Recent Developments on the Application of the Most Favoured Nation Clauses in Tax Treaties. The Indian Case Study

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Abstract
The Indian Central Board of Direct Taxes issued a Circular in February 2022 stating its position on the activation of the Most Favoured Nation clauses included in the tax treaties concluded by India with the Netherlands, France and Switzerland. The paper aims to analyse such document and, therefore, the point of view of the Indian Government on this topic. It starts with an overview of the facts and circumstances taken into consideration in the Circular and then assesses critically the different approaches and principles stated by the Central Board of Direct Taxes in the same document.

1. Introduction

The debate on the Most Favoured Nation ("MFN") clauses in the tax treaties has increased in the last years mainly because of certain judicial precedents and consequential developments that occurred in the international tax community.

The issues around these clauses are mainly due to: (i) the lack of a model clause in the OECD and UN Model Convention ("OECD/UN MC") and the consequent proliferation of many variants of the clause in the relevant double tax treaties ("DTTs"); (ii) the general lack of a clear wording, and the consequent different interpretations of the same clauses by the relevant contracting states (see *infra*); (iii) the limited number of DTTs in which they are present (i.e. mainly those concluded with developing countries), and the consequent lack of detailed studies on their functioning, application and interpretation.

The authors have recently published an article on this topic[1], assessing the historical background of the MFN clauses and some of the above main issues; the article also includes a comparative analysis of the different MFN clauses included in the tax treaties of certain jurisdictions[2].

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[1] JALAN, N.; MANZI, G.; GREVE ARCIL, G. Most Favoured Nation clauses in tax treaties: comparative analysis and main issues. *World Tax Journal*, vol. 14, no. 1, 2022.

[2] I.e., India, Italian and Chilean jurisdictions.

In this article, the authors intend to cover a very recent development on this topic, i.e. the Indian Central Board of Direct Taxes ("CBDT") Circular no. 3/2022, dated 3 February 2022 ("Circular"), where the Indian Government has taken specific positions on some of the main critical issues on the application of MFN clauses in the tax treaties[3].

In particular, the Circular assesses the functioning and mechanics of application of the MFN clauses included in the DTTs concluded by India with the Netherlands, France and Switzerland and the circumstances in which the taxpayers can claim benefits of such clauses. The debated question is about whether these clauses have been activated by the subsequent DTTs concluded by India with Slovenia, Lithuania and Colombia, as these States were not OECD member countries at the time of conclusion of such DTTs; they obtained the OECD membership at a later stage.

The analysis starts with an overview of the facts taken into consideration in the Circular and then continues with a chapter about what the Circular said (or should have said), including the authors' analysis of the different points taken into consideration by the CBDT[4], and finally provides some considerations on the actual weight of the document at hand.

2. Facts assessed in the Circular

The Circular assesses whether the MFN clauses included in the DTTs with the Netherlands, France and Switzerland have been actually activated by the conclusion of the subsequent DTTs with Slovenia, Lithuania and Colombia and their subsequent change in the status from non-OECD to OECD member countries.

In particular, the relevant MFN clauses are those reported below:

– the India-Netherlands DTT, concluded on 30 July 1988, entered into force on 21 January 1989, provides with the following clause: "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* it 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

[3] JALAN, N.; MANZI, G.; GREVE ARCIL, G. Op. cit. The Circular was published after the publication of the decision on the Indian Concentrix case (Delhi HC, 22 April 2021, Concentrix Services Netherlands B.V. vs. Income Tax Officer (TDS), Cases W.P.(C) 9051/2020 and W.P.(C) 882/2021 (2021)), which brought the attention of the Indian tax community on certain issues regarding the MFN clause application in tax treaties.

[4] Only §4.5. of the Circular has been considered outside the scope of this paper.

that Convention or Agreement on the said items of income shall also apply under this Convention" (Protocol, point no. IV);

- the India-France DTT, signed on 29 September 1992, entered into force on 1 August 1994[5], provides with the following clause: "In respect of articles 11(Dividends), 12 (Interests) and 13 (Royalties, fees for technical services and payments for the use of equipment), if under any Convention, Agreement or Protocol *signed after 1-9-1989*, between India and a third State *which is a member of the OECD*, *India limits 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, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention, *with effect from the date on which the present Convention or the relevant Indian Convention*, Agreement or Protocol *enters into force*, whichever enters into force later" (Protocol point no. 7);
- the India-Switzerland DTT, concluded on 2 November 1994, entered into force on 29 December 1994, provides with the following clause: "In respect of articles 11(Dividends), 12 (Interest) and 12 (Royalties and fees for technical services), if under any Convention, Agreement or Protocol between India and a third State *which is a member of the OECD signed after the signature of this Amending Protocol*, *India limits* its taxation at source on dividends, interest, royalties or fees for technical services to a rate lower than the rate provided for in this agreement on the said items of income, the same rate as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply between both Contracting States under this Agreement *as from the date on which such Convention, Agreement or Protocol enters into force*" (Protocol point no. 10);

The above MFN clauses have been (allegedly) activated by the following DTTs:

- with regard to the India-Netherlands DTT and the India-France DTT: by India-Slovenia DTT, concluded on 13 January 2003, entered into force on 17 February 2005, in which it has been agreed a lower 5% dividends rate in case holding is above 10%;
- with regard to the India-Switzerland DTT: (i) first, by India-Lithuania, concluded on 26 July 2011, entered into force on 10 July 2012. The DTT with Lithuania includes a lower 5% dividends rate in case holding is above

[5] The first Convention between France and India was concluded on 26 March 1969. It has been subsequently abrogated by the one signed in 1992 that included for the first time the quoted MFN clause.

