



THE JUDICIAL SHIFT IN DIVIDEND TAXATION:

Reconciling DDT with Treaty Protections

The landscape of dividend taxation in India has long been a battleground between domestic legislative intent and international treaty obligations. A landmark ruling by the Bombay High Court in **Colorcon Asia (P.) Ltd. v. JCIT** has significantly altered this terrain, potentially opening doors for non-resident shareholders to claim beneficial treaty rates against the erstwhile Dividend Distribution Tax (DDT).

THE HISTORICAL CONTEXT: A SEE-SAW OF TAX REGIMES

For decades, India has alternated between two distinct philosophies of dividend taxation, seeking an optimal balance between administrative collection efficiency and global investor competitiveness. This structural tug-of-war is defined by two mechanisms:

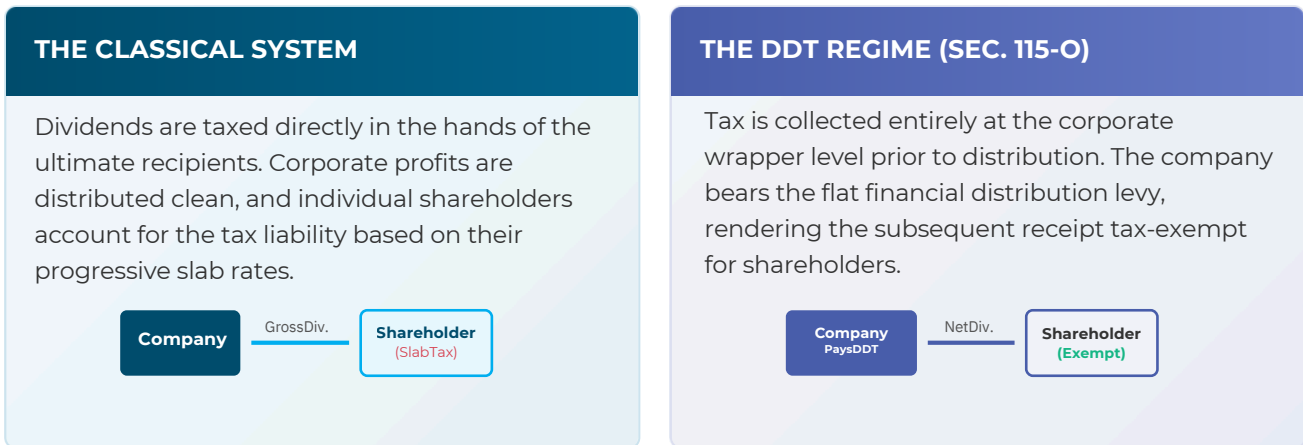


FIGURE 1: COMPARISON OF CLASSICAL SYSTEM VS. DDT REGIME ARCHITECTURE

The legislative trajectory of the Dividend Distribution Tax has undergone multiple reversals, shifting continuously between simplicity of collection and vertical fairness:

1997 — Introduction

DDT is introduced into the Income-tax Act via Section 115-O to aggregate corporate collections, streamline regulatory filing, and eliminate compliance paperwork across vast retail investor portfolios.

2002 – 2003 — The See-Saw Reversal

Briefly abolished in 2002 to test standard client-level models, it was swiftly reinstated in 2003 under the explicit logic of "**administrative convenience**," as collecting from a centralized corporate midpoint proved vastly simpler for state machinery.

The Inequity & Escalation Phase

The mechanism created sharp vertical inequity, taxing modest retail portfolios at the exact same flat percentage as high-net-worth promoters. Due to statutory grossing-up rules, surcharges, and education cesses, the effective corporate DDT burden escalated to over **20.56%**.

2020 — Permanent Abolition

The Finance Act 2020 formally dissolved the DDT architecture, permanently returning corporate dividend distributions to the Classical tax framework to align with global norms.

THE COLORCON ASIA DISPUTE: FACTS AND ISSUES

The Context: Colorcon Asia Pvt. Ltd., an active Indian subsidiary of an established United Kingdom parent organization, distributed dividends between Assessment Years 2016-17 and 2018-19.

The Operational Conflict: While the company fulfilled its structural domestic commitments by remitting DDT at the statutory rate exceeding 20% under Section 115-O, it subsequently filed for treaty relief. The taxpayer argued that because the dividends were ultimately distributed to a cross-border entity, the sovereign tax exposure must be strictly capped at the **10% threshold** guaranteed under Article 11(2) of the India-UK Double Taxation Avoidance Agreement (DTAA).

The Tax Authority Defense: The Revenue Department argued that DDT was an autonomous, additional corporate income tax levied exclusively on the domestic enterprise's own undivided earnings rather than a direct tax on the underlying non-resident shareholder's income. This interpretation had previously been upheld by a Special Bench of the Mumbai Tribunal in the *Total Oil India* case (in the context of the India-France treaty), which stated that general DTAA benefits do not apply to DDT unless explicitly written into the treaty text.

THE JUDICIAL BREAKTHROUGH: HIGH COURT REASONING

Overtaking the Board for Advance Rulings (BFAR) decision, the Hon'ble Bombay High Court ruled decisively in favor of the taxpayer. The landmark ruling centered on four core judicial pillars with custom typography hierarchies and icons:

01 Substance Over Form

The Court ruled that the true test for invoking Article 11 of a DTAA is the nature of the income as a *dividend*. Shifting the collection point to the corporate wrapper for government ease does not alter the fact that DDT is essentially an economic levy on the shareholder's profit share.

02 Supremacy of Treaties

Under Section 90(2) of the Income-tax Act, bilateral DTAA terms categorically override domestic statutes if they are more favorable. The High Court stressed that unilateral domestic updates cannot weaken or alter negotiated international treaty safe harbors.

03 Supreme Court Precedent

The High Court relied on the apex court's ruling in *Union of India v. Tata Tea Co. Ltd.*, which explicitly defined DDT as an "Income Tax" falling within Entry 82 of the Constitutional Union List, linking its identity directly to broader income tax rules.

04 Constitutional Mandate

Collecting tax revenue beyond the limits established in international treaties directly breaks **Article 265 of the Constitution of India**, which strictly states that no tax can be levied or collected without clear authority of law.

CONCLUSION & STRATEGIC IMPACT

The *Colorcon Asia* judgment represents a milestone in international tax coordination within India. By establishing that international treaty caps hold clear priority over historical domestic corporate distribution levies, the judiciary has re-established the principles of global trust and tax certainty.

JURISDICTION / CONTEXT	DOMESTIC DDT BURDEN	TREATY CAP UNDER DTAA
Standard Indian Corporate Outflow (AY 2016-17 to 2018-19)	> 20.56% (Grossed Up)	Not applicable inside domestic tax code
United Kingdom (DTAA Article 11)	Overridden by High Court	10% Capped Max Rate
Other Core Treaties (e.g., Japan, Germany, Netherlands)	Overridden by High Court	5% to 15% (Based on holdings)

- **Refund Channels:** Multinational groups now have a solid legal basis to review historical dividend payments made during open assessment cycles and consider filing retroactive tax refund claims.

- **Precedent Adoption:** Various regional tax benches have already started applying the *Colorcon* principle to cross-border remittances involving overseas parents in several partner countries.

STRATEGIC RISK MANAGEMENT ADVISORY

It is important to emphasize that the final appeal on this matter remains pending before the Supreme Court of India. Until a binding apex ruling is issued, multinational corporations should review their tax positions carefully, weighing both the restrictive Special Bench rulings and the protective High Court precedents.

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