MFN Clause

A 360°Analysis

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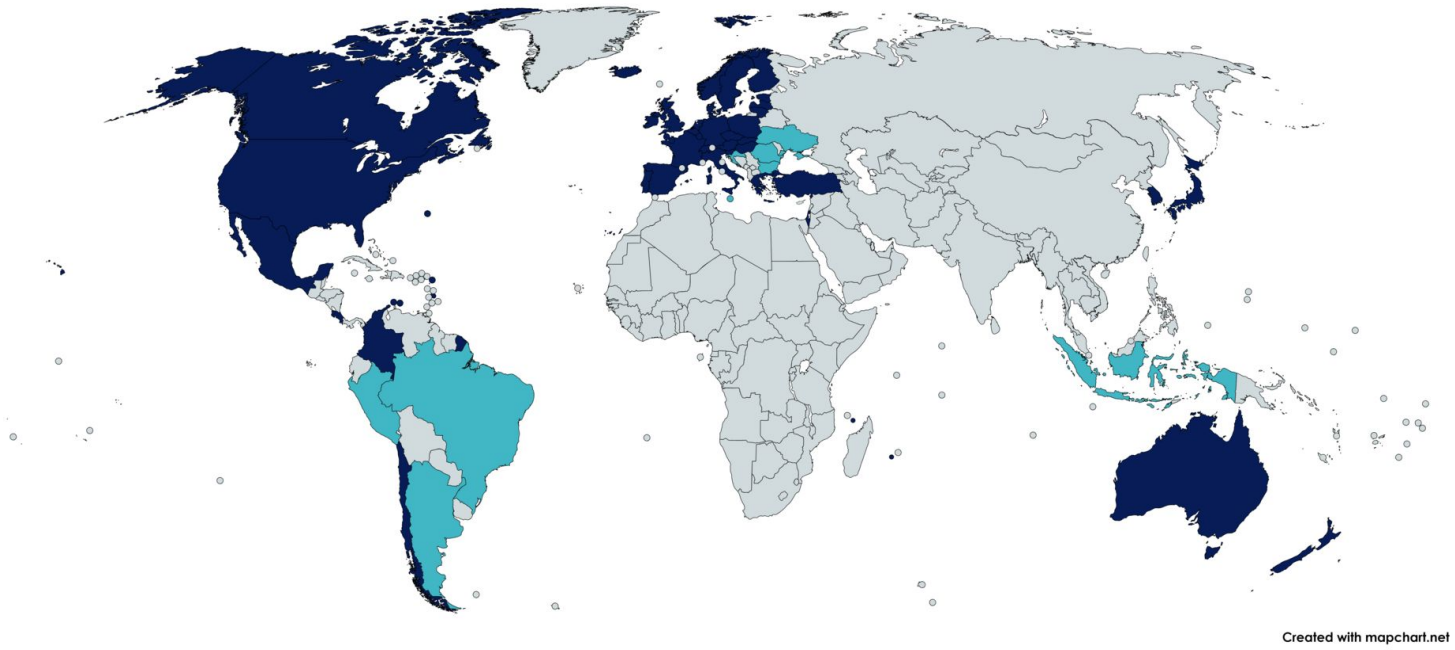


MFN clause

- Most Favoured Nation (MFN) clause in a DTAA is provision that ensures that *a* Contracting State receives the same treatment that the *other* Contracting State offers to *any third* State.
- If the other contracting state provides a lower tax rate or other favourable tax treatment to a third state, the contracting state must receive the same tax treatment (provided that certain conditions are met)
  - Favourable tax treatment can be Rate, Scope etc.
- Example: India-France <-> India-UK

Purpose of MFN

- Purpose of MFN was to promote non-discrimination among member States
- To ensure taxpayers are not disadvantaged based on their country of residence
- Example: If you are in *x* country you get a better deal with India than in *y* country with respect to taxes.

MFN: Bulwark of world trade

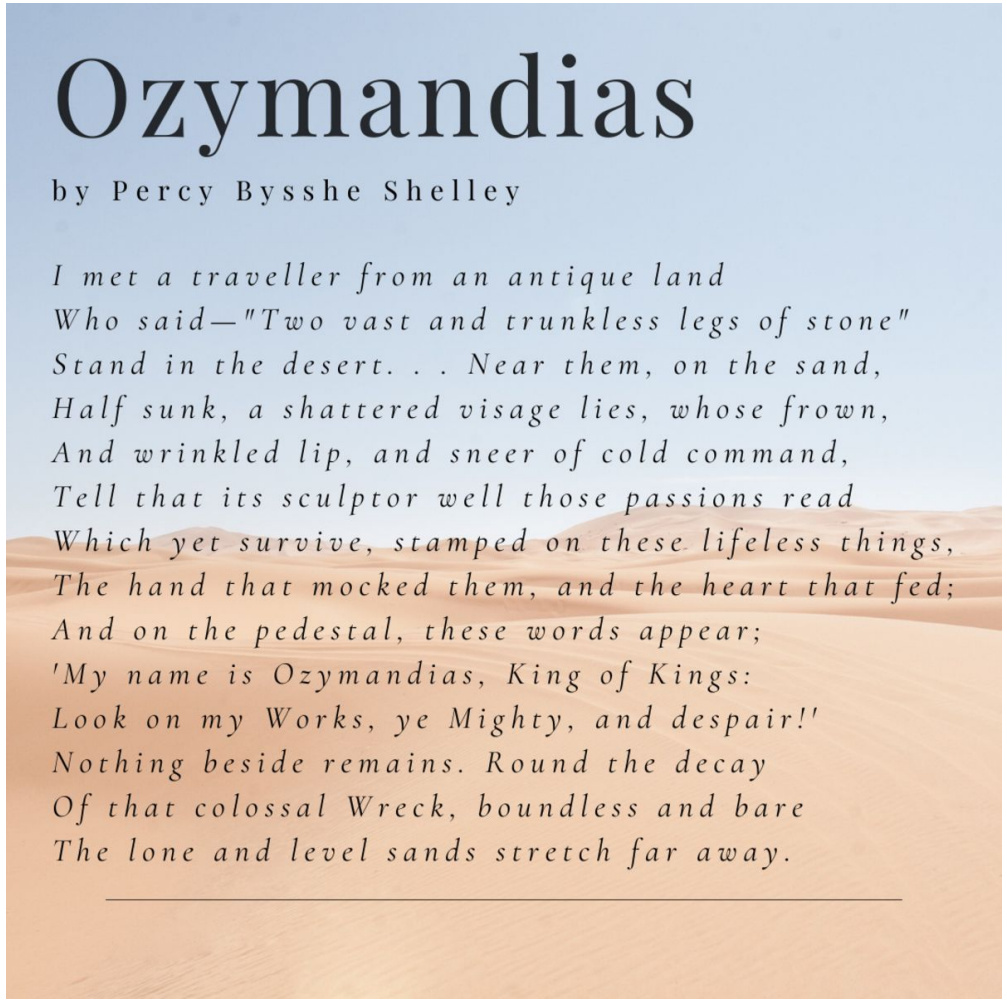
Step outside Income Tax for a minute!

- Most-favoured-nation (MFN): Under the WTO agreements, countries cannot normally discriminate between their trading partners.
- Grant someone a special favour (lower customs duty rate for one of their products!)? You have to do the same for all other WTO members.
- It is so important that it is the first article of the General Agreement on Tariffs and Trade (GATT), which governs trade in goods.
- MFN is also a priority in the General Agreement on Trade in Services (GATS) (Article 2) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) (Article 4), although in each agreement the principle is handled slightly differently.
- Together, those three agreements cover all three main areas of trade handled by the WTO.

WORLD TRADE ORGANIZATION

Parity group

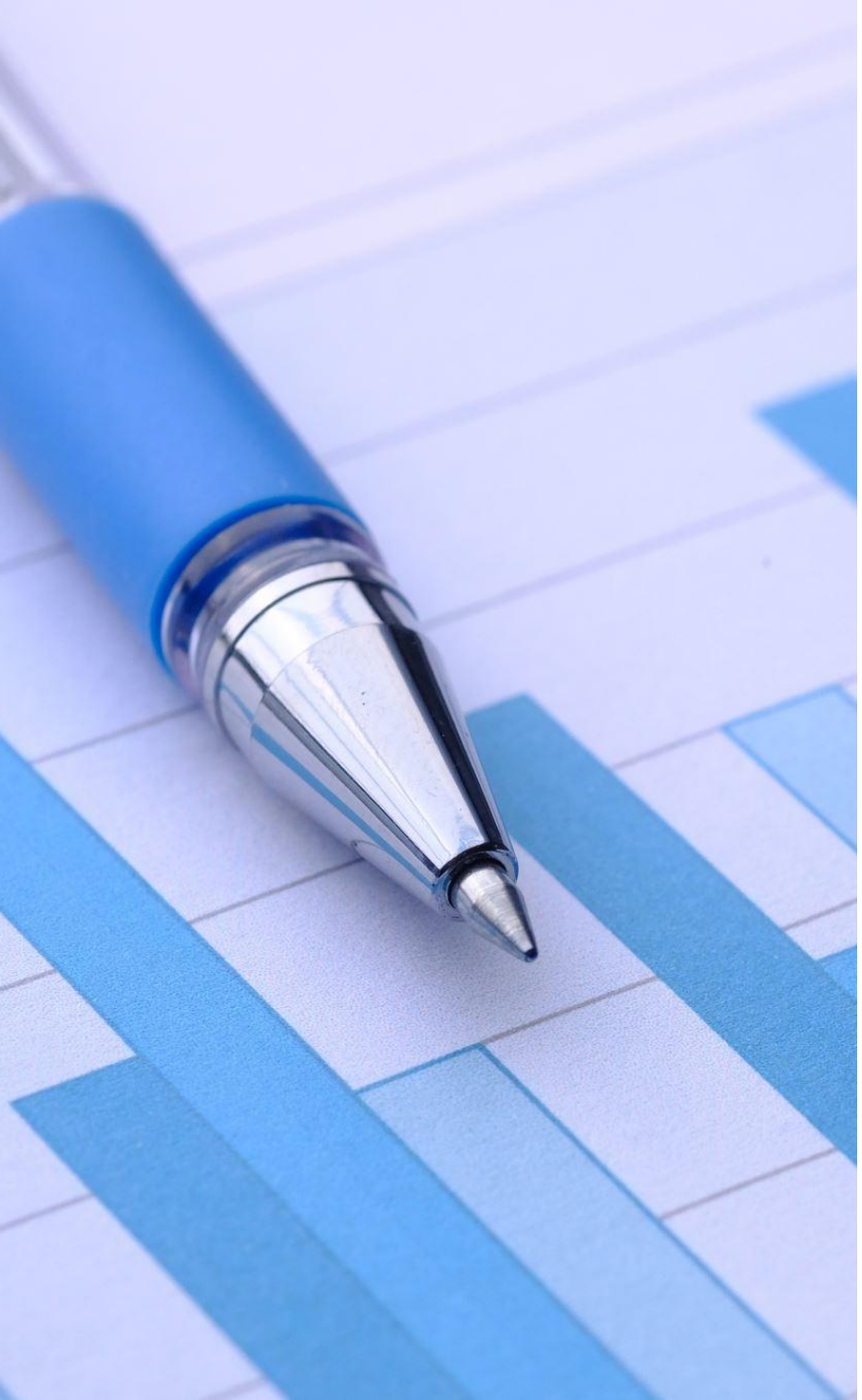
Concept of Parity group :	• **Traditionally OECD capital exporting "developed" countries were the parity group ☺**
OECD started with mainly capital Exporting countries	• Late 90's OECD was relatively homogenous – the need for parity group was there due to common thread between OECD Members
OECD expansion (2004-2021)	• Whole lot of countries which were not primarily capital exporters became OECD countries (Lithuania, Latvia, Estonia, Colombia, Chile etc) • Character of parity group changed