10%; (ii) secondly by India-Colombia DTT, concluded on 13 May 2011, entered into force on 7 July 2014. The DTT with Colombia, instead, includes a lower 5% dividends rate for dividends arising from qualified interests and portfolio dividends.

In relation to the above, the main issue on the application of the MFN clauses goes around the moment when these States (i.e. Slovenia, Lithuania and Colombia) became OECD members.

OECD membership, in fact, is one of the requirements specifically indicated by all the abovementioned MFN clauses necessary to trigger their application.

Anticipating some of the issues assessed in the next chapter, the CBDT believes that the MFN clauses have not been activated by the subsequent DTTs, because Slovenia, Lithuania and Colombia were not OECD members at the time of the signing/conclusion of the relevant DTTs with India, but become OECD members thereafter (i.e. Slovenia on 21 July 2010; Lithuania on 5 July 2018; Colombia on 28 April 2020).

The Netherlands, France and Switzerland believe the contrary, considering the OECD membership a requirement that can also be fulfilled at a later stage (i.e. at the time of the application of the MFN clause). For this purpose, these countries issued (unilateral) official communications related to the application of the above MFN clauses:

- with respect to the Netherlands: Decree no. IFZ 2012/54M dated 28 February 2012 ("Decree"), stating the MFN clause application from the moment Slovenia became an OECD member (i.e. 21 July 2010);
- with respect to France: official bulletin of Public finances-Taxes (*Bulletin Officiel des Finances Publiques-Impots*) published by DGFIP on 4 November 2016 ("Bulletin"), stating the MFN clause application from the moment Slovenia became an OECD member (i.e. 21 July 2010);
- with respect to Switzerland: the publication made by the Federal Department of Finance – the Swiss Confederation on 13 August 2021 ("Publication") stating the MFN clause application starting from: (i) for the Lithuania DTT's clause: when Lithuania became an OECD member (i.e. 5 July 2018); (ii) for the Colombia DTT's clause: when Colombia became an OECD member (i.e. 28 April 2020).

3. What the Circular (should have) said

Four main statements/principles can be extracted from the Circular[6]. This section aims to go through them, critically assessing the arguments upheld by the CBDT.

[6] The sub-titles of this §3 represent the statements of the different sub-section of the Circular from §4.1. to §4.4.

3.1. Unilateral Decree/Bulletin/Publication do not represent shared understanding of the treaty partners on applicability of the MFN clause

The first point raised by the Circular[7] deals with the unilateral communications issued by the Netherlands, France and Switzerland (as stated in section 2), in relation to the activation of the relevant MFN clauses.

According to the Circular, such unilateral communications (i) do not represent a shared understanding of the MFN clauses' applicability and, thus, (ii) they cannot have any binding force as far as interpretation of the clauses at hand is concerned. At most, these unilateral approaches can represent the view of the other Contracting States for providing relief from taxes to be paid in the respective countries. Since these unilateral communications have not been agreed upon with India cannot have any impact on the taxes to be paid in India.

Thus, the Circular seems to suggest that a further agreement between India and the relevant Contracting States is required in order to activate the mentioned MFN clauses.

From a technical/theoretical standpoint, this statement seems not correct[8], having considered the wording of the MFN clauses of the Indian tax treaty with the Netherlands, France and Switzerland.

The MFN clauses in these tax treaties, related to passive income tax rates, do not require any further activities/duties[9]. by the relevant Contracting States to apply the beneficial treatment provided by the same clauses[10]. The wording of these clauses, in fact, says that if, after the conclusion of the DTT between India and the Netherlands/France/Switzerland, India concludes another DTT with a third country which is an OECD member[11], granting more favourable rates for passive income, it has to provide the same rates to the Netherlands/France/Switzerland from the date of entry into force of the treaty with the third country. The wording suggests an automatic application of the MFN clause if the other requirements stated in the clause are satisfied.

Nearly 75% of the treaties signed by India which include an MFN clause are similar to the clauses at hand and, thus, do not require any additional negotiations or notifications duties by the relevant Contracting States[12].

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7 Circular §4.1.

8 At least in relation to dividend income tax rates. See *infra*: there is a second MFN clause in the DTT concluded between India and Switzerland, which has a different functioning, and it is able to challenge the position of the Indian Government.

9 The activation of the MFN clause varies across tax treaties, and it can have either automatic application, it may require negotiation with the other Contracting state, or it may require notification duties. See: JALAN, N.; MANZI, G.; GREVE ARCIL, G., op. cit., §2.2.

10 See *infra*: there is a second MFN clause in the treaty concluded between India and Switzerland, which has a different functioning, and it is able to challenge the position of the Indian Government.

11 This requirement will be assessed in more detail below.

12 JALAN, N.; MANZI, G.; GREVE ARCIL, G., op. cit., §2.2.2.1.

In certain cases, brought before Indian courts, the Indian judges have already rejected the alleged notification requirements invoked by the Indian Tax Authorities with respect to the same clauses, i.e. with respect to clauses that do not mention such requirement (e.g. see: *SCA Hygiene Products* case[13]). Analogously, there are also certain Indian courts' judgements[14], where the Indian DTTs with France, Switzerland and Netherlands have been tested, and courts have ruled on the automatic application of the MFN clause[15].

Further, the position of the CBDT seems difficult to be upheld for another reason. There are treaties signed by India in which additional activities are required by the relevant Contracting States in order to activate the MFN clause. Thus, it can be said that the Indian government is aware of this topic, i.e., of the fact that without mentioning a specific duty (e.g., notification or further agreement/negotiation), the MFN clause could be of automatic application; in other words, the different possibilities mentioned above are something well known in the Indian tax treaty policy.

