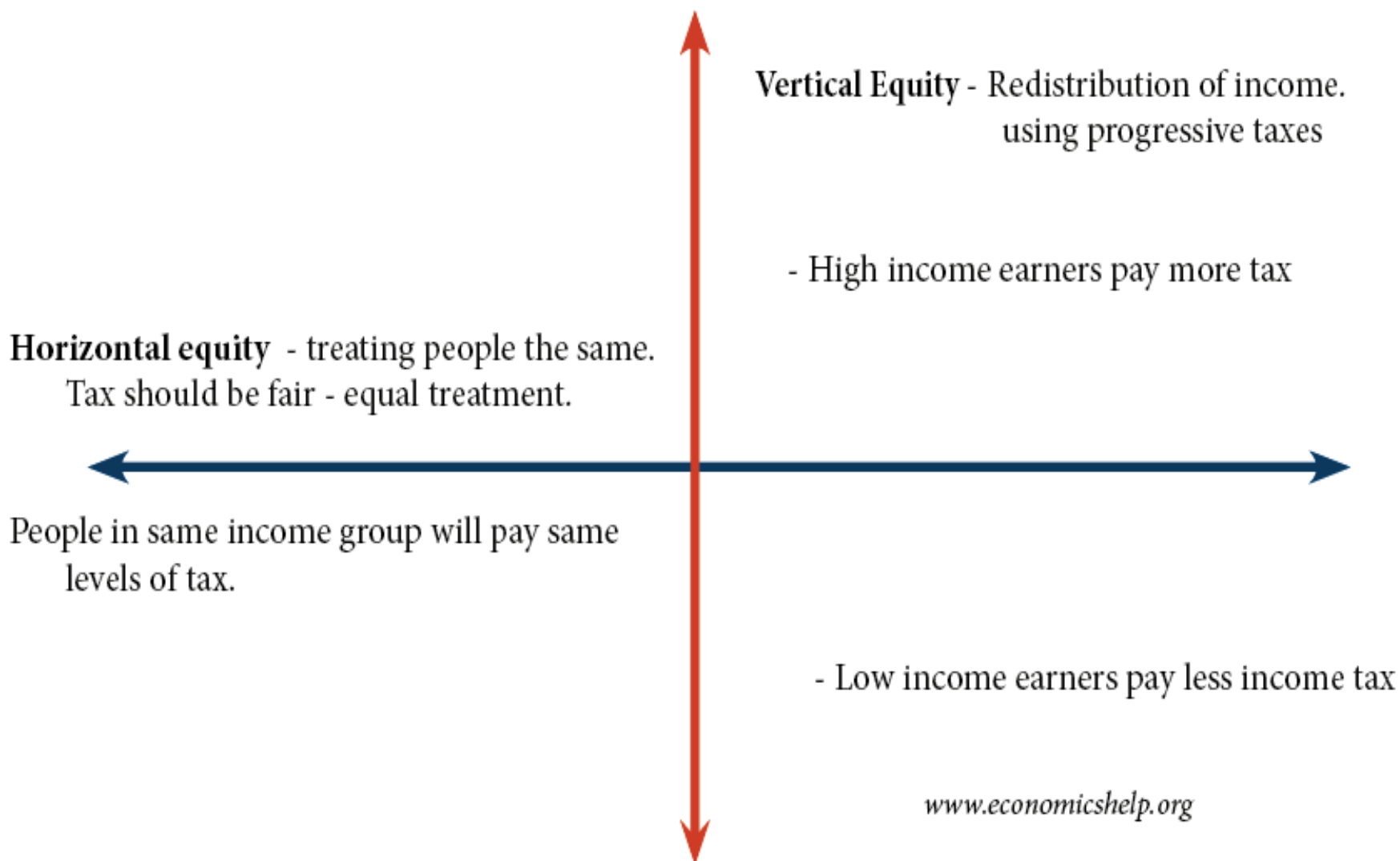
- ▶ DDT has no linkage to income of the company
- ▶ Section 10(34) – any income by way of dividends
- ▶ Section 115BBDA rationale of introduction – to bring equity in taxation; it held that the shareholders with high income would be subject to only 15%.
- ▶ Judicial precedents
- ▶ Evolution of DDT

DDT is a tax on shareholder

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Introduction of section 115BBDA

- ▶ *Under the existing provisions of clause (34) of section 10 of the Act, dividend which suffer dividend distribution tax (DDT) under section 115-O is exempt in the hands of the shareholder. Under section 115-O dividends are taxed only at the rate of fifteen percent at the time of distribution in the hands of company declaring dividends. This creates vertical inequity amongst the tax payers as those who have high dividend income are subjected to tax only at the rate of 15% whereas such income in their hands would have been chargeable to tax at the rate of 30%.*



DDT is a tax on shareholder

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Ruling on SGS India (P.) Ltd.