MFN clause: Different routes

Three types of routes typically

- **Automatic route:** Where the reading of Protocol, if you give a better treatment to somebody else in parity group, same will apply to me also
  - Self-operational clauses: nothing to be done
  - SC in Nestle: Different interpretation.
  - Notification if issued is out of abundant caution
  - India-France, India-Hungary
- **Mixture of automatic + negotiation route:**
  - India-Swiss treaty: Rate follows automatic route, Scope requires further negotiations
- **Inform/Negotiation route:**
  - India-Philippines: Inform treaty partner. Negotiations will likely happen thenceforth



MFN Example #1: Automatic route (India-Sweden, India-NL)

Protocol : Clause IV Ad Articles 10, 11, 12

*"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.""*

MFN Example #2: Mixture of Automatic & Negotiation route

India-Swiss Confederation Protocol

*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.]*

MFN Example #3: Inform route India-Philippines

4. With reference to Articles 8 and 9 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.*

Crux of the MFN issue

Whether there is any right to invoke the MFN clause when the third country with which India has entered into a DTAA with was not an OECD member yet (at the time of entering into such DTAA)?

And if so, what is **effective date** for granting the favourable treatment - either from DTAA was initially signed with Lithuania (2013) or from when Lithuania became OECD member (2018)?

Whether the MFN clause is to be given effect to automatically or if it is to only come into effect after a Notification is issued by Indian Govt?

Is India obligated to issue a notification u/S 90 to amend India-Netherlands DTAA to incorporate the new provisions?

MFN History: DCIT vs. ITC Ltd. (2002) 82 ITD 239 (Cal)

- **Installation and Commission fees not FTS?** India-UK/India-USA/India-Switzerland has 'fees for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property'.
- **India-France vs India-UK/India-USA/India-Switzerland.** Both scope (make available) and rate were different
- But **CBDT Notification SO 650(E), dt. 10.7.2000 [(2000) 244 ITR (St) 134}:** While Indian Government made amendment to Indo-French DTAA **with respect to the lower rate of withholding tax envisaged in the said tax treaties** as compared to rate in Indo-French DTAA for FTS etc, it has **NOT** taken note of the favourable provisions contained in tax treaties signed by India with OECD member countries!!
- *"It is difficult to comprehend as to how the Central Government can unilaterally amend, in exercise of the powers under Section 90 of the IT Act, a bilateral agreement that a DTAA inherently is, but, for the present purposes and for the reasons we shall now state, it is not even necessary to be drawn into that controversy about legality of the aforesaid notification"*
- Did not deal with legality of Notification as it was issued after impugned AY. But held lower rate to be applied is not dependent on any further action by the Governments (i.e no need for Notification) to incorporate India-UK/India-US/India-Switzerland rates.
- Ruling appears to have been accepted by Department since it was not agitated before HC (even though tax effect involved was above monetary limits)

MFN History: Steria case (W.P.(C) 4793/2014, 28.07.2016 Delhi HC)

- Before AAR, Steria contended that as per Clause 7 of the Protocol of **India-France DTAA** the more restrictive definition of FTS in the India-Portugal, India-UK DTAA, must be read as forming part of the India-France DTAA as well. **AAR held against assessee.**
- **Notification of 10.7.2000 of India-France Protocol MFN benefit** consciously omitted "make available" present in India-Portugal and India-UK both DTAA's signed after France and who were OECD Members at that time!
- Delhi HC reversed AAR view holding that a **Protocol is considered as part of the treaty itself and does not have to be separately notified** for the purposes of application of the MFN clause
    - The AAR had concluded that **even though** conditions set out in MFN clause were satisfied, benefit could not be availed unless specific notification by GoI effectuating the benefit under MFN clause was issued

MFN Controversy: Concentrix case

- 21.1.1989: India-Netherlands DTAA
- 27.3.1989: Notified
- 30.3.1989: Subsequent amendment
- 2020: Concentrix and Optum BV applied under S.197 seeking certificate of lower deduction of tax @ 5% on remittance of dividends but issued certificate @ 10%
    - Dividend article of India-NL DTAA provides dividend paid by Indian entities to residents of Netherlands are liable to tax at rate not exceeding 10%
    - However, Protocol to India-NL DTAA has an MFN clause which provides that if India enters into a DTAA on a later date with a third country, which “is” an OECD member, providing a beneficial rate of tax or restrictive scope for taxation of dividend, interest, royalty, etc. a similar benefit should be accorded to India-NL DTAA as well.

MFN Controversy: Concentrix case
India-Netherlands Protocol 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.""*

MFN Controversy: Concentrix case Slovenia, Colombia, Lithuania

- DTAAs signed subsequently by India with countries like Slovenia, Colombia, Lithuania (third countries) provide for lower rate of 5% tax for dividend taxation, subject to certain conditions. Accordingly, if MFN clause were to be applicable, the rate under India-NL DTAA may be claimed to be reduced to 5%.
- **However, these third countries were not OECD members when their respective DTAAs were entered into with India.** Instead, these countries became OECD members only at a later date.

MFN Controversy: Concentrix case Delhi HC view

"16. However, the principle of parity kicks-in, only if the following conditions are fulfilled:

i. First, the third State with whom India enters into a Convention/DTAA should be a member of the OECD.

ii. Second, India should have, in its Convention/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 subject Convention/ DTAA.

Once the aforementioned conditions are fulfilled, then, from the date on which the Convention/DTAA between India and a third State comes into force, the same rate of withholding tax or scope as provided in the Convention/DTAA executed between India and the third State would necessarily have to apply to the subject DTAA. "

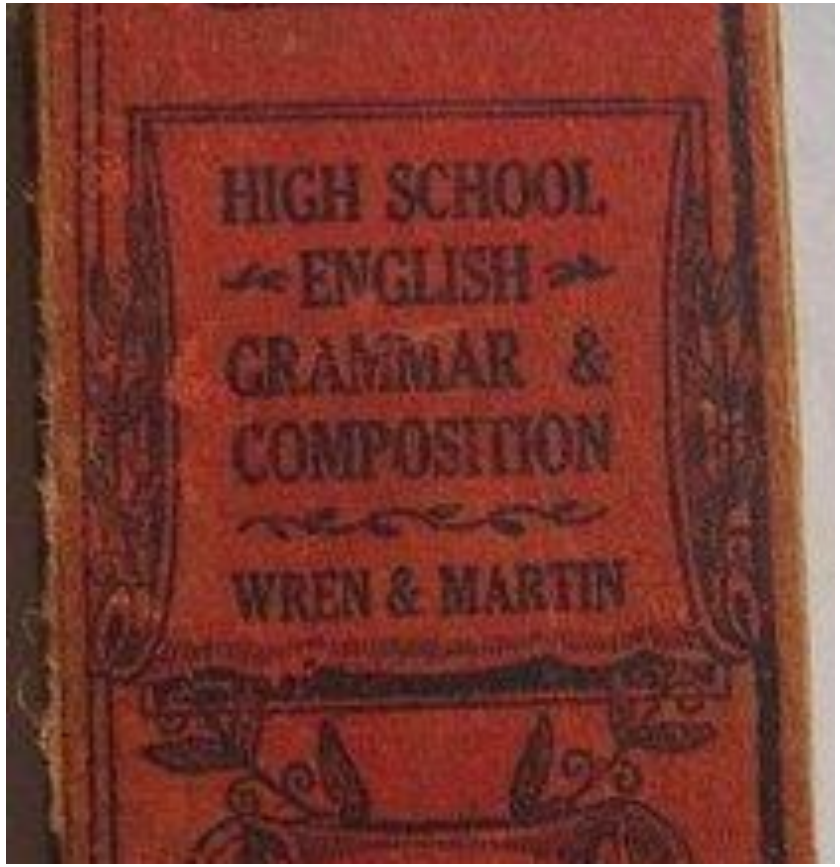
Delhi HC dismissed Revenue's argument of inapplicability of MFN clause.