For example, this is the case of the India-Finland DTT, which includes an MFN clause with a similar functioning of those mentioned above, but which conditions its application to a specific notification requirement. Literally, the clause says: "The competent authority of India shall inform the competent authority of Finland without delay that the conditions for the application of this paragraph have been met and *issue a notification to this effect for application of such exemption or lower rate*" (emphasis added)[16].

But the most relevant argument against the coherence of the reasoning made by the CBDT is demonstrated by one of the treaties that have been assessed in the Circular itself, i.e. the DTT with Switzerland.

This MFN clause in the treaty has two parts. The first one has been quoted above and relates to the passive income rates; as anticipated, it does not provide any further activities for its application.

The second one, instead, concerns the scope of certain passive incomes and reads as follows: "If after the date of signature this Amending Protocol, India under any Convention, Agreement or Protocol with a third State which is a mem-

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13 In: ITAT Mumbai, *SCA Hygiene Products AB*, Case TS-4-ITAT-2021(Mum). See also: JALAN, N.; MANZI, G.; GREVE ARCIL, G., op. cit., §2.2.2.1.

14 India-France DTT: Steria India Ltd vs. CIT [TS-5588-HC-2016(DELHI)-O] / Poonawalla Aviation (P.) Ltd., In re [TS-717-AAR-2011-O], In re; India-Switzerland DTT: Torrent Pharmaceuticals Ltd. vs. ITO (Case TS-609-ITAT-2016(Ahd)); India-The Netherlands DTT: Concentrix Services Netherlands B.V. vs. Income Tax Officer (TDS), Cases W.P.(C) 9051/2020 and W.P.(C) 882/2021 (2021), Delhi HC.

15 For example, in the ITAT case of Torrent Pharmaceuticals Ltd., Case TS-609-ITAT-2016(Ahd)). Except for a specific situation in the DTT with Switzerland, where a second MFN clause requires re-negotiation in certain cases.

16 India-Finland DTT, Protocol point no. II.

ber of the OECD, restricts the scope in respect of royalties or fees for technical services than the scope for these items of income provided for in Article 12 of this Agreement, then Switzerland and India shall enter into *negotiations* without undue delay in order to provide the same treatment to Switzerland as that provided to the third State" (emphasis added)[17].

The clarification mentioned above clearly suggests that India and Switzerland expressly agreed to condition only this second MFN clause to further negotiation. Otherwise, they would have put the same wording also in the text of the first one on passive income rates.

This is even more clear when assessing the history of such a clause. The footnote No. 10 to point No. 5 of the Protocol[18] says that the MFN clauses quoted above have not always been in the present shape but have been modified in 2011. In particular, the mentioned point No. 5 of the Protocol was substituted by Notification No. SO 2903(E), dated 27 December 2011. Prior to its substitution, the same paragraph[19], which was amended by Notification No. GSR 74(E), dated 7 February 2001, read as follows: "With reference to Articles 10, 11 and 12: 4. If after the signature of the Protocol of 16 February 2000 under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD, India should limit its taxation at source on dividends, interest, royalties or fees for technical services to *a rate lower* or a *scope more restricted* than the rate or scope provided for in this Agreement on the said items of income, then, Switzerland and India shall enter into *negotiations* without undue delay in order to provide the same treatment to Switzerland as that provided to the third State" (emphasis added).

The above further underlines that previously the treaty conditioned the application of the MFN clauses to further negotiations between the relevant Contracting States both in the case of lower passive income rates and more restricted scope of the same.

In 2011, the Contracting States intentionally modified the clause, subjecting it to further negotiation only in the case of more restricted scope of passive income DTTs articles. This amendment *de facto* set off the automatic application of the MFN clause related to passive income rates.

In the light of the above, it can be upheld that, at least from a theoretical standpoint, the Circular is wrong when it says that "[s]ince 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"[20]. This is because the Netherlands/France/

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17 India-Switzerland DTT, Protocol point no. 5.

18 The Protocol of the India-Switzerland DTT.

19 Previously this paragraph had a different numbering, it was the no. 4. Then, it has been renumbered as paragraph no. 5 by Notification no.SO 2903(E), dated 27 December 2011.

20 Circular §4.1., p. 3.

Switzerland were not obliged to reach any further agreement with India before applying the relevant MFN clauses (i.e. at least those relating to dividend rates in this case).

At most, a notification duty vis-a-vis the other Contracting State may be required by the country that recorded a change in its taxation laws due to the conclusion of a DTT with the third state and, thus, to the activation of the relevant MFN clause (India in this case); such a duty could be upheld on the basis of a provision similar to the one provided by article 2(4) OECD MC, which is included in the DTTs signed by India with the Netherlands, France and Switzerland[21]. However, such a notification would be more a matter of courtesy vis-a-vis the other contracting states, where it is not conceived in the DTT as an express condition for the MFN clause activation.

Having said that, here, there is definitely another problem, which relates to a different interpretation of the MFN clause. In fact, even if it can be upheld the automatic application of the MFN clause related to passive income rates, such an application entails, in any case, the satisfaction of the conditions required by the same MFN clause. India disagrees on the fulfilment of the OECD membership condition and – according to the Circular[22] – communicated its position to the relevant Contracting States without receiving any response (this issue is assessed more in detail in the next paragraph).

3.2. Conditionality for the third State being a member of the OECD on the date of conclusion of the DTT

As anticipated above, the main disagreement between the CBDT and the relevant Contracting States concerns the actual fulfilment of the conditions required for the MFN clause activation, specifically the "OECD membership" one.

