



# Update on IN-NL dividend WHT rate: Indian Supreme Court Ruling

February 2024

Reading time: 15 minutes

*This blog is related to our previous blogs about the effective dividend withholding tax (“WHT”) rate as per the provisions of the Double Taxation Avoidance Agreement (“DTAA”) between the Netherlands and India. In this blog, we cover the latest update on this topic – an Indian Supreme Court (“SC”) ruling regarding the interpretation of Most Favoured Nation (“MFN”) clauses in Indian tax treaties with various OECD member countries.*

*This Indian SC ruling has caused quite a stir among companies invested in India as it could lead to a flurry of tax and penalty demands from the Indian tax authorities. Notably, with regard to the Netherlands, the impact of the SC ruling appears to be limited to the dividend WHT rate under the India-Netherlands DTAA. The dividend WHT rate in Indian DTAA is only relevant since 1 April 2020 (i.e., when India abolished its domestic Dividend Distribution Tax).*

*The WHT rate and definition of Fees for Technical Services (“FTS”) under the India-Netherlands DTAA do not seem to be affected by the ruling of the Indian SC. However, the Indian SC’s view that MFN clauses in Indian DTAA are triggered only upon notification by the Indian tax authorities necessitates a closer look at all Indian DTAA containing MFN clauses. For an in-depth analysis of all Indian DTAA that might be affected by this Indian SC ruling, look out for our next blog on this topic.*

On 19<sup>th</sup> October 2023, the Supreme Court of India pronounced its decision in the case of *Assessing Officer Circle (International Taxation) vs. M/S Nestle SA & others (Civil Appeal No(s). 1420 of 2023)*<sup>1</sup>. The apex Indian court ruled that the Most Favoured Nation (“MFN”) clauses in Indian tax treaties are not triggered unless notified by the concerned authority under Sec. 90(1) of the Income Tax Act, 1961. In doing so, the Indian Supreme Court (“SC”) has overturned several judgements of the Delhi High Court and gone against the widely held view that an MFN clause is an integral part of a Double Tax Avoidance Agreement (“DTAA”) and is triggered automatically, without the requirement of a specific notification under domestic law.

The part of the judgement that deals specifically with the effective dividend WHT rate under the India-Netherlands DTAA hinges upon the interpretation of the word “is” in the MFN clause (i.e., clause IV(2) of the Protocol to the DTAA). The MFN clause reads as follows: *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, interest, 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 India 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 SC’s interpretation of the clause is that it allows for reliance only on those Indian DTAA which are signed after the coming into force of the India-Netherlands DTAA and wherein the treaty partner countries are already

<sup>1</sup> [https://api.sci.gov.in/supremecourt/2022/6394/6394\\_2022\\_8\\_1502\\_47832\\_Judgement\\_19-Oct-2023.pdf](https://api.sci.gov.in/supremecourt/2022/6394/6394_2022_8_1502_47832_Judgement_19-Oct-2023.pdf)

members of the OECD when their respective DTAA with India are signed. Hence, the SC has implied that, if India grants favourable terms w.r.t. WHT on dividends, interest, royalties and/or fees for technical services to a country which subsequently becomes a member of the OECD (after the date on which its DTAA with India is signed), those favourable terms cannot be relied upon by Dutch taxpayers based on the MFN clause in the India-Netherlands DTAA.

India's DTAA with the Netherlands came into force on 21 January 1989, when both countries had notified each other of the completion of the procedures required under their respective laws for bringing the DTAA into force. Art. 10 of the DTAA provides for a 15% WHT rate on dividends. The India-Germany DTAA, which came into force on 26 October 1996, provides for a 10% WHT rate on dividends. Germany was already a member of the OECD at the time the India-Germany DTAA was signed. On 30 August 1999, the Indian tax authorities issued a Notification No. S.O. 693(E)<sup>2</sup>. One of the items in this notification deals with the lowering of the dividend WHT rate under the India-Netherlands DTAA by operation of the MFN clause in article IV of the Protocol to the DTAA and reliance on the dividend WHT rate in India-Germany DTAA. The notification states that the dividend WHT rate under the India-Netherlands DTAA is reduced to 10%, w.e.f. 1 April 1997.