- Observing date of OECD membership of third State is from when benefits can kick in

MFN Controversy: Concentrix case: Delhi HC
Delhi HC view of "… which *is* a member of the OECD …"

- Delhi HC held that "is" is both autological and heterological
  - Expresses a property that it possesses, heterological is opposite ie it does not describe itself. ("English", "Word" vs "long")
- Delhi HC followed **how the other contracting State [i.e., the Netherlands] has interpreted the provision**:
  - *"*Decree of Feb 28, 2012

    … Under the most favored nation clause in the Protocol to the Convention, this event has the effect that, with retroactive effect to July 21, 2010, a rate of 5 per cent will apply to participation dividends paid by a company resident in the Netherlands to a body resident in India."
- Delhi HC held that **principle of Common Interpretation** to be followed so that there is consistency in the interpretation of the provisions by the tax authority and courts of the concerned contracting State
  - Followed Lord Denning's *Corocraft Ltd. vs. Pan American Airways Inc., [1968] 3 W.L.R. 1273, 1283*



MFN Controversy: Unilateral Decrees Netherlands, France, Switzerland

International Fiscal Affairs, Netherlands (Decree No IFZ 2012/54M dated 28.2.2012) (“lithe decree")

Bulletin Officiel des Finances Publiques-Impot by DGFIP, France on 4.11.2016 (“lithe bulletin ")

Federal Department of Finance, Swiss Confederation on 13.8.21 (“lithe publication").

- Unilateral decree/bulletin of The Netherlands and France declare tax rate on dividends under their respective DTAAs with India stands modified to lower tax rate of 5% if holding > 10% under the MFN clause after India-Slovenia DTAA with retrospective effect from when Slovenia became member of the OECD being 21st July, 2010.
- Unilateral publication of Swiss Confederation declares tax rate on dividends under their DTAA with India stands reduced to 5% if holding > 10% under the MFN clause after India entered into a DTAA with Lithuania and Colombia effective 5th July, 2018 and 28th April, 2020 respectively when they became members of OECD

MFN Controversy: CBDT Circular 3 of 2022 dated 3.2.22

- Unilateral decree/bulletin/publication do not represent shared understanding of the treaty partners on applicability of the MFN clause
  - “Not with the object/purpose enshrined in respective DTAAs”
- Application of concessional rates/restricted scope from the date of entry into force of the DTAA with the third State and not from the date the third State becomes member of the OECD
  - Intention of the MFN clause in the Protocol of the DTAAs is not to give the benefit of India's DTAA with the third State which was not a member of DECO when India entered into DTAA with i
- Requirement of notification under Section 90 of the Income-tax Act, 1961
  - “India has not issued any notification importing the benefit of treaties with Slovenia, Lithuania and Colombia to treaties with The Netherlands, France or the Swiss Confederation”
- No selective import of concessional rates under MFN clause
  - 5% and 15% split rate of dividends based on direct

FOR MFN: ALL THE CONDITIONS TO BE FULFILLED

1. The second treaty (with the third State) is entered into after the signature/ Entry into Force (depending upon the language of the MFN clause) of the treaty between India and the first State;
2. The second treaty is entered into between India and a State **which is a member of the OECD at the time of signing the treaty with it;**
3. India limits its taxing rights in the second treaty in relation to rate or scope of taxation in respect of the relevant items of income; and
4. **A separate notification has been issued by India, importing the benefits of the second treaty into the treaty with the first State**, as required by the provisions of sub-section (1) of Section 90 of the Income Tax Act, 1961.

MFN Controversy: Nestle Delhi HC case

- In the revenue's appeals in Nestle what was considered by the Delhi High Court, were provisions of the **India-Switzerland** DTAA and its three protocols.

"3. Consequently, a certificate under Section 197 of the Income Tax Act, 1961 will be issued in favour of the petitioner, indicating therein, that the rate of tax, on dividend, as applicable qua the petitioner is 5% under India-Swiss DTAA."

MFN Controversy: SC in Nestle SA & Ors Revenue position

- **Articles 253** (read with Entries 13, 14 and 15 of List I of the Seventh Schedule) of the Constitution, Parliament has exclusive power to legislate in respect of any treaty or convention, entered into by India, with any other nation; such treaty can only be entered into in exercise of executive power of the Union
- Relied upon the decisions in ***Gramaphone Co. of India Ltd v. Birendra Bahadur Pandey & Ors. and Union of India (UOI) v. Azadi Bachao Andolan & Ors.***
- **Relied upon S.90.** In absence of any law, mere entering into treaty or convention or protocol cannot give rise to any right. Thus, trigger to MFN can happen when India enters into a treaty with other nations which happens to be member of OECD at the time of entering the treaty with India and if DTAA provides for more favourable treatment. Even in such case there must be Notification to give effect.
- Submits Protocol executed between India and Netherlands notified on 30.08.1999 and was itself triggered by the benefit granted to the India-USA 1990 DTAA; India-Germany 1996 DTAA; India-Sweden 1997 DTAA and India-UK 1993 DTAA:
  - It showed that triggering event itself (here, mere entering into DTAA with country which was/became OECD member) did not result in grant of any benefit to Netherlands.
  - **It was after bilateral negotiations that the Protocol was entered into, and yet later a notification under Section 90 was issued, bringing it into effect.**

S.90. *(1) 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,…..

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

….

(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.

…

Explanation 3.—For the removal of doubts, it is hereby declared that where any term is used in any agreement entered into under sub-section (1) and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued under sub-section (3) and the notification issued thereunder being in force, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.

Explanation 4.—For the removal of doubts, it is hereby declared that where any term used in an agreement entered into under sub-section (1) is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.

MFN Controversy: Constitution of India Article 73, 253

Article 73. Extent of executive power of the Union

(1) Subject to the provisions of this Constitution, **the executive power of the Union shall extend--**

(a) to the matters with respect to which Parliament has power to make laws; and

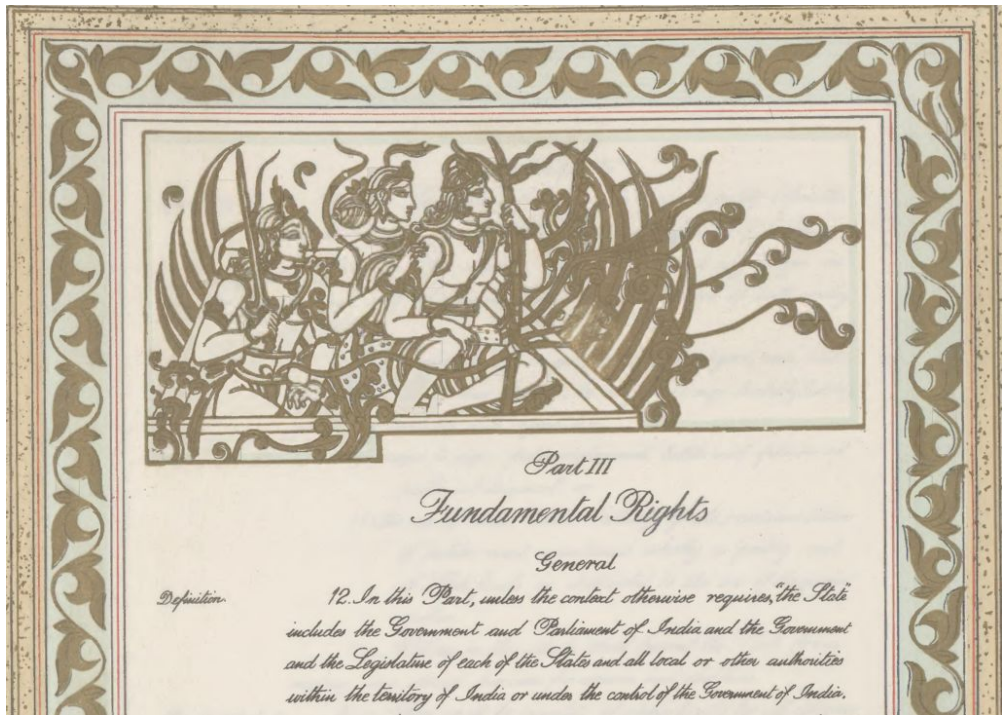
(b) to the exercise of such rights, authority and jurisdiction as are exercisable by the Government of India by virtue of any treaty on agreement:

Provided that the executive power referred to in sub-clause (a) shall not, save as expressly provided in this Constitution or in any law made by Parliament, extend in any State to matters with respect to which the Legislature of the State has also power to make laws.

(2) Until otherwise provided by Parliament, a State, and any officer or authority of a State may, notwithstanding anything in this article, continue to exercise in matters with respect to which Parliament has power to make laws for that State such executive power or functions as the State or officer or authority thereof could exercise immediately before the commencement of this Constitution.

Article 253. Legislation for giving effect to international agreements

Notwithstanding anything in the foregoing provisions of this Chapter, Parliament has power to make any law for the whole or any part of the territory of India for **implementing** any treaty, agreement or convention with any other country or countries or any decision made at any international conference, association or other body.



Part III

Fundamental Rights

General

Definition. 12. In this Part, unless the context otherwise requires, "the State" includes the Government and Parliament of India and the Government and the Legislature of each of the States and all local or other authorities within the territory of India or under the control of the Government of India.

MFN Controversy: SC in Nestle SA & Ors Revenue position: Ram Jethmalani & VCLT Article 31

- Revenue relied on ***Ram Jethmalani v. Union of India***, referring to the General Rule on Interpretation of Vienna Convention on Law of Treaties, 1961 (hereafter “VCLT”).Though India is not a party to the VCLT, the convention the principle of interpretation in Article 31 provides a broad guideline as to what should be an appropriate manner of interpreting a treaty in the Indian context as well.
- Broad principle of interpretation **would be that ordinary meaning of words be given effect to, unless context requires otherwise**.
  - That such treaties are drafted by diplomats, and not lawyers [!!], also implies that care has to be taken to not render any word, phrase, or sentence redundant, especially where it would lead to a manifestly absurd situation.
  - This principle of interpretation was applied by the AP HC in *Sanofi Pasteur Holding SA v. Department of Revenue*

MFN Controversy: SC in Nestle & Ors Assessee position

- A plain reading of Section 90 of the Act demonstrates that it does not require each article or paragraph thereof of an already notified agreement to be further notified separately if the amendment is as a consequence of a self-operative MFN clause.
- Undoubtedly if the amendment is as a consequence of a bilateral negotiation, then, a separate notification is required.
- To ascertain if any such requirement exists or otherwise, one will have to refer to the respective clauses itself.
- It is urged that the subject MFN clause in the Protocol to IndiaNetherlands DTAA has no such requirement.