These clauses are activated only if a subsequent treaty is concluded by India with a third country which is an OECD member. However, the same clauses are not clear in determining at which date the third country should be an OECD member, e.g. (i) at the time the DTT with India is concluded, (ii) it enters into force, or (iii) when the taxpayer/the other Contracting State applies the MFN clause.

According to the Circular[23], it is clear from the MFN clauses' wording that the third state has to be an OECD member both at the time of the conclusion of the DTT and at the time of applicability of the MFN clause. Slovenia was not an

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[21] The wording of article 2(4) OECD MC reads as follows: "[...] The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation law". For a more detailed analysis of this issue, see: JALAN, N.; MANZI, G.; GREVE ARCIL, G., op. cit., §2.3.3.1.

[22] Circular §4.1.1. and §4.1.2., p. 3.

[23] Circular §4.2.

OECD member when India entered into the DTT with it. Reliance on the fact that Slovenia was an OECD member at the time of the application of the MFN clause is contrary to the object and purpose of the DTT.

The first objection to the Circular is that the wording is all but clear; in fact, it has been interpreted in the opposite way by all the other Contracting States, and it is very debated in academia[24]. It does not specify when the OECD membership condition has to be met like many other DTTs do.

For example, the MFN clause included in the DTT signed between Italy and Lithuania literally says: "it is understood that if Lithuania agreed in a convention for the avoidance of double taxation with another State which *at 1 January 1996 is a member of the OECD*" (emphasis added)[25]. Another example is provided by the MFN clause included in the DTT between Italy and New Zealand according to which: "if, in a Convention for the avoidance of double taxation that is subsequently made between New Zealand and a third State *being a State that at the date of signature of this Protocol is a member of the OECD*" (emphasis added)[26].

As can be seen below, the wording used in the MFN clauses assessed in this paper is more ambiguous than the one mentioned above:

- DTT with the Netherlands: "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";
- DTT with France: "if under any Convention, Agreement or Protocol signed after 1-9-1989, between India and a third State which is a member of the OECD";
- DTT with Switzerland: "if under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD signed after the signature of this Amending Protocol".

In this regard, the authors have already pointed out that the wording used can allow different interpretations, depending on the approach adopted[27].

In particular, on one hand, one may say that the subsequent DTT with the third state shall be necessarily signed with a country that already has the OECD membership at the moment of the conclusion of the same DTT. In the case at hand, India did not sign the subsequent DTTs with OECD members but with countries that became OECD members at a later stage (i.e., Slovenia, Lithuania, Colombia). This is the position upheld by the CBDT in the Circular.

On the other hand, the grammatical analysis of the verb "is" shows that its meaning can have past, present or future connotations, thus, allowing the fulfil-

[24] JALAN, N.; MANZI, G.; GREVE ARCIL, G., op. cit., §2.3.2.1.
[25] Italy-Lithuania DTT, Protocol lett. b).
[26] Italy-New Zealand DTT, Protocol lett. g).
[27] JALAN, N.; MANZI, G.; GREVE ARCIL, G., op. cit., §2.3.2.1.

ment of the OECD membership condition also after the signing of the DTTs with the relevant third states. Based on the unilateral notifications, it seems this is the position upheld by the Netherlands, France and Switzerland.

Situations in which different interpretations are possible is not uncommon in tax treaties, especially where terms are not defined therein.

However, the circumstances addressed in this article appear a bit different: the main issue here seems not only about the interpretation of a term that could have a slightly different significance under the relevant jurisdictions involved. Here, there is a disagreement also on certain basic elements required for the MFN clauses' activation, e.g., the possible starting dates of their effects.

Is it possible that the Contracting States did not discuss this matter/reach an agreement on such conditions and that they have left the wording of the clause ambiguous on purpose just to conclude the treaty?

In the authors' opinion, the answer to the above question should be negative since, as said above, the point under discussion is a really basic element of the clause at hand. Further, the hypothesised behaviour would be in contrast with the acting in good faith enshrined in the Vienna Convention on the Law of Treaties 1969 ("VCLT") and a professional approach.

The determination of the conditions for the MFN clause application is not something that could remain unclear or could be left to the different interpretations of the parties; it is like the Contracting States did not agree on the date of the entry into force of the DTT, or similar.

This is also strange because at the time of the conclusion of the DTTs with the Netherlands (1988), France (1992) and Switzerland (1994), in the international treaty network, there were already some DTTs, including MFN clauses with a clearer wording than the one used in the MFN clause at hand. Just to mention one, the DTT between Italy and Australia concluded in 1982 reads as follows: "third State being a State that at the date of signature of this Protocol is a member of the OECD"[28]. One may expect from treaty negotiators an assessment of the potential issues that similar clauses have triggered in other treaty networks, especially where such clauses are not frequently included in DTTs, have not been assessed at the OECD/UN level and lack an OECD/UN MC wording.

Further, the timing of the Circular publication is curious. This document has been issued in 2022 and pretends to challenge the interpretation document on the MFN clause's application published by the Netherlands in 2012, i.e. ten (10!) years before, by France in 2016, i.e. six years before, and by Switzerland in 2021.

Except for the Switzerland case, it seems too much time to take a position on such a sensitive topic. It also seems too much time to consider the CBDT behaviour in accordance with the object and purpose of the relevant DTTs and the

[28] Italy-Australia DTT, Protocol, article 8.

legitimate expectations of the relevant taxpayers. Could the behaviour of a taxpayer be challenged after so much time? In particular, could the Indian tax authorities challenge the application of a reduced tax rate by the taxpayer because of the MFN clause application?