- ▶ Though, reading of Article-10 of India Switzerland DTAA prima-facie gives an impression that it will only apply to non-resident shareholder receiving the dividend, however, still it leaves a scope for examining the claim of the assessee that DDT being a tax on dividend, Article-10 of the DTAA would be applicable even if such dividend is payable by the domestic company. In our view, it will be too simplistic to reject the contention of the assessee on the plea that it will only apply where the non-resident recipient of dividend incurs the liability in respect of dividend.

SGS India (P.) Ltd. v ACIT [2017] 165 ITD 583 (Mumbai - Trib.)

DDT is a tax on shareholder

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Ruling on SSKI Investors

- ▶ *The above legislative changes show that exemption given to the dividend has direct nexus with the tax levied on the companies on distributed profits. It is well-settled legal proposition of taxation that no income should be tax doubly though the recipient is changed. Another important aspect of the legislative changes is that the tax levied on the companies on their distributed profit is in addition to normal tax under the Income-tax Act, which is directly linked with the declaration or distribution of dividend.*

SSKI Investor Services (P.) Ltd v DCIT [2009] 34 SOT 412 (Mumbai)

DDT is a tax on shareholder

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Supreme Court in Tata Tea

- ▶ Entry 82 (List I) of the constitution deals with tax on income
- ▶ Income as defined in section 2(24) includes dividend
- ▶ Section 115-O pertains to additional tax on dividend and is thus covered by Entry 82
- ▶ Dividend distributed by a company, being a share of profits, is not impressed with the character of the profits from which it reaches the hands of the shareholder.

UOI v Tata Tea Co Limited [2017] 398 ITR 260 (SC)

DDT is a tax on shareholder

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Introduction of DDT

- ▶ Tax on 'distributed profits' – is it a shift in the responsibility to pay tax rather than burden of tax?
- ▶ The phrase 'additional income-tax' is only an additional compliance rather than burden? Income in the phrase income-tax would refer to shareholder's income?
- ▶ The point of taxation in **section 115-O concurs with section 8** [declaration, distribution or payment].

DDT is a tax on shareholder

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Circular no. 763 dated 18.2.1998

- ▶ **16.1** According to the existing provisions of the Income-tax Act, ...
- ▶ **16.2** The existing method involves a lot of paperwork. There have also been demands that tax on dividends should be abolished as it tantamounts to double taxation, once in the hands of the company and again in the hands of the shareholders.
- ▶ **16.3** The Act, therefore, introduces a new system of collecting tax on profits distributed by companies by way of dividends. A new Chapter XII-D has been inserted in the Income-tax Act which brings to charge the profits distributed by domestic companies at a modest rate of 10%. The new tax will be in addition to the income-tax chargeable in respect of the total income of the company...

DDT is a tax on shareholder

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Memorandum to Finance Bill, 2003

- ▶ *“It has been argued that it is easier to collect tax at a single point, ie from the company rather than compel the company to compute the tax deductible in the hands of the shareholders.*
- ▶ It is therefore, proposed to substitute subsection (1) of section 115O...”

DDT is a tax on shareholder

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Finance Minister Speech while withdrawing DDT in 2002

- ▶ **181.** *Under the present system of taxation of dividends and income from units, the company or the mutual fund pays a 10% tax, and the income is exempt in the hands of the recipient. Such a system not only taxes income in the hands of a person to whom it does not belong; it also militates against the pass-through status which is the very essence of a mutual fund. There is also an inherent inequity in the present system, which allows persons in the high-income groups to be taxed at much lower rates than the rates applicable to them. These issues have been troubling me over the past four years, and I am now convinced that the existing system must go. I, therefore, propose to abolish the distribution tax of 10% on companies and mutual funds on the dividends or income distributed by them.*

DDT under tax treaties

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DDT is eligible for a claim under DTAA

- ▶ Is DDT a 'tax' covered under the DTAA?
- ▶ Is Article 10 applicable?
- ▶ Is Article 10 applicable only to withholding tax?
- ▶ Support from Circular no. 9 of 2007
- ▶ How different it is from underlying tax credit?

