Analysis of Dividend Payment Taxation: Insights from Article 10 of the OECD and UN Model Conventions through the Lens of Indian Jurisprudence

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Abstract

Understanding and applying international taxation concepts is necessary when a resident of one country taxes dividend income paid to a resident of another. Article 10 of the Organisation for Economic Cooperation and Development Model Convention (OECD MC) 2017, as well as the United Nations Model Convention (UN MC) 2021, deals with "Taxation of Dividends". This article seeks to analyse the viewpoint of the Indian judicial system on Article 10 of the OECD MC and UN MC and concludes that the dividend distribution tax on dividends paid by the domestic company to non-resident shareholders is taxable as per section 115-O of the ITA 1961 (IND). Based on the analysis of various judgments related to Article 10 pronounced by various courts in India, it can be said that the provisions of section 90(2) of the ITA 1961 (IND) are not applicable when the provisions of DTAA are not applicable at all. Furthermore, courts have ruled that the payment of DDT should align with the tax rates under section 115-O of the ITA 1961 (IND), rather than the rates outlined in the DTAA. Furthermore, any protocol that pertains to one OECD country also applies to another OECD country.

I. Introduction

Dividend income earned by a resident of one country from the resident of another country requires the understanding and application of international taxation concepts. Article 10[1] of the Organisation for Economic Cooperation and Development Model Convention (OECD MC) 2017, as well as the United Nations Model Convention (UN MC) 2021, deals with "Taxation of Dividends". As per Paragraph I of Article 10[2] of both Model Conventions, "dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State." However, Paragraph 2 of Article 10 of both Model Conventions also gives the taxing rights of dividend income to the resident of the dividend paying country but puts a restriction on the maximum amount of tax charged on such dividend income. Section 115-O[3]of the ITA 1961 (IND)[4] puts the obligation of payment of Dividend Distribution Tax (DDT) @ 15% on the amount of dividend declared or distributed or paid by it. However, the tax rate on dividends under the Double Taxation Avoidance Agreements (DTAAs) are normally less than the rate as prescribed under section 115-O[5] of the ITA 1961 (IND).

Section 90(2)[6] of the ITA 1961 (IND) is a beneficial provision for the assessees who are earning income outside India. This section allows the assessees to apply the provisions of the ITA 1961 (IND) or the DTAA, whichever is more beneficial to them.

II. Analysis of Judgments delivered by Indian Courts/ Tribunals related to Article 7

A. Schaeffler India Ltd. vs. ACIT (2024) – Country involved is Germany – DDT should be paid as per the tax rates applicable under section 115-O of the ITA 1961 (IND) and not as per the rates under the DTAA

Schaeffler India Ltd. vs. ACIT [7]*(2024)* case, heard by the Income Tax Appellate Tribunal (ITAT) Ahmedabad, concerns an Indian tax resident company that has paid dividends to its Associated Enterprise (AE) in Germany, Schaeffler GMBH, a tax resident of Germany, on which the Dividend Distribution Tax (DDT) of 16.995% was paid by the payer Indian company in India. The assessee company argued that as per Para 2 of Article 10[8] of the India-Germany DTAA, the DDT rate of 10% is applicable to the assessee company paying dividends to its AE in Germany and thus, wanted to claim excess DDT paid as a refund.

The Assessing Officer (AO) denied the grant of a refund of such excess amount of DDT paid by the assessee company, and the decision of the AO was upheld by the CIT (Appeals).

The assessee company argued that the department taxed the dividend income paid by it to a non-resident shareholder more than the rates mentioned in Para 2 of Article 10[9] of the India-Germany DTAA and did not apply the provisions of section 90(2)[10] of the ITA 1961 (IND).