In the authors' opinion, the answer should be negative. The taxpayer should legitimately see the lack of any answer or challenge by the Indian government for ten/six years as an implicit acceptance of the interpretation given by the other relevant Contracting States. The implicit agreement could be seen as a "subsequent practice in the application of the treaty" with the meaning of article 31(3)(b) VCLT, able to endorse the interpretation of the Netherlands/France/Switzerland as the common interpretation of the relevant DTT[29].

It would not be the first time that an unchallenged unilateral document qualifies as such. As mentioned by J. Avery Jones[30], "[a]n unchallenged Foreign and Colonial Office circular giving guidance on whether a member of a diplomatic mission was permanently resident in the United Kingdom (and hence liable to tax) was accepted as subsequent practice in a UK tax case [i.e., UK: SpC, 23 June 2004, Jimenez v. IRC, [2004] STC (SCD) 371, at para. 69, *a.n.*]".

Notwithstanding the above, however, one may say that the unilateral communications issued by the relevant Contracting States (India included) show a different story, i.e. the lack of an agreement on this matter. If this is really the case, the issue around the MFN clause application should be solved through a common interpretation, i.e. a further agreement between the relevant Contracting States; in this regard, unilateral approaches should be avoided and should not be decisive in determining the meaning/application of certain treaty provisions.

Also, as anticipated above, the CBDT believes that the OECD membership condition should be met both (i) at the time of the conclusion of the subsequent treaty with the third state and (ii) at the time of the MFN clause application.

It should be noticed that this approach seems more creative than the one adopted by the Netherlands/France/Switzerland under a certain point of view. The circumstance according to which the OECD membership condition has to be also met at the time of the MFN clause application is something that does not emerge at all from the wording of the clauses at hand. Thus, the CBDT seems to increase the number of the conditions required for the MFN clause application: the OECD membership should not be met only at the time of the conclusion of the treaty but should last for the entire duration of the relevant DTT.

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[29] Paragraph no. 6 of the Circular says that the statements of the Circular do not impact any favourable decision received by a taxpayer in these years. This statement, however, does not solve the issue since many more taxpayers could have decided to benefit from the relevant MFN clause without passing through a court judgement.

[30] AVERY JONES, J. F. Treaty Interpretation. *Global Tax Treaty Commentaries*, Amsterdam, sec. 3.4.7., Global Topics IBFD, 2018.

The above approach seems not coherent with the challenges made by the CBDT to the Netherlands/France/Switzerland. On the one hand, the CBDT says that the OECD membership condition could not be met at the moment later than the conclusion of the DTT with the third state. On the other hand, the CBDT is technically pretending the same from another perspective, i.e. the fulfilment of this condition (also) at a later moment, when the MFN clause is applied.

3.3. Application of the MFN beneficial treatment from the date of entry into force of the DTT with the third state and not from the date the third state becomes an OECD member

Paragraph 4.3 of the Circular, instead, aims to clarify when the MFN clauses would start to produce some effects in case the relevant conditions are met.

According to the Circular, the wording of the MFN clauses under discussion is very clear also on this matter, stating that the starting point for the MFN clauses' effects coincides with the entry into force of the subsequent treaties concluded with the third states.

At least from a literal perspective, it is possible to agree with the CBDT since the general wording of such clauses 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* it 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" (emphasis added)[31].

In the light of the above, the Circular challenged the unilateral statements included in the Decree, in the Bulletin and in the Publication, where, instead, the moments when the third states (i.e., Slovenia, Lithuania and Colombia) became OECD members (date subsequent to the entry into force of the DTTs with such third states) have been identified as the respective starting date for the MFN effects.

As per the Circular, these statements are not in accordance with the relevant MFN clauses. The tenor of the Circular seems to suggest, in this regard, that the Netherlands, France and Switzerland, were forced to indicate a different starting date for the MFN clause's effects (other than the one indicated in the MFN clause itself, i.e. the entry into force of the DTT with the third state) since the third states in question were not OECD members when the relevant DTTs were concluded with India. Therefore, the above Contracting States apparently went against the

[31] India-Netherlands DTT, Protocol point no. IV.

literal wording of the MFN clauses at hand to benefit de facto from an (allegedly) undue MFN treatment.

In other words, the Circular sees in this circumstance[32] a proof of the fact that the OECD membership condition was something to be met at the time of the conclusion of the DTT with the third state. The line of reasoning is the following: the OECD membership condition cannot also be fulfilled at a later stage (e.g., MFN clause application) because, according to the MFN wording, it should start producing effects from the date of the entry into force of the DTTs with the third state. Taking the example of the Netherlands-India DTT and the subsequent DTT with Slovenia, the MFN clause included in the former DTT should start producing its effect from 2005 when the India-Slovenia DTT entered into force, but at that time, Slovenia was not an OECD member (it joined the OECD in 2010). Only if such a condition was met at the time of the conclusion of the treaty with Slovenia (i.e., 2003) the MFN clause included in the DTT with the Netherlands could have produced its effects from the entry into force of the same DTT (i.e., 2005).

