Most Favoured Nation Clause

- **Concentrix Services Netherlands B.V. v. ITO (TDS) [2021] 127 taxmann.com 43 (Delhi HC)**

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Facts

- Concentrix Services Netherlands B.V. (Concentrix) and Optum Global Solutions International B.V. (Optum) are residents of Netherlands (assessees).
- Assessees had subsidiaries in India, namely Concentrix India and Optum India, wherein they hold 99.99% shares respectively. The Indian companies are the remitter of dividend to their respective parent entity.
- As per India - Netherlands DTAA the dividend payments shall be subjected to tax withholding @ 10%.
- The assessees submitted an application seeking lower tax withholding certificate under section 197 . They requested the applicability of lower rate of 5% by placing reliance on Most Favoured Nation (MFN) in the protocol of Netherlands DTAA
- The tax authorities issued lower withholding tax certificate at the rate @10%.
- The assessees filed a writ petition before the High Court.

Article 10 –Dividends

1. Dividends paid by a company which is a resident of one of the States to a resident of the other State may be taxed in that other State.
2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed 10 per cent of the gross amount of the dividends.

Protocol

At the moment of signing the Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, this day concluded between the Kingdom of the Netherlands and the Republic of India, **the undersigned have agreed that the following provisions shall form an integral part of the Convention.**

IV. Ad Articles 10, 11 and 12

1. …..
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.

Assessee’s contentions

- The assessees sought a lower rate withholding tax certificate of 5% placing reliance upon MFN clause i.e. clause IV (2) of the protocol.
- India had entered into DTAAs with other countries, which were members of OECD, hence the lower rate / restricted scope in the DTAA executed between India and such a country would **automatically** apply to the DTAA under consideration.
- No fresh notification was required as the preface of the protocol, inter alia stated that the protocol "**shall form part an integral part of the Convention**" i.e., the DTAA.
- The reasons cited by the tax authorities that there was no separate notification issued to import the benefit of the MFN clause is completely misconceived, given the provisions are contained in the protocol appended to the subject DTAA.
- The protocol contained in Netherlands DTAA was configured, **to self-trigger**, upon the execution of other DTAA, if it provided a lower rate of tax/ scope more restricted.

Revenue's contentions

- A bare reading of the MFN clause in protocol would show that the benefit of the lower rate of withholding tax or a scope more restricted would be available only if the country with which India enters into a DTAA was a member of the OECD at the time of the execution of the Netherlands DTAA.
- Tax authorities submitted the different DTAAs, which provides for a withholding tax rate of 5%.

DTAAs	Date of execution	Date of becoming member of OECD (Slovenia, Lithuania and Columbia)
India-Slovenia	17-02-2005	August 2010
India-Lithuania	10-07-2012	July 2018
India-Columbia	07-07-2014	April 2020

Revenue's contentions

- Slovenia, Lithuania and Columbia were not members of the OECD when the subject DTAA was executed.
- Furthermore, DTAAs were signed with Slovenia, Lithuania and Columbia before they became members of OECD. Therefore, clause IV (2) of the protocol will have no applicability.
- Mere fact that Slovenia, Lithuania, and Columbia have chosen to become members of OECD cannot be the reason for applying the provisions contained in the DTAAs concerning them (which are more beneficial) to the Netherlands DTAA only because of the protocol accompanying it.

High Court ruling

- A perusal of relevant extract of protocol of DTAA shows that the protocol forms an integral part of the convention. N**o separate notification is required**, insofar as the applicability of provisions of the protocol is concerned.
- Placed reliance on the decision in the case of Steria (India) case[1] wherein the court had held as follows:
  - Protocol shall form an integral part of the Convention. Once the DTAA (India-France DTAA) has itself been notified and contains the protocol, there is no need for the protocol itself to be separately notified.
  - Commentary of Klaus Vogel was referred to highlight that protocols and, in some cases, other completing documents are frequently attached to treaties. Legally they are part of the treaty, and their binding force is equal to that of the principal treaty text

High Court ruling

- Clause IV (2) incorporates the principle of parity between the Netherlands DTAA and the DTAAs executed thereafter, only if the following conditions are fulfilled:
  - First, the third State with whom India enters into a DTAA should be a member of the OECD.
  - Second, India should have, in its DTAA, executed with the third State, limited its rate of withholding tax, on subject remittances, at a rate lower or a scope more restricted, than the rate or scope provided in the Netherlands DTAA.
- Upon fulfillment of above conditions, **from the date on which the DTAA between India and a third State comes into force**, the same rate of withholding tax or scope as provided in the DTAA executed between India and the third State would apply to the Netherlands DTAA.

High Court ruling

- The construct of clause IV (2) is such that in certain cases there could be a hiatus between the dates on which the DTAA is executed between India and the third State and the date when such third State becomes a member of OECD**. The limit on the lower rate of tax or the scope more restricted contained in DTAA executed between India and the third State can only apply when the third State fulfils the attribute of being a member of the OECD**.
- The word "is" describes a state of affairs that should exist not necessarily at the time when the DTAA was executed but when a request is made for issuance of a lower rate withholding tax certificate.
- The best interpretative tool that can be employed to gather the intent of the Contracting States in framing clause IV (2) of the protocol would be as to how the other contracting State [Netherlands] has interpreted the provision.

High Court ruling

- It noted the contents of the decree issued by the Netherlands on 28.02.2012 [No. IFZ 2012/54M, Tax Treaties, India] which was published on 13.03.2012.
- Clearly, the Netherlands has interpreted clause IV (2) of the protocol in a manner, which is, that the lower rate of tax in the India-Slovenia DTAA will be applicable on the date when Slovenia became a member of the OECD, i.e., from 21-8-2010.
- Court noted that the approach adopted by it aligns with the accepted principle applied in the interpretation of DTAAs. This is the principle of "Common Interpretation".
- This principle of Common Interpretation is also recognized in private international law with regard to conflict rules. **The purpose, it appears, is to allocate tax claims equally between the contracting States**. The Courts of the contracting States are, thus, required to ensure that DTAAs are applied efficiently and fairly so that there is consistency in the interpretation of the provisions by the tax authority and courts of the concerned contracting State.

High Court ruling

- While interpreting international treaties including Tax treaties the rules of interpretation that apply to domestic or municipal law need not be applied, for the reason, that international treaties, conventions and tax treaties are negotiated by diplomats and not necessarily by men instructed in the law. Therefore, their interpretation is liberated from the technical rules which govern the interpretation of domestic/municipal law.
- The core function of a DTAA should be seen to aid commercial relations and equitable distribution of tax revenues in respect of income which falls for taxation in both the deductor and the deductee States, i.e., the contracting States.
- The certificates were quashed with instruction that fresh certificate would be issued @5%.

India – Switzerland DTAA

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.*

Thank you