Tax Insights

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Supreme Court of India holds that entering into a tax treaty or protocol does not result in its automatic enforceability till such time as appropriate notifications are issued

In brief

The Supreme Court[1] of India has held that a notification under section 90 of the Income tax Act,1961 (the Act) is a necessary and mandatory condition to give effect to a Double Taxation Avoidance Agreement (DTAA) or any protocol that has the effect of altering the existing provisions of law. Moreover, a claim under the Most Favoured Nation (MFN) clause of a Treaty with a country which is a member of Organisation for Economic Cooperation and Development (OECD), which relies on a third OECD member's Tax Treaty with India, is valid only if the third country was a member of OECD at the time of entering into its DTAA with India. The Supreme Court, while adjudicating the aforesaid principles, had considered the MFN clause provided in the DTAA between India and France, the Netherlands and Switzerland (FNS countries), respectively.

In detail

Facts

- India had entered into a DTAA agreement with various OECD member countries, i.e. the FNS countries, to provide for the rate and scope of taxability of income. Subsequently, India also entered into a protocol/ MFN clause with the respective FNS countries to provide that, if India provides a rate more favourable or a scope more restricted to any other OECD member, then such favourable rate or restricted scope be also provided to the respective FNS countries from the date on which such subsequent relevant DTAA enters into force.
- India entered into a DTAA with Slovenia, Lithuania and Colombia (SLC countries) to provide for lower rate of taxation on dividend income at the rate of 5%. At the time of providing such favourable rate of taxation, those countries were not the members of the OECD but became members subsequently.
- Considering the aforesaid protocol, the taxpayer from respective FNS countries urged before the tax authorities to invoke the MFN clause in their tax treaties and provide the benefit of rate lower or a scope more restricted, while issuing a lower withholding certificate for dividend income, as provided to the respective SLC countries, which became OECD members. The said requests were rejected by the tax authorities, a decision that was later challenged before the Delhi High Court in various instances.

[1] Civil Appeal No(s). 1420 of 2023

- The Delhi High Court subsequently ruled in favour of the taxpayers. The High Court, in giving its decision considered the executive decree issued by the Netherlands authorities.
- In light of the above, the decisions of the Delhi High Court involving the interpretation of the MFN clause contained in various Indian DTAAs with countries that are members of OECD went before the Supreme Court of India in the batch of appeals. The bilateral treaties in question are between India and the respective FNS countries.

Issues before the Supreme Court

The issues arising are whether there is any right to invoke the MFN clause in a OECD member country's Treaty, which relies upon the Treaty with a third OECD member country with which India has entered into a DTAA, and it was not an OECD member at the time of entering into such DTAA and 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.

Supreme Court's decision

- As per the judicial precedents, India entering into a DTAA or protocol does not result in such DTAA or protocol's automatic enforceability in courts and tribunals. The provisions of such treaties and protocols do not, therefore, confer rights upon parties until appropriate notifications are issued in terms of section 90 of the Act.
- The structure of the main DTAA and its phraseology, based on negotiations with the countries concerned, i.e. the FNS countries, also play a role in the kind of benefits that are assured thereof. The structure and terms of other DTAAs might be different; the coverage and definition of certain terms (FTS, permanent establishment, etc.) might be dissimilar. The Revenue's argument – that granting of automatic benefits to one country based on another country's entry into the OECD is unfeasible – has merit.
- The Court has opined that the treaty after its signature is ratified in different ways and the status of treaties and conventions and the manner of their assimilation are radically different from what the Constitution of India mandates. The DTAA practice of the FNS countries is dictated by conditions peculiar to their constitutional and legal regimes.
- However, in India, either the DTAA concerned has to be legislatively embodied in law through a separate statute or be assimilated through a legislative device, i.e. notification in the gazette, based upon some enacted law (some instances are the Extradition Act, 1962, and the Act itself). Absent this step, treaties and protocols are per se unenforceable.
- The Court thus declared that a notification under section 90 of the Act is a necessary and mandatory condition to give effect to a DTAA or any protocol that has the effect of altering the existing provisions of law.
- For a party to claim benefit of 'same treatment' through the MFN clause, the date of relevance is the one at which time the other country entered into the DTAA with India, and not a later date, when, after entering into the DTAA with India such country becomes an OECD member, i.e. when a third-party country enters into the DTAA with India, it should be a member of OECD for the earlier treaty beneficiary to claim parity.

The takeaways

This is a very significant decision with far reaching consequences. Many taxpayers have taken the benefit of lower rate of dividend taxation of 5% as provided in the DTAA between India and the respective SLC countries pursuant to the MFN clause. However, now the Supreme Court has clarified that such beneficial rate of taxation provided to these countries cannot be provided to the aforesaid taxpayers in the absence of any notification issued under section 90 of the Act. This would also have implications on other Treaties which have MFN clauses where notifications have not been issued. It would also be interesting to see if there is any reaction from any of India's bilateral Treaty partners which have MFN clauses, which will get impacted by this decision.

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