

Direct Tax Alert

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Delhi High Court invokes Most Favored Nation clause and applies 5% withholding tax on dividend income under India-Netherlands Tax Treaty

The Delhi High Court quashed the withholding tax certificates issued to two Netherlands companies which prescribed a rate of 10% on dividends to be received from Indian subsidiaries. The High Court applied a 5% withholding tax rate on dividend income basis the MFN clause under India-Netherlands Tax Treaty.

The issue in the present case was on the withholding tax rate which should be applied by an Indian company on remittance of dividend to its parent company based in The Netherlands. The Delhi High Court¹ has quashed the withholding tax certificates issued to two Netherlands companies wherein a rate of 10% was prescribed by the TDS Officer and the claim of lower withholding tax rate of 5% by virtue of Most Favored Nation ('MFN') clause was denied. The taxpayer had placed reliance on the MFN clause and had contended

that since India had agreed on a 5% withholding tax rate in its subsequent tax treaties (with Slovenia, Lithuania, and Colombia), the lower rate of 5% should equally apply to India-Netherlands Tax Treaty as well.

The Delhi High Court upheld the applicability of MFN clause and directed the TDS officer to issue a fresh withholding tax certificate indicating a withholding tax rate of 5%. This alert attempts to summarise the decision of the Delhi High Court.

¹ Concentrix Services Netherlands B.V. v. ITO (TDS) & Anr [W.P. (C) 9051/2020], Optum Global Solutions International B.V. v. DCIT & Anr [W.P. (C) 882/2021, CM Appl. 2302/2021]



Facts of the case

- Concentrix Services Netherlands B.V. and Optum Global Solutions International B.V. (hereinafter referred to as ‘the Assessee’ or ‘the taxpayers’), are companies which are tax resident of The Netherlands. Their wholly owned Indian subsidiaries were required to remit dividends after appropriate withholding of tax.
- Accordingly, the taxpayers applied for a lower withholding tax certificate under section 197 of the Income-tax Act, 1961 (‘the Act’) in accordance with the India-Netherlands Tax Treaty read with the Protocol appended thereto. The taxpayers placed reliance on the MFN clause contained in the Protocol and contended that the withholding tax rate under the India-Netherlands Tax Treaty ought to be 5%.
- To put it simply, the MFN clause of India-Netherlands Tax Treaty provides that if India enters into a tax treaty with an OECD member country wherein the tax rates (on dividends, interest, royalties and technical services) agreed to are lower than those agreed to in India-Netherlands Tax Treaty, then those lower rates would equally apply for the purposes of India-Netherlands Tax Treaty as well. The text of the MFN clause is reproduced hereunder:

*“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”.

- The taxpayers placed reliance on the aforementioned MFN clause and contended that since India had agreed on a 5% withholding tax rate in its subsequent tax treaties (with Slovenia, Lithuania and Colombia), the lower rate of 5% should equally apply to the India-Netherlands Tax Treaty as well.
- Slovenia, Lithuania and Colombia became members of the OECD after India signed treaties with them. The core issue therefore was whether these countries needed to be members of OECD at the time of signing of their tax treaty for the MFN clause to apply. The relevant dates in this regard are tabulated below:

Particulars	Netherlands	Slovenia	Lithuania	Columbia
Entry into force of tax treaty with India	21/01/1989	17/02/2005	10/07/2012	07/07/2014
Date of signing tax treaty with India	13/07/1988	13/01/2003	26/07/2011	13/05/2011
Date of becoming OECD member	13/11/1961	21/07/2010	05/07/2018	28/04/2020



Arguments by the Assessee

- Based the language of the MFN clause, which is an integral part of the Tax Treaty, since India had entered into Tax Treaties with other countries (Slovenia, Lithuania and Colombia) which are members of OECD, the lower rate in the Tax Treaty executed between India and such a country would automatically apply to India-Netherlands Tax Treaty.
- No fresh notification is required for importing the benefit of Tax Treaty with Slovenia, Lithuania, Colombia into India-Netherlands Tax Treaty and thus the application of MFN clause is automatic. Reliance was placed on certain decisions² for this proposition.
- Even if the aforementioned countries whose benefit is sought to be imported were not members of OECD at the time of their execution of tax treaties with India, as long as they are members of OECD at the point of time the MFN clause is sought to be invoked, the concession of lower tax rate should be available.