The Tribunal relied upon the ruling of ITAT Mumbai (SB) in *DCIT vs. Total Oil India (P.) Ltd.*[11] *(2023)* case and held that DTAA provisions are not applicable when the domestic company pays DDT under section 115-O[12] of the ITA 1961 (IND). The Tribunal ruled that where a dividend is declared/ distributed/ paid by a domestic company to a non-resident shareholder, the DDT shall be applicable as per the provisions of section 115-O[13] of the ITA 1961 (IND) and not as per the rates applicable on such dividend income in the relevant DTAA. This case went in favour of the department.

B. DCIT vs. Total Oil India (P.) Ltd.[14] *(2023) – Country involved is France - DDT should be paid as per the tax rates applicable under section 115-O of the ITA 1961 (IND) and not as per the rates under DTAA*

DCIT vs. Total Oil India (P.) Ltd. (2023) case, heard by the ITAT, Mumbai, concerns an Indian tax resident company that has paid a dividend to its non-resident shareholders in France, a tax resident of France, on which the DDT was paid by the payer Indian company in India, which was higher than the rate of 10% as applicable in Para 2 of Article 11[15] of the India-France DTAA.

The assessee company argued that as per Para 2 of Article 11[16] of the India-France DTAA, the DDT rate of 10% is applicable on the assessee company paying dividends to its non-resident shareholder in France and thus, wanted to claim excess DDT paid as a refund.

The Tribunal relied upon the ruling of the Bombay HC in *Godrej & Boyce Mfg. Co. Ltd. vs. DCIT*[17]*(2010)* case that DDT is a tax on the profits of the company distributed and not a tax on behalf of the shareholders. On this basis, the Tribunal held that there is no double taxation of the same income in both nations entered into the relevant DTAA because in India, tax is applicable in the hands of the payer company, and in France, the tax is payable in the hands of the recipient shareholder, and thus, the domestic company under section 115-O[18] of the ITA 1961 (IND) does not enter the domain of DTAA at all.

Though the judgement of the Bombay HC in *Godrej & Boyce Mfg. Co. Ltd. vs. DCIT (2010)* case was overturned by the Hon'ble SC in the appeal filed by the Godrej & Boyce Mfg. Co. Ltd. in *Godrej & Boyce Mfg. Co. Ltd. vs. DCIT[19] (2017) case,* the following emphasis of the Tribunal in the said case is reproduced here as "The aspect which weighed with the Hon'ble Supreme Court was the fact that the payment of DDT was not a payment on behalf of the shareholder. Leaving aside the question whether it is a tax on company or shareholder, the position that remains undisturbed is the conclusion that DDT is not a payment on behalf of the shareholder by the domestic company. The observations of the Hon'ble Bombay High Court regarding the legal characteristics of DDT that it is tax on a company paying the dividend and is chargeable to tax on its profits as a distinct taxable entity and that the domestic company paying DDT does not do so on behalf of the shareholder nor does it act as an agent of the shareholder in paying the tax under section 115-O, cannot therefore be said to have been diluted or overruled by the Hon'ble Supreme Court. It can be said that the Hon'ble Supreme Court has taken a different basis to reach the same conclusion but without diluting the reasoning of the Hon'ble Bombay High Court that DDT is not a tax paid by the domestic company on behalf of the shareholder. The additional reasoning in the Hon'ble Bombay High Court's judgment is the conclusion that it is a tax on domestic company on its profits/amount payable on declaration, distribution or payment, as the case may be, of amount as dividend out of accumulated profits. Therefore the argument that DDT is paid on behalf of the shareholder and has to be regarded as payment of liability of the shareholder, discharged by the domestic company paying DDT, is neither correct nor does it flow from the ratio laid down in the decision by the Hon'ble Apex Court in the case of Godrej & Boyce (supra)."

The Tribunal also held that if a domestic company is to enter the domain of DTAA, the contracting states should specifically agree in the DTAA to that effect, like in the protocol to the Indo-Hungarian Tax Treaty, it has been specifically provided 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 per cent of the gross amount of dividend."

It was also said by the Tribunal that "When the taxes are paid by the resident of India, in respect of its own liability in India, such taxation in India, in our considered view, cannot be protected or influenced by a tax treaty provision, unless a specific provision exists in the related tax treaty enabling extension of the treaty protection."

