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**INTERNATIONAL TAXATION AND ECONOMIC RECOVERY:
THE ROLE OF EMERGING COUNTRIES**

PANEL 03 • PANEL THEME

Most-favoured-nation clauses in treaties to avoid double taxation: recent developments and trends

NUPUR JALAN

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MFN CLAUSES IN INDIAN TAX TREATIES

- MFN clauses are active in 12* DTTs (nearly 14% of Indian DTT's)
- While in most DTTs future treaties signed by India with other State can activate MFN clauses, in two* DTTs, the activation of the MFN clauses can be due to the activities of the other contracting states
- Condition of qualification of the third state – with which the relevant contracting state should conclude a DTT to activate the MFN clause – may vary, e.g., in treaties with EU Member States, the third country should qualify as an OECD member, while in other DTTs, similar qualifications may not be required, and any state can represent the third country (ex, India-Saudi Arabia DTT)
- MFN clauses has been litigated many times, and there are plethora of judicial precedents on various issues related to MFN clauses.

• Belg.-India Income Tax Treaty (1993), Fin.-India Income Tax Treaty (2010), Fr.-India Income Tax Treaty (1992), Hun.-India Income Tax Treaty (2003), India-Nepal Income Tax Treaty (2011), India-Neth. Income Tax Treaty (1988), India-Philip. Income Tax Treaty (1990), India-Saudi Arabia Income Tax Treaty (2006), India-Spain Income Tax Treaty (1993), India-Swed. Income Tax Treaty (1997), India-Switz. Income Tax Treaty (1993) and India-UK Income Tax Treaty (1993).
• India-Nepal Income Tax Treaty (2011), India-Philip. Income Tax Treaty (1990)

VARIATION IN THE MFN CLAUSE

BASED ON ITEMS OF INCOME COVERED

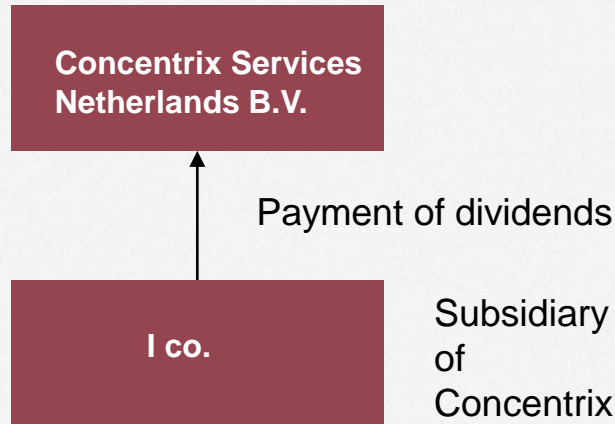
Passive Income	<ul style="list-style-type: none"> - Most DTTs covers only passive income (mainly interest, dividend, royalties, FTS) - Mostly covers both rate and scope of passive income (e.g., DTT with <i>Belgium, France, Netherlands etc.</i>) - Some may cover only rate (e.g., DTT with <i>Finland</i>)
Active Income	<p>Found in very few DTT, may cover deduction of expenses in the case of a PE and/or for air transport and shipping income</p> <ul style="list-style-type: none"> • <i>United Kingdom DTT/ Saudi Arabia DTT covers the deduction of expenses in relation to a PE</i> • <i>Philippines DTT covers income from air transport and shipping</i>

BASED ON APPLICATION MODES

Automatic Application	<p>Nearly 75% of Indian DTTs with this variant (Ex., DTTs with Belgium, France, Hungary etc.) <i>Relevant cases: SCA Hygiene Products*/ ITC Ltd.**</i></p>
Additional notification duties	<ul style="list-style-type: none"> - Few MFN clauses adopted by India specifically highlight the requirement of the notification <p><i>Ex., DTT signed with Finland, where a formal notification between the contracting states is required for the application of the MFN clause</i></p>
Additional negotiation duties	<ul style="list-style-type: none"> - Few Indian DTTs specifically state the requirement of negotiations. - Ex., DTT with Switzerland, additional negotiation is required for certain items of income covered in MFN clause <p><i>Relevant case: Torrent Pharmaceuticals Ltd.***</i></p>

* SCA Hygiene Products AB, Case TS-4-ITAT-2021(Mum). ** DCIT v. ITC Ltd., (2002) 82 ITD 239(ITAT Kolkata) ***Torrent Pharmaceuticals Ltd., Case TS-609-ITAT-2016(Ahd).

