Direct Tax Study Group -
Western India Regional Council of
The Institute of Chartered Accountants of India

MFN Clause in Tax Treaties
including latest updates

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Agenda for Discussion

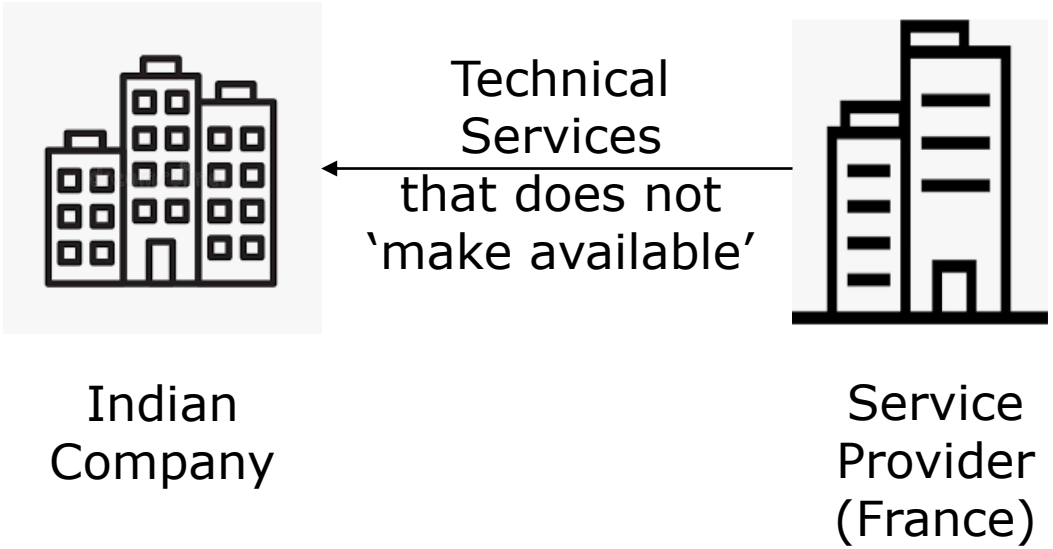
- Recap – Tax Treaties and MFN Clause
- Hon. Delhi High Court ruling - Concentrix Services *
- Other relevant aspects for discussion
- CBDT Circular No. 3/ 2022
- Pune ITAT ruling – GRI Renewable Industries #
- Summing-up

* Concentrix Services Netherlands B.V. v. ITO (TDS) 434 ITR 516 (Delhi)

GRI Renewable Industries S.L., v. ACIT [TS-79-ITAT-2022(PUN)]

Recap – Tax Treaties and MFN Clause

- Example



- Fee for Technical Services is deemed to accrue or arise in India u/s 9(1)(vii) of the Income Tax Act, 1961 ('the Act').
- Explanation 2 to 9(1)(vii):

  "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel)

Recap – Tax Treaties and MFN Clause

- Section 90(1): Central Government empowered to enter into Treaties ('DTAA')
- Section 90(2): Provisions of the Act shall apply to the extent more beneficial *

- India – France DTAA - Article 13:

  2. However, such royalties, fees and payments may also be taxed in the Contracting State, in which they arise and according to the laws of that Contracting State, but if the recipient is the beneficial owner of these categories of income, the tax so charged shall not exceed 10 per cent of the gross amount of such royalties, fees and payments.

  4. The term "fees for technical services" as used in this Article means payments of any kind to any person, other than payments to an employee of the person making the payments and to any individual for independent personal services mentioned in Article 15, in consideration for services of a managerial, technical or consultancy nature.

* *CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC);*
Azadi Bachao Andolan (2003) 263 ITR 706
CBDT Circular No 333 of 1982

Recap – Tax Treaties and MFN Clause

- India – France DTAA (notified on 7 Sep 1994) - '**Protocol**'

  At the time of proceeding to the signature of the Convention between France and India for the avoidance of double taxation with respect to taxes on income and on capital, the undersigned have agreed on the following provisions which shall form an integral part of the Convention:

  7. In respect of articles 11 (Dividends), 12 (Interest) 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, 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 of 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 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.

Recap – Tax Treaties and MFN Clause

- India – USA DTAA (notified on 20 Dec 1990) – Article 12

4. For purposes of this Article, "fees for included services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services :

*(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 * is received ; or*

(b) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design.

* Para 3 defines Royalty. In a nutshell, royalty is consideration for right to use of various intangibles and equipment of certain nature.

Recap – Tax Treaties and MFN Clause

- Plethora of ruling upholding the operation of the Protocol/ MFN Clause in the tax treaties.