The Tribunal ultimately held that where a dividend is declared/ distributed/ paid by a domestic company to its non-resident shareholder, on which DDT is payable by the domestic company declaring/ distributing/ paying the dividend, the DDT will be applicable as per the rates mentioned in section 115-O[20] of the ITA 1961 (IND) and not as per the rates mentioned in the relevant DTAA except in cases where there is a specific provision in the relevant DTAA that such dividend shall be deemed to be taxed in the hands of the shareholders.

C. Van Oord India (P.) Ltd. vs. DCIT[21] (2023) – Country involved is Netherlands – Protocol with reference to any OECD country becomes applicable to another OECD country tooVan Oord India (P.) Ltd. vs. DCIT (2023) case, heard by the ITAT, Mumbai, concerns an Indian tax resident company that has paid dividends to its holding company (shareholder) in the Netherlands, a tax resident of the Netherlands, on which DDT under section 115-O[22] of the ITA 1961 (IND) was paid by the payer Indian company in India.

The assessee company argued that, as per Article 10 of the India-Netherlands DTAA read with the Most Favoured Nation (MFN) clause under Article IV of the Protocol to the India-Netherlands DTAA[23], the DDT rate of 10% is applicable to the assessee company paying dividends to its holding company in the Netherlands and thus, wanted to claim excess DDT paid as a refund. The assessee argued that if India signs any DTAA with any OECD member nation after the date of the India-Netherlands DTAA which has a more restrictive scope towards taxation of dividends, then such restrictive scope shall apply to the India-Netherlands DTAA too, and this is so because of the MFN clause in the India-Netherlands DTAA. The assessee wanted the protocol with reference to Article 10 of the India-Hungary DTAA[24] regarding taxation of dividends to be made applicable to taxation of dividends as per the India-Netherlands DTAA.

The Tribunal concluded that there is no doubt that “the protocol with reference to Article 10 of India-Hungary DTAA, with regard to taxation of dividend should be applicable to taxation of dividend as per India Netherlands DTAA.”. However, the Tribunal also held that “If we look at the wordings in the India Hungary DTAA, what it provides is that the tax on the profits distributed by an Indian company is taxable at the rate of 10% in the hands of the shareholders. The treaty does not contain anything whereby the domestic company is protected by the DTAA and that the rate mentioned therein shall be considered by domestic company distributing the profit for the purpose of DDT. The clause only specifies that the distributed profits will be taxable in the hands of the shareholders who are residents of Hungary/Netherlands at the rate of 10% which otherwise be subject to tax in accordance with Article 10 of the Treaty. If the tax laws of recipient shareholder country so provides, they can take the benefit of tax credit.”. The present case raised several grounds of appeal by the appellant but as far as the matter related to tax rate of dividend was concerned, the judgment went in favour of the department as the Tribunal concluded that “the Protocol with reference to Article 10 as per India Hungary DTAA on taxability of distributed profits cannot be interpreted so as to say that it covers the domestic companies, since there is no specific clause in the Treaty to that effect.”.

D. Deccan Holdings B V vs. Income Tax Officer (2022) – Country involved is Netherlands - Protocol with reference to any OECD country becomes applicable to another OECD country too

Deccan Holdings B V vs. Income Tax Officer[25] *(2022) case,* heard by the Hon'ble High Court of Delhi, concerns a company that is a tax resident of the Netherlands and holding shares of a company incorporated in India from whom the Netherlands based company is getting the dividend income.

The petitioner company filed an application under section 197[26] of the ITA 1961 (IND) before the AO requesting him to issue a certificate to receive dividend income from the Indian company at a lower withholding tax rate of 5% as applicable under the India-Netherlands DTAA read with the protocol. The petitioner company argued that as per Article 10 of the India-Netherlands DTAA read with the Most Favoured Nation (MFN) clause under Article IV of the Protocol to the India-Netherlands DTAA, the lower withholding rate of 5% be made applicable on the dividend income covered under the India-Netherlands DTAA because India has entered into DTAAs with Slovenia/Lithuania/Colombia, the OECD member countries wherein tax rate on dividend income has been agreed at a lower withholding tax rate of 5%.