Philip Baker

- ▶ *(on paragraph 1) ... It is immaterial on behalf of which authorities such taxes are imposed; it may be the State itself or its political subdivisions or local authorities...The method of levying the taxes is equally immaterial; by direct assessment or by deduction at the source, in the form of surtaxes or surcharges, or as additional taxes etc.*

India-USA

- ▶ 1.....In India: the income-tax including any surcharge thereon, but excluding income-tax on undistributed income of companies, imposed under the Income-tax Act and the surtax;
- ▶ 2. The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes

India-Argentine

- ▶ 1. *The taxes which are the subject of this Agreement are in India, taxes of every kind and description imposed by the Central Government or the Governments of political subdivisions or local authorities, irrespective of the manner in which they are levied..*
- ▶ 2. *This Agreement shall also apply to any identical or substantially similar taxes imposed after the date of signature of this Agreement in addition to, or in place of, the existing taxes.*

India-Austria

- ▶ 2. *There shall be regarded as taxes on income all taxes imposed on total income, or on elements of income, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.*

India-Sweden

- ▶ 1. The existing taxes to which the Convention shall apply are:
 - (a) in India:
 - ▶ (i) the income-tax and any surcharge thereon; (ii) the surtax; and (iii) the wealth-tax;
 - (b) In Sweden:
 - ▶ (i) the State income-tax, including the sailors' tax and the coupon tax;
 - ▶ (ii) the tax on the undistributed profits of companies and the tax on distribution in connection with reduction of share capital or the winding up of a company;
 - ▶ (iii) the tax on public entertainers; (iv) the communal income tax; (v) the profit sharing tax; and (vi) the State capital tax;

China-Cambodia

- ▶ 1. The existing taxes to which the Agreement shall apply are in particular:

in Cambodia:

- (i) Tax on Profit including Withholding Tax, Minimum Tax, Additional Profit Tax on Dividend Distribution and Capital Gains Tax;
- (ii) Tax on Salary;

Nothing in this Agreement shall prevent the application of the Minimum Tax.

India-Hungary/ Austria

- ▶ *1. Dividends paid by a company which is resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.*
- ▶ *2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends the tax so charged shall not exceed 10 per cent of the gross amount of the dividends. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.*

Dividend income

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India-Hungary/ Austria



India-Hungary (Protocol)

- ▶ *With reference to Article 10 : 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 per cent of the gross amount of dividend.*

India-Cyprus (Protocol)

- ▶ *It is clarified that at present, dividends distributed by an Indian Company is exempt from tax by virtue of section 10(34) of the Income-tax Act, 1961. Accordingly, even though the treaty provides for withholding tax rate of 10%, so long as the present system of taxation of dividends in India continues, there will be no withholding tax from dividends paid by an Indian company to its shareholders.*

India-Austria (Hungary has similar language)

- ▶ *In the case of Austria, double taxation shall be eliminated as follows:*
- ▶ *Where a resident of Austria derives items of income which, in accordance with the provisions of paragraph 2 of Articles 10, 11, 12, paragraphs 4 and 5 of Article 13 and paragraph 3 of Article 22 may be taxed in India, Austria shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in India. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from India.*

- ▶ *Where a resident of Singapore derives income from Cambodia which, in accordance with the provisions of this Agreement, may be taxed in Cambodia, Singapore shall, subject to its laws regarding the allowance as a credit against Singapore tax of tax payable in any country other than Singapore, allow the Cambodian tax paid, whether directly or by deduction, as a credit against the Singapore tax payable on the income of that resident. Where such income is a dividend paid by a company which is a resident of Cambodia to a resident of Singapore which is a company owning directly or indirectly not less than 10 per cent of the share capital of the first-mentioned company, the credit shall take into account the Cambodian tax paid by that company on the portion of its profits out of which the dividend is paid.*

- ▶ Netherlands and Swiss treaty contain MFN clauses
- ▶ However they have to be pressed into action with utmost caution
 - ▶ *2. If after the signature of this convention under any Convention or Agreement between India and a third State which is a member of the OECD India should limit its taxation at source on dividends, interests, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, then as from the date on which the relevant Indian Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention [Netherlands protocol]*