Arguments by the Revenue

- A bare reading of the MFN clause would show that the benefit of the lower withholding tax rate would be available only if the country with which India enters into a Tax Treaty was a member of the OECD **at the time of the execution of the subject Tax Treaty**.
- For instance, the Tax Treaty between India and Slovenia which provided for a withholding tax rate of 5% on dividends was executed on February 15, 2005 whereas Slovenia became a member of OECD in August 2010. Similar

was the case for Lithuania and Colombia whose tax treaties with India were executed prior to they becoming members of OECD.

- Since none of the countries were members of the OECD on the date when they executed their tax treaties with India, the MFN clause of India-Netherlands Tax Treaty has no applicability.
- Furthermore, as Slovenia, Lithuania and Colombia were not OECD members at the time of execution of India-Netherlands Tax Treaty, the benefit of MFN clause is not available on this count as well.
- Several amendments have been made to the India-Netherlands Tax Treaty which have been ratified by both India and Netherlands but no specific amendment for the lower withholding tax rate was carried out either by India or Netherlands.

Ruling of the High Court

- The MFN clause forms an integral part of the Tax Treaty. Therefore, no separate notification is required, in so far as the applicability of provisions of the MFN clause is concerned as the same would get triggered automatically.
- The MFN clause incorporates the principle of parity which is applicable on fulfilment of following conditions:
 - The third country with whom India entered into a Tax Treaty should be a member of the OECD.

² Steria (India) Ltd v. CIT [2016] 386 ITR 390 (Delhi), Apollo Tyres Ltd v. CIT [2018] 92 taxmann.com 166 (Kar), EPCOS Electronic Components S.A. v. UOI [2019] 107 taxmann.com

227 (Delhi). However, it may be noted that a Special Leave Petition against the decision of *Steria (India) Ltd* is pending before the Supreme Court of India.



- India should have, in its tax treaty, limited its rate of withholding tax at a rate lower than the one mentioned in the subject Tax Treaty (i.e. India-Netherlands Tax Treaty in the present case).
- Once the aforementioned conditions are fulfilled, the lower rate agreed to by India in its subsequent tax treaties would apply to India-Netherlands Tax Treaty as well. Even if the third countries are not members of OECD at the time of signing of their tax treaties, as long as they are OECD members on the point of time when the MFN clause is sought to be invoked, the benefit of MFN clause should be available,
- The word “is” as provided in the expression *“which is a member of the OECD”*, **describes a state of affairs that should exist not necessarily at the time when the subject Tax Treaty was executed but when a request is made by the taxpayer or deductee for issuance of a lower rate withholding tax certificate under Section 197 of the Act.** Thus, the MFN clause would trigger as soon as the third country becomes a member of the OECD.
- The High Court also held that the best interpretative tool that can be employed to understand the intent of India and Netherlands in framing the MFN clause would be as to how Netherlands has interpreted the same. In this regard, the High Court observed the Decree³ issued by the Netherlands wherein Netherlands had extended the lower rate as provided in India-Slovenia Tax Treaty to be applicable to India-Netherlands Tax Treaty. As per the High Court, India cannot have an understanding contrary to that of Netherlands basis the principles of interpretation and understanding of Tax Treaties.
- The Court held that one of the avowed purposes of entering into a tax treaty is the equitable allocation of taxes concerning transactions that are taxable in both the countries. This interpretation is in alignment with the principles of common interpretation which could be adopted for interpreting tax treaties. Even though the Court held that the principles of common interpretation should be applied cautiously, it also stated that in this particular case since Netherlands had already interpreted the MFN clause in a particular manner, the common interpretation should be applied to ensure consistency and equal allocation of tax.
- Lastly, the Court also held that the rules of interpretation of domestic laws cannot be applied for interpreting international treaties since international treaties are negotiated by diplomats and not men of law. Thus, their interpretation is liberated from technical rules.
- The High Court thus granted the benefit of 5% withholding tax rate by virtue of the MFN clause and directed the Revenue to issue a new certificate in this regard.

Dhruva Comments

Given that India has reintroduced the classical system of dividend taxation in the hands of the shareholder, this decision will assume significance given that Netherlands based companies would want to claim the benefit of lower tax rates as provided in India’s treaties with

³ Decree of February 28, 2012 No. IFZ 2012 / 54M



Slovenia, Lithuania and Colombia. Further, this decision will not only assume importance for dividend income but also for other categories like royalty and fees for technical services wherein a lower rate and restricted scope may have been provided. Even though the decision has been rendered in the context of India-Netherlands Tax Treaty, the same should equally apply for other tax treaties which have a comparable language in the MFN clause (refer, for instance, tax treaties with France, Hungary, Spain, Switzerland,

Sweden, etc). Taxpayers in the aforementioned jurisdictions may wish to evaluate the impact of this ruling on their dividend and other streams of income.

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