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Government of India

Ministry of Finance

Department of Revenue

Central Board of Direct Taxes

(FT&TR-I)

New Delhi, 3rd February, 2022

Subject: Clarification regarding the Most-Favoured-Nation (MFN) clause in the Protocol to India's DTAAs with certain countries– Reg.

The Protocol to India's Double Taxation Avoidance Agreements (DTAAs) with some of the countries, especially European States and OECD members (The Netherlands, France, the Swiss Confederation, Sweden, Spain and Hungary) contains a provision, referred to as the Most-Favoured-Nation (MFN) clause. Though each MFN clause in these DTAAs has a different formulation, the general underlying provision is that if after the signature/ entry into force (depending upon the language of the MFN clause) of the DTAA with the first State, India enters into a DTAA with another OECD Member State, wherein India limits its source taxation rights in relation to certain items of income (such as dividends, interest income, royalties, Fees for Technical Services, etc.) to a rate lower or a scope more restricted than the scope provided for those items of income in the DTAA with the first State, such beneficial treatment should also be extended to the first State.

2. The Central Board of Direct Taxes (CBDT) has received representations seeking clarity on the applicability of the MFN clause (particularly to dividend withholding rates) available in the Protocol to some of the DTAAs with OECD member States. India's DTAAs with countries,

namely Slovenia, Colombia and Lithuania, provide for lower rate of source taxation with respect to certain items of income. However, these States were not members of the OECD at the time of the conclusion of their DTAAs with India and have become members of the OECD thereafter.

3. Reference is drawn to the decree issued by the Directorate General for Fiscal Affairs, International Fiscal Affairs, Netherlands (Decree No IFZ 2012/54M dated 28th February 2012) (hereinafter referred to as "the decree"), the French official bulletin of Public finances-Taxes (Bulletin Officiel des Finances Publiques-Impôts) published by DGFIP on 4th November, 2016 (hereinafter referred to as "the bulletin ") and the publication by the Federal Department of Finance, the Swiss Confederation on 13th August, 2021 (hereinafter referred to as "the publication"). The unilateral decree/bulletin of The Netherlands and France declare that the tax rate on dividends under their respective DTAAs with India stands modified under the MFN clause after India entered into a DTAA with Slovenia, which became a member of the OECD on 21st July, 2010. The DTAA has a lower tax rate of 5% if the holding is above 10%. It has been further stated in the decree/bulletin that the lower rate will be applicable retrospectively from the date Slovenia became member of the OECD. Similarly, the unilateral publication of the Swiss Confederation declares that the tax rate on dividends under their DTAA with India stands modified under the MFN clause after India entered into a DTAA with Lithuania and Colombia who became members of the OECD on 5th July, 2018 and 28th April, 2020 respectively. The publication further states that the lower rate of 5% will be applicable for holding above 10% retrospectively from 5th July, 2018 (i.e. date of Lithuania joining the OECD) and for dividends arising from qualified interests and portfolio dividends retrospectively from 28th April, 2020 (i.e. date of Colombia joining the OECD).

4. In view of the above-mentioned decree/bulletin/publication on interpretation of the MFN clauses and the representations received from the taxpayers and field formation seeking clarity, the CBDT hereby issues the following clarifications on the applicability of the MFN clause:

4.1 **Unilateral decree/bulletin/publication do not represent shared understanding of the treaty partners on applicability of the MFN clause:**

Both The Netherlands and France have passed the said decree/bulletin without having any bilateral consultation with India. Therefore, these decree/ bulletin do not represent the shared understanding of India and the respective treaty partners on the applicability of the MFN clause and have no binding force as far as interpretation of MFN clause in the respective treaties is concerned. At best these unilateral decree/bulletin only represent the views of the respective governments for providing relief from The Netherlands/France tax. Since these decree/bulletin were passed without any discussion with the Government of India, it would not have any effect on curtailing the tax liability that is payable to the Government of India under the respective tax treaty.

4.1.1 India has also communicated its position to The Netherlands and France that the decree/bulletin in question is not in accordance with the object and purpose enshrined in the respective DTAAs and that the lower tax rate in the India-Slovenia treaty cannot be imported into these treaties by virtue of the MFN clause as Slovenia **was not** a member of the OECD when India had entered into DTAA with it. Reliance on the mere fact that Slovenia is an OECD member State at the time of applicability of the MFN clause defeats the object and purpose of the MFN clause. There has been no response from The Netherlands and France to India's interpretation of MFN clause conveyed to them.