For ease of reference, the table below shows the date of signature and date of entry into force of the relevant DTTs, whose MFN clauses are discussed in the Circular:

DTT	Date of signature	Date of entry into force
India-Netherlands DTT	30 July 1988	21 January 1989
India-France DTT	29 September 1992	1 August 1994
India-Switzerland DTT	2 November 1994	29 December 1994

Relevant dates for the third states DTT discussed in the Circular are presented in the table below:

DTT	Date of signature	Date of entry into force	Date of OECD membership
India-Lithuania DTT	26 July 2011	10 July 2012	5 July 2018
India-Slovenia DTT	13 January 2003	17 February 2005	21 July 2010
India-Colombia DTT	13 May 2011	7 July 2014	28 April 2020

From the above table, it can be seen that none of these countries was OECD member countries when their DTTs with India entered into force. Thus, if one would uphold the view of the Circular, then in such situations, the benefits of the MFN clauses in the Indian DTTs with Netherlands, France and Switzerland should not be claimed.

[32] I.e., in the 'entry into force' requirement.

The Circular also quoted an extract from the Indian Supreme Court decision in the case of Ram Jethmalani & Others (writ petition civil no 176 of 2009), where the Supreme Court referred to the landmark Judgement of Azadi Bachao Andolan to substantiate its viewpoints while stating that the real intent of the specific wordings of MFN cannot be ignored. The relevant parts from the extract quoted in the Circular are reproduced below:

> "[...] 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".

The CBDT used the above quotation to highlight that in the interpretation process, the interpreter should not omit to assess any word or phrase and render them redundant. According to this principle, the idea of the CBDT is that the only way to not render redundant the sentence "as from the date on which the relevant Indian Convention or Agreement enters into force" mentioned above is to consider the entry into force the moment at which the OECD membership condition should be met. Analogously, allowing the fulfilment of this condition at a later stage would mean rendering the same sentence redundant.

Notwithstanding the above, also with regard to this point, different interpretations could be upheld depending on the different approaches adopted since the wording of the clause under investigation is not straightforward[33].

On the one hand, as upheld by the CBDT, literary analysis of the wording of the MFN clause may suggest that the MFN clause's effects will be produced at the time of the entry into force of the treaty with the third state only if at that point in time the third state is an OECD member, as a particular DTT cannot enter into force twice (unless there was the cessation of the DTT and later on the contracting parties decides to enter into a new DTT).

On the other hand, the counter arguments could be that the criteria of the 'entry into force' should be seen as just the starting point from when the MFN clause can potentially start producing its effects and should be read together with the entire clause to give it correct meaning along with the word "is an OECD member"[34]. The above argument was used, in the past, by the Delhi High Court in the case of Concentrix[35], stating that the clause must be interpreted to apply

[33] JALAN, N.; MANZI, G.; GREVE ARCIL, G., op. cit., §2.3.2.2.

[34] JALAN, N.; MANZI, G.; GREVE ARCIL, G., op. cit., §2.3.2.2.

[35] Delhi HC, 22 April. 2021, Concentrix Services Netherlands B.V. vs. Income Tax Officer (TDS), Cases W.P.(C) 9051/2020 and W.P.(C) 882/2021 (2021).

when the third state fulfils the condition of being an OECD member country. The MFN clause also does not anywhere state that if the effects cannot be produced at the time of the entry into force of the DTT with the third state, no effects will be produced ever at a later moment.

Thus, in deciding which approach should fit better in a given situation, the intention of the parties is pivotal and should be further investigated. In the case at hand, for the reasons stated in the previous §3.2, it seems very strange that the parties did not reach an agreement on a basic element of the clause at hand, i.e. the starting point of its effect. However, the diverging unilateral communications issued by the relevant Contracting States could suggest the lack of a common understanding on the same clause and the need for a further agreement on this matter.

On a separate note, however, it should be also noted that a taxpayer should not suffer negative consequences due to the lack of a DTT clear meaning. It should be for the contracting states to describe in detail the parties' intention behind each clause in a treaty negotiation document and provide them publicly were required for the correct interpretation of a clause. Also, in the Indian situation, there has been a wide range of judicial precedents for MFN clauses at various levels of authorities held in favour of the taxpayer. Hence, again the question that arises here is why only at this point of time the CBDT felt it necessary to issue the Circular clarifying this point.

Pertinent to mention that there are MFN clauses where such criteria of entry into force have not been specifically stated, and in such a situation, the issue discussed in this paragraph would not arise. For example, the MFN clause present in the Protocol to India-Sweden DTT reads as follows: "In respect of Articles 10 (Dividends), 11 (Interest) and 12 (Royalties and fees for technical services) if under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, or fees for technical services 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, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention". Thus, the discussion in this paragraph cannot be imported uniformly, and a lot depends on how MFN clauses are worded in the different tax treaties.

One last comment in this paragraph can be made to the Circular approach. As seen above, the CBDT used the condition of the 'entry into force' as something in favour of its view on the OECD membership requirement. One may say that this is not necessarily true, as this requirement can also worsen India's position.

In fact, one may interpret the OECD membership requirement as it can be fulfilled at a later stage (i.e., after the entry into force of the treaty with the third state) and believe that according to the literal wording of the clause, its effects

must (retroactively) start from the "date on which the relevant Indian Convention or Agreement enters into force". Under this scenario, even more years could remain open to claim the MFN clauses' benefit by the relevant taxpayers.

This approach would be probably contrary to the principle of 'non-retroactivity' in tax treaties enshrined in article 28 of the VCLT, according to which "[u]nless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party". However, under certain tax systems, such a principle is interpreted as valid only where the provision that should retroact is not in favour of the taxpayer. Thus, also this approach could offer a different point of view of the issue at hand and deserve a more detailed case-by-case analysis.

3.4. Requirement of notification under Section 90 of the Income-tax Act, 1961

The Circular[36] also discusses the requirement of the "separate notification" for the activation of the protocols as per the Indian domestic income tax laws.

