Corporate Tax Alliance

Newsletter
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Corporate Tax Alliance
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Intro talk

Dear all,

In the Northern Hemisphere, Summer is in full swing. In Belgium, where our next annual meeting will be held, it is the hottest of the four seasons. In September it will mildly cool down. Perfect weather for our Face-to-Face meeting, bringing out fresh ideas and keeping friendships alive!
Our friends from Tiberghien are kindly and generously supporting us with the organisation, providing the meeting venue (located in Tour & Taxis's showpiece: the Royal Warehouse), and fuel for the bodies to enable our minds to function at their best.

We have also resumed fee payments after the pandemic lull. Invoices for 2022 have been sent by Jan to all. Please make the payments as instructed in case you haven't already done so. If you haven't received the invoices, please let us know at info@corptax.org.

Welcome to our new CTA member:
- Belgium: Rik Smet, Tiberghien

In this edition of the Newsletter, we have contributions from:
- India: Ameya Kunte and Vasudevan G, Globeview Advisors LLP
- USA: Paul Tadros, Schwartz International

As many of us will be meeting and connecting in September, the next Webinar will be held at the end of 2022.

Meanwhile, enjoy your summer breaks.

As always, stay in touch, share your news proactively with the network, ask questions, send comments…
Let's build a stronger network and interact!

All the best,
Jan, Guido & Nico

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Most Favoured Nation Clause – Multi-dimensional tests for applicability in the Indian context

By Ameya Kunte and Vasudevan G, Globeview Advisors LLP

MFN Clauses in the Indian context

The Most Favoured Nation clause ("**MFN Clause**") in a Double Tax Avoidance Agreement (**"DTAA"/ "Treaty"**) provides for an extension of specified treaty benefits to a country (DTAA with which country has MFN clause), based on Treaty provisions adopted with a third country providing certain beneficial treatment. Depending on the language of the MFN clause, the benefit therein, could be subject to further negotiation between the countries or negotiation or might even get auto triggered. India has entered into treaties with a few countries adopting the MFN clause in the Protocol. A few types of MFN clauses adopted by India, along with an indicative list of countries having such clauses, are given in the table below:

Action required for application of MFN Clause	**Countries**	**Sample text extract of the MFN clause requirements**
Information and Notification	Finland	*The competent authority of India shall inform the competent authority of Finland without delay that the conditions for the application of this paragraph have been met and issue a notification to this effect for application of such exemption or lower rate.*
Bilateral re-negotiation	Switzerland (only on the FTS clause)	*If after the date of signature this Amending Protocol, India under any Convention, Agreement or Protocol with a third State which is a member of the OECD, restricts the scope in respect of royalties or fees for technical services than the scope for these items of income provided for in Article 12 of this Agreement, then Switzerland and India shall enter into negotiations without undue delay in order to provide the same treatment to Switzerland as that provided to the third State.*
Clauses requiring bilateral consultation/review	United Kingdom, Philippines, Saudi Arabia	*Sample from India-UK DTAA:* *Where the law of the Contracting State in which the permanent establishment is situated imposes a restriction on the amount of the executive and general administrative expenses which may be allowed, and the restriction it relaxed or overridden by any Convention between that Contracting State and a third State which is a member of the Organisation for Economic Cooperation and Development or a State in a comparable stage of development, and that Convention enters into force, after the date of entry into force of this Convention, the competent authority of that Contracting State shall notify the competent authority of the other Contracting State of the terms of the relevant paragraph in the Convention with that third state immediately after the entry into force of that Convention and, if the competent authority of the other Contracting State so requests, the provisions of this Convention shall be amended by protocol to reflect such terms*
Auto-triggering (silent on procedure on application of MFN clause)	France, Netherlands, Hungary, Sweden, Spain	Sample from India-Netherlands DTAA: ***"2.** If after the signature of this Convention under any Convention or Agreement between India and a third State which is a member of the OECD India should limit its taxation at source on dividends, interests, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, then as from the date on which the relevant Indian Convention or Agreement enters into force the same rate*

		or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention."