The counsel for the department agreed with the argument of the petitioner company.

The Hon'ble High Court of Delhi ruled that a certificate under section 197[27] of the ITA 1961 (IND) is to be issued to the petitioner company where the withholding rate of tax of 5% is allowed on dividend income covered under the India-Netherlands DTAA. The case went in favour of the assessee.

E. SGS India (P.) Ltd. vs. Additional Commissioner of Income-tax, Circle-10(3), Mumbai (2017)[28] *– Country involved is Switzerland – Matter referred back to the CIT (Appeals) to decide whether the provisions of Article 10 of the India-Switzerland DTAA would apply when the dividend is paid by the domestic company SGS India (P.) Ltd. vs. Additional Commissioner of Income-tax, Circle-10(3), Mumbai (2017)* case, heard by the ITAT, Mumbai, concerns an Indian tax resident (the assessee) that pays a dividend to its 100% holding company in Switzerland and deducts the tax as prescribed under section 115-O[29] of the ITA 1961 (IND).

The assessee submitted that "as per Article-10 of the India Switzerland DTAA, the tax on dividend distributed should have been restricted to maximum of 10% instead of the rate prescribed under section 115O of the Act. It was submitted by the assessee that as a wholly owned subsidiary of SGS, Switzerland, it had declared dividend of Rs. 35.93 crore during the year and has deducted tax as per the rate prescribed under section 115O.". From the submissions of the assessee, it could be said that the assessee treats DDT as a tax on dividends, and thus, the provisions of Article 10 of the India-Switzerland DTAA should apply where tax is charged at a maximum rate of 10% on the dividend income. The assessee further submitted that since the provisions of the DTAA are more beneficial to it in terms of section 90[30] of the ITA 1961 (IND), the provisions of the DTAA will be applicable.

The CIT (Appeals) held that "DDT is a tax imposed under the domestic law on a domestic company on a transaction arising within the territorial jurisdiction of India. Therefore, the DTAA would not apply to such transactions. The learned Commissioner (Appeals) observed, Article 10(2) of DTAA relates to tax on dividend income and not relating to tax on distribution of profit by way of dividend by a company. He further observed that on analysis of section 115O, it would appear that DDT is levied on the company distributing dividend and not on the shareholders who receive the dividend. Referring to the provisions of sub-section (4) and (5) of section 115O, the learned Commissioner (Appeals) observed that DDT charged under section 115O is a tax on distributed profit and is charged on the company distributing the dividend and has no element of being a withholding tax payable on behalf of any other entity, shareholders or otherwise. Thus, the learned Commissioner (Appeals) ultimately held that the provisions of DTAA are not applicable."

To determine whether the provisions of Article 10 of the India-Switzerland DTAA would apply when the domestic company pays the dividend, the Tribunal referred the matter back to the CIT (Appeals).

III. Conclusion

The above decisions of Indian courts are related to the application of Article 10 of the OECD and UN MC, i.e., Dividends, and reaffirm the importance of understanding the relationship between domestic tax legislation [ITA 1961 (IND)] and DTAAs when deciding the tax on dividends declared or distributed or paid by a domestic company to its non-resident shareholder. Based on analysis of the above cases, it is clear that the provisions of section 90(2)[31] of the ITA 1961 (IND) are not applicable when the provisions of the DTAA are not applicable at all. Further, it has been ruled that DDT should be paid as per the tax rates applicable under section 115-O[32] of the ITA 1961 (IND) and not as per the rates under the DTAA. Furthermore, any protocol that pertains to one OECD country also applies to another OECD country.

