Amicus
Transcending Frontiers

Concentrix Services Netherlands: Applying Common Interpretation Principle to Dividend MFN Clause

August 06, 2021

Recently Delhi High Court in the case of **Concentrix Services Netherlands BV v. ITO (TDS)**[1] had the opportunity to interpret the Most Favoured Nation ("**MFN**") clause in the protocol to India-Netherlands tax treaty. The High Court held that the lower withholding tax rate of 5% (on dividend) provided in Indian tax treaties viz. Slovenia, Colombia and Lithuania would equally apply to the Indo-Dutch Remittance in view of the MFN clause under the India-Netherlands tax treaty.

Factual Background

Concentrix Services Netherlands BV and Optum Global Solutions International BV (Taxpayers) are two Dutch entities with subsidiaries in India. Their wholly owned Indian subsidiaries were to remit dividends after withholding tax at rates prescribed under Law. The Taxpayers accordingly approached Indian tax authorities for a certificate to authorize deduction at lower rate of5% under the India-Netherlands Tax Treaty read with the protocol containing the MFN clause. The taxpayers' argument was that lower rate of 5% provided in India's tax treaties with Slovenia (2005), Colombia (2011)[2] and Lithuania (2011) should apply in view of the MFN clause in the Protocol. However, taxpayers' contention was rejected leading to a writ being filed before Delhi HC.

---

1. [2021] 127 taxmann.com 43 (Delhi)
2. These countries were not OECD members at the time of signing the treaty,but were subsequently made so in 2010 (Slovenia), 2020 (Colombia) and 2018 (Lithuania).

Briefly put, the MFN clause in the India-Netherlands treaty provided that if India enters into a tax treaty with an OECD member wherein, inter-alia, the tax rate on dividend is lower (than the one stipulated in India-Netherlands treaty), then such lower rate shall apply.

A question thus arose as to whether MFN benefits were available in a scenario wherein the Third-Party States were not OECD Members when the tax treaties with them were signed but became members subsequently.

Summary of the Judgment:

The Judgment can be divided into two parts based on the objections raised by the Revenue.

(i) Whether separate official notification was required?

- The High Court held that a perusal of the protocol text indicated that the protocol formed an integral part of the tax treaty. Therefore, no separate notification was required insofar as the applicability of provisions of the protocol was concerned. The High Court relied on its own observation in the case of **Steria (India) Ltd. v. CIT**[3].

3. [2016] 386 ITR 390 (Del)

(i) Whether benefits under MFN Clause were available on Slovenia, Colombia, and Lithuania becoming OECD Members?

- The Court held that the protocol incorporates the principle of parity between the subject tax treaty and the tax treaties executed thereafter qua the rate of withholding tax or the scope of tax treaties in respect of dividends, interest, royalties, FTS or payments for use of equipment.
- The principle of parity kicks-in, only if the following conditions are fulfilled:

    - First, the Third State with whom India enters into tax treaty should be a member of the OECD.
    - Second, India should have in its tax treaty with the Third State, more beneficial treaty terms such as a lower rate of withholding or more restricted scope for taxation of remittances.

- The Court further held that the word '**is**' provided in the expression *"which is a member of the OECD"* in the MFN clause of the tax treaty was to be seen not necessarily at the time when the subject tax treaty was executed but when a request is made by the taxpayer for issuance of a lower rate withholding tax certificate under Section 197.
- The Court also made reference to the decree issued by the Kingdom of Netherlands which was published on March 13, 2012 wherein the protocol was interpreted in a manner that the lower rate of tax in the India-Slovenia tax treaty will be applicable on the date when Slovenia became a member of the OECD, i.e., from 21 July 2010, although, such tax treaty came into force on 17 February 2005. Therefore, participation dividend paid by companies' resident in the Netherlands to a resident in India would bear a lower withholding tax rate of 5 per cent.

- The Court held that one of the primary purposes of entering into tax treaties is the equitable allocation of taxes between the Contracting States. **The High Court's approach in interpreting the treaty in light of the decree passed in the Netherlands aligned with the accepted principle of 'Common Interpretation' generally applied for interpreting tax treaties.**

- The Court also made reference to the decision of the Supreme Court in the case of **Azadi Bachao Andolan and Anr**[4] wherein it was observed that "*while interpreting 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.*"

Conclusion

The principle of common interpretation of tax treaties is one of the important takeaways from the Ruling. The principle simply states that such interpretation should be applied which is most likely to be accepted in both contracting states. The principle stems from the doctrine of 'Consensus ad idem' which underlines the signing of all treaties – like any other contract, is founded upon a 'meeting of minds' between nations and hence, only such interpretation should be accorded to a treaty phrase or expression that is commonly agreed to between the Contracting States.

---

4. (2004) 10 SCC 1

The endeavour of Treaty Interpretation is to further the goal of the treaty i.e. reduce double taxation while aiming to allocate tax claims fairly between contracting states. This goal can only be achieved if the treaty is applied consistently by the Authorities and Courts of both Contracting States.