Elimination of double taxation – India-France

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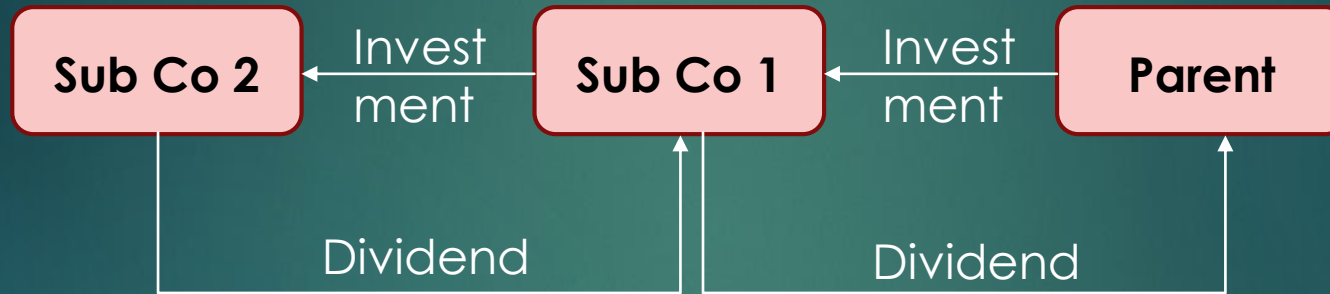
- ▶ 7. *In respect of articles 11 (Dividends), 12 (Interest) and 13 (Royalties, fees for technical services and payments for the use of equipment), if under any Convention, Agreement or Protocol signed after 1-9-1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate of scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items income shall also apply under this Convention, with effect from the date on which the present Convention or the relevant Indian Convention, Agreement or Protocol enters into force, whichever enters into force later*

Practical issues qua company

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- ▶ DDT disclosure in ITR
- ▶ DDT disclosure in Form 3CD
- ▶ Possibility of uploading at a lower rate in ITR
- ▶ Is refund possible?
- ▶ AAR or MAP may be a solution

Permissible set-offs



DDT



DDT



115BBD

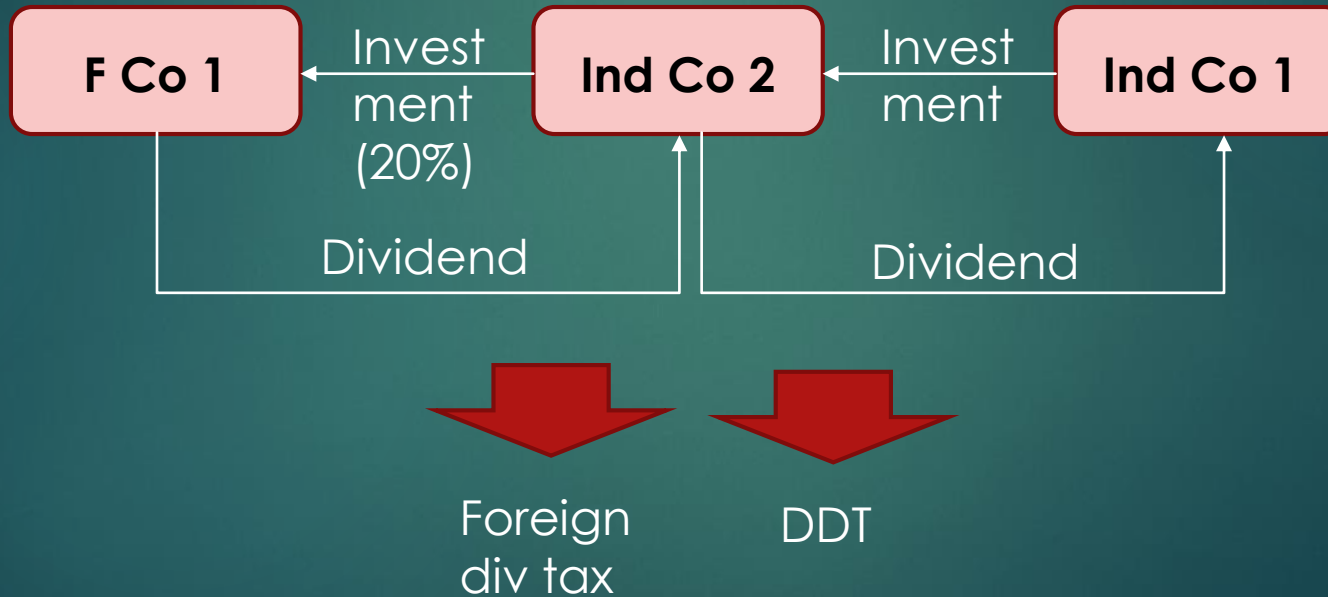


DDT

Other aspects

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DDT	Domestic Co [Ind Co & Other Co with arrangement]
115BBD	Ind Co receiving from F Co in which 26% or more holding is required



No credit

Possible variations

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Receipt of foreign div by Ind Co

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- ▶ Section 115BBD of the Act provides for taxation of dividends received by an Indian company from a foreign company (in which it has shareholding of 26% or more).
- ▶ Can credit of section 115BBD tax be availed?
- ▶ Section 115-O(1A)(i) be triggered?

