

SATURDAY INTERNATIONAL TAX GYAN !!!

#taxmadeeasy

SITG No. 237

Switzerland has revoked its unilateral statement and now both the countries share the same understanding about MFN clause



What is the MFN Clause in DTAA?



- ❖ MFN relates to Most Favoured Nation Clause. The MFN clause ensures that if one contracting state (e.g., India) provides more favorable tax treaty benefits to another state, the same benefits automatically extend to the MFN clause holder (e.g., Switzerland). It typically applied to tax rates or conditions on passive income like dividends, interest, royalties, or fees for technical services.
- ❖ In terms of Switzerland if India enters into an agreement with a third State which is a Member of the Organisation for Economic Cooperation and Development (OECD), which enters into force after the 1st January, 1990, India limits its taxation at source on royalties or fees for technical services to a rate lower than the rate provided for in this Convention on the said items of income, the same rate as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention.

Background of the case

- ❖ Switzerland and India entered into a Double Taxation Avoidance Agreement (DTAA) on 2 November 1994. **Notably, an amending protocol dt. 30 August 2010 introduced Most Favoured Nation (MFN) Clause**, which ensures that any reduction in tax rates on dividends, interest, royalties, or fees for technical services under any later treaty entered between India and an OECD member state would also apply retroactively to the India-Switzerland DTAA.
- ❖ **As per Supreme Court ruling in case of Azadi Bachao Andolan (2004, 10 SCC), a notification is required to implement the provisions of tax treaty** and India has not issued any notification importing tax treaty provisions of Slovenia, Lithuania and Colombia into tax treaties of Netherlands, Switzerland and France.

Background of the case

- ❖ Subsequently, India concluded two new DTAA with other countries that include reduced dividend tax rates:
 - **DTAA with Lithuania (26 July 2011):** Offers a reduced dividend withholding tax rate of 5% on dividends paid to a company owning at least 10% of the capital of the paying company. Lithuania joined the OECD on 5 July 2018.
 - **DTAA with Colombia (13 May 2011):** Provides a 5% general tax rate on dividends. Colombia became an OECD member on 28 April 2020.

The benefit of above two DTAA was claimed by Nestle SA Civil Appeal No. 1432/ 2023 in India based on India- Switzerland DTAA-MFN clause. However Hon'able Supreme Court vide order dated 19.10.2023 clarified three things as under:



Issues emerged between India and Switzerland after Nestle SA case

- **Notification u/s 90**: It is the mandatory condition for the court, authority, or tribunal to give effect to any DTAA or any protocol, for changing terms or conditions, which has the effect of altering its existing provisions of law.
- **Automatic benefit**: The DTAA done with another country, which is also an OECD member and given better treatment, does not automatically lead to integration of such extended benefit to the first nation (entered into DTAA with India) as well. In such cases, the article of DTAA of first nation shall be required to be amended through a separate notification u/s 90.
- **Interpretation of 'Is'**: Such expression shall have a present significance. Therefore, for claiming the 'extended benefit' as made available to another country who is also an OECD member and have a DTAA, the relevant date is entering into treaty with India, and not a later date. Countries becoming member of OECD at the later date after the date of signing the DTAA, in terms of India's practice, shall not be eligible for the 'extended benefit'



Unilateral Notification is not binding



- ❖ Switzerland published a unilateral statement dt. 13 August 2021 that the lower rate of 5% apply for shareholding above 10% retrospectively from 5th July, 2018 and for dividends arising from qualified interests and portfolio dividends retrospectively from 28th April, 2020.
- ❖ Further, Unilateral decree given by other treaty partner doesn't represent shared understanding of MFN Clause
 - The unilateral instrument issued by Netherlands, Switzerland and France have no binding effect as the same has been issued without any consultation with India.
 - Benefit of lower rate in Slovenia treaty cannot be extended under MFN clause since Slovenia was not an OECD member when India entered into tax treaty



Implication of the Removal

- ❖ On 11 December 2024, the Swiss finance department issued a statement highlighting that Swiss tax authorities have waived the unilateral application of the MFN clause from 1 January 2025, aligning the tax rates on dividends between India and Switzerland with those stated in the original DTAA. The impact is summarised below:
 - For tax years 2018-2024, Indian tax residents are eligible for a lower withholding tax rate of 5% in Switzerland, applying the MFN clause.
 - From 1 January 2025 onwards, India tax residents cannot apply the reduced withholding tax rates on dividends in Switzerland and shall suffer a withholding tax of 10%.
- ❖ The removal simplifies the treaty interpretation process, as India will no longer need to monitor Switzerland's treaties with third countries for possible MFN-triggered benefits.



India



Switzerland



Visit our website blog for previous case laws.-

<https://jainshrimal.com/blog/#taxgyaan>



Join Whatsapp group for discussion on International taxation
By scanning the QR-



International Tax Gyan
WhatsApp group

Disclaimer

- ❑ This presentation has been prepared on the basis of information available in the public domain and is intended for guidance purposes only.
- ❑ Jain Shrimal & Co. has taken reasonable care to ensure that the information in this presentation is accurate. It however accepts no legal responsibility for any consequential incidents that may arise from errors or omissions contained in this presentation.
- ❑ This presentation is based on the information available with us at the time of preparing the same, all of which are subject to changes which may, directly or indirectly impact the information and statements given in this presentation.
- ❑ Neither Jain Shrimal & co., nor any person associated with us will be responsible for any loss however sustained by any person or entity who relies on this presentation. Interested parties are strongly advised to examine their precise requirements for themselves, form their own judgments and seek appropriate professional advice.

