

MISCELLANEOUS AMENDMENTS BY FINANCE ACT, 2022

CLARIFICATION REGARDING THE MOST-FAVOURED-NATION (MFN) CLAUSE IN THE PROTOCOL TO INDIA'S DTAAS WITH CERTAIN COUNTRIES (CIRCULAR NO.3/2022 DATED 3.2.2022)

Illustration:

Matrix Inc. incorporated in Country X, holds 26% controlling interest in Pilu Ltd., an Indian Company. Pilu Ltd. declared dividend of 50,00,000 during the P.Y. 2022-23. The DTAA between India and Country X, which came into force on 1.1.2018, provides for taxation of dividend @15%. Thereafter, India entered into a DTAA with Country Y, which came into force from 15.5.2018. The India-Country Y DTAA, inter alia, provides for concessional tax rate of 10% in respect of dividend. Country X is an OECD member since 2015 and Country Y is also an OECD member since 2017.

Mr. Jack, CFO of Matrix Inc. seeks your opinion on whether the concessional tax rate provided in the DTAA between India and Country Y can be availed by a resident of Country X and if so, are there any further conditions to be satisfied in this regard. You may assume that the protocol annexed to India's DTAAS with all OECD member countries contain the relevant tax parity clause.

Would your answer change, if Country Y had become an OECD member only in the year 2020?

Answer:

The CBDT has, vide Circular No. 3/2022 dated 3.2.2022, clarified that the applicability of the Most Favoured Nation (MFN) clause and benefit of the lower rate or restricted scope of source taxation rights in relation to certain items of income including dividends provided in India's DTAAS with the third State (Country Y, in this case) will be available to the first (OECD) State (Country X, in this case) **only when all the following conditions are met:**

Condition		Satisfaction of condition in the case on hand
(i)	The second treaty (with the third State) is entered into after the signature/ Entry into Force of the	This condition is satisfied as India has entered into a DTAA with Country Y on

	treaty between India and the first state	15.5.2018, after it has entered into a DTAA with Country X on 1.1.2018.
(ii)	The second treaty is entered into between India and a State which is a member of the OECD at the time of signing the treaty with it.	This condition is satisfied as India has entered into a DTAA on 15.5.2018 with Country Y, which is a member of OECD since 2017. Hence, on 15.5.2018, Country Y was an OECD member
(iii)	India limits its taxing rights in the second treaty in relation to rate or scope of taxation in respect of relevant items of income	This condition is satisfied since in DTAA between India and Country Y, dividend is taxable @ 10%.
(iv)	A separate notification has been issued by India, importing the benefits of the second treaty into the treaty with the first State as required by the provisions of section 90(1) of the Income-tax Act, 1961.	In this case, conditions (i), (ii) and (iii) mentioned above have been satisfied. The concessional rate of 10% can be applied for taxing the dividend received by Matrix Inc. from Pilu Ltd., an Indian company, only if India has issued a separate notification importing the benefits of India-Country Y tax treaty into India-Country X tax treaty, as required by the provisions of sections 90(1). If such notification has been issued, then, the concessional rate of 10% can be applied for taxing the dividend received by Matrix Inc. from Pilu Ltd., an Indian company. otherwise it cannot be applied, even if other conditions are satisfied.

In case if Country Y became an OECD member only in the year 2020, then, the concessional rate of 10% cannot be applied for taxing dividend received by Matrix Inc. from Pilu Ltd., since Country Y was not an OECD member on 15.5.2018, at the time when India signed the DTAA with it. Consequently, condition (ii) mentioned above would not be satisfied in such a case. Hence, dividend received by Matrix Inc. from Pilu Ltd. would be subject to tax @ 15%.