

Most Favoured Nation (MFN) clause existing in a DTAA

The MFN clause in DTAA provides that if, after signature of the tax treaty with the first country (original treaty), 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 the first country.

In a landmark judgment, the Hon'ble Supreme Court (SC) on 19 October 2023 in the case of Nestle SA, ruled that in order to invoke the beneficial provisions of a DTAA pursuant to MFN clause, India is required to specifically issue a notification to this effect. In absence of specific notification reflecting consequential amendment, MFN provisions cannot be invoked. The SC broadly concluded the controversy by laying down following three principles:

1. 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, notification under Section 90(1) of the Income Tax Law is necessary and mandatory.
2. MFN clause in a DTAA does not automatically lead to extending the benefit covered in the DTAA of third country (which is a member of OECD), with which India entered into DTAA subsequently. In such an event, the terms of the earlier DTAA require to be amended through a separate notification under Section 90 of the Income Tax Law.
3. On the aspect of the time period when a third country should be an OECD member in order to apply the beneficial treatment accorded to such country by invoking MFN clause, the SC clarified that the relevant date is the initial treaty signing date with India and not any subsequent date when that third country becomes an OECD member.

The SC decision is likely to impact the Indian companies that may have made remittances outside India, in respect of payments towards interest, royalty, fees for technical services, dividend etc, without deducting taxes or after deducting taxes at a lower tax rate, by relying on MFN provisions and its scope as understood by lower courts. The impacted taxpayers may need to explore and revisit the applicable provisions for making subsequent foreign payments.

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