Newsflash:
Supreme Court rules issuance of notification is mandatory to invoke MFN clause in DTAA

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1.0 Background

1.1 In a batch of appeals arising from the decision of the Hon'ble High Court of Delhi in the case of Nestle SA[1] and Others, the Hon'ble Supreme Court of India examined the Most Favored Nation ('MFN') clause of the India-Netherlands, India-France, and India-Switzerland tax treaties and ruled that a separate notification is required under section 90(1) of the Income-tax Act, 1961 ('Act') to give effect to a tax treaty or its Protocol changing terms and conditions that modifies existing provisions of the law.

1.2 The MFN clause provides for a reduction in the rate of taxation at source on dividends, interest, royalties, or fees for technical services (FTS), as applicable, or a restriction on the scope of royalty/FTS in the tax treaty, similar to a concession granted to another OECD country subsequently.

1.3 The High of Delhi in its earlier judgments in the case of Steria India Limited[2], Concentrix Services Netherlands BV[3] and Optum Global Solutions International BV[4] has held as under:

- A protocol is considered as a part of the treaty itself and does not have to be separately notified for the purposes of application of the MFN clause.
- The lower tax rate or more limited scope mentioned in the tax treaty concluded between India and the third State could only apply if the third State satisfied the criterion of being an OECD member.
- An emphasis was laid on the word 'is' that is mentioned in the context of the third State with which India has entered into the tax treaty after execution of the subject tax treaty.
- The word 'is' described as a state of affairs that should exist not necessarily at the time when the subject DTAA was executed but when a request is made by the taxpayer or deductee for issuance of a lower rate withholding tax certificate under Section 197 of the Act.

1.4 The Supreme Court set aside the favourable rulings of the Delhi High Court and examined the following two issues:

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

(b) 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?

[1] TS-616-SC-2023
[2] [2016] 386 ITR 390 (Delhi)
[3] W.P. (C) 9051/2020
[4] W.P. (C) 882/2021

2.0 Contentions of the Revenue

2.1 The main arguments of the Revenue were that in terms of Article 253[5] (read with Entries 13, 14, and 15 of List I of the Seventh Schedule) of the Constitution of India, Parliament has exclusive power to legislate in respect of any treaty or convention, entered into by India, with any other nation. It was urged that without Parliamentary legislation, such treaties are unenforceable, having regard to the express terms of Article 253.

2.2 Revenue relying on the earlier rulings of the Supreme Court Gramaphone Co. of India Ltd. v Birendra Bahadur Pandey & Ors[6]. and Union of India (UOI) & Ors. v. Azadi Bachao Andolan & Ors[7] submitted that India follows and adopts 'dualist' practice which means that international treaties and conventions are not, upon their ratification, automatically assimilated into the national legal system but would require an enabling legislation. This is in contrast to those countries which are 'monist', wherein the treaty provisions are enforceable like municipal law, and are to be given equal weight by courts.

2.3 Revenue relied on Section 90 of the Act, which requires a separate notification to be issued to give effect to any treaty or convention, relevant extract is reproduced as under:

"90. (1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—
(1) ……..….

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

2.4 The revenue also alluded to the treaty practice between India and each of the aforesaid three nations and by citing examples, argued that the triggering event itself (mere entering into DTAA with OECD member country) do not result in grant of any benefit or advantage to the nation(s) and that a Protocol is entered into after bilateral negotiations and yet a notification u/s 90 of the Act is required to be issued for bringing the same into effect

2.5 Revenue also asserted that the term 'is a member of the OECD' used in the Protocols' MFN clause can have a current, past, or future meaning depending on the context, citing Article 3(2) of the DTAAs, which expressly states that a treaty term shall be interpreted in accordance with the domestic tax law in effect at the time the treaty is applied, unless the context requires otherwise.

2.6 It was further submitted MFN clause clearly demonstrates that the other country is required to be an OECD member as on the date of the signing of the treaty and not on any future date. Thus, when Slovenia, Lithuania, or Columbia entered into respective DTAAs with India, they had to have been members of OECD at that time, for Netherlands, France, and Switzerland to claim parity of treatment.

2.7 Lastly, it was submitted that notifications are necessary and there could not be any automatic applicability of such benefits given to other OECD members.

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[5] 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.
[6] 1984 [2] SCR 664
[7] 2003 (Supp 4) SCR 222

3.0 Contentions raised by the Assessee

3.1 The assessee contended that once the DTAA and the Protocols (including the MFN clause) have been notified under section 90(1) of the Act and have entered into force, any subsequent amendment to the same becomes operative automatically, and there is no legal requirement to notify such amendment subsequently, particularly where the said amendment is the result of a self-operative MFN clause.

3.2 It was further submitted that section 90 merely requires notification of a treaty or protocol; it does not require notification of each clause of such an agreement separately. A simple reading of section 90 of the Act indicates that it does not need each article or paragraph of an already notified agreement to be separately notified if the amendment is the result of a self-operative MFN clause. Undoubtedly if the amendment is as a consequence of a bilateral negotiation, then, a separate notification is required.