India's DTAA with Slovenia and Lithuania provide for a 15% WHT rate on dividends, except in cases where the company in receipt of the dividends directly holds at least 10% of the capital of the company paying the dividends. In such cases, the prescribed dividend WHT rate is 5%. India's DTAA with Slovenia came into force in 2006 and the DTAA with Lithuania came into force in 2013 (i.e., respectively, 15 years and 22 years after the India-Netherlands DTAA came into force). However, at the time these DTAA were signed/came into force, Slovenia and Lithuania were not members of the OECD. Slovenia became a member of the OECD in 2010 (i.e., 4 years after the India-Slovenia DTAA was in force), whereas Lithuania became a member of the OECD in 2018 (i.e., 5 years after the India-Lithuania DTAA was in force). Further, India's DTAA with Columbia, which came into force in 2015 (i.e., 17 years after the India-Netherlands DTAA came into force), provides for a 5% WHT rate for dividends (without any minimum holding criteria). Columbia was not a member of the OECD when this DTAA was signed/came into force (in 2015), and only became a member of the OECD in 2020.

Treaty partner	Treaty in force	Dividend WHT rate	OECD member status
Netherlands	1989	15%	1961
Germany	1997	10%	1961
Slovenia	2006	5% ( $\geq$ 10% shareholding)	2010
Lithuania	2013	5% ( $\geq$ 10% shareholding)	2018
Colombia	2015	5%	2020

According to the Indian SC ruling, the aforementioned favourable rates/terms in India's DTAA with Slovenia, Lithuania and Columbia cannot be imported into the India-Netherlands DTAA via the MFN clause therein (unlike the favourable rate in the India-Germany DTAA) because (i) these countries were not members of the OECD when their respective DTAA with India were signed (i.e., it does not matter that they became OECD-member-countries subsequently); and (ii) there is no notification from the concerned Indian authorities giving effect to such interpretation.

This is, however, contrary to the interpretation of the Dutch tax authorities and Dutch government. Decree No. IFZ 2012/54M dated 28th February 2012, issued by the Directorate General for Fiscal Affairs of the Netherlands,

<sup>2</sup> Notification: S. O. 693(E) Date of Issue: 30/8/1999 ([incometaxindia.gov.in](http://incometaxindia.gov.in))

declares that the dividend WHT rate under the India-Netherlands DTAA is 5% with effect from 21 July 2010 (i.e., the date on which Slovenia became a member of the OECD) provided that the beneficial owner of the dividend is a company which directly holds at least 10% of the capital of the company paying the dividends.

The Dutch Decree was relied on by the Delhi High Court, in its judgement of 22 April 2021 in the case of Concentrix Services Netherlands B.V. and Optum Global Solutions International B.V., wherein the High Court stated that, “the best interpretative tool that can be employed to glean the intent of the Contracting States in framing Clause (IV)(2) of the Protocol would be as to how the other contracting State (i.e., the Netherlands) has interpreted the provision”. Accordingly, “for efficient and fair application of the India-Netherlands DTAA”, the Delhi High Court had held that, “a common interpretation should be applied to ensure consistency and equal allocation of tax claims between the Contracting States”. The Delhi High Court further emphasized that, while interpreting international treaties including tax treaties, “the rules of interpretation that apply to domestic or municipal law need not be applied, for the reason that international treaties, conventions and tax treaties are negotiated by diplomats and not necessarily by men instructed in the law”.

The Delhi High Court also upheld the 5% dividend WHT rate in the case of a Swiss company in receipt of dividends from its Indian subsidiary in 2021<sup>3</sup>. In this case, the Delhi High Court based its decision on the MFN clause in article 11 of the (amending) Protocol to the India-Switzerland DTAA (dated 30 August 2010), which is similar to the MFN clause in the India-Netherlands DTAA. Like the Dutch tax authorities, the Swiss tax authorities had also released a notification (dated 13 August 2021) stating that, on the basis of the MFN clause in the India-Switzerland DTAA, Lithuania's and Colombia's inclusion to the OECD (on 5 July 2018 and 28 April 2020, respectively) has the effect of retroactively reducing the dividend WHT rate in the India-Switzerland DTAA from 10% to 5% for qualified participations under the DTAA.