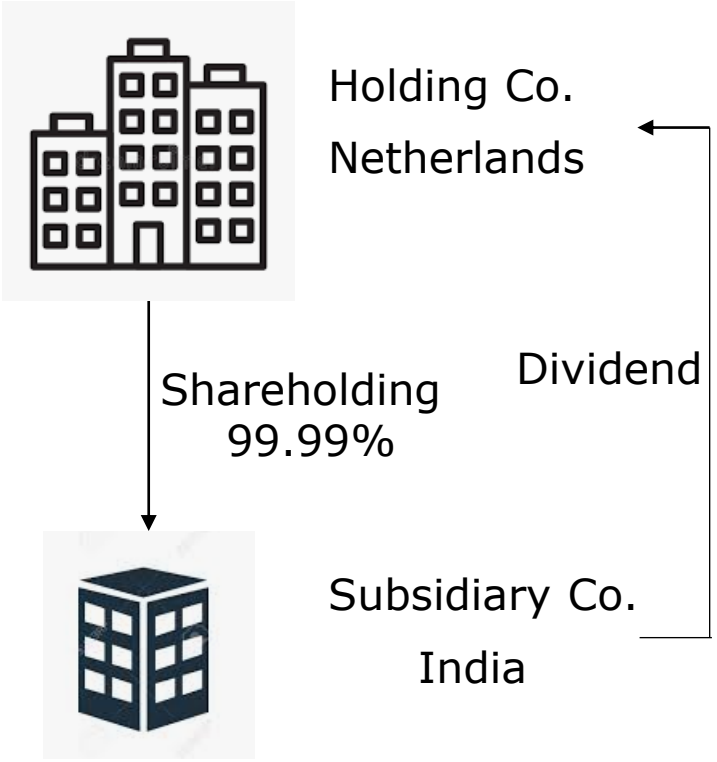
- The favourable clauses in the DTAA read with protocol override the provisions of the Income-tax Act in the matter of ascertainment of chargeability to income-tax and ascertainment of total income to the extent of inconsistency with terms of DTAC. - *CIT v. ISRO Satellite Centre [2013] 35 taxmann.com 352 (Karnataka)*

- The restricted scope provided in India-US DTAA and India-Portuguese DTAA are applicable even under India-France DTAA as per clause 7 of the protocol - *DDIT v. IATA BSP India [2014] 46 taxmann.com 150 (Mumbai - Trib.)*

- It is a settled position in law that protocol is an indispensable part of the treaty with the same binding force as the main clauses therein, as protocol is an integral part of the treaty and its binding force is equal to that of the principal treaty. The provisions of the aforesaid DTAAs are, therefore, required to be read with the protocol clauses and are subject to the provisions contained in such protocol - *Maruti Udyog Ltd v. ADIT [2009] 34 SOT 480 (Delhi ITAT)*

Hon. Delhi High Court ruling - Concentrix Services

Facts of the case:



India – Netherlands Treaty - Article 10(2) Dividends:

- Tax rate shall not exceed 10% in source country

- Protocol – forms integral part of the convention

  *IV(2): 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.*

Hon. Delhi High Court ruling - Concentrix Services

- India's tax treaties with Netherlands ('NL'), Slovenia, Lithuania and Colombia

Particulars	NL	Slovenia	Lithuania	Colombia
Source country tax rate for Dividend - Company beneficially holding >=10% - Other cases	10%	 5% 15%	 5% 15%	5%
Date of treaty coming into force	21 Jan 1989	17 Feb 2005	10 July 2012	7 July 2014
Date of Notification	30 Aug 1999	31 May 2005	25 July 2012	23 Sep 2014
Date of becoming a OECD member	1961	Aug 2010	July 2018	April 2020

Hon. Delhi High Court ruling - Concentrix Services

Assessee's arguments:

- Tax rate @ 5%, based on India – Netherlands treaty, read with MFN
- Provisions of treaties with Slovenia/ Lithuania/ Colombia, which are members of OECD would automatically apply to India- NL Treaty, as the protocol reads as "*shall form part an integral part of this convention*"
- Protocol in India – NL Treaty – configured to self-trigger upon execution of DTAA with OCED member country, with reduced rate/ restricted scope. No fresh notification required*

Tax Authorities' arguments:

- MFN can be invoked only when India enters into DTAA with a country, which is a member of OECD at the time of execution of the treaty and the date on which reduced rate/ restricted scope is claimed.
- Lower tax rate granted to these countries in their own right and not as members of OECD.
- Several amendments made to India – NL treaty, ratified by both partners, do not include lower tax rate for dividend