MFN Controversy: SC in Nestle & Ors
Assessee position

- **Different MFN clauses:** India-Finland DTAA requires India to immediately inform the Finland authorities and notify such beneficial provision whenever the MFN clause gets triggered. India-Philippines DTAA, too clearly requires the countries to inform each other and review the provisions. **Why the differences in MFN clauses then?**

- **Article 7(3)** specifically notes that where expense limit is relaxed for computing the profits attributable to PE in any other convention, the CA of one state would notify such CA of the other state, and at request of that CA which is notified, the terms of Treaty shall be amended by Protocol to reflect such beneficial terms. Naturally, once amendment is agreed pursuant to bilateral negotiations, it has to be notified. This language, it was pointed out, was absent in the MFN clause

- **Case laws:** ITAT in *SCA Hygiene Products AB v. DCIT* and Delhi decision in *Mitsubishi Electric India Pvt Ltd v CIT* where Tribunal noted the difference in triggers of the MFN clause.

- Karnataka HC in **Apollo Tyres Ltd.vs CIT (92 Taxmann.com 166 (Karnataka))** had similarly considered the same Protocol to India-Netherlands DTAA which Revenue did not challenge.

MFN Controversy: SC in Nestle & Ors
Assessee: Unilateral Notifications by Revenue

- Revenue's reference to the **notification dated 30.08.1999**, where the restricted scope of FTS is only given by India w.e.f. 01.04.1997, whereas the limited scope of FTS was agreed in the India-USA DTAA which came into force from 18.12.1990 – Assessee argued this was a **unilateral** notification and not a bilateral amendment by both states
- The assessees highlight, in this regard that the notification nowhere clarifies that both states had agreed to its contents.
- In contrast, Notification No. GSR 382(E)/ Notification No.2/2013 dated 14.1.2013 which notified the Protocol to India-Netherlands dated 10.5.2012 bilaterally amending the DTAA and states

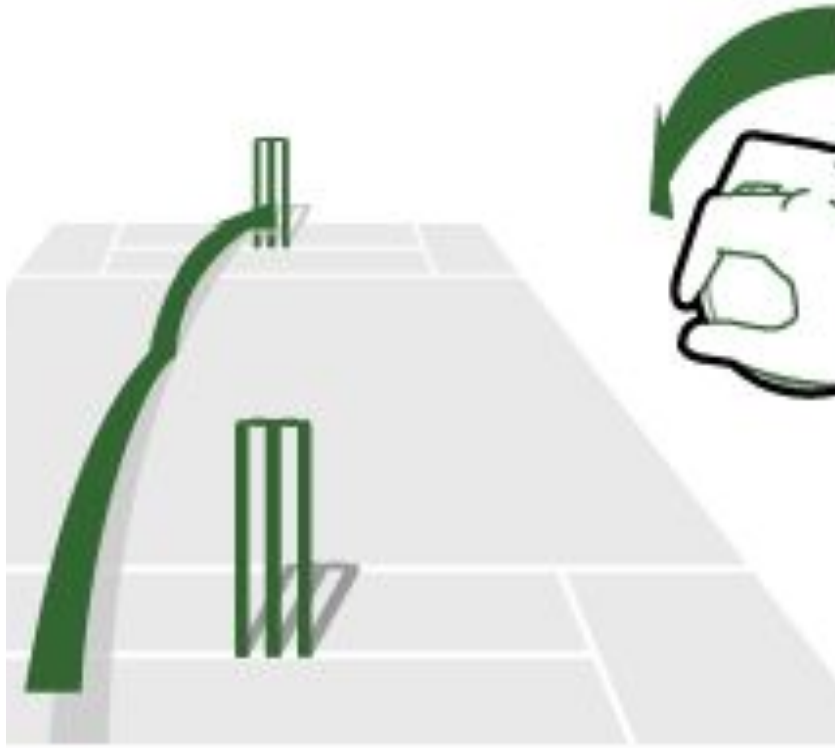
"India and Netherlands... Desiring to conclude a Protocol (hereinafter referred to as "Amending Protocol") to amend the Convention....have agreed as follows"

MFN Controversy: SC in Nestle & Ors Assessee position: Treaty vs Act

- Absence of a unilateral notification which may have in the past been issued as an administrative practice **cannot override the clear language of an MFN clause which provides for automatic application**.
- ***Union of India of India v. Agricas LLP [2020] 14 SCR 372*** held that the State cannot breach a treaty to which it is a party by referring to domestic law-be it legislative, executive, or judicial decision.
- ***Engineering Analysis Centre of Excellence P Ltd vs CIT 432 ITR 471*** applied the principle in ***Director of Income Tax v New Skies Satellite BV 382 ITR 114*** wherein the Delhi High Court held that mere executive position cannot alter the law under the DTAA.

MFN Controversy: SC in Nestle & Ors Assessee position: 197 Googly!!

"On the OECD membership issue, it was argued that the revenue's only reason in the orderdenying the applicability of the lower rate of withholding tax at 5%..... MFN clause cannot be given as Lithuania, Columbia, etc, ***were not OECD members at the time of signing of the India Netherlands DTAA****. OECD membership requirement for the third country at the time of signing of its own DTAA was not the reason given for rejection in the order impugned before the High Court."*



MFN Controversy: SC in Nestle & Ors Assessee position

Country	DTAA signed	DTAA Entry into force	Date Notified	OECD Members	Dividend Tax	Art. 10
Slovenia	13.01.2003 (pg.512 of revenue's Compilation-Vol. III, pdf pg.16)	17.02.2005 (pg.501 of revenue's compilation-Vol. III), pdf pg.5)	31.05.2005 (pg.501 of revenue's Compilation-Vol. III, pdf pg.5)	21.07.2010	5%	Art 10(2)(a) has 10% beneficial ownership requirement (pg.505 of revenue's Compilation-Vol. III, pdf pg.9)
Lithuania	26.07.2011 (pg.534 of revenue's Compilation-Vol. III), pdf pg.38	10.07.2012 (pg.534 of revenue's Compilation-Vol. III, pdf pg.38)	25.07.2012 (pg.534 of revenue's Compilation-Vol. III, pdf pg.38)	05.07.2018	5%	Art 10(2)(a) has 10% beneficial ownership requirement (pg.538 of revenue's compilation-Vol. III, pdf pg.42)
Columbia	13.05.2011 (pg.90 Assessee's Common Comp.-Vol. VI, pdf pg.93)	07.07.2014 (pg.90 Assessee's Common Comp.-Vol. VI, pdf pg.93)	23.09.2014 (pg.90 Assessee's Common Comp.-Vol. VI, pdf pg.93)	28.04.2020	5%	Art 10(2) (pg.91 Assessee's Common Comp.-Vol. VI, pdf pg.94)

MFN Controversy: SC in Nestle & Ors Assessee position

If argument, of the revenue that the phrase "is a member of OECD" is ***literally interpreted***, it would mean Slovenia, Lithuania, and Columbia ought to be members of OECD

- at the time of signing of India- Netherlands DTAA [!]
- at the time of execution of their own DTAA, and also
- At the time when the assessee invokes the MFN clause is to be accepted;

then, the consequence would be that while interpreting Article 10(1) of India-Netherlands DTAA which also uses the same word “is” (“is a resident”) the same meaning ought to be given.

However, undisputed that for Article 10 benefit, assessee needs to be resident of India/NL only for year in which benefit of Article 10 is sought.

Therefore, when for Article 10, *"is"* does not postulate continuous requirement of residence, the same word *"is"* when it appears in the MFN clause can only mean that Slovenia etc. need to be OECD members only when benefit of the MFN clause is invoked.

“35. Learned senior counsel also referred to the opinions of Professor Dr. Robert J Dannon and Prof. Dr. Stef Van Weeghel on the history of treaty provisions and the applicable rules of interpretation, to support the assessees’ arguments.” – that is all??

