

# TAX FLASH NEWS

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## Interest on income-tax refund received by a Dutch company is not taxable in India, beneficial treatment under the India-Italy tax treaty applied through MFN clause under the India-Netherlands tax treaty

### Executive Summary

Some of the Indian tax treaties contain a Most Favoured Nation (MFN) clause, whereby taxation of dividend, interest, royalties, fees for technical services (FTS), etc. can be further restricted if India extends a more beneficial treatment to another country in a subsequent tax treaty. Recently, the Kolkata Bench of the Income-tax Appellate Tribunal (the ITAT) in the case of Koninklijke Philips N.V.<sup>1</sup> (KPNV) held that interest on income-tax refund is not taxable in India under the India-Netherlands tax treaty by applying beneficial treatment in the subsequent tax treaty with Italy through MFN clause. Under the India-Italy tax treaty, interest earned by a resident of Italy from the government of India is not taxable in India. By invoking the MFN clause, benefit of such non-taxation was extended to the India-Netherlands tax treaty.

### Facts of the case

- KPNV, a Dutch company, received interest on tax refund from the tax department after the deduction of tax at source.
- KPNV contended that the interest on the tax refund was received from the government of India. Thus, in view of the MFN clause under the India-Netherlands tax treaty, applying the beneficial India-Italy tax treaty provisions<sup>2</sup>, such interest is not taxable in India and not liable for tax deduction at source.

### ITAT's decision

- As per the India-Italy tax treaty, interest earned by a resident of Italy is not taxable in India, where the payer of such interest is the government of India.
- The Madras High Court in the case of Ansaldo Energio SPA<sup>3</sup> held that the interest on income-tax refund is a 'debt claim' payable by the government in terms of the 'interest' article under the India-Italy tax treaty. Thus, such interest was not taxable in India.
- Relying on the Delhi High Court's decision in the case of Steria (India) Ltd<sup>4</sup>, the ITAT observed that as per the MFN clause, the beneficial treatment to interest under the India-Italy tax treaty will be available to the India-Netherlands tax treaty.
- Therefore, the interest on tax refund received by KPNV from the government is not taxable in India and not liable for deduction of tax at source. Accordingly, the Assessing Officer was directed to refund the tax deducted at source to KPNV.

### Our comments

The Central Board of Direct Taxes (CBDT) has issued a circular in February 2022 clarifying India's position on various aspects pertaining to application of the MFN clause. One of the aspects covered in the circular is requirement of issue of notification by CBDT under section 90 of the Act to allow benefit of one treaty to be

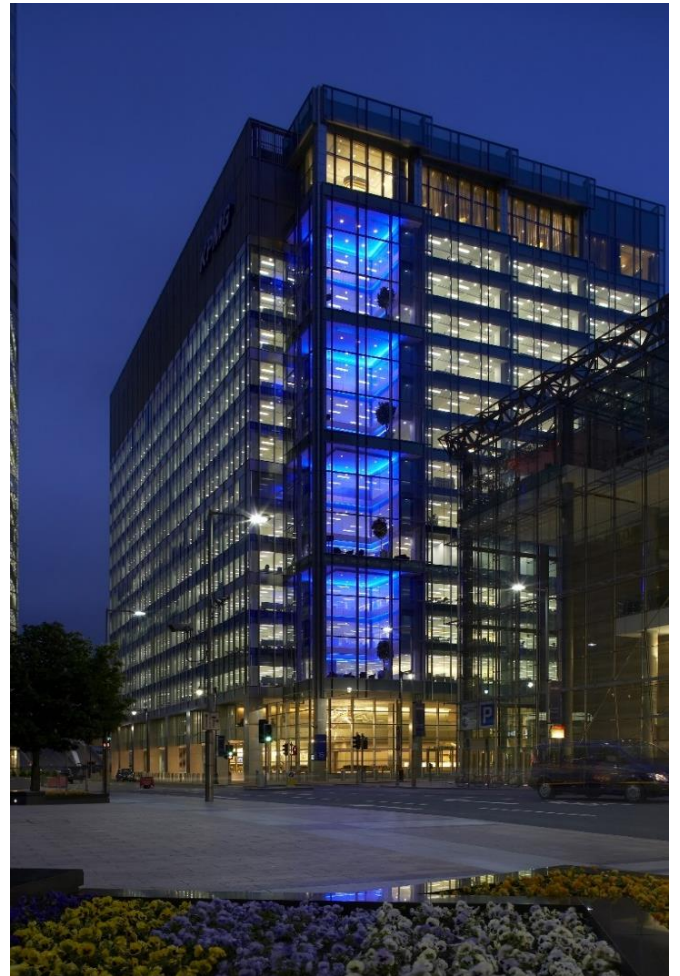
<sup>1</sup> Koninklijke Philips N.V. v. DCIT (ITA Nos.437 to 441/Kol/2021) – Taxsutra.com

<sup>2</sup> Interest earned by a resident of Italy will not be taxable in India, where the payer of such interest is the Government of India.

<sup>3</sup> Ansaldo Energio SPA v. CIT [2016] 240 Taxman 107 (Mad)

<sup>4</sup> Steria (India) Ltd. v. CIT [2016] 241 Taxman 268 (Del)

imported in another i.e., MFN benefit can be invoked only after it is notified by the CBDT. This position is contrary to the view taken by Delhi High Court in the case of Steria, which is now pending before the the Supreme Court. Similarly, there are other issues on availability of benefit of MFN clause with respect to dividend income under the India-Switzerland and the India-Netherlands tax treaties applying Indian tax treaties with Slovenia, Lithuania and Colombia. The Supreme Court's decision on these issues may provide much needed clarity on the applicability of the MFN clause and its interpretation.



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