Section 90(1)[37] of the Indian Income tax Act, 1961, empowers the Central Government to enter into the tax treaty, but such treaty comes into force after its notification in the Official Gazette.

The Circular has raised the question of whether where a DTT is already notified in the Official Gazette in such situations: (i) the activation of a clause in a protocol would require separate notification, or (ii) the protocols would be considered suo-moto an integral part of the DTT.

Professor Vogel, in his commentary, states that: "protocols and in some cases, other completing documents are frequently attached to treaties. Such documents elaborate and complete the text of a treaty, sometimes even altering the text. *Le-*

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[36] Circular §4.4.

[37] Relevant parts from Section 90(1) of the Indian Income tax Act, 1961, are reproduced: "The *Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,*—
(a) for the granting of relief in respect of (i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or (ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or
(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be,[95] [without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory),] or
(c) […];
(d) […];
and may, *by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement*" (emphasis added).

gally, they are a part of the treaty, and their binding force is equal to that of the principal treaty text. Therefore, when applying a tax treaty, it is necessary carefully to examine these additional documents" (emphasis added)[38].

Further, this is a largely settled position in the Indian Judiciary; protocols are considered an integral part of the DTTs and, thus, should be self-operational[39]. For example, the Delhi High Court, in the case of Steria India[40], relying on the case of ITC ltd[41] and Professor Vogel's commentary held that the Protocol to India-France DTT forms an integral part of the DTT, and there is no need for separate notification for it. In the ITC case[42], it was stated that the protocol is an indispensable part of the DTT with the same binding force as the main clauses therein.

Reference can also be made to paragraph no. 11 of the GRI case[43], which came after the release of the Circular and where the Circular was discussed at length. The Court reaffirmed that no separate notification is required for protocol, saying literally the following: "*the Circular* specifying the need for a separate notification for importing the beneficial treatment from another Agreement as a corollary of section 90(1) of the Act, *overlooks the plain language of the section seen in juxtaposition to the language of the Protocol, which treats the MFN clause an integral part of the Agreement. On notifying the Agreement or Convention, all its integral parts get automatically notified. As such, there remains no need to again notify the individual limbs of the Agreement so as to make them operational one by one*" (emphasis added).

Considering the above, the requirement of separate notification for protocols does not sound convincing. When something is part of DTT, why would a separate notification be required for its activation (if not expressly agreed upon between the parties). At most, as said in previous §3.1., a notification duty[44] maybe required by the country that recorded a change in its taxation laws due to the activation of the relevant MFN clause (India in this case)[45], but such a notification would be just a matter of courtesy vis-a-vis the other contracting states and not a required condition for the activation of the MFN clauses.

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[38] REIMER, E.; RUST, A. (ed). *Klaus Vogel on double taxation conventions*. 4. ed. Alphen aan den Rijn, Netherlands: Wolters Kluwer, 2014, para. 69, p. 34.

[39] Poonawalla Aviation (P.) Ltd., In re [TS-717-AAR-2011-O], Steria India Ltd vs. CIT [TS-5588-HC-2016(DELHI)-O], DCIT vs. ITC Ltd. [TS-5462-ITAT-2001(KOLKATA)-O], Sumitomo Corpn vs. DCIT [TS-5294-ITAT-2007(DELHI)-O], Idea Cellular Ltd. [TS-120-AAR-2012-O], Concentrix Services Netherlands BV (supra no. 35).

[40] Steria India Ltd *vs.* CIT [TS-5588-HC-2016(DELHI)-O].

[41] DCIT *vs.* ITC Ltd. [TS-5462-ITAT-2001(KOLKATA)-O].

[42] Ibid., 41.

[43] GRI Renewable Industries S. L. vs. ACIT (IT) [TS-79-ITAT-2022(PUN)].

[44] E.g., on the basis of a provision similar to the one provided by article 2(4) OECD MC.

[45] For a more detailed analysis of this issue, see: JALAN, N.; MANZI, G.; GREVE ARCIL, G., op. cit., §2.3.3.1.

Additionally, one may place a reference on Article 31 of the OECD MC dealing with 'Entry into Force'[46], where it is stated that DTT enters into force after the completion of the internal procedure of ratification. However, no reference to such requirement of internal procedure of ratification is mentioned anywhere in the DTTs with France, Netherlands and Switzerland for the activation of the protocols. Thus, any further procedure should be completed before applying the relevant MFN beneficial treatment.

Further, Indian courts[47] have upheld that "the law declared by this Court is binding on the Revenue/Department and once the position in law is declared by this Court, the contrary view expressed in the circular should perforce lose its validity and become non-est". In the case of Hindustan Aeronautics Ltd[48] it is stated that "when the Supreme Court or the High Court has declared the law on the question arising for consideration, it will not be open to a Court to direct that a circular should be given effect to and not the view expressed in a decision of the Supreme Court or the High Court".

If these principles could be applied to the issue analysed in this paragraph, one could argue that Courts have already held in multiple precedents[49] that the protocols should be considered part of the relevant DTTs, and there should be no need for a separate notification requirement for the activation of the MFN clauses included therein. Thus, the contrary view stated in the Circular of requiring a separate notification for the activation of a clause in the Protocol (where no such notification requirements are specified in the clause) seems even more contradictory.

4. Binding nature of the Circular

The CBDT Circular binds the tax authorities and not the taxpayers. Also, courts are not bound by the CBDT Circular. This principle has been upheld in several Indian judicial precedents[50].

There is a possibility that taxpayers can still follow the past court decisions/rulings to claim the beneficial treatment under the MFN clause. When the tax authorities deny such beneficial claims of the taxpayers, they can bring the matter before the court.

