Force of Attraction
Rules and Most Favored Nation

BCAS - DTAA training
CA Jayesh Kariya
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Today’s Journey

1. Permanent Establishment (‘PE’) & Attribution – General Concepts
2. Force of Attraction Rules
3. Most Favored Nation (‘MFN’)
Permanent Establishment
and
Attribution of profits – General Concepts
Concept of Permanent Establishment (PE)

1. Residence State
2. Source State
3. Enterprise
4. Income
5. Taxation
6. (a) Passive Incomes
   - Dividends, Interest, Royalties, FTS
7. (b) Business Income of PE
8. Source Country’s right to tax Residents of Other Contracting State under Tax Treaties
9. Taxation of passive income not effectively connected to PE - Dividends, Interest, Royalties, FTS
10. Taxation of business income (including passive incomes) attributable to PE
11. Concept of Permanent Establishment - Important for taxation of business income
   - Fixed Place PE
   - Agency PE
   - Service PE
   - Construction PE
**Attribution of Profits**

- **Enterprise**
  - Income
  - Taxation

- **Residence State**

- **Source State**
  - (a) Passive Incomes
  - (b) Business Income of PE

**Business profits generally taxable in the country of residence**

- Unless carried out through a PE in the source state

**Attribution of profits to a PE covered under Article 7 of the MC**

**Conditions for attribution of profit**

- Existence of PE must for attribution
- Business should be carried on - Preparatory activities do not trigger attribution
- Only profits attributable to such PE are taxable in the source country

**Concept of “Force of Attraction”**
Force of Attraction Rules
“Principle under which a country may tax a foreign enterprise in respect of income it derives in the other country if the enterprise maintains a permanent establishment in the other country irrespective of whether that income is derived through or otherwise economically connection with the permanent establishment…”
Article 7 of the UN Model Convention

“The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to

(a) that permanent establishment;

(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or

(c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment

‘Force of attraction’ rule not present in OECD Model Convention
<table>
<thead>
<tr>
<th>Particulars</th>
<th>OECD Model</th>
<th>UN Model</th>
<th>US Model</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type</strong></td>
<td>No Force of Attraction</td>
<td>Limited Force of Attraction</td>
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</tr>
</tbody>
</table>
| **Methodology**                  | Adopts economic connection principle in attribution of profits | • Adopts Restricted Force of Attraction principle  
• FAR Analysis                      | • Adopts concept of “effectively connected” with trade or business in USA |
| **Taxation of Business profits in Source Country** | Attributable to: 
- PE                              | Attributable to: 
- PE  
- Direct sale of same / similar goods as those sold through PE  
- Other same / similar business activities carried on through PE | Per India-USA tax treaty Article 7(1) on lines of UN Model – Limited Force of Attraction |
Principle of Force of Attraction primarily concerned with taxation of business profits in the Source Country

Rationale:

- Prevent tax evasion / avoidance through artificial contracts / business arrangements
- Identification of business transactions - source based taxation

Types of Force of Attraction

**Full force of Attraction:** All profits derived in Source State taxable as profits of the PE whether or not through PE <<Not followed internationally>>

**Limited Force of Attraction:** Profits derived through PE as well as profits from sale of goods / activities same or similar to that of PE directly carried out by the HO in the Source country taxable as profits of PE