4.1.2 In the case of the Swiss Confederation, India has communicated its position that the benefits of India's DTAA with the third State cannot be imported into the India-Swiss DTAA unless the third State was a member of the OECD at the time of signing that treaty.

4.2 Conditionality for the third State being a member of the OECD on the date of conclusion of the DTAA:

On a plain reading of the MFN clauses in India's DTAAs especially with respect to the above-mentioned countries, it is clear that there is a requirement that the third State is to be a member of the OECD both at the time of conclusion of the treaty with India as well as at the time of applicability of MFN clause. Therefore, it is clarified that for applicability of the MFN clause, the third State has to be an OECD member State on the date of conclusion of DTAA with India.

4.3 Application of concessional rates/restricted scope from the date of entry into force of the DTAA with the third State and not from the date the third State becomes member of the OECD:

It may also be pointed out that the MFN clause in these DTAAs clearly states that the reduced rate takes effect from the date of entry into force of Indian DTAA with the third State. Thus, the declaration in the decree/bulletin/publication of The Netherlands, France and the Swiss Confederation to make the reduced rate effective from the date of the third State becoming member of OECD subsequent to entry into force of a DTAA is not in accordance with the relevant provision of the MFN clause in the Protocol. In fact, these countries could not have made it effective from the date of entry into force of Indian DTAA with the third State as the third State was not a member of the OECD on such date of entry into force. This makes it clear that the intention of the MFN clause in the Protocol of the DTAAs is not to give the benefit of India's DTAA with the third State which was not a member of OECD when India entered into DTAA with it. In this regard, Hon'ble Supreme Court in the case of Ram Jethmalani & Others (writ petition civil no 176 of 2009) had observed that :

> *"61. This Court in Union of India v. Azadi Bachao Andolan approvingly noted Frank Bennion's observations that a treaty is really an indirect enactment, instead of a substantive legislation, and that drafting of treaties is notoriously sloppy, whereby inconveniences obtain. In this regard this Court further noted the dictum of Lord Widgery, C.J. that the words "are to be given their general meaning, general to lawyer and layman alike.... The meaning of the diplomat rather than the lawyer." The broad principle of interpretation, with respect to treaties, and provisions therein, would be that ordinary meanings of words be given effect to, unless the context requires or otherwise. However, the fact that such treaties are drafted by diplomats, and not lawyers, leading to sloppiness in drafting also implies that* ***care has to be taken to not render any word, phrase, or sentence redundant, especially where rendering of such word, phrase or sentence redundant would lead to a manifestly absurd situation****, particularly from a constitutional perspective. The government cannot bind India in a manner that derogates from Constitutional provisions, values and imperatives."* (emphasis supplied)

Thus, one cannot ignore the clear wording of the MFN clause which mandates the application of lower rate from the date of entry into force of the Indian DTAA with the third State. All three countries have in effect through their unilateral decree/bulletin/publication made this part of the MFN clause redundant which according to the above Indian Supreme Court judgment cannot be done. The above-mentioned decree/bulletin/publication have no application so far as taxation liability of a person in India is concerned.

4.4 Requirement of notification under Section 90 of the Income-tax Act, 1961:

Further, it is a domestic requirement in India under sub-section (1) of section 90 of the Income-tax Act, 1961 that DTAA or amendment to DTAA are implemented after its notification in the Official Gazette. In the famous case of *Azadi Bachao Andolan (2004, 10 SCC)* as well, Hon'ble Supreme Court of India has observed that the DTAA provisions come into force on the date of issue of notification of such DTAA. Hon'ble Supreme Court also made it clear in the judgment that the beneficial provision of sub-section (2) of section 90 springs into operation once the notification is issued. The relevant extract of that judgment reads as under :

"A survey of the aforesaid cases makes it clear that the judicial consensus in India has been that section 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a double taxation avoidance agreement. When that happens, the provisions of such an agreement, with respect to cases to which where they apply, would operate even if inconsistent with the provisions of the Income-tax Act. We approve of the reasoning in the decisions which we have noticed. If it was not the intention of the legislature to make a departure from the general principle of chargeability to tax under section 4 and the general principle of ascertainment of total income under section 5 of the Act, then there was no purpose in making those sections "subject to the provisions of the Act". ***The very object of grafting the said two sections with the said clause is to enable the Central Government to issue a notification under section 90 towards implementation of the terms of the DTAs*** *which would automatically override the provisions of the Income- tax Act in the matter of ascertainment of chargeability to income tax and ascertainment of total income, to the extent of inconsistency with the terms of the DTAC.....*

.....