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[46] Provisions similar to article 31 OECD MC are included in the relevant DTTs assessed in this article, i.e. article 28 in the India-Switzerland DTT, article 29 in the India-Netherlands DTT, article 30 in the India-France DTT.

[47] Commissioner of Central Excise, Bolpur vs. Ratan Melting & Wire Industries C.P. 4022 OF 1999.

[48] Hindustan Aeronautics Ltd vs CIT [AIR 2000 SC 2178 at 2180].

[49] That in all the cases considered in this article include the MFN clauses.

[50] Navnit Lal C Jhaveri vs. K K Sen [TS-5055-SC-1964-O]; UCO Bank vs. CIT [TS-2-SC-1999-O]; CIT vs. Anjum M H Ghaswala [TS-10-SC-2001-O], Keshavji Ravji & Co. vs. CIT [TS-5047-SC-1990-O], Hindustan Aeronautics Ltd vs. CIT 2000 243 ITR 808 CCE vs. Kores (Ltd 1997 89 ELT 441), Ellerman Lines Ltd vs. CIT 1971 82 ITR 913.

As per section 119(1) of the Income tax Act, 1961, the CBDT can "issue such orders, instructions and directions to other income tax authorities as it may deem fit for the proper administration of this Act". Section 119(2) allows the Board "for the purpose of proper and efficient management of the work of assessment and collection of revenue" to issue directions even by relaxing certain statutory provisions as specified in this sub-section. Though this does not mean these powers of Administration and Management can be extended to Dispensing power[51].

Even the GRI Renewable Industries judgement[52], which came after the release of the Circular, did not agree with the principles outlined in the Circular. The taxpayers, in this case, claimed the benefit of the MFN clause under India-Spain DTT, referring to India-Portugal DTT for a rate of 10% instead of 20% for 'fee for technical services' and 'royalties'. It was held that "the Agreement between India and Spain was signed on 08.08.1993, entered into force on 12.01.1995 and was notified on 21.04.1995. The Protocol was amended and made part of the Agreement, and it was agreed that the same should be an integral part of the agreement. It was held that the Agreement stood notified on 21.04.1995, and the Protocol also got automatically notified along with the Agreement as the same was an integral part of the agreement. Further, the Tribunal held that this Circular could only have prospective effect as it introduced new conditionalities and had no application to the year under consideration. ITAT observes that "(I)t is a trite law that a circular issued by the CBDT is binding on the AO and not on the assessee or the Tribunal or other appellate authorities".

There was another case where tax authorities denied the application of lower withholding taxes to a Dutch shareholder (DXC Gatriam Holdings BV). The non-resident taxpayer wanted to claim the benefit of the India-Netherland DTT MFN clause in lieu of which the applicable rate for tax deduction at source/ withholding taxes for dividends should have been 5% instead of 10%. While rejecting the taxpayer's claim, tax authorities relied on CBDT's Circular No. 3 of 2022. The non-resident shareholder filed a writ petition[53] in the Karnataka High Court by stating that the applicable rate should only be 5% considering the Courts' decisions. The taxpayer, though, was contesting the rate of 10%, yet agreed to deposit 10%, and as regards to 5%, extra deposit sought that the extra deposit of 5% should be treated as a deposit in protest until the final outcome of the petition is provided. The Court accepted this and allowed interim relief to the taxpayer by stating that out of 10% of deduction of taxes on dividends, 5% will be treated as a deposit under protest, which shall be subject to the outcome of the writ petition.

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[51] JHA, Shivkant. Chapter 21: CBDT's Circular making power: frontiers still to be settled. In: JHA, Shivkant. *Judicial Role in Globalised Economy*. Web Edition, 2012. Available at: http://shivakantjha.org/pdfdocs/JRIGE/chapter_21.pdf. Accessed: 12 July 2022.

[52] GRI Renewable Industries S. L. vs. ACIT (IT) [TS-79-ITAT-2022(PUN)] (Ibid., 43).

[53] WP 6595/2022.

Even though the Circular may not be finding support from the Indian Judiciary, needless to mention, the Circular could impact the pending and future cases on MFN clauses in India (and maybe not only). This would add additional challenges for taxpayers as the tax authorities being bound by the Circular would deny the claim of beneficial treatment under the MFN clause to the taxpayers. Further, the application for lower withholding taxes under Section 197[54] of the Indian Income tax Act, 1961, would also be impacted. Taxpayers in such a situation will have no option but to go into litigation where they would want to claim the beneficial treatment under the relevant MFN clauses.

In the authors' view, the Circular needs to be carefully revisited, taking into consideration also the judgements issued on the matter; otherwise, it would be a wastage of additional resources in terms of manpower, and litigation costs, from both the revenue authorities and taxpayers' sides.

5. Conclusive remarks

The analysis of the different statements made by the CBDT in the Circular showed that the available knowledge on the functioning of the MFN clauses is still of scarce relevance and that the debate on the issues surrounding their application/interpretation in tax treaties is far from an end and to reach a common consensus.

The lack of model rules and a clear wording led the parties involved to disagreements, mainly to the detriment of the relevant taxpayers and their legitimate expectations.

A uniform approach, also at the OECD/UN level, seems necessary at this point to give the governments a proper understanding of the impact that the inclusion of such clauses could have in the relevant treaty networks, the necessary tools to handle complex situations involving the same clauses, and also to protect tax certainty and the taxpayers' rights.

[54] As per section 197 of the Indian Income tax Act, 1961, a tax authority may issue the taxpayer a lower or Nil withholding tax certificate based on the taxpayer's application.