Source: Copies of DTAA are available at https://incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx

India entered into DTAA with Slovenia, Lithuania and Columbia, providing beneficial rates for certain income streams, including dividend and interest income. These countries subsequently acceded to membership of OECD. Some relevant data regarding these DTAA are provided below for reference:

Name of the country	Date of Entry into Force of DTAA	Date of Notification of DTAA	Date of OECD membership
Slovenia	February 17, 2005	May 31, 2005	July 21, 2010
Lithuania	July 10, 2012	July 25, 2012 w.e.f. April 01, 2013	July 05, 2018
Colombia	July 07, 2014	September 23, 2014	April 28, 2020

Interestingly, these countries went on to become OECD members after the date of entry in force of their DTAA with India. As a result, some taxpayers from Netherlands and Switzerland (both of which DTAAs were entered into, prior to DTAA with above three countries) sought to apply the beneficial rate provided to the countries stated above, by invoking the MFN clause.

Controversy in applying the benefit under the MFN clause

The Indian tax department denied the benefit of the MFN clause, inter-alia, stating that for application of the MFN clause, the third country, which has been provided with beneficial treatment under the DTAA, should have been an OECD member as of the date of entering into the DTAA with that country. In the absence of such a fact, the benefit cannot be allowed. However, The High Court of Delhi[1] [in the case of Concentrix Services Netherlands B.V. v. ITO[2]] held in favour of the taxpayer. The Court ruled that the beneficial dividend tax rate under Indo-Slovenian DTAA shall apply to the dividend income earned by the Dutch taxpayer. The Court proceeded on the ground that the fulfillment of conditions for applicability of the MFN clause should be ascertained on the date when the benefit under DTAA is sought to be claimed, irrespective of whether at the time of entering into DTAA with the third country (Slovenia in this case), such country was a member of OECD or not. In this regard, the Court also referred to and relied on Decree No. IFZ 2012/54M dated 28.02.2012 issued by Directorate General for Tax Affairs, Kingdom of Netherlands to extend the benefit invoking the MFN clause retroactively from July 21, 2010, the date when Slovenia became OECD member citing that the principle of "common interpretation" should be applied to ensure consistency and equal allocation of tax claims between the contracting states.

Notably, the French Government in November 2016[3] and the Swiss Government in August 2021[4] have also issued unilateral communications similar to Dutch Decree referred above, extending the benefit of a lower tax rate of 5% on participatory dividend as per India-Slovenia or India-Lithuania or India-Colombia DTAA.

Subsequently, The Indian Government (Central Board for Direct Taxes), on February 03, 2022, in the context of the above controversy, issued Circular No. 3 of 2022 (which is a unilateral communication). The Circular states that the benefits from India's treaty with a Slovenia, Lithuania and Colombia cannot be availed by invoking the MFN clause, inter-alia, on the following broad grounds:

Unilateral decree/publication do not represent shared understanding of treaty partners on MFN clause – India has communicated its position to Swiss Confederation on this issue.

On the date of entering into DTAA with these countries, they were not a member of OECD.

Concessional rate/ restricted scope from date of entry into force from DTAA with the third state and not from the date when the become member of OECD.

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[1] A constitutional court in the territory of Delhi, the capital of India

[2] (2021) 434 ITR 516 (Del) decided on April 22, 2021. The Supreme Court of India has admitted Special Leave Petition filed by the Tax Department to appeal against this order.

[3]https://bofip.impots.gouv.fr/bofip/1188-PGP.html/identifiant%3DBOI-INT-CVB-IND-20161104.

