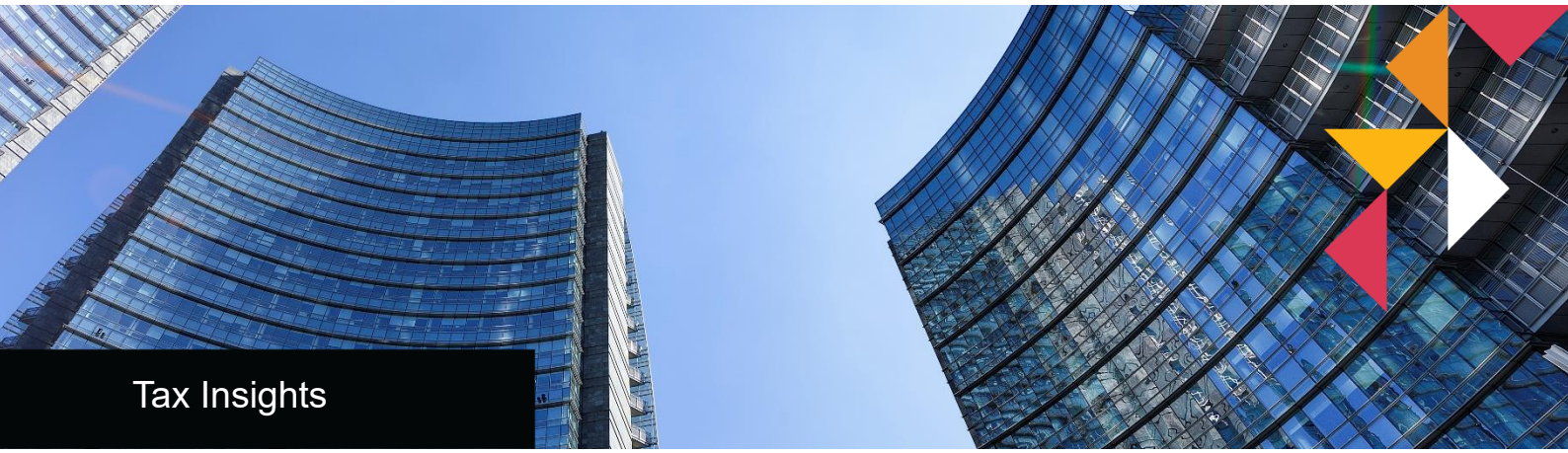

Tax Insights

21 March 2024

Lower tax rate for royalties and FTS under the India-Spain DTAA notified – Ministry of Finance

In brief

The Ministry of Finance recently issued a notification[1] invoking the most-favoured nation (MFN) clause under the double taxation avoidance agreement (DTAA) between the Government of the Republic of India and the Kingdom of Spain. As per the notification, the Central Government modified the India-Spain DTAA by importing a lower tax rate of 10% for royalties and fees for technical services (FTS) from the India-Germany DTAA.

In detail

Background

The India-Spain DTAA was signed by the competent authorities of both states on 8 February 1993, and it came into force on 12 January 1995. Paragraph 7 of the Protocol to the India-Spain DTAA provides that if, under any DTAA between India and a third state that is a member of the Organisation for Economic Cooperation and Development (OECD), which enters into force after 1 January 1990, India limits its taxation at source on royalties or FTS to a rate lower or a scope more restricted than the rate or scope provided under the India-Spain DTAA, then the same rate or scope as provided for in that DTAA on royalty or FTS will also apply to the India-Spain DTAA.

Exercising the powers conferred by section 90 of the Income-tax Act, 1961 (the Act), the Central Government now invoked the provisions of the MFN clause enshrined under paragraph 7 of the Protocol to the India-Spain DTAA. The DTAA signed between India-Germany entered into force on 26 October 1996 (i.e. after 1 January 1990), and Germany was an OECD member at the time of entering into this DTAA with India. Since India has limited the taxation at source on royalties and FTS to a rate lower than that provided under the India-Spain DTAA on said items of income, the Central Government notified that such lower rate provided under the India-Germany DTAA will now be imported into the India-Spain DTAA.

Accordingly, paragraph 2 of Article 13 of India-Spain DTAA stands modified as reproduced in the below table. This will be applicable with effect from assessment year 2024–25.

[1] Notification No. 33/2024 dated 19 March 2024

Article 13 in the India-Spain DTAA prior to the notification	Article 13 in the India-Spain DTAA after the notification
'2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State, but if the recipient is the beneficial owner of the royalties or fees for technical services the tax so charged shall not exceed : *(i) in the case of royalties relating to the payments for the use of, or the right to use, industrial, commercial or scientific equipment, **10 per cent of the gross amount of the royalties**;* *(ii) in the case of **fees for technical services and other royalties, 20 per cent** of the gross amount of fees for technical services or royalties'.*	*'2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State, but if the recipient is the beneficial owner of the royalties or fees for technical services the tax so charged **shall not exceed 10 per cent of the gross amount of the royalties or fees for technical services'.***

The takeaways

Automatic applicability of the MFN clause has been a subject matter of dispute.

The Central Board of Direct Taxes clarified in February 2022[2] that, among other things, the following conditions must be satisfied cumulatively to apply the MFN clause in a DTAA –

1. The second DTAA is signed after signing the DTAA between India and the first country, subject to the language of the MFN clause.
2. Such third country is a member of the OECD at the time of signing the DTAA with India.
3. The second DTAA provides a beneficial tax rate or scope in respect of the relevant items of income.
4. India issues a separate notification to import the benefits of the second DTAA into the first DTAA.

Subsequently, the Supreme Court of India held[3] that a notification under section 90 of the Act is a necessary and mandatory condition to give effect to a DTAA or any Protocol that has the effect of altering the existing provisions of law. A review petition against the Supreme Court judgement is pending.

The present notification is in line with the findings of the Supreme Court and the benefit of a lower tax rate under the India-Germany DTAA; i.e. a tax rate of 10% is now extended to the taxpayers on royalties and FTS taxable under the India-Spain DTAA.

Under some of the other DTAAs signed by India with an OECD member country that entered into force after 1 January 1990, India has limited the taxation at source on royalties and FTS to not only a lower rate but also a restricted scope compared with that provided in the India-Germany DTAA (e.g. the DTAA signed between India and Portugal). However, in this case, only the rate has been imported from the India-Germany DTAA.

It will be interesting to see if, as a consequence of the above Supreme Court decision, the Central Government notifies a similar lower rate or restricted scope for other OECD member countries who have signed a DTAA with India.

2 Circular no. 3/2022 dated 3 February 2022

3 Civil Appeal No(s). 1420 of 2023; You may click here to refer to our Tax Insights.

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