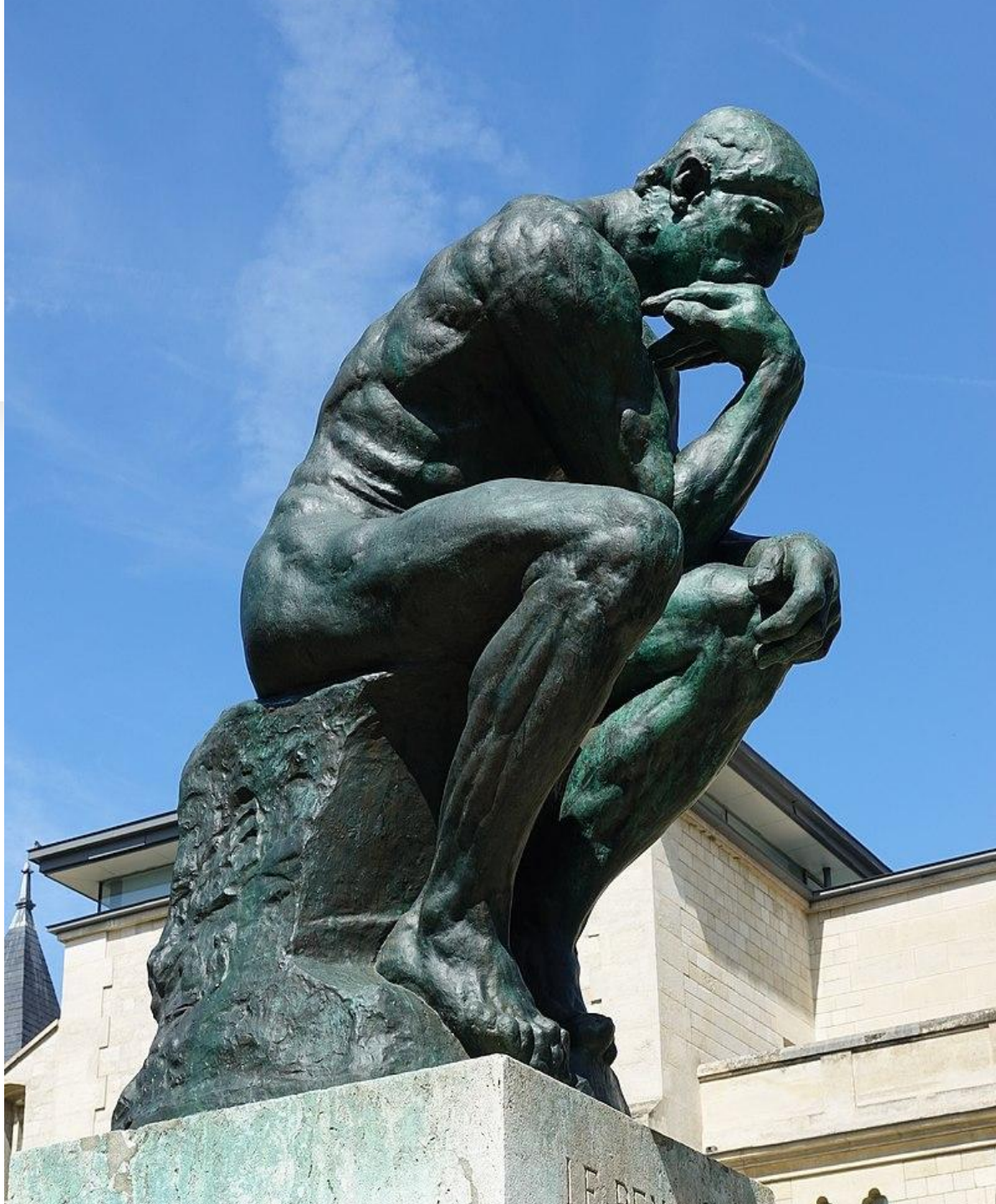
Article 10: Dividends
1. Dividends paid by a company which is a resident of one of the States to a resident of the other State may be taxed in that other State.

MFN Controversy : Nestle & Ors Judgment
SC: Treaty alteration requires legislation

- The structure and phraseology of Article 253 leaves one in no doubt, that it is when a treaty is enacted by law, or enabled through legislation, which assimilates it, that such provisions are enforceable in India.

- Relies on *State of W.B. v. Jugal Kishore More 1969 (1) SCR 320* wherein it was held *executive may make treaties with foreign States for the extradition of criminals, but those treaties can only be carried into effect by Act of Parliament, for the executive has no power, without statutory authority, to seize an alien here and deliver him to a foreign power*

- *State of Gujarat v. Vora Fiddali Badruddin Mithibarwala 1964 (6) SCR 461: "This court observed that in India, unlike some other countries the stipulations of a treaty duly ratified do not by virtue of such event (i.e. signing the treaty alone) have the force of law and Article 253 of the Constitution of India recognises this position.* ***If a treaty either requires alteration of or addition to existing law, or affects the rights of the subjects,*** *or are treaties on the basis of which obligations between the treaty-making state and its subjects have to be made enforceable in municipal courts, or which, involves raising or expending of money or conferring new powers on the government recognizable by the municipal courts,* ***a legislation will be necessary."***



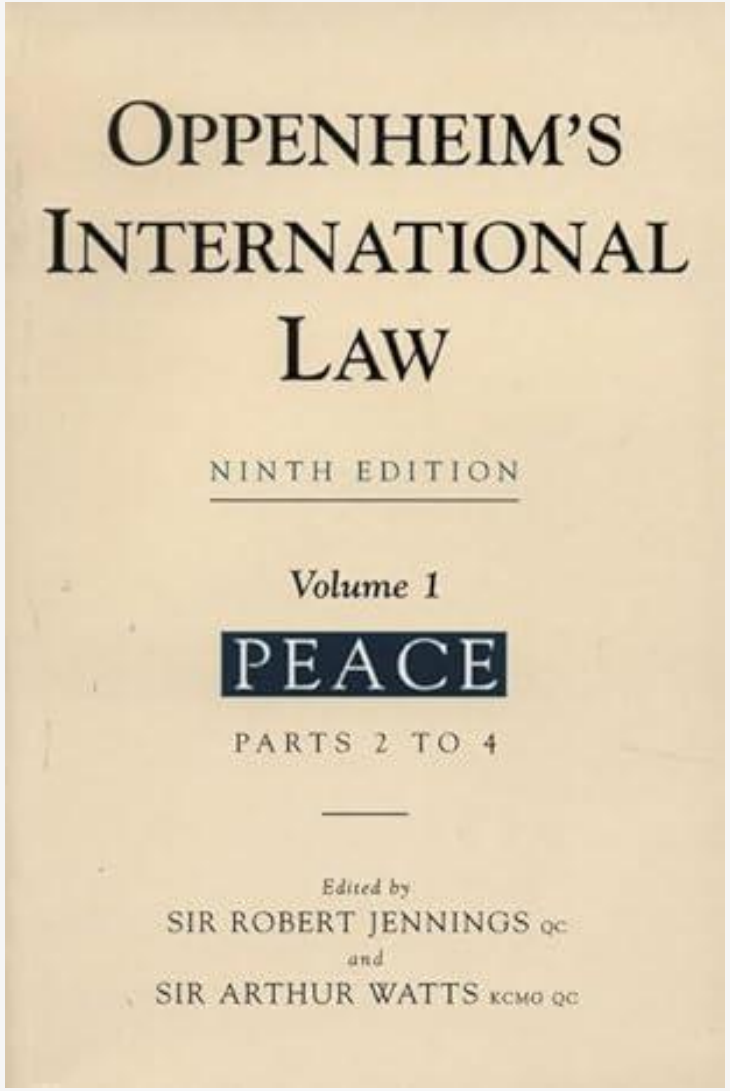
MFN Controversy : Nestle & Ors Judgment
SC reasoning: Formation vs Performance

- Relies on ***Maganbhai Ishwarbhai Patel v. Uol 1970 (3) SCR 53***

*"It will be essential to keep in mind the **distinction between (1) the formation, and (2) the performance, of the obligations constituted by a treaty,** using that word as comprising any agreement between two or more sovereign States. **Within the British Empire** there is a well-established rule that the **making of a treaty is an executive act**, **while the performance of its obligations, if they entail alteration of the existing domestic law, requires legislative action**. Unlike some other countries, the stipulations of a treaty duly ratified do not within the Empire, by virtue of the treaty alone, have the force of law. If the national executive, the Government of the day, decide to incur the obligations of a treaty which involve alteration of law they have to run the risk of obtaining the assent of Parliament to the necessary statute or statutes.... .Parliament, no doubt, ...has a Constitutional control over the executive : but it cannot be disputed that the creation of the obligations undertaken in treaties and the assent to their form and quality are the function of the executive alone. Once they are created, while they bind the State as against the other contracting parties, Parliament may refuse to perform them and so leave the State in default. These observations are valid in the context of our Constitutional set up."*

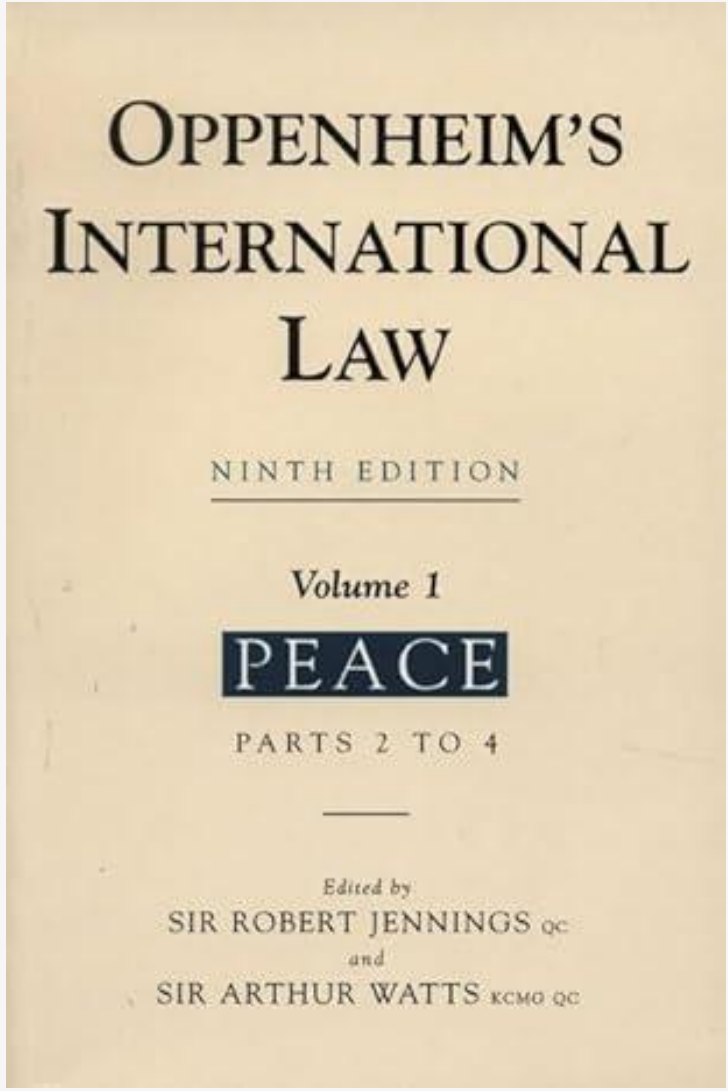
MFN Controversy : Nestle & Ors Judgment SC : Oppenheim's Internationa Law