The two Delhi High Court rulings discussed above have been overturned by the Indian SC ruling, along with another Delhi High Court ruling concerning the definition of FTS under the France-India DTAA<sup>4</sup>. Hence, the Indian SC ruling could be a cause for concern for companies doing business in India as it could serve as a basis for the Indian tax authorities to re-assess withholding taxes paid in the last 4-6 years<sup>5</sup>. For instance, Dutch companies that have received dividends from their Indian subsidiaries in the last 3-4 years<sup>6</sup> and paid 5% WHT in India, could (potentially) receive reassessment notices from the Indian tax authorities, demanding the 5% (deficit) tax, along with interest and perhaps, also penalties. Swiss companies in receipt of dividends from Indian companies in the last 3-4 years and French companies in receipt of service fees (and especially, fees for managerial services) from Indian companies in the last 6 years could (potentially) suffer a similar fate.

There is a chance, however, that the Indian tax authorities could show some leniency w.r.t. penalties since Dutch, Swiss and French taxpayers were availing the lower WHT rates/more restrictive definition of FTS based on decrees issued by the concerned authorities in their respective countries as well as previous (favourable) Indian lower court rulings. It is also expected that the Indian tax authorities will issue a Circular clarifying if and how the deficit tax will be collected because there is no clear procedure relating to the collection/payment of such back-taxes. For instance, it is unclear whether domestic law allows for such tax to be levied on the Indian payee and then on-charged to the foreign company; this could be an issue under the Foreign Exchange Management Act, 1999.

<sup>3</sup> Delhi High Court decision of 4 June 2021 in the case of Nestle S.A. vs. Indian Income Tax Office; W.P.(C) 3243/2021

<sup>4</sup> Delhi High Court decision of 28 July 2016 in the case of Steria (India) Ltd. vs Commissioner Of Income Tax; W.P.(C) 4793/2014 & CM APPL. 9551/2014

<sup>5</sup> Usually, Indian tax authorities can re-visit an assessment for up to 4 -6 years (depending on the amount in question).

<sup>6</sup> The dividend WHT rate under the India-Netherlands DTAA is only relevant since 1 April 2020 (i.e., since the abolition of the Indian Dividend Distribution Tax).

Although a review appeal has been filed against the SC ruling by the taxpayers directly affected by the ruling, it is unlikely that the SC will overturn its own judgment, as this has only happened on the rarest of rare occasions, and never in a tax case. Under these circumstances, from the date of the SC ruling, Indian companies are obliged to follow the SC's view that the MFN clauses in Indian tax treaties are not triggered unless notified by the concerned authority under Sec. 90(1) of the Income Tax Act, 1961. The implication for Dutch and Swiss companies is a 10% WHT on dividends received from their Indian subsidiaries. For French companies, the restrictive definition of FTS (that excludes services that do not *make available technical knowledge, experience, skill, know-how or processes, or consist of the development and transfer of a technical plan or technical design*) cannot be applied. For an in-depth analysis of all Indian DTAA's that might be affected by this Indian SC ruling, look out for our next blog on this topic.

### Key takeaways

- For Dutch companies doing business in India, the impact of the Indian SC ruling is limited to the dividend WHT rate. The ruling does not impact the rate or scope of royalties, FTS or other items of income under the India-Netherlands DTAA. Post the SC ruling, Indian companies need to apply the 10% WHT rate on dividends paid to their Dutch shareholders.
- Dutch companies in receipt of dividends from Indian subsidiaries on and after 1 April 2020 (from which 5% WHT has been deducted and paid) may need to deposit the additional 5% WHT (along with the applicable interest) with the Indian tax authorities. In such case, the Dutch companies would also have to file corrected tax returns in India for the relevant year(s). Fines/penalties levied by the Indian tax authorities in this regard should be appealed against based on previous (favourable) Indian lower court rulings.

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