

# EY Tax Alert

Government of India issues notification to give effect to MFN clause for lower tax rate under India-Spain DTAA

## Executive summary

EY Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

The Government of India (GoI) has issued Notification No. 33/2024 dated 19 March 2024 (Notification)<sup>1</sup>, by exercising its powers under the Indian Tax Laws (ITL), conferring lower tax rate benefit of 10% under the India-Spain Double Taxation Avoidance Agreement (DTAA) in accordance with the most favored nation (MFN) clause of the India-Spain DTAA. The benefit has been accorded with reference to royalty and fees for technical services (FTS) payments based on the beneficial treatment provided under the India-Germany DTAA. The amendment is effective from tax year 2023-24.

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<sup>1</sup> F.No. 503/2/1986-FTD-I

# Background

- ▶ India's DTAA's with certain Organisation for Economic Co-operation and Development (OECD) countries<sup>2</sup> have an MFN clause which provides that if, after signature/entry into force<sup>3</sup> of the DTAA with the first country (original treaty), India enters into a DTAA on a later date with a third country, which is an OECD member, that provides a beneficial rate of tax or restrictive scope for taxation of dividend, interest, royalty, FTS etc., a similar benefit should be accorded to the first country.
- ▶ On similar lines, the India-Spain DTAA contains an MFN clause which provides that where any DTAA between India and other OECD member nations has come into force after 1 January 1990 wherein India limits its taxation at source on royalties or FTS by way of lower tax rate or reduced scope, then the same rate or scope as provided for in that DTAA on the said items of income shall also be applicable under the India-Spain DTAA.
- ▶ On application of the MFN clause, a controversy which arose was if a notification by the GoI is required to confer the benefit of the MFN clause or if the provisions operate on an automatic basis if any favorable treatment has been accorded to a third state, subject to the conditions stated therein. This controversy has now been settled by a Supreme Court (SC) decision in a batch of appeals in the case of Nestle SA and others<sup>4</sup>, wherein the SC, *inter-alia*, ruled that in order to invoke the MFN clause, the GoI is required to issue a notification under the respective DTAA's in order to give effect to the MFN clause for the benefit accorded to a third country and that the same cannot operate on an automatic basis<sup>5</sup>.
- ▶ It appears that pursuant to the SC decision above, the GoI has issued the Notification providing details of the MFN benefit with respect to the India-Spain DTAA.

## Details of the Notification

Presently, the tax rate for royalties and FTS under the India-Spain DTAA is 10% with reference to equipment royalty and 20% for all other royalty and FTS payments.

In this regard, with respect to Germany, an OECD member at the time of entering into a DTAA with India which came into force on 26 October 1996, India has limited the taxation at source on royalties and FTS at the rate of 10%.

Thus, in order to give effect to the MFN clause under the India-Spain DTAA, the GoI, by exercising

its power under the ITR, has issued the Notification to restrict the tax rate at 10% on payments in the nature of royalty and FTS under the India-Spain DTAA.

This amendment is effective from tax year 2023-24.

## Comments

The Notification confers lower tax rate with respect to royalty and FTS under the India-Spain DTAA pursuant to the MFN clause. The issuance of this Notification is in line with the view of the Central Board of Direct Taxes (CBDT) as expressed in Circular No. 3/2022 dated 3 February 2022, as also with the Supreme Court (SC) decision in the case of Nestle (*supra*) wherein it was ruled that the MFN clause is not auto-executory and a notification is required in order to grant beneficial treatment. Against the aforesaid SC decision, a review petition<sup>[6]</sup> has been filed before the SC and the same is currently pending. Further, it may also be noted that certain Special Leave Petitions (SLP)<sup>[7]</sup> have been filed<sup>[8]</sup> on similar matter and will be heard in due course.

Interestingly, it may be noted that although the MFN clause under the India-Spain DTAA provides beneficial treatment with respect to lower tax rate as well as restricted scope with reference to royalty/FTS, the present Notification has been issued only with reference to providing the benefit of lower tax rate as per the India-Germany DTAA. It may be worthwhile to note that, post 1 January 1990 (being the date of trigger of the MFN clause under the India-Spain DTAA), India has entered into DTAA's with various OECD member countries such as Sweden<sup>[9]</sup>, USA<sup>[10]</sup> etc., wherein India has restricted the scope of royalties and/or FTS.

Further, although the India-Germany DTAA came into force on 26 October 1996, the amendment, by way of the present Notification for lower tax rate, has been made effective from tax year 2023-24 only.

<sup>6</sup> Diary No. 48138/2023, Case No.00077/2024 registered on 18 January 2024

<sup>7</sup> An SLP is filed in the Supreme Court of India as a special permission to be heard in appeal against an order from any High Court or Tribunal. This legal mechanism is governed by Article 136 of the Constitution of India.

<sup>8</sup> Illustratively, SLP(C) No. 2969/2024 against the WP(C) No. 9316/2022, judgement dated 17 November 2023

<sup>9</sup> Equipment royalty is excluded from the royalty definition

<sup>10</sup> Make available clause with reference to FTS income

<sup>2</sup> Illustratively, Netherlands, France, Switzerland, Sweden, Spain, Hungary

<sup>3</sup> Depending on the language of the MFN clause

<sup>4</sup> Civil Appeal Nos. 1420 of 2023 [TS-616-SC-2023]

<sup>5</sup> Refer EY Tax Alert titled "Supreme Court rules notification to be mandatory to invoke most favored nations clause" dated 21 October 2023

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