Indian High Court holds MFN clause in India-Netherlands Protocol applicable from date of OECD membership; Approves lower dividend

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Indian High Court holds MFN clause in India-Netherlands Protocol applicable from date of OECD membership; Approves lower dividend WHT

An Indian state high court set aside withholding tax certificates of 10% and directed Revenue (the Indian income tax department) to issue fresh certificates at a lower rate of 5% on dividend payments from Indian subsidiaries to a Dutch parent. It applied the principle of common interpretation and adopted the view expressed in a decree issued by the Kingdom of Netherlands clarifying that a beneficial rate of 5% in the India-Slovenia DTAA will be applicable to recipients of the Netherlands from the date on which Slovenia became an OECD member country, i.e. from 21 July 2010, although the India-Slovenia DTAA came into force on 17 February 2005. It observed that the Protocol is an integral part of the India-Netherlands DTAA and no separate notification is required to apply the provisions thereof (as incorrectly contended by Revenue). Assessees (Concentrix Services Netherlands BV and Optum Global Solutions International BV), residents of the Netherlands, applied for lower withholding certificates, seeking a withholding rate of 5% on dividends payable by their Indian subsidiaries by importing the benefit of MFN clauses from DTAAs executed with Slovenia, Lithuania, and Columbia, which provide for a beneficial withholding rate of 5% on dividend payments. Revenue refused such lower rate of WHT on the contention that Slovenia, Lithuania, and Columbia were not OECD member countries when the relevant DTAAs were executed. The high court clarified that the word “is” in clause IV(2) of the Protocol, which reads “which is a member of the OECD”, describes the state of affairs when a request for application of withholding tax at the lower rate is made, not at the time when the DTAA was executed. The court referred to the principle of common interpretation and judgement cited by the assessees in *Corocraft Ltd v. Pan American Airways Inc*. on the applicability of the common interpretation principle in the context of foreign decisions. It remarked that, in the present case, the “principle of common interpretation should apply on all fours to ensure consistency and equal allocation of tax claims between the contracting States”. It further relied on an Indian Supreme Court ruling, *Azadi Bachao Andolan*, and held that “while interpreting international treaties … the rules of interpretation that apply to domestic or municipal law need not be applied, for the reason, that international treaties … are negotiated by diplomats and not necessarily by men instructed in the law”.

Comments from Indian Experts on the judgement:

Shefali Goradia (Partner, Business Tax, Deloitte Touche Tohmatsu India LLP)

The availability of tax treaty benefits based on a most favoured nation (MFN) clause has been a subject matter of litigation. The Delhi High Court (HC) has affirmed that the Protocol to the India-Netherlands DTAA forms an integral part of the tax treaty and no separate notification was required to apply the MFN clause in the Protocol. Further, by applying the principle of parity and the principle of common interpretation with reference to a decree issued by the Dutch authorities, the HC has granted the benefit of a lower withholding tax rate of 5% to dividends received by a Dutch tax resident from an Indian subsidiary company.

On reading the MFN clause, it appears that the effect of MFN occurs "as from the date on which the relevant Indian Convention or Agreement *enters into force*". This aspect does not seem to have been dealt with by the HC. "Entry into force" is a well understood term, and a tax treaty "enters into force" only once. Slovenia and Lithuania were not members of the OECD on the date on which their DTAAs with India entered into force. Despite this, the question of whether these DTAAs could be invoked on that date under the MFN clause of the India-Netherlands DTAA has not been specifically addressed by the HC. In addition, the reliance on the decree issued by the Dutch authorities could also be questioned, since it deviates from the plain and natural meaning of the MFN clause and documents the understanding of only one contracting state, i.e. the Netherlands.

This ruling is of significance for investors from the Netherlands and other countries (like Spain, Hungary and France) that have a comparable MFN clause, and for other categories of income, as applicable. However, as the HC has left some questions unanswered, it will be good to see how this aspect is dealt with in other cases.