* *Steria (India) Ltd. v. CIT [2016] 72 taxmann.com 1 (Delhi),*
Apollo Tyres Ltd. v. CIT [2018] 92 taxmann.com 166 (Karnataka)

Hon. Delhi High Court ruling - Concentrix Services

Ruling of the Hon. Delhi High Court:

- It is specifically stated in the Protocol that the same forms an integral part of the convention.
- Relies on Divisional bench ruling in the case of *Steria (India)* * which states:
  - no separate notification of protocol is required and the protocol has equal binding force
  - Also refers to *Klaus Vogel Commentary* on Double Taxation Conventions that - *Legally they* (Protocol) *are part of the treaty, and their binding force is equal to that of the principal treaty text. When applying a tax treaty, therefore, it is necessary carefully to examine these additional document.*
- the word "is" describes
  - the state of affairs that should exist **not** necessarily at the time when subject DTAA was executed
  - but when the provisions of the treaty is applied.

* *Steria (India) Ltd. v. CIT [2016] 72 taxmann.com 1 (Delhi)*

Hon. Delhi High Court ruling - Concentrix Services

Ruling of the Hon. Delhi High Court (Contd.):

- Decree issued by the Kingdom of Netherlands on 28 Feb 2012 [No. IFZ 2012/54M, Tax Treaties, India] published on 13 March 2012
- Principle of Common interpretation
- Observations of Supreme Court concerning interpretation of treaties *
  - the language of treaty drafted at the stroke of a pen distinguished from precision drafting by a parliament/ legislator
  - *unconstrainted by technical rules of English law, or by English legal precedent, but conducted on broad principles of general acceptation... are to be given their general meaning, general to lawyer and layman alike… the meaning of the diplomat rather than the lawyer #*
  - *treaties are negotiated and entered into at political level and and have several consideration as their bases.*

** Union of India v. Azadi Bachao Andolan (2003) 263 ITR 706*

 # Francis Bennion: Statutory Interpretation, p. 461 [Butterworths, 1992 (2nd Edn.)]

Hon. Delhi High Court ruling - Concentrix Services

Ruling of the Hon. Delhi High Court (Contd.):

- *main function of a treaty should be seen in the context of aiding commercial relations between the treaty partners and as being essentially a bargain between two treaty countries as to the division of tax revenues… @*
- *treaties are negotiated and entered into at political level and and have several consideration as their bases.*
- *Apart from the allocation of tax between the treaty partners, tax treaties can also help to resolve problems and can obtain benefits which cannot be achieved unilaterally*

Conclusion of Hon. Delhi High Court

- Tax rate of 5% with respect to Dividend granted to Netherlands Company.

@ David R Davis: Principles of International Double Taxation Relief p. 4 (London, Sweet & Maxwell, 1985)

Other relevant aspects for discussion

- Interpretation of tax treaties – Principles set out by Vienna Convention on law of treaties ('VCLT') *
  - Article 31(1): *a treaty is to be interpreted based on the text of the relevant provision i.e., in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose*.
  - Article 32: *in interpreting the terms of a treaty, supplementary materials, especially, the preparatory work for the treaty may be used* in certain circumstances including where the provisions are ambigous.
  - *Article 26: every treaty in force is binding on the parties to it and must be performed by them in good faith*
  - Mumbai Tribunal# has rejected the ambulatory approach to interpret terms of the treaty which would run contrary to Article 26 of VCLT.

* *Hon SC has referred to VCLT time and again. Example, Ram Jethmalani Vs Union of India [(2011) 339 ITR 107 (SC)]*

 # ACIT vs. Reliance Jio Infocomm Ltd [2020] 77 ITR(T) 578 (Mumbai-Trib.)

Other relevant aspects for discussion

- Other possible options that may be resorted to for resolution:
  - Mutual Agreement Procedures: Article 25(3) of the OECD Model Convention, as also a number of tax treaties entered into by India, permit competent authorities to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention
  - Notification of meaning to terms under Section 90(3) ?