The binding force of a treaty concerns in principle the contracting States only, and not their subjects. As International Law is primarily a law between States only and exclusively, treaties can normally have effect upon States only. This Rule can, as has been pointed out by the Permanent Court of International Justice, be altered by the express or implied terms of the treaty, in which case its provisions become self-executory. ***Otherwise, if treaties contain provisions with regard to rights and duties of the subjects of the contracting States, their Courts, officials, and the like, these States must take steps as are necessary according to their Municipal Law, to make these provisions binding upon their subjects, Courts, officials, and the like."***



MFN Controversy : Nestle & Ors Judgment SC: Oppenheim's International Law

"The power to legislate in respect of treaties lies with the Parliament under Entries 10 and 14 of List I of the Seventh Schedule. ***But making of law under that authority is necessary when the treaty or agreement operates to restrict the rights of citizens or others or modifies the laws of the State. If the rights of the citizens or others which are justiciable are not affected, no legislative measure is needed to give effect to the agreement or treaty"***



MFN Controversy : Nestle & Ors Judgment
SC conclusion: Relies on Azadi Bachao Andolan

"26. A survey of the aforesaid cases makes it clear that the judicial consensus in India has been that ***section 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a double taxation avoidance agreement.*** *When that happens, the provisions of such an agreement, with respect to cases to which where they apply, would operate even if inconsistent with the provisions of the Income Tax Act…..*

29. In our view, the contention is wholly misconceived. Section 90, as we have already noticed (including its precursor under the 1922 Act), was brought on the statute book precisely to ***enable the executive to negotiate a DTAC and quickly implement it. Even accepting the contention of the respondents that the powers exercised by the Central Government under section 90 are delegated powers of legislation****, we are unable to see as to why a delegate of legislative power in all cases has no power to grant exemption. There are provisions galore in statutes made by Parliament and State legislatures wherein the power of conditional or unconditional exemption from the provisions of the statutes are expressly delegated to the executive. For example, even in fiscal legislation like the Central Excise Act and Sales Tax Act, there are provisions for exemption from the levy of tax. (See Section 5A of Central Excise Act, 1944 and Section 8(5) of the Central Sales Tax Act, 1956). therefore we are unable to accept the contention that the delegate of a legislative power cannot exercise the power of exemption in a fiscal statute."*

MFN Controversy : Nestle & Ors Judgment
SC conclusion on Need for MFN Notification

1. The terms of a treaty ratified by the Union **do not** ipso facto acquire enforceability;

2. The Union has exclusive executive power to enter into international treaties and conventions under Article 73 [read with corresponding Entries - Nos. 10, 13 and 14 of List I of the VIIth Schedule to the Constitution of India] and Parliament, holds the exclusive power to legislate upon such conventions or treaties.

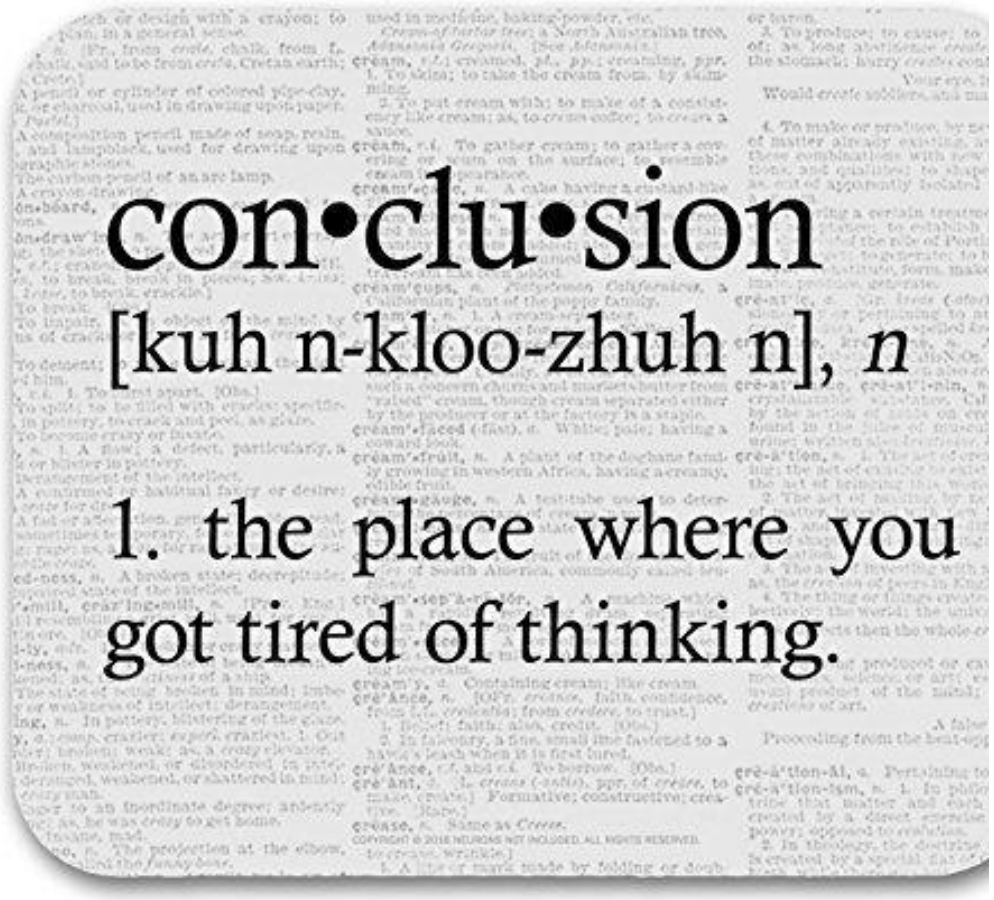
3. Parliament can refuse to perform or give effect to such treaties. In such event, though such treaties bind the Union, vis a vis the other contracting state(s), leaving the Union in default.

4. The application of such treaties is binding upon the Union. Yet, they "are not by their own force binding upon Indian nationals".

5. **Law making by Parliament in respect of such treaties is required if the treaty or agreement restricts or affects the rights of citizens or others or modifies the law of India.**

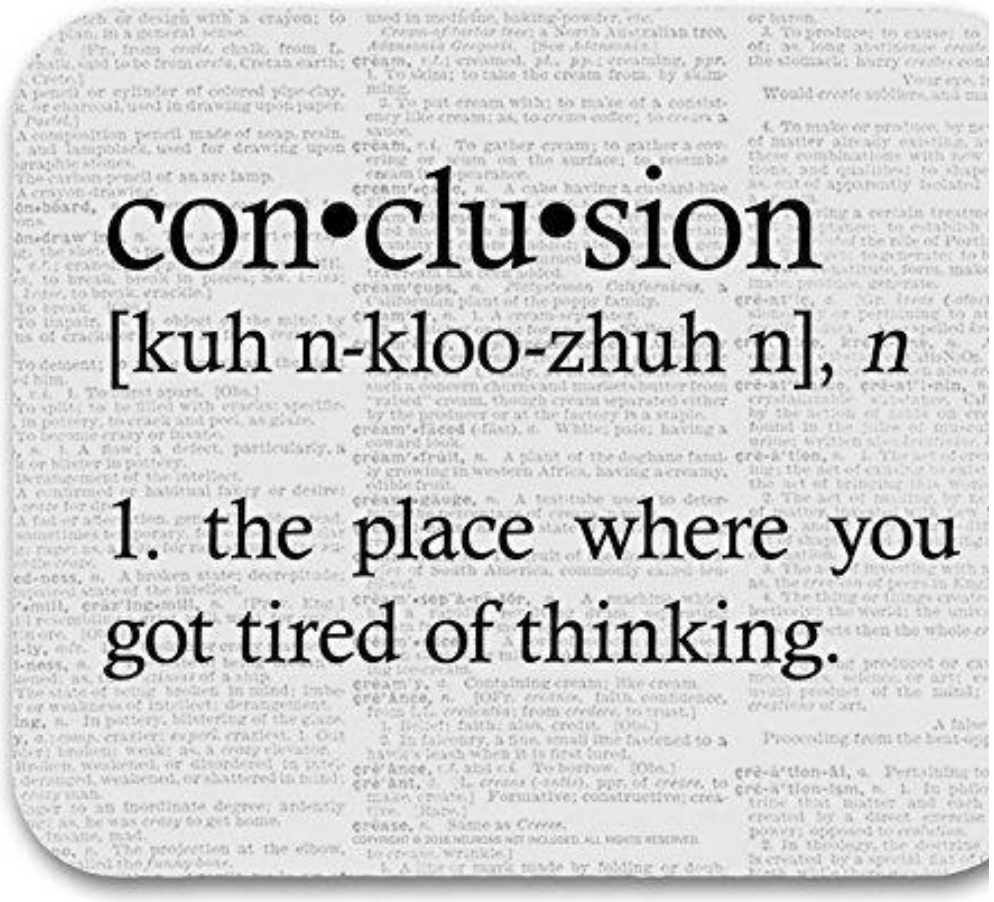
6. If citizens' rights or others' rights are not unaffected, or the laws of India are not modified, no legislative measure is necessary to give effect to treaties.

7. In the event of any ambiguity in the provision or law, which brings into force the treaty or obligation, the court is entitled to look into the international instrument, to clear the ambiguity or seek clarity.