[4]https://www.estv.admin.ch/dam/estv/fr/dokumente/intsteuerrecht/themen/auslaendische-quellensteuern-pro-land/i/indien-fachmitteilung-mfn.pdf.download.pdf/indien-fachmitteilung-mfn.pdf

Requirement to domestically notify the amendment to DTAA importing the benefit of treaties with these countries

The view taken by the Indian Government is per se contrary to the judgment of the Delhi High Court and the interpretation of treaty benefits by countries like the Netherlands, Swiss Confederation and France. The Delhi High Court in fact, specifically rejected some of these arguments in its judgment. Moreover, it is well settled by the Indian judiciary that circulars issued by Government are binding on the tax authorities alone and not on the taxpayers.

Critical issues on application and interpretation of MFN Clause

At this juncture, some other pertinent questions that arise are:

a) *Whether the concerned countries need to take any affirmative action to activate the MFN benefit, or does it apply automatically?*

b) *Can unilateral communication on the interpretation of the MFN clause and resultant treaty benefit be relied upon to avail treaty benefits invoking the MFN clause?*

Regarding the above question a) above, clear distinction in the requirement is evident from the language of the Protocol in different DTAA. For example, DTAA between India and Finland specifically requires that for application of exemption or lower rate by MFN clause, *"the competent authority of India shall inform the competent authority of Finland without delay that the conditions for the application of this paragraph have been met and issue a notification to this effect"*. Another example is of India-Swiss DTAA, wherein the scope of MFN clause extends to dividend, interest and Royalty or Fees for technical services (FTS), but only in respect of restriction of the scope of Royalty or FTS, it provides that *"Switzerland and India shall enter into negotiations without undue delay to provide the same treatment to Switzerland as that provided to the third State"*.

The above clauses provide affirmative action from the treaty parties to effectuate the benefit under the MFN clause. A similar requirement is not envisaged in treaties with other countries containing the MFN clause, say, with Netherlands or France. Therefore, it is arguable that treaty parties do not need to take any collective actions unless expressly provided in the Protocol granting MFN benefit. Even in the previous judgment of the Delhi High Court, the Court stated that Protocols being an integral part of the treaty itself, the benefits get triggered automatically and are self-operational[5]. Of course, where the Protocol requires re-negotiation, the same would have to be followed.

The question b) above, is a question concerning interpretation. A unilateral declaration of the legal position is the interpretation by one of the parties and might not necessarily reflect the interpretation of the other party to the treaty. Article 31 of the Vienna Convention on the Law of Treaties, providing for the General rule of interpretation, provides that for interpretation of treaties, *inter-alia*, the following documents should be considered:

- Instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
- Together with the context, any subsequent agreement between the parties regarding the interpretation of the treaty or its application or a subsequent practice in the treaty establishes the Agreement of the parties.

The above requirements indicate that treaty interpretation should be based on the Agreement or consensus of both the treaty parties regarding a particular provision in the treaty. Therefore, a unilateral declaration of treaty interpretation should not be considered binding on the other contracting State. However, conferring the benefit under the MFN clause might be appropriate if there are different grounds and reasons beyond a unilateral declaration by a country granting the benefit under the MFN clause. Moreover, if unilateral declarations are considered for conferring benefits under the Treaties, it would encourage other countries having MFN clauses in their DTAA with India to issue a unilateral declaration to extend the benefits to its residents, of course with reciprocity of benefits to Indian residents for income arising in the respective countries.

In interpreting the MFN clause, it also needs to be kept in mind that at the time of negotiation of the Treaty with Slovenia, Lithuania and Columbia, such countries were not OECD members. Therefore, the extension of benefits under those treaties to other OECD members due to subsequent membership might not have been factored in by India. The treaty provisions might have been negotiated differently if such variability had been factored in.

However, the plain text of the Protocol on MFN (e.g., India Netherlands tax treaty) provides, "*If after the signature of this convention under any Convention or Agreement between India and a third State which is a member of the OECD…*". Here, to trigger MFN benefits, the requirement is that the beneficial provision should exist under an agreement with a third state which is a

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[5] Also, refer to the judgment of Delhi High Court in *Steria (India) Ltd. v. CIT* (2016) 386 ITR 390 (Del) and also the Commentary by Klaus Vogel, which was relied upon in this case.

member of OECD. In the absence of an express limitation, the requirement is that the Agreement is with a third state**,** a member of OECD. The phrase "is", therefore describes the current State of Affairs that shall exist at the time when the benefit under the clause is sought to be applied and not necessarily when the subject DTAA was executed.