3.3 The use of different language in the DTAA by the two contracting states is indicative of their intent and cannot be disregarded whilst interpreting their terms. There is no requirement in the subject MFN clause to issue any notification to bring into force the beneficial provisions from subsequent DTAAs or by way of a notified protocol or negotiation. The MFN clause simply states that the reduced rate as extended to an OECD country 'shall also apply' under this current convention and, hence, such clause is automatic in operation. For instance, like in case of India-Switzerland DTAA, the existing MFN clause does not require any negotiation but for change in scope, the same is still required.

3.4 On the issue of OECD membership, it was submitted that the revenue's sole reason in the order denying the applicability of the lower rate of withholding tax at 5% - which was challenged by the assessee in the relevant impugned decision - was that the benefit of the MFN clause could not be given because Lithuania, Columbia, and other countries were not OECD members at the time the India-Netherlands DTAA was signed.

3.5 Refuting the argument of the Revenue that the meaning of the expression 'is a member of OECD' means that the membership of the OECD is a continuous requirement, the Counsel of the Assessee submitted that the term 'is' does not postulate continuous requirement of membership of OECD but at the time when the MFN clause is invoked.

4.0 Decision by the Hon'ble Supreme Court

4.1 Treaties are an attribute of sovereignty, and the Union alone has the authority to enter into them. The Supreme Court emphasized the structure and phraseology of Articles 253 and 73 of the Indian Constitution and noted that treaty provisions are enforceable in India only when they are enacted by law or enabled through legislation that assimilates them.

4.2 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 Seventh Schedule to the Constitution of India] and Parliament, holds the exclusive power to legislate upon such conventions or treaties.

4.3 Supreme Court noted by placing reliance on its earlier rulings in V.O. Tractoroexport v. Tarapore & Co[8], Maganbhai Ishwarbhai Patel & Ors. v Union of India & Ors[9] that India's entry into a treaty or protocol does not result in its automatic enforceability in courts and tribunals; thus, the provisions of such treaties and protocols do not confer rights on parties until appropriate notifications are issued,

[8] (1969) 3 SCC 562
[9] 1970 (3) SCR 53

in accordance with Section 90(1).

4.4 The three 'third party' nations: Lithuania, Colombia and Slovenia, were initially not members of OECD when they entered into treaties and protocols with India; they became members later. The SCI emphasized that the term 'is' is fact dependent and has to be read contextually. Therefore, 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.

4.5 Supreme Court also examined the treaty practice of India in relation to DTAA and their protocol, and practices of Netherlands, France and Switzerland. The Court concluded that the status of treaties and conventions and the manner of their assimilation is radically different from what the Constitution of India mandates. The treaty practice of Switzerland, Netherlands and France is dictated by conditions peculiar to their constitutional and legal regimes.

4.6 In India, either the treaty in question must be legislatively contained in law, via a new legislation, or it must be assimilated by a legislative device, i.e. announcement in the gazette, based on some enacted law (for example, the Extradition Act of 1962 and the Income Tax Act of 1961). Treaties and protocols are unenforceable unless this step is implemented.

4.7 The Supreme Court also referred to the International Law Commission and International Court of Justice rulings and concluded that though they are not binding, but certainly provided valuable insights into the tax treaty interpretation. Whilst considering the treaty interpretation, it is vital to take into account practice of the parties. Much depends upon the relationship of the parties, the mutuality of their interests, and the extent of co-operation or accommodation they extend to each other. The issue of tax treaty interpretation and treaty integration into domestic law is driven by constitutional and political factors subjective to each signatory. The treaty practice of Switzerland, Netherlands and France is dictated by conditions peculiar to their constitutional and legal regimes.

4.8 Based on the above, the Supreme Court concluded that:

- A notification under Section 90(1) is necessary and a mandatory condition for a court, authority, or tribunal to give effect to a DTAA, or any protocol changing its terms or conditions, which has the effect of altering the existing provisions of law.

- The fact that a stipulation in a tax treaty or a Protocol with one nation, requires same treatment in respect to a matter covered by its terms, subsequent to its being entered into when another nation (which is member of a multilateral organization such as OECD), is given better treatment, does not automatically lead to integration of such term extending the same benefit in regard to a matter covered in the tax treaty of the first nation, which entered into tax treaty with India. In such event, the terms of the earlier tax treaty require to be amended through a separate notification under section 90 of the ITA.

- The interpretation of the expression 'is' has present signification. Therefore, for a party to claim benefit of a 'same treatment' clause, based on entry of tax treaty between India and another state which is member of OECD, the relevant date is entering into treaty with India, and not a later date, when, after entering into tax treaty with India, such country becomes an OECD member, in terms of India's practice.

5.0 Our Comments and Key Takeaways:

5.1 The manner by which an MFN clause in a tax treaty with one country is applied as a result of a subsequent beneficial provision signed with another country has been the subject of litigation. The Supreme Court has finally put an end to this debate by upholding the provisions of the law and the practice of the government in the past.

5.2 The Supreme Court's judgement would have far-reaching consequences for multinational corporations from all countries with whom India has an MFN clause and who have taken advantage of it for dividend, interest, royalties, and FTS payments. It will be interesting to observe how the Revenue will use this Supreme Court decision to reopen the various concluded assessments.

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