    Section 90(3): Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

CBDT Circular No. 3/ 2022

Salient aspects:

Particulars	Para
Acknowledges that *each MFN clause in these DTAAs has a different formulation*	1
Outlines the representations received seeking clarity on applicability on MFN for dividend with reference to India's treaty with Slovenia, Colombia and Lithuania	2
Decree/ official bulletin/ publication issued by treaty partners (i.e. Netherlands, France, Swiss Confederation) on activation of MFN clause and consequent tax rate of 5% *do not represent the shared understanding of the treaty partners* *India has also communicated its position to …. the decree/ bulletin is not in accordance with the object and purpose enshrined in the DTAA*	3, 4 & 4.1
The third state must be a member of OECD both at the time of conclusion of the treaty with India as well as at the time of applicability of MFN Clause The above is in line with intention of MFN, which can be made out from the language of the MFN that – the reduced rates/ restricted scope takes effect from entry into force of treaty with third state, and not the date of third state becoming a OECD member	4.2 4.3

CBDT Circular No. 3/ 2022

Salient aspects:

Particulars	Para	Matters for Attention
Requirement of notification under Section 90 of the Act	4.4	• Reference to the Supreme Court ruling case of Azadi Bachao Andolan in the context of over-riding effect of treaty upon its notification is referred to in the circular out of the context that notification is required for operation of MFN Clause. • Protocol in different treaties have different languages employed (Refer *Annexure)*. • Blanket requirement for notification of all MFN Clause under Section 90 ○ may not be consistent with the language adopted in the protocol in several treaties ○ is contrary to the ruling of High Courts * • This requirement laid down in the circular has pervasive impact on no. of MFN Clauses/ Treaties and Royalty/ FTS/ other income, which traverse beyond providing clarification w.r.t. application of MFN for dividend.

* *Steria (India) Ltd. v. CIT [2016] 72 taxmann.com 1 (Delhi),*
Apollo Tyres Ltd. v. CIT [2018] 92 taxmann.com 166 (Karnataka)

Annexure: Application of MFN

Examples:

Tax Treaty	Language from the treaty/ protocol on application of MFN
India – Sweden	*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.*

Annexure: Application of MFN

Examples:

Tax Treaty	Language from the treaty/ protocol on application of MFN
India – Swiss Confederation	*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 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.* *If after the date of signature this Amending Protocol, India under any Convention, Agreement or Protocol with a third State which is a member 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.*

Annexure: Application of MFN

Examples:

Tax Treaty	Language from the treaty/ protocol on application of MFN
India – Finland	*It is agreed that if after coming into force of this Agreement, any agreement or convention between India and a Member State of the Organisation for Economic Cooperation and Development provides that India shall exempt from tax dividends, interest, royalties or fees for technical services (either generally or in respect of specific categories of dividends, interest, royalties or fees for technical services) arising in India, or limit the tax charged in India on such dividends, interest, royalties or fees for technical services (either generally or in respect of specific categories of dividends, interest, royalties or fees for technical services) to a rate lower than that provided for in paragraph 2 of Article 10 or paragraph 2 of Article 11 or paragraph 2 of Article 12 of the Agreement, such exemption or lower rate shall be made applicable to the dividends, interest, royalties or fees for technical services (either generally or in respect of those specific categories of dividends, interest, royalties or fees for technical services) arising in India and beneficially owned by a resident of Finland and dividend, interest, royalties or fees for technical services arising in Finland and beneficially owned by a resident of India under the same conditions as if such exemption or lower rate had been specified in those paragraphs. 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.*

Annexure: Application of MFN

Examples:

Tax Treaty	Language from the treaty/ protocol on application of MFN
India – Philippines	*With reference to Articles 8 and 9* (Air Transport and Shipping) *if at any time after the date of signature of the Convention the Philippines agrees to a lower or nil rate of tax with a third State the Government of the Republic of the Philippines shall without undue delay inform the Government of India through diplomatic channels and the two Governments will undertake to* ***review*** *these Articles with a view to providing such lower or nil rate to profits of the same kind derived under similar circumstances by enterprises of both Contracting States.*
India – Saudi Arabia	*For the purposes of Para 3 of Article 7* (Allowbility of deduction of expenses in taxation of business profits)*, the deductions of expenses to be allowed by a Contracting State shall be in accordance with the provisions of and subject to the limitations of the tax laws of that Contracting State. In case India removes this restriction in any of its Conventions after the date of signing of this Convention, the two sides shall review this issue.*

Annexure: Application of MFN

Examples:

Tax Treaty	Language from the treaty/ protocol on application of MFN
India – UK	*Article 7(6): Where the law of the Contracting State in which the permanent establishment is situated imposes a restriction on the amount of the executive and general administrative expenses which may be allowed, and the restriction is relaxed or overridden by any Convention between that Contracting State and a third State which is a member of the Organisation for Economic Co-operation and Development or a State in a comparable stage of development, and that Convention enters into force after the date of entry into force of this Convention, the competent authority of that Contracting State shall notify the competent authority of the other Contracting State of the terms of the relevant paragraph in the Convention with that third State immediately after the entry into force of that Convention and, if the competent authority of the other Contracting State so requests, the provisions of this Convention shall be amended by protocol to reflect such terms.*