.....This Court is not concerned with the manner in which tax treaties are negotiated or enunciated; nor is it concerned with the wisdom of any particular treaty. Whether the Indo-Mauritius DTAC ought to have been enunciated in the present form, or in any other particular form, is none of our concern. Whether section 90 ought to have been placed on the statute book, is also not our concern. Section 90, which delegates powers to the Central Government, has not been challenged before us, and, therefore, we must proceed on the footing that the section is constitutionally valid. The challenge being only to the exercise of the power emanating from the section, ***we are of the view that section 90 enables the Central Government to enter into a DTAC with the foreign Government. When the requisite notification has been issued thereunder, the provisions of sub-section (2) of section 90 spring into operation*** *and an assessee who is covered by the provisions of the DTAC is entitled to seek benefits thereunder, even if the provisions of the DTAC are inconsistent with the provisions of Income-tax Act, 1961."* (emphasis supplied)

4.4.1 It may be noted that India has not issued any notification importing the benefit of treaties with Slovenia, Lithuania and Colombia to treaties with The Netherlands, France or the Swiss Confederation.

4.5 No selective import of concessional rates under MFN clause:

Without prejudice to the above discussion, it may be further noted that some jurisdictions have been selective in invoking and applying the MFN clause, which the provisions of the treaty, read with the Rules of interpretation of international treaties do not permit. India's treaties with Slovenia and Lithuania consist of a split rate of tax for dividends. Article 10(2) of the India-Lithuania treaty is being reproduced here:

"However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10 per cent of the capital of the company paying the dividends;

(b) 15 per cent of the gross amount of the dividends in all other cases. "

A plain reading of the above extract leads to the inference that the beneficial rate of 5% on Dividend income is applicable only if the company (other than a partnership) receiving the dividends holds directly at least 10% of the capital of the company paying the dividends. The same was also communicated to the authorities of The Netherlands, France and the Swiss Confederation. Even though The Netherlands, France and the Swiss Confederation have taken this into account in their decree/bulletin/publication by providing that the rate of 5% will be applicable only when the condition of 10% ownership is satisfied, there is no sound rationale/basis provided for the selective import on account of not switching to 15% tax rate in other cases. The concern expressed by India to these countries, on this issue, has remained unaddressed.

5. In view of the above, it is hereby clarified that the applicability of the MFN clause and benefit of the lower rate or restricted scope of source taxation rights in relation to certain items of income (such as dividends, interest income, royalties, Fees for Technical Services, etc.) provided in India's DTAAs with the third States will be available to the first (OECD) State only when all the following conditions are met:

(i) The second treaty (with the third State) is entered into after the signature/ Entry into Force (depending upon the language of the MFN clause) of the treaty between India and the first State;

(ii) The second treaty is entered into between India and a State which is a member of the OECD at the time of signing the treaty with it;

(iii) India limits its taxing rights in the second treaty in relation to rate or scope of taxation in respect of the relevant items of income; and

(iv) A separate notification has been issued by India, importing the benefits of the second treaty into the treaty with the first State, as required by the provisions of sub-section (1) of Section 90 of the Income Tax Act, 1961.

If all the conditions enumerated in Paragraph 5(i) to (iv) are satisfied, then the lower rate or restricted scope in the treaty with the third State is imported into the treaty with an OECD

State having MFN clause from the date as per the provisions of the MFN clause in the DTAA, after following the due procedure under the Indian tax law.

6. Notwithstanding the clarification given in the above paragraphs, where in the case of a taxpayer there is any decision by any court on this issue favourable to such taxpayer this Circular will not affect the implementation of the court order in such case.

03/02/2022

(Sukhad Chaturvedi)

Under Secretary to the Government of India

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