MFN Controversy : Nestle & Ors Judgment
SC conclusion: Need for MFN Notification

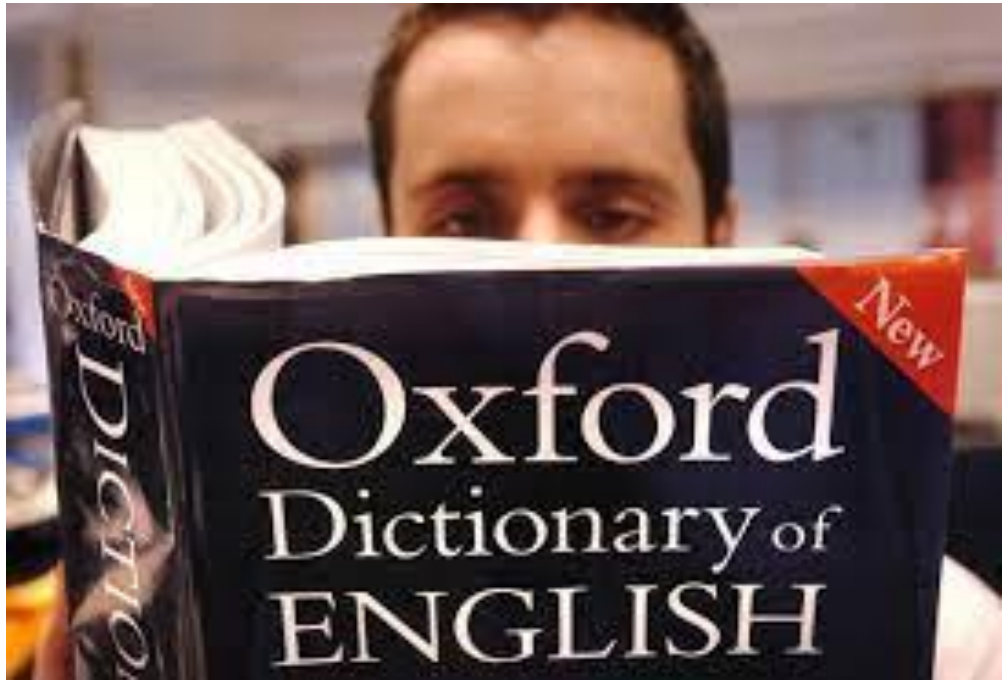
"The legal position discernible from the previous discussion, therefore is that upon India entering into a treaty or protocol does not result in its automatic enforceability in courts and tribunals; the provisions of such treaties and protocols do not therefore, confer rights upon parties, till such time, as appropriate notifications are issued, in terms of Section 90(1). "



MFN Controversy : Nestle & Ors Judgment SC on “is”[!!]

- *Jagir Kaur v. Jaswant Singh 8 (1964) 2 SCR 73* "is" was fact dependent and had to be read contextually
- *P. Anand Gajapati Raju v. P.V.G Raju 39 (2000) 4 SCC 539* in the context of the Arbitration and Conciliation Act, 1996, SC explained that “is” normally has present signification
- *Vijay Kumar Prasad v. State of Bihar (2004) 5 SCC 196* relied on

51. From the above discussion, it is clear that the expression “is” has a present signification and it derives meaning from the context. Given this interpretation, the conclusion is that when a third-party country enters into DTAA with India, it should be a member of OECD, for the earlier treaty beneficiary to claim parity.



MFN Controversy : Nestle & Ors Judgment
SC on Treaty practice of India viz a viz Netherlands,

Taxation at source on dividends, interest, royalties, FTS, use of equipment: rate lower or scope more restricted in India-Germany, India-Sweden, India-Swiss, India-USA entered into earlier dates than India-Netherlands.

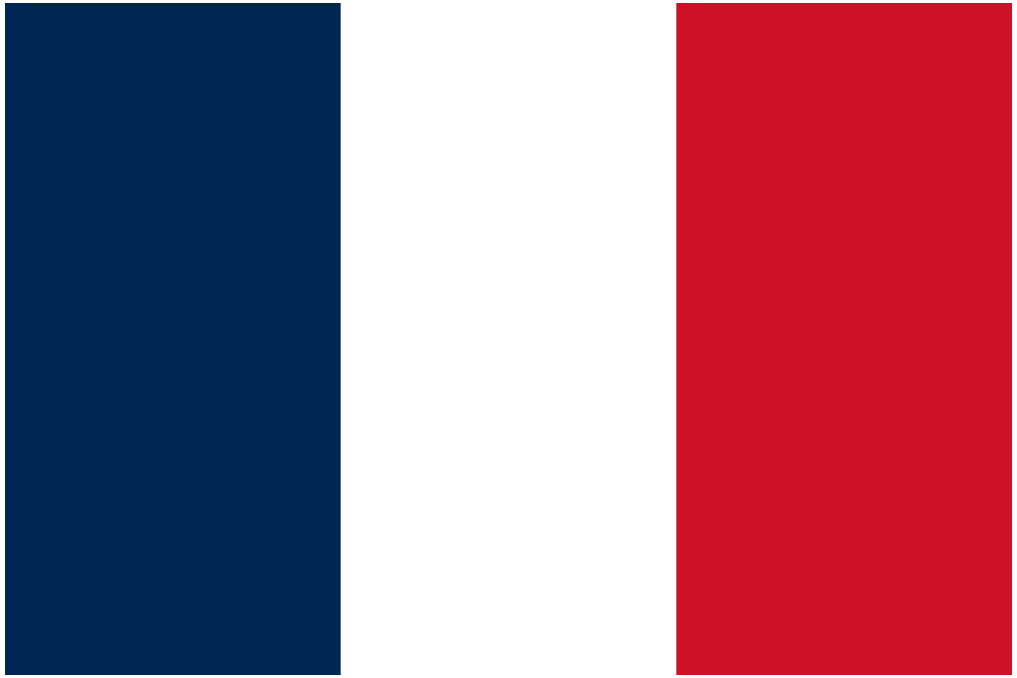
Thus, Notification of 30.8.1999 for India-Netherlands provided benefits expressly on different dates. **SC analyzed this:**

1. Clear that date for relief of rate of taxation for interest, dividends was 01.04.1997; different dates (01.04.1995 and 01.04.1998) were applied as applicable to FTS etc; the rates varied depending on period(s).
2. Notification u/S 90 was issued by Indian Govt on 30.08.1999.
3. Favourable treatment was given to other OECD nations on 26.10.1996 (India-Germany); India and Sweden entered on 25.12.1997, India-Swiss Confederation on 19.10.1994 itself. **But these earlier dates, did not result in India automatically extending benefits to Netherlands as per India-Netherlands DTAA Protocol**

"55. Clearly, therefore, so far as India-Netherlands DTAA goes, there is established and clear precedent, of behaviour, in relation to treaty practise and interpretation. This was uncontested, and is a matter of record."

MFN Controversy : Nestle & Ors Judgment
SC on Treaty practice of India viz a viz France

- The amending notification again followed same pattern as India-Netherlands DTAA, of defining the rate and nature of relief on interest, and dividends and the rates applicable, and different definition for different dates for “fees on royalties and technical services”, i.e. 01.04.1995 and 01.04.1997 for Articles 11, 12, 13.
- This notification again reinforced India’s practise and conduct of giving effect of the subsequent event of a more beneficia arrangement with a third country, to the country which had entered into a DTAA previously, on the basis of a treaty provision, through an express action i.e., a notification under Section 90.

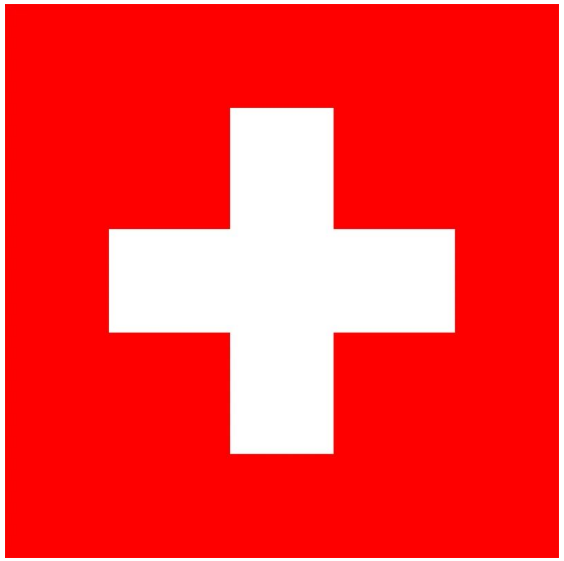


MFN Controversy : Nestle & Ors Judgment SC on Treaty practice of India - Switzerland

"ARTICLE 16: The Governments of the Contracting States shall notify each other through diplomatic channels

1. that all legal requirements and procedures for giving effect to this Protocol have been satisfied. [..]"

- SC points out Article 16 in second Protocol which initially had the negotiations trigger and says Switzerland cannot claim an exception, based only on the language of the third Protocol which did away with negotiations for better *rate.*
- SC held there are *compelling constitutional and legal requirements* to be satisfied, before *benefits are integrated within the national legal regimes.*



Notification Date	Notification	India-Switzerland
21.4.1995	Notification No. GSR 357(E),	Treaty
07.02.2001	Amended by Notification No. GSR 74(E)	Protocol
27.12.2011	Notification No. S.O. 2903(E)	Protocol

MFN Controversy : Nestle & Ors Judgment
SC on Treaty practice of India - Canada

- India-Canada treaty notified 25.9.1986 viz a viz India-Sweden signed 12.12.1998. Latter extended benefits. Former had automatic route MFN clause:

"With reference to paragraph 2 of article 13, in the event that pursuant to an Agreement or a Convention concluded with a State which is a member of the Organisation for Economic Co-operation and Development after the date of signature of this Agreement, India would accept a rate lower than 30 per cent for the taxation of royalties or fees for technical services paid by a resident of India to a resident of that State, it is understood that ***such lower rate will automatically be applied for the taxation of royalties and fees for technical services*** *paid by a resident of India to a resident of Canada where the royalties or fees for technical services are paid in respect of a right or property which is first granted, or under a contract which is signed, after the date of entry into force of the first-mentioned Agreement or convention."*

- **India still issued a Notification u/S 90 dated 28.10.1992**
- SC held treaty practice of India was consistent; notification even under automatic route

MFN Controversy : Nestle & Ors Judgment SC on Treaty ratification abroad

Switzerland:

The Federal Council has the authority to negotiate and sign treaties and conventions. The treaty after its signature is **ratified in four different ways:**

(a) In certain cases, Parliament authorizes the Federal Council in advance to sign the treaty and bring it into force as well;

(b)Some treaties require prior approval of the Parliament to be enforceable;

(c) In some cases, the treaty is subjected to optional referendum provided under Article 89 (3) of the Constitution;

(d)In some cases, the international agreement needs sanction through compulsory referendum in terms of Article 89 (5) of the Constitution44

Consequential process then follows having regard to the nature of the treaty.