Conclusion

With the Government of India taking a stance to not confer benefits under the treaties with Slovenia, Lithuania and Columbia to other OECD member countries by virtue of the MFN clause, the position is likely to be litigious till the issue is finally settled by the Supreme Court of India. The tax treaties, unlike domestic law, reflect an agreement between the two counties and any unilateral interpretation from either side is contrary to the treaty's spirit.

Introduction to the Us Foreign Tax Credit System for Corporations Part I

By Paul Tadros, Schwartz International

Introduction

Prior to the Tax Cuts and Jobs Act ("TCJA") signed into law in the last week of December, 2017, the foreign tax credit ("FTC") rules, while complex, were manageable. With the passage of the TCJA and the new regulations issued approximately six (6) months ago, complexity exponentially increased resulting in an increased administrative burden. When all of this is layered on the Pillars One and Two proposals by the OECD, the economic effects will be mind boggling (and not in a positive way). We will address the interactions of Pillar Two, in particular, with the FTC rules in Part II.

To provide a flavor of the OECD proposals, let's take a look at the acronyms used by the EU: IIR (income inclusion rule); UTPR [under taxed payment rule] (referred to as the "backstop" ["gotcha"] to IIR; GloBE (global anti-base erosion rules, i.e., IIR and UTPR); STTR (subject to tax rule); UPE (ultimate parent entity); IPE (intermediate parent entity); and POPE (partially-owned parent entity).

Conditions for credit

1. Must be a compulsory tax. If a taxpayer voluntarily foregoes a tax benefit in a country, compulsory element may not be met. For example, entitled to and met all the conditions to claim an investment tax credit and foregoes claiming such credit may result in tainting all of the income taxes paid / accrued.

2. Must be based on net income, i.e.:

(a) Realization principle;

(b) Gross receipts;

(c) Cost recovery [with limitations similar to the US (for example, interest)]; and,

(d) Attribution (economic nexus).

Income Baskets

Unlike most countries, the US FTC system is not on a country-by-country basis; thus, high and low taxes are mixed in the respective income baskets. Prior to the TCJA, there were, basically, four (4) baskets: general; passive; sanctioned countries; and income resourced under an income tax treaty. With the TCJA, two (2) additional baskets were added, i.e., GILTI [global intangible low-taxed income (in essence, active business income such as manufacturing automobiles, etc.)] and foreign branch (either a "true" branch or through a disregarded (transparent) entity).

Key principles

1. Of course, the income generated must be foreign source which is determined by the US sourcing rules [as modified, if any, under an applicable treaty which contains traps for the unwary, i.e., not a blanket resourcing rule. The term “notwithstanding” is used to revert back to domestic law];

2. The relevant income must be grossed-up by the total foreign taxes. See item 5 below.;

3. Revenues, by type, with the expenses applicable to each type segregated at the foreign level;

4. Item 3 above is further refined by explicit rules allocating expenses at the US level to each relevant income basket;

5. There is a “haircut” on the foreign taxes applicable to GILTI of twenty percent (20%) notwithstanding that all of the said taxes are included in the total amount being included in income;

6. Unused credits in the GILTI basket are lost forever;

7. Except for item 6, unused credits can be carried back one (1) year and ten years (10) years forward; and,

8. Option available: deduction or credit. If in a tax year, a deduction is elected, all foreign income taxes must be deducted and vice-versa. The following year, another option can be made.

Added complexity arises where items such as “dual consolidated losses” and overall foreign / overall domestic losses arise (unique concepts intended to avoid “double-dipping” in a cross-border context).

In Part II, we will discuss the interactions with Pillars 1 and 2.