CONCENTRIX* CASE



Facts:

Benefit of lower WHT under India-NL DTT was claimed (Based on favorable rate in Slovenia, Lithuania, Columbia DTT) on dividends. However, benefit of lower WHT was not granted by tax authorities.

Main issues	HC ruling
<p>Date on which third state (i.e., Slovenia) should be OECD member? at the time of signing tax treaty with India or at the time of application of MFN clause?</p>	<p><i>The use of the wording ‘which is a member of the OECD’ requires countries to be OECD members when source taxation is triggered in India and not at the time when the subject treaty was executed.</i></p>
<p>Requirement of separate notification for enforcing the MFN clause</p>	<ul style="list-style-type: none"> - Protocol forms an integral part of the DTT. - No separate notification is required, for application of provisions of the protocol

India-NL MFN 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 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*

* Concentrix Services Netherlands B.V. v. Income Tax Officer (TDS), Cases W.P.(C) 9051/2020 and W.P.(C) 882/2021 (2021)

CIRCULAR (3/2022) – MAIN PRINCIPLES

Per Circular	Certain prevalent arguments for/ against being taken in the available Indian literature on the analysis of Circular
Unilateral Decree/Bulletin/Publication do not represent shared understanding of the treaty partners on applicability of the MFN clause	<ul style="list-style-type: none">- Stated DTT does not require any notification/ negotiation duties- Judicial precedents that upheld automatic application in such cases in past: <i>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))</i>; <i>India-The Netherlands DTT: Concentrix Services Netherlands B.V. v. Income Tax Officer (TDS), Cases W.P.(C) 9051/2020 and W.P.(C) 882/2021 (2021), Delhi HC</i>
Conditionality for the third State being a member of the OECD on the date of conclusion of the DTT	<ul style="list-style-type: none">- ‘Grammatical analysis of the verb ‘is’ shows that its meaning can have past, present or future connotations, thus, fulfilment of the OECD membership condition can also be after the signing of the DTTs with the relevant third states’ – Concentrix case- India did not enter into force a DTT with OECD members i.e., Slovenia, Lithuania, Colombia
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	<ul style="list-style-type: none">- Literal reading of the wording of the MFN clause may suggest that the MFN clause can be activated only at the time of the entry into force of the DTT with the third state provided other conditions are met, as a particular DTT cannot enter into force twice- Uniformity in reading the entire clause: Criteria of the ‘entry into force’ should be seen as just the starting point from when the MFN clause could potentially be activated. However, to give correct interpretation the clause should be read in uniformity(“is an OECD member” condition) – Concentrix case

CBDT CIRCULAR – MAIN PRINCIPLES

Per Circular	Certain prevalent arguments for/ against being taken in the available Indian literature on the analysis of Circular
Requirement of notification under Section 90 of the Income-tax Act, 1961	<ul style="list-style-type: none">- Largely settled position in the Indian Judiciary; protocols are considered an integral part of the DTTs and, thus, should be self operational- Article 31 of the OECD MC dealing with 'Entry into Force', where it is stated that DTT enters into force after the completion of the internal procedure of ratification – Nothing is stated for protocol in Article 31- Reference to GRI case: <i>the Circular</i> 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, <i>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</i>

BINDING NATURE OF CIRCULAR AND WAY FORWARD

- CBDT Circular binds the tax authorities and not the taxpayers. Courts are not bound by the CBDT Circular. (Ex., GRI renewables* case which came after Circular)
- Circular could impact the pending and future cases on MFN clauses in India
- Penalty and prosecution risk should not arise for deductor/ deductee for lower WHT based on bonafide claim of MFN benefit by the taxpayers, where tax authorities denies the lower deduction
- Taxpayers will have no option but to go into litigation where they would want to claim the beneficial treatment under the relevant MFN clauses
- The matter could come to rest only when Circular is revisited or matter is tested before the Supreme Court

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

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