France:

French Constitution of 1958 by Article 52 empowers President to negotiate and ratify treaties. Treaty ratification is authorized by the National Assembly and Senate when that treaty would affect the sovereignty of France or alter an existing statute, though such authorization has no normative value. A treaty affecting the rights of the citizens has to be published; after publication it prevails over French legislation. Article 55 confers upon treaties a status superior to that of domestic legislation and provides that concluded treaties do not require any implementing legislation to be enforceable.

Netherlands:

The Kingdom of Netherland is party to a number of treaties, international Agreements and Conventions. Such treaties have to receive approval of the Lower and Upper House of its Parliament (States General;). If a provision in a treaty is in conflict with the Constitution, a two-thirds majority of the houses is mandatory (Article 91 paragraph 3 Constitution46). The Netherlands government and its courts are not bound by a treaty until the States General have ratified it.

SC: "72. In the opinion of this court, the status of treaties and conventions and the manner of their assimilation is radically different from what the Constitution of India mandates……in India, either the treaty concerned has to be legislatively embodied in law, through a separate statute, or get assimilated through a legislative device, i.e. notification in the gazette, based upon some enacted law. Absent this step, treaties and protocols are per se unenforceable"

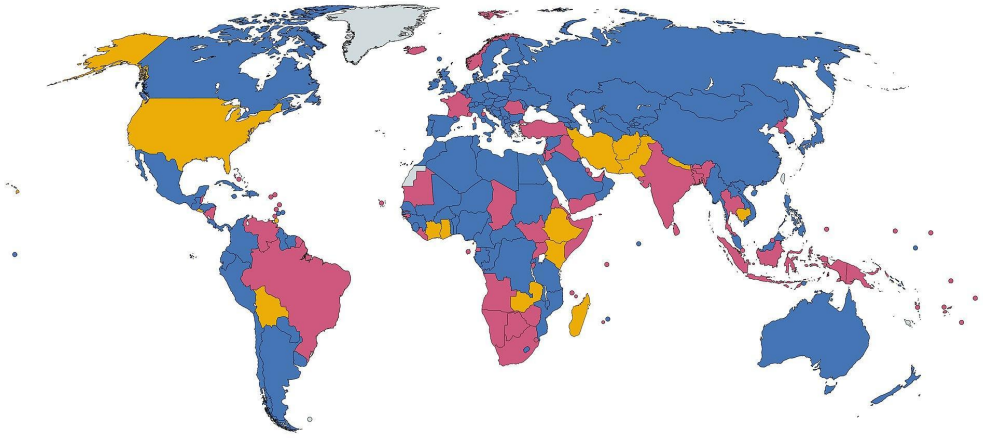
MFN Controversy : Nestle & Ors Judgment SC on International practice

- SC discusses **Klaus Vogel** treatise on DTAAs to buttress its view
- SC talks at length about **Vienna Convention on Law of Treaties.** Article 31(3) on interpretation of treaties:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding the interpretation of the treaty or the application of its provisions;

(c) any relevant rules of international law applicable in the relations between the parties.



MFN Controversy : Nestle & Ors Judgment SC on International practice viz a viz ICJ

- SC gives examples from **International Court of Justice (ICJ)** which has accepted a wide variety of activities as interpretive conduct by states: domestic legislation, diplomatic correspondence, and the silence or inactivity of one state in the face of the conduct of another.
- **Rights of Nationals Case**, the ICJ took into account the practice of local customs officials.
- **Asylum Case**, Colombian failure to raise the Havana Convention in diplomatic correspondence was used to show that Colombia did not construe the convention as applicable.
- **Corfu Channel Case**, Albanian failure to challenge the court's power to fix the amount of compensation was used in interpreting the Special Agreement as not precluding the court from fixing the quantum of damages.
- **Land, Island and Maritime Frontier Dispute (El Salvador v Hondurus)**
- **Kasikili/Sedudu Island- Botswana v Namibia**

MFN Controversy : Nestle & Ors Judgment
SC : (Subsequent) Practice makes perfect

- ILC Draft Conclusions on Subsequent Agreements and Practices heavily relied upon.
  - Provisions of the "ILC Draft Conclusions" on subsequent practice consolidates writings of eminent publicists in international law. **Cumulative effect of these provisions is that state practice subsequent to the adoption of a treaty confirms and solidifies the intent of the parties to the treaty.**
- Cites **Steven Ratner**: *"goal of treaty interpretation under….VCLT is to determine meaning of treaty viewed from perspective of the contemporary shared understanding of the parties…"* , **James Crawford**: *'the parties…own the treaty',* **Bruno Simmo** who notes subsequent practice denotes the decisive consent of the parties, and acts as a cogent, peremptory means of treaty interpretation.
- SC quotes **Sir Gerald Fitzmaurice who helped draft Article 31 of VCLT** who outlined 3 subsidiary principles of interpretation, 'effectiveness', **'subsequent practice**', and 'contemporaneity', which he saw as complementary to the three primary ones: 'actuality', the 'natural and ordinary meaning', and 'integration'.
- SC cites **Donald Regan** who states *"ILC Commentary says the practice is 'objective evidence' of the understanding of the parties"*

MFN Controversy : Nestle & Ors Judgment
SC rules on Need for Notification

- SC holds that whilst considering treaty interpretation, **it is vital to take into account practice of the parties**.
    - Issue of treaty interpretation into domestic law is driven by constitutional, political factors subjective to each signatory. So, domestic courts cannot adopt the same approach to treaty interpretation in a black letter manner.
- **SC holds treaty practice of Switzerland, Netherlands and France dictated by conditions peculiar to their constitutional regimes.**
    - *"Could it conceivably be argued that in the event of failure of the Swiss Confederation to secure the requisite majority in a referendum by the Swiss Parliament, or in absence of approval by both houses of States General in Netherlands, a DTAA provision could nevertheless be assimilated into executive decrees? The answer is obviously in the negative."*
    - Likewise, **treaty practice in India points to a consistent pattern of behaviour** when signatory to existing DTAA, points to the event of a third state entering into OECD membership, and a resultant trigger event, the beneficial effect given to the later third-party state has to be notified in earlier DTAA, as a consequential amendment, preceded by exchange of communication (and perhaps, negotiation) and acceptance of that position by India. **Essential requirement of a notification u/S.90 of the consequences of the trigger** event cannot be undermined

Ratio of Nestle Supreme Court Judgment
AO (Intl Tax) vs Nestle SA [2023] 155 taxmann.com 384 (SC)

- **Mandatory to notify:** SC affirmed that a notification under Section 90(1) is **necessary and mandatory**. It is a condition that must be fulfilled for a Court, Tribunal or Authority to give effect to a DTAA/protocol that alters its terms and conditions, thus affecting the existing provisions of law.
- **No automatic application:** The Court held merely because a provision in a DTAA or Protocol with one nation requires same treatment in a specific matter, subsequent to its initial signing when another nation receives preferential treatment, this does not automatically lead to integration of such provision to extend same benefit in context of the DTAA of first nation. In such a scenario, the terms of the earlier DTAA need to be amended through a separate notification under Section 90.
- **Relevant date:** To claim benefit of the MFN clause, based on the DTAA between India and the third state that is an OECD member, the relevant date is date when the treaty was entered into with India, not a later date when that country becomes an OECD member.

Will Nestle SC be reviewed? New developments

- SC has been asked to reconsider its judgment of Nestle citing that there is a lot of international material which were not cited.
- Interplay of international law and domestic law on interpretation of treaties including Indian national **Kulbhushan Jadhav's** case where India succeeded before the International Court of Justice (ICJ).
  - That matter was argued before ICJ where Pakistan refused at first to give consular access to Mr. Jadhav based on their practice **but the international treaty/conventions prevailed.**
- France is giving the benefit of MFN but India citing **executive practice** is not doing so.
  - **“Can you pitch executive practice against international law? "** **“**Dimensions of public international law that have been missed in the judgment... “
- SC isn’t convinced…yet?
  - "Executive practice is not the issue you are arguing, you are arguing that the MFN Clause has actually been notified under Section 90. “
  - While agreeing to hear in March, SC indicated steep threshold for petitioners to meet as it is not merely about interpretation of a judgment, but rather its reconsideration. No notice issued for now.

MFN: Nestle SC judgment Consequences

- **The adverse SC ruling could make payers liable for recovery of TDS shortfall, interest u/s. 201(1A) and initiation of penalty proceedings**
- **CBDT Circular No. 11/2017 dated 24 March 2017** provides for guidelines for waiver of interest u/s. 201(1A). Similarly, CBDT Order No. F No. 400/129/2002-IT(B) dated 26 June 2006 provides for guidelines for waiver of interest u/s. 234A/B/C.
    - Hurdle in making applications for waiver of interest is guidelines provide relief only if shortfall due to favourable jurisdictional HC ruling. Way out is to follow *Devarsons. v. U.P. Singh 284 ITR 36* and *Bhanuben Panchal Chandrikaben Panchal269 ITR 27*
- **Bombay Chamber representation to Revenue Secretary:**

"Payers may be permitted to file a revised TDS return without payment of interest and penalties. Once right amount of TDS is paid as reflected in revised TDS return, payees may be absolved from further compliance (or) alternatively be permitted to file an updated return for all past AYs, without payment of additional taxes or interest and consequential immunity from penalty and prosecution.

Payee may also be given an assurance that assessments shall not be reopened on this account as long as the relevant taxes are deposited by the payers or by the payees themselves….

Time limit up to 31st March 2025 may be provided to avail the benefit of automatic waiver of interest and penalty and immunity from initiation of reassessment proceedings"

Thanks!

Vikram Vijayaraghavan, Advocate

Subbaraya Aiyar, Padmanabhan & **Ramamani** Advocates

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