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Reference

1. Available at https://www.oecd.org/en/publications/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en.html and https://financing.desa.un.org/sites/default/files/2023-05/UN%20Model_2021.pdf
2. Article 10, above fn. 1.
3. The Income-tax Act, 1961, No. 43 of 1961 (IND), s. 115-O:

   "Tax on distributed profits of domestic companies.

   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 15[but on or before the 31st day of March, 2020], 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:]…………………………………………..."

4. The Income-tax Act, 1961, No. 43 of 1961 (IND).
5. ITA 1961 (IND), above fn. 4, s. 115-O, above fn. 3.
6. ITA 1961 (IND), above fn.4, s. 90:

"**Agreement with foreign countries or specified territories.**

90. (1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—

(a) for the granting of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or

(*ii*) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory), or

(c) ……………..

(d) ……………..

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

(3) Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf." available at: https://incometaxindia.gov.in/pages/acts/income-tax-act.aspx

7. [2024] 159 taxmann.com 250 (Ahmedabad - Trib.) [12-01-2024] In the ITAT Ahmedabad Bench 'D'
8. Para 2 of Article 10 of the India-Germany DTAA states:

"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."

available at: https://incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx

9. Para 2 of Article 10 of the India-Germany DTAA, above fn. 8.
10. ITA 1961 (IND), above fn. 4, s. 90(2), above fn. 6.
11. [2023] 104 ITR(T) 1 (Mumbai -Trib.) (SB) [20-04-2023]
12. ITA 1961 (IND), above fn. 4, s. 115-O, above fn. 3.
13. ITA 1961 (IND), above fn. 4, s. 115-O, above fn. 3.
14. [2023] 104 ITR(T) 1 (Mumbai -Trib.) (SB) [20-04-2023]
15. Para 2 of Article 11 of the India-France DTAA states:

"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 Contracting 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."

available at: https://incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx

16. Para 2 of Article 11 of the India-France DTAA, above fn. 15.
17. [2010] 234 CTR 1 (Bombay) [12-08-2010].
18. ITA 1961 (IND), above fn. 4, s. 115-O, above fn. 3.
19. [2017] 394 ITR 449 (SC) (para 17).
20. ITA 1961 (IND), above fn. 4, s. 115-O, above fn. 3.
21. [2023] 155 taxmann.com 462 (Mumbai - Trib.) [20-09-2023]
22. ITA 1961 (IND), above fn. 4, s. 115-O, above fn. 3.
23. *India and Netherlands*

Protocol

With reference to Article 10

IV. *Ad Articles 10, 11 and 12*

(a) ……………..

(b) 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.

24. Para 2 of Article 10 of the India-Hungary DTAA states:

"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."

India and 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.

25. [2022] 445 ITR 486 (Delhi) [25-10-2021].
26. ITA 1961 (IND), above fn. 4, s. 197:

" **Certificate for deduction at lower rate.**

197. (1) Subject to rules made under sub-section (2A), where, in the case of any income of any person or sum payable to any person, income-tax is required to be deducted at the time of credit or, as the case may be, at the time of payment at the rates in force under the provisions of sections 192, 193, 194, 194A, 194C, 194D, 194G, 194H, 194-I, 194J, 194K, 194LA, 194LBA, 194LBB, 194LBC, 194M, 194-O, 194Q and 195, the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income-tax at any lower rates or no deduction of income-tax, as the case may be, the Assessing Officer shall, on an application made by the assessee in this behalf, give to him such certificate as may be appropriate."

27. ITA 1961 (IND), above fn. 4, s. 197, above 26.
28. [2017] 189 TTJ 398 (Mumbai - Trib.) [12-04-2017]
29. ITA 1961 (IND), above fn. 4, s. 115-O, above fn. 3.
30. ITA 1961 (IND), above fn. 4, s. 90, above fn. 6.
31. ITA 1961 (IND), above fn. 4, s. 90, above fn. 6.
32. ITA 1961 (IND), above fn. 4, s. 115-O, above fn. 3.