Though, in most cases reliance is placed on foreign Court Rulings which have interpretated the treaty based on similar facts, the Court in this instance relied on a unilateral administrative position adopted by a treaty partner. Tax Tribunals in India have a mixed track record of accepting unilateral positions as an aid to interpretate tax treaties. There are various rulings by the ITAT wherein reliance was placed upon the technical explanation issued by tax authorities of United States of America, holding them to be the best guide to interpret India-US tax treaty[5]. On the other hand, in one instance, the ITAT has held that such a technical explanation is not the official protocol or clarification which has been mutually agreed upon between the two countries and therefore, the said technical explanation would not bind the Tribunal as it was a unilateral document[6].

This case is the first occasion where a Constitutional Court had the opportunity to examine the applicability of a unilateral position and the decision signifies an inclination towards accepting the same. This position appears to be in line with the position taken by other countries like the United States where the courts have accepted unilateral position as an aid to interpret tax treaties[7].

5. See DCIT v. Bank of America NT & SA [2011] 13 taxmann.com 103 (Mumbai); Automated Securities Clearance Inc v. ITO [2008] 118 TTJ 619 (Pune).
6. NGC Network Asia LLC Vs. DDIT [TS-705-ITAT-2020]
7. See United States v. Stuart, 489 U.S. 353, 374 (1989)

Though the High Court Ruling has been rendered in the context of India-Netherlands Tax Treaty, the same would equally apply for other tax treaties with comparable language in the MFN clause (for instance, tax treaties with France, Hungary, Spain, Switzerland, Sweden, etc). Taxpayers transacting with the aforementioned jurisdictions may wish to evaluate the impact of this ruling on dividend and other streams of income with respect to the rate and scope of taxation.

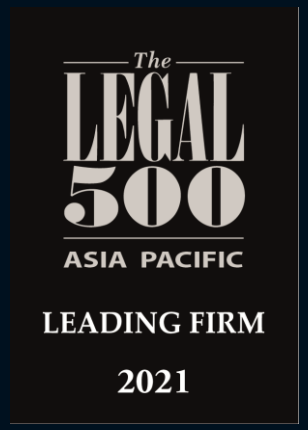
It is further advised that the impact of the ratification of Multilateral Instrument by India on MFN clause should be duly considered. For instance, under the Principal Purpose Test (PPT), if the tax department reasonably concludes that obtaining tax benefit through the application of MFN clause was one of principal purposes of business restructuring or tax planning, the benefit of lower rate and restricted scope under MFN provisions could be denied.

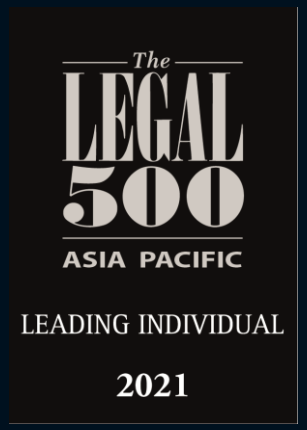
The Article has been authored by Ashutosh Mohan Rastogi (Partner, Amicus – Advocates & Solicitors) and Vibhu Jain (Associate, Amicus) - Views expressed are personal.

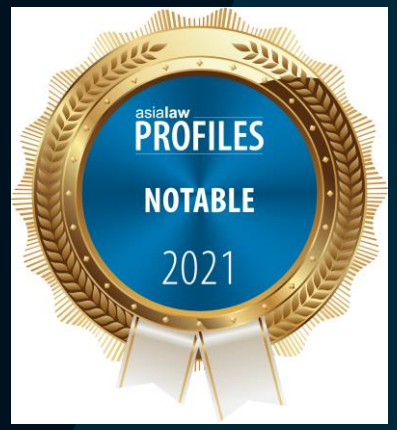
ABOUT AMICUS

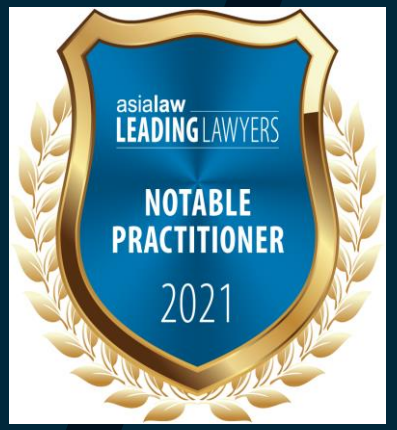
Amicus is legal and tax consulting firm with focus on corporate finance, re- structuring, private equity, international taxation, transfer pricing and goods and services tax. The Firm's tax team also represents clients in assessments and litigation including Tax Tribunal and Higher Courts.

The Firm focuses on providing efficient, effective, solution- oriented advice and representation based on specialist knowledge and experience. Amicus' boutique tax practice has been consistently been ranked as a leading practice by Legal 500, Asia Law and World Tax (ITR).









Amicus
Transcending Frontiers

Amicus
Transcending Frontiers

Amicus

I-1, Jangpura Extension
New Delhi-110014

Tel: 011-41553433
011-40541821

Key Contacts:

ashutosh@amicusservices.in

shivi@amicusservices.in

madhav@amicusservices.in

Email: info@amicusservices.in

Web: www.amicusservices.in