Receipt of foreign div by Ind Co

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- ▶ “(1A) The amount referred to in sub-section (1) shall be reduced by -
 - (i) the amount of dividend, if any, **received** by the domestic company during the financial year, if such dividend is received from its subsidiary and, -
 - (a) where such subsidiary is a domestic company, the subsidiary has paid the tax which is payable under this section on such dividend;
 - (b) where such subsidiary is a foreign company, the tax **is payable** by the domestic company under section 115BBD on such dividend;

- ▶ What if tax is paid under MAT?

Receipt of foreign div by Ind Co

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- ▶ Role of section 115JB?
 - ▶ To ensure minimum rate of taxation
 - ▶ To ensure companies pay minimum tax
- ▶ Objective of section 115-O to remove cascading effect
- ▶ Clause (b) of section 115-O(1A) - 'tax payable' under 115BBD **vis-à-vis clause** (a) which requires 'tax paid' u/s 115-O)
- ▶ Circular 13 dated 9.11.2011
- ▶ DCIT v Subex Technology Limited (2015) 63 taxmann.com 124
- ▶ CIT v Metal & Chromium Plater (P) Ltd (2016) 76 taxmann.com

Receipt of foreign div by Ind Co

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Pain points

- ▶ Literal reading
- ▶ Rate difference (15% v 18.5%) can be a guiding factor
- ▶ Being a part of comparison for section 115JB indicates that they are separate.

BEPS Action Plan 2 - Neutralizing hybrid mismatch arrangement

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- ▶ Illustration 1.11 therein gives out an interesting message
- ▶ Overall ensure that profits of the company whether distributed or undistributed – cumulatively suffer entirely the corporate taxes levied in the state where company is located.

How different is buy-back route?

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- ▶ Role of section 115QA
 - ▶ 'Distributed income' paid for buyback, to be levied with 'additional income-tax'
 - ▶ Under section 10(34A), exemption granted to shareholder on income arising to the shareholder on account of buyback of shares as referred to in section 115QA
- ▶ Objective of section 115QA:
- ▶ *A company, having distributable reserves, has two options to distribute the same to its shareholders either by declaration and payment of dividends to the shareholders, or by way of purchase of its own shares (i.e. buy back of shares) at a consideration fixed by it. In the first case, the payment by company is subject to DDT and income in the hands of shareholders is exempt. In the second case the income is taxed in the hands of shareholder as capital gains.*

How different is buy-back route?

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- ▶ Objective of section 115QA:
- ▶ *Unlisted Companies, as part of tax avoidance scheme, are resorting to buy back of shares instead of payment of dividends in order to avoid payment of tax by way of DDT particularly where the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate.*
- ▶ *In order to curb such practice it is proposed to amend the Act, by insertion of new Chapter XII-DA, to provide that.... The additional income-tax payable by the company shall be the final tax on similar lines as dividend distribution tax. The income arising to the shareholders in respect of such buy back by the company would be exempt where the company is liable to pay the additional income-tax on the buy-back of shares.*

How different is buy-back route?

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- ▶ Income from buyback, can only be that of the shareholder – it can never be the income of the company
- ▶ Once there is income, income-tax is leviable. Who has to pay it depends on what the Parliament lays down.
- ▶ Nothing prevents the tax on the income of the shareholder to be collected from the company if the Parliament so chooses e.g. EL
- ▶ Nature of the tax is different from mechanism of collection of the tax

Article 13 – Indo-Netherlands treaty

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- ▶ 5. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 4 shall be taxable only in the State of which the alienator is a resident.
- ▶ However, gains from the alienation of shares issued by a company resident in the other State which shares form part of at least a 10 per cent interest in the capital stock of that company, may be taxed in that other State if the alienation takes place to a resident of that other State. However, such gains shall remain taxable only in the State of which the alienator is a resident if such gains are realised in the course of a corporate organisation, reorganization, amalgamation, division or similar transaction, and the buyer or the seller owns at least 10 per cent of the capital of the other.

Is issue of bonus shares an alternative?

- ▶ If a company distributes its accumulated profits through the release of any of its assets to shareholders, the distribution will be regarded as a dividend under section 2(22).
- ▶ Issue of bonus shares does not entail the release of all or any of the assets of the company, thus does not satisfy the definition of dividend.
- ▶ In as early as in 1921, the issue as to whether the receipt of bonus shares constitutes a taxable income was dealt with in *IRC vs. John Blott* - on issuance of bonus shares nothing goes out of the coffers of the company and nothing gets into shareholder's pocket hence issue of bonus shares is not taxable as dividend. [(1964) 52 ITR 567 and others]

End of Case Study 1

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