CBDT Circular No. 3/ 2022

Salient aspects:

Particulars	Para	Matters for Attention
Requirement of notification under Section 90 of the Act	4.4	• Hon. Kolkatta ITAT* w.r.t notification dated 20 Aug 2000 issued in the context of India – France Treaty had held as follows: *It had been pointed out that, so far as 'fees for technical services' are concerned, while the Central Government has made amendment by Notification dated 20-7-2000 to the Indo-French DTAA with respect to the lower rate of withholding tax envisaged in the said tax treaties as compared to the rate of tax contained in Indo-French DTAA with respect to incomes of aforesaid nature, the Central Government has not taken note of the favourable provisions contained in the tax treaties signed by India with the OECD member countries. A perusal of the aforesaid notification gives a* prima facie *impression that it constitutes the Central Government's independent action to implement the understanding arrived at by virtue of protocol clauses in the India-France DTAA. It is difficult to comprehend as to how the Central Government can unilaterally amend, in exercise of the powers under section 90 of the Income-tax Act, a bilateral agreement that a DTAA inherently is.*

* *DCIT v. ITC Ltd. [2002] 82 ITD 239 (Kolkata ITAT)*

CBDT Circular No. 3/ 2022

Salient aspects:

<table>
<tr><th>Particulars</th><th>Para</th><th>Matters for Attention</th></tr>
<tr><td>Bar on selective import of concessional rates under MFN Clause</td><td>4.5</td><td>
• Taxation of dividend under Slovenia, Lithuania treaties:
<table>
<tr><th>Particulars</th><th>Slovenia</th><th>Lithuania</th></tr>
<tr><td>Source country tax rate for Dividend
- Company beneficially holding >=10%
- Other cases</td><td>
5%
15%</td><td>
5%
15%</td></tr>
</table>
• The MFN Clause, by itself has application only where lower tax rate/ restricted scope of taxation is agreed between treaty partner and third country satisfying certain conditions

• Obviously, where tax rate is higher between treaty partner and third country, MFN doesn’t trigger and the provisions of one’s own DTAA would be appliable.
</td></tr>
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Pune ITAT Ruling - GRI Renewable Industries *

- On *CBDT Circular No. 3/ 2022* dated 3 Feb 2022:
  - The plain language of Section 90(1) has been overlooked. Notification may be necessary for implementation of the agreement and not that notification is to be issued piecemeal and in truncated manner. On notifying the agreement or Convention, all the 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.
  - Circular issued by CBDT is binding on the AO and **not** on the assessee or the tribunal or other appellate authorities. The Circular transgresses the boundaries of Section 90(1).
  - Not withstanding the above, a piece of legislation which imposes a new obligation or attaches a new disability is considered prospective unless the legislative intent is clearly to give it to a retrospective effect.

* GRI Renewable Industries S.L., v. ACIT [TS-79-ITAT-2022(PUN)]

Summing-up

- SLP has been filed against Delhi High Court ruling* that no separate notification is required for operation of MFN Clause and the same is pending before Hon SC.

- Income-tax authorities may appeal to Hon SC. against the Delhi High Court ruling # that Slovenia/ Lithuania/ Colombia treaties can be read into other treaties by virtue of MFN Clause and dividend could be taxed @ 5%.

- India's position w.r.t. application of Slovenia/ Lithuania/ Colombia treaties through MFN has been brought out in the CBDT Circular.

- Hon. Delhi High Court had considered the decree/ official bulletin issued by tax authorities of treaty partners and had applied the principle of Common interpretation. With CBDT Circular, we have the treaty partners taking conflicting positions. We can expect the Courts to come up with their independent interpretation in subsequent rulings on the similar question of law.

** Steria (India) Ltd. v. CIT [2016] 72 taxmann.com 1 (Delhi)*
 # Concentrix Services Netherlands B.V. v. ITO (TDS) 434 ITR 516 (Delhi), Nestle SA v. AO (Intl Tax) [W.P. (C) 3243 of 2021, dated 15-3-2021], Deccan Holdings B V vs ITO [2022] 284 Taxman 300 (Delhi)

Summing-up

- Requirement of notification under Section 90 of the Act for operation of MFN in each of the treaties as laid down in the CBDT Circular No. 3/ 2022 appears to be far-fetched. While relief can be expected from appellate authorities, invocation of almost every MFN could become a matter of litigation at lower levels of tax administration.

- Further, the above requirement is against the different provisions laid down for operation of MFN in each of the treaties.

- Invocation of Mutual Agreement Procedures (MAP) under the tax treaty by the tax-payer would help in bringing certainty on this matter?

Thank you!

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