Himanshu Parekh (Partner and Head, Corporate and International Tax, KPMG India)

In a very interesting development, the Delhi High Court, in the case of *Concentrix Services Netherlands BV and Optum Global Solutions International BV* (taxpayers), has held that the lower tax rate of 5% on dividends provided in the subsequent Indian tax treaties with Slovenia, Colombia and Lithuania would apply to the India-Netherlands tax treaty, in view of the MFN clause under the treaty.

The court observed that the word "is" in the MFN clause of the tax treaty describes a state of affairs that should exist not necessarily at the time when the 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 was not impressed with the argument of the Tax Department that, since Slovenia, Lithuania, and Columbia became members of the OECD after their tax treaties with India came into force, the lower rate of withholding tax on dividends would not apply to recipients in the Netherlands.

It is worthwhile to note that, wherever required, the tax treaties provide for clear language that the subsequent tax treaty partner should be a member of the OECD *at a specified time* to avail itself of the benefit of the MFN clause. For example, the Switzerland-Kazakhstan tax treaty has an MFN clause that provides that the benefit is available only if Kazakhstan has signed a tax treaty *with a present member country of the OECD* that provides for a lower effective rate on interest or on royalties.

The court also placed significant reliance on the decree issued by the Netherlands wherein the Netherlands has adopted the position that the lower rate of tax in the India-Slovenia tax treaty will be applicable to the India-Netherlands tax treaty on the date on which Slovenia became a member of the OECD, i.e. from 21 July 2010.

The court's approach aligns with an accepted principle applied in the interpretation of tax treaties, i.e. the principle of "common interpretation". Where the other contracting state, i.e. the Netherlands, has interpreted the Protocol in a particular manner, in the fitness of things, the principle of common interpretation should apply to ensure consistency in interpretation of the tax treaty and equal allocation of tax claims between the contracting states.

The court also held that no separate notification was required insofar as the applicability of provisions of the Protocol is concerned.

This is a welcome decision by the Delhi High Court. Not only will the decision provide comfort to taxpayers based out of Netherlands, it may also be possible for taxpayers based out of France, Switzerland, Sweden and Hungary to rely on this decision and avail themselves of the lower withholding tax rate of 5% on dividend income, having regard to similar MFN clauses under the tax treaties between India and those countries."

Parul Jain (Co-head, International Tax Practice, Nishith Desai Associates)

The recent decision of the Delhi High Court in the case of *Concentrix Netherlands BV* has raised some eyebrows in the tax fraternity, making it a controversial decision. A literal reading of the Protocol to the Dutch treaty provides for the reduced rate of tax to be applicable only for Indian treaties entered into with OECD countries post the entering into force of the Dutch tax treaty. However, since tax treaties are negotiated by diplomats and not officers of the law, a tax treaty should not be interpreted in a literal technical sense. From this perspective, one can say that the word "is", read along with the provision providing for the dating back of the effective date of the applicability of such reduced rate, should therefore be accorded a contextual meaning and a purposive interpretation. Such an interpretation does not result in a part of the MFN provision being rendered otiose. This would result in the 5% withholding tax rate on dividend income becoming applicable from the date that Slovenia became an OECD member. This is the position that has also been taken by the Dutch State Secretary of Finance and has not been refuted at any time by the Indian government. Any other interpretation would limit the reduced rate only to cases of new treaties with OECD members but not provide the same rate for existing treaties with OECD members or in cases where a country with which India has entered into a tax treaty becomes an OECD member. On the flip side, the tax authorities would also be well within their right to argue that the timing issue cannot be waived aside on the arguments of "contextualization" or purposive interpretation and that the principle of common interpretation does not apply in the current case, especially where the MFN provides for India's (and not the Netherlands') rights to reduce withholding taxes. This interpretation would also bear in mind negotiators' intentions at the time of treaty negotiations specifically with OECD member countries. Given this, one can expect the controversy to be finally settled by the Supreme Court or through the MAP under article 25(3), which provides for the removal of difficulties of interpretation and application. Until that time, given the attractive 5% rate of tax on dividend payments, the tax authorities can expect to see Dutch-owned Indian corporates taking the benefit of the contextual interpretation taken by the Delhi High Court.