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Common Interpretation – it's Time to Make it Common

Sudin Sabnis, Yogesh Kale (Nangia Andersen LLP) · Wednesday, October 13th, 2021

Though India has been having tax treaties with over 90 countries across the globe for several decades now, interpretation of various provisions of the treaties continues to be a subject matter of protracted litigation to date. Many issues remain vexed in India, as very few of them are settled at the Supreme Court level. As against this, various countries have officially notified their interpretation of such issues. As one of the avowed purposes of entering into a tax treaty is equitable allocation of taxes on transactions that are taxable in both the states, the principle of "common interpretation" should be followed and such notifications by other countries may be used by Revenue as aids to interpretation of the tax treaties. However, use of "common interpretation" seems to be very uncommon in India, as instruments expounding interpretation issued by the tax treaty partners aren't generally taken into account.

Recent Delhi High Court Decision on Common Interpretation:

Recently, the Delhi High Court ruled in favour of the appellant taxpayer resorting to the principle of common interpretation in *Concentrix Services Netherlands B.V. v. DCIT*. In this case, the taxpayer company (a tax resident of the Netherlands) sought to apply a lower rate of tax as prescribed in the Indian tax treaties with Slovenia, Lithuania and Colombia in relation to the dividend that it earned from its Indian subsidiary, resorting to the Most Favoured Nation ("MFN") clause in the India-Netherlands tax treaty. The said MFN clause provides that if a later tax treaty entered into by India with an OECD member country provides for restricted scope or a lower rate for taxation at source of dividend (amongst others), such restricted scope or lower rate can be used for taxation of dividend in the source state under the India-Netherlands tax treaty. While Slovenia, Lithuania and Colombia are members of OECD, Revenue's contention was that none of these countries were OECD member on the date on which the respective Indian tax treaties entered into force, let alone the date on which the aforesaid MFN clause became effective. Referring to a decree issued by the Kingdom of Netherlands, the High Court ruled in favour of the taxpayer.

The said decree specifically states that by virtue of the MFN clause, the benefit of a lower rate of tax under the India-Slovenia tax treaty would be applicable for taxing Netherlands-sourced dividend in the hands of a tax resident of India from the date from which Slovenia became an OCED member. The High Court observed that the courts of the contracting states are required to ensure that the tax treaties are applied efficiently and fairly, so that there is consistency in interpretation. In doing so, the High Court referred to the principle of common interpretation and stated that in the fitness of the things, the interpretation adopted by the Netherlands should also be applied by Revenue to ensure consistency and equal allocation of tax claims between the

Clarification Issued by Switzerland:

While the aforesaid Delhi High Court decision still remains a cause célèbre, the Swiss Federal Department of Finance ("the FDF") has very recently clarified its legal position on the MFN clause in the India-Switzerland tax treaty on a similar issue. The clarification states that Indian tax residents receiving dividend from a Swiss source can choose to offer it to tax in Switzerland at the lower rate as per the Indian tax treaties with Lithuania and Colombia. The clarification further mentions that although Lithuania and Colombia have become OECD members much later than the MFN clause in the India-Switzerland tax treaty became affective, the benefit of the lower rate of tax in respect of dividend as prescribed in those treaties may be availed by the Indian residents with effect from the dates on which the two countries became OECD members. Going a step ahead, the FDF is ready to issue a refund to the Indian tax residents in a time bound manner and subject to fulfilment of certain conditions, in respect of the additional tax paid by them in respect

of dividend in Switzerland 5th July 2018 onwards (the date on which Lithuania joined OECD).

The FDF has of course added a caveat that it reserves the right to reverse its interpretation and to readjust the treaty rates applicable to income accruing on 1st January 2023, in case India fails to reciprocate on the interpretation of the MFN Clause. It needs to be clarified if the FDF expects reciprocation by India retrospectively (i.e., with effect from 5th July 2018) or prospectively. Further, considering the Dividend Distribution Tax ("DDT") regime that prevailed till 31st March 2020, it would also be interesting to see if Indian companies stake a claim to restrict DDT rate to 5% for dividend paid till that date and claim refund of additional DDT paid.

Time to Return the Compliment?

What the Netherlands has done long ago and what Switzerland has done now is certainly a good step in the direction of providing certainty to the taxpayers in the respective country.

"Ease of doing business" in India has been on the cards of the Indian government for quite some time now. The Revenue has also been reiterating "certainty to the taxpayers" as one its primary objectives and taken some steps in this direction (like withdrawal of retrospective law regarding taxation of indirect transfers). If the aforesaid objectives are to be achieved, the government should make sure that the objectives are inculcated in the executive system as a whole and the system is adequately trained and well equipped. It would be contextual to look at the observations of the Supreme Court in its very recent judgement in *South Indian Bank Ltd. v. CIT*. The Supreme Court has stated that "the tax an individual or a corporate is required to pay, is a matter of planning for a taxpayer and the Government should endeavour to keep it convenient and simple to achieve maximization of compliance. Just as the Government does not wish for avoidance of tax equally it is the responsibility of the regime to design a tax system for which a subject can budget and plan. If proper balance is achieved between these, unnecessary litigation can be avoided without compromising on generation of revenue."

If some countries are taking steps forward of their own accord in bringing in clarity and certainty on tax treaty issues, the Indian government should also positively respond to such initiatives, for example, by issuing circulars honouring the clarifications issued by other counties, to begin with. Of course, this would not be as easy for India as Switzerland considering the magnitude of investment from Switzerland to India and vice-versa. (As of 2019, the investment from Switzerland to India was almost 4 times the investment from India to Switzerland.) Clearly, India will have to forego a much larger share of the tax pie. Moreover, the FDF's initiative may give rise to a host of issues in India. The additional tax paid by the Indian tax residents in respect of dividend in Switzerland, which is proposed to be refunded by the FDF, would have been claimed by the Indian tax residents as Foreign Tax Credit ("FTC") in their Indian tax returns. The Revenue would expect such taxpayers to make good the excess FTC claimed by them. This may also trigger interest liability for such taxpayers. Further, for the years for which revision of tax returns is time barred, this could pose challenges in the absence of enabling machinery provisions.

Nevertheless, reciprocating the treaty partners' interpretations to the extent possible as a goodwill gesture would help us in taking India's image in the international tax firmament and rank in ease of doing business several notches up.

Views expressed are personal.

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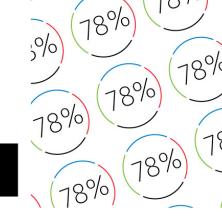
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