



# Tax Flash News

21 March 2024

## Notification issued to give the benefit of lower tax rate for royalties and fees for technical services under the India-Spain tax treaty in view of MFN clause with prospective effect

### Background

Indian tax treaties with some of the countries have a Most Favoured Nation (MFN) clause. MFN clause provides that if after the signature/ entry into force<sup>1</sup> of the tax treaty with a country (original treaty), India enters into a tax treaty with a third country, which is an OECD<sup>2</sup> member, providing a lower rate of tax or restrictive scope of taxation with respect to the specified incomes<sup>3</sup>, a similar benefit should be accorded for such incomes under the original treaty.

In this regard, an issue had arisen as to whether a benefit under the MFN clause can be adopted based on its inclusion in the tax treaty/protocol or a separate notification is needed to give effect to it.

The Supreme Court in the case of *Nestle*<sup>4</sup> had held that a notification under section 90 of the Income-tax Act, 1961 (the Act) is necessary and a mandatory condition to give effect to a tax treaty or any protocol that has the effect of altering the existing provisions of the law. With reference to the MFN clause already agreed as part of the original treaty, the beneficial provisions entered into with the third country cannot be made applicable automatically unless a notification is issued.

The judgment was rendered in the context of the Indian treaties with France, Switzerland and the Netherlands. The India-Spain treaty was not considered by the Supreme Court.

### Notification

On 19 March 2024, the Government<sup>5</sup> issued a notification<sup>6</sup> to give the benefit of the MFN clause in the India-Spain treaty (1995).

The tax rate under the Indian-Spain treaty for fees for technical services (FTS) and royalties<sup>7</sup> was 20 per cent. The Protocol to the treaty contains the MFN clause.

Subsequently, India signed a tax treaty with Germany<sup>8</sup> which provided for a tax rate of 10 per cent for FTS and royalties. It entered into force on 26 October 1996.

In view of the MFN clause, the Government vide this notification has extended the benefit of a lower rate of 10 per cent under the India-Spain tax treaty for FTS and royalties.

The amendment is applicable with effect from the assessment year 2024-25.

### Our comments

There are a few proceedings pending before the Supreme Court in relation to the MFN issue. A review petition<sup>9</sup> has been filed in the Supreme Court in the *Nestle* case.

<sup>1</sup> Depending on the language of the relevant MFN clause. This could be any other date as well.

<sup>2</sup> Organisation for Economic Cooperation and Development

<sup>3</sup> Which could be interest, dividend, royalties, fees for technical services (FTS)

<sup>4</sup> *AO v. Nestle SA* [2023] 458 ITR 756 (SC)

<sup>5</sup> Ministry of Finance (Department of Revenue)

<sup>6</sup> Notification No. 33/2024 F. No. 503/2/1986-FTD-I

<sup>7</sup> Other than payments for the use of, or the right to use, industrial, commercial or scientific equipment for which the tax rate was 10 per cent.

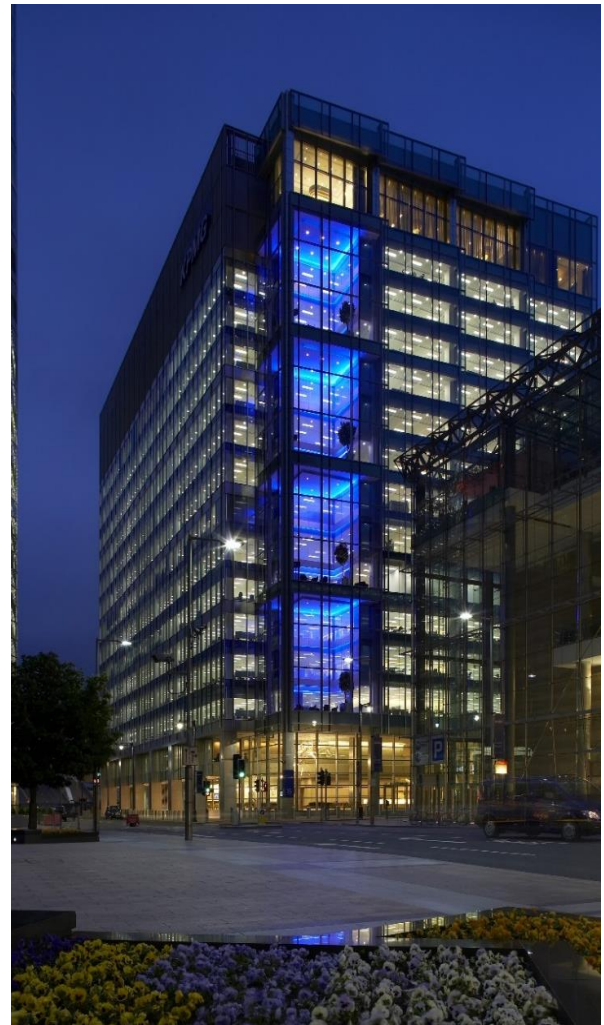
<sup>8</sup> An OECD member country

<sup>9</sup> *Nestle SA v. AO* [R. P. (C) No. 000077/2024], dated 18 January 2024

In November 2023, the Delhi High Court<sup>10</sup> had dismissed the taxpayer's appeal on the MFN issue citing the Supreme Court judgment in *Nestle SA*. A Special Leave Petition<sup>11</sup> has been filed before the Supreme Court against the High Court decision. The Supreme Court has allowed the taxpayer to file a short submission. The next hearing is scheduled for 30 July 2024.

In addition, there are proceedings pending in another case<sup>12</sup> which was de-tagged by the Supreme Court in the *Nestle* decision as it related to the interpretation of the India-Spain treaty which was not considered by the Court. It will be interesting to see how the Supreme Court will deal with this case given that the notification is specifically for the India-Spain treaty.

Since the notification is issued with a prospective effect, leaving taxpayers without MFN benefit for the past years, it will be interesting to see how it is considered by the Supreme Court in the ongoing matters.



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<sup>10</sup> *Societe De Participations Financiers v. ACIT* (W.P.(C) 9316/2022 & CM APPL. 27903/2022)

<sup>11</sup> *Societe De Participations Financiers v. ACIT* (SLP No. 2975/2024)

<sup>12</sup> *CIT v. EPCOS Electronic Components S.A* (CA No. 1428/2023)

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