**No Force of Attraction:** Only profits derived through PE taxable
# Force of Attraction in Indian DTAAs

**Generally Article 7(1) of Indian DTAAs are in line with the UN Model or US Model**

<table>
<thead>
<tr>
<th>Types of FoA Rules</th>
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<tbody>
<tr>
<td><strong>Type 1: Same or Similar goods or services without the role of a PE</strong></td>
</tr>
<tr>
<td><strong>Type 2: Motive of Tax Avoidance – for not routing the transactions through PE for business rationale</strong></td>
</tr>
<tr>
<td><strong>Type 3: Profits directly or indirectly attributable to the PE ??</strong></td>
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<table>
<thead>
<tr>
<th>Around 30 of 85 Indian DTAAs contain Force of Attraction rule</th>
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<th>Generally Article 7(1) of Indian DTAAs are in line with the UN Model or US Model</th>
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<th>Many Indian DTAAs adopt the Article 7(1) as per the UN Model convention i.e. Limited Force of Attraction</th>
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<tr>
<th>Canada, Belgium, Denmark, Italy, USA</th>
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<tr>
<th>Some DTAAs adopt only part of the Article 7(1) of the UN Model (sale of similar goods)</th>
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<tr>
<th>New Zealand, Indonesia</th>
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<th>Some DTAAs adopt the provisions of UN Model with a “Right to Prove Otherwise”</th>
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<tr>
<th>• Enterprise can prove that profit from sale of same or similar goods / activities are not attributable to PE - E.g. Cyprus, Germany</th>
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<th>Some DTAAs adopt OECD Model with a variation</th>
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<th>• Phrase “directly or indirectly attributable to that PE”</th>
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<th>Japan, Singapore, United Kingdom, Malta, Oman</th>
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<th>Recent trend in India tax treaties –</th>
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<tr>
<th>• Force of attraction rule has been omitted. E.g. Norway, Australia and latest Sri Lanka</th>
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Example Type 1: Article 7(1) of India - USA DTAA

“The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in the other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment.”

Cyprus  Denmark  Indonesia  New Zealand  Italy
Example Type 2: Article 7(1) of India - Germany DTAA

(c) In respect of paragraph 1 of Article 7, profits derived from the sale of goods or merchandise of the same or similar kind as those sold, or from other business activities of the same or similar kind as those effected, through that permanent establishment, may be considered attributable to that permanent establishment if it is proved that:

i. this transaction has been resorted to in order to avoid taxation in the Contracting State where the permanent establishment is situated, and

ii. the permanent establishment in any way was involved in this transaction.
Example Type 3: Article 7(3) of India - UK DTAA

3. Where a permanent establishment takes an active part in negotiating, concluding or fulfilling contracts entered into by the enterprise, then, notwithstanding that other parts of the enterprise have also participated in those transactions, that proportion of profits of the enterprise arising out of those contracts which the contribution of the permanent establishment to those transactions bears to that of the enterprise as a whole shall be treated for the purpose of paragraph 1 of this Article as being the profits indirectly attributable to that permanent establishment.
“......... It is understood that the words directly or indirectly mean.........., that where a permanent establishment takes an active part in negotiating, concluding, or fulfilling the contracts entered into by the enterprise, then ................., there shall be attributed to the permanent establishment that portion of .......... contribution of the permanent establishment to those transactions bears to that of the enterprise as a whole. It is also understood that profits shall be regarded as attributable to the permanent establishment to the above mentioned extent, even when the contract in question are made directly with the Head Office of the enterprise ............”
A Co., resident of Country X, has Branch in Country Y

Branch sells garments to customers in Country Y

A Co. also sells garments directly to customers in Country Y

Possible that Business in being passed from Branch to A Co. thereby reducing profits of the Branch

‘Force of Attraction’ rule seeks to tax such profits derived by A Co.

FOA applies when profits are derived from sale of same / similar goods / activities akin to that of PE
FOA applies when profits are derived from sale of same / similar goods / activities akin to that of PE

Services provided by PE to the Customer A taxable as per Article 7

Services provided by HO to Customer B ideally taxable under Article 13

As per Article 13(6) - even in the presence of PE - only the services effectively connected to the PE taxable as per Article 7

As per Force of Attraction rule – Profits from same or similar sales / activities taxable as per Article 7 even if not connected / provided through PE
A Co, resident of host country, is a MNC engaged in several business sectors

ACo has a PE in Source Country for sale of Cars

ACo also directly sells cars and Aluminum Products in Source Country

Limited FOA – Only profits with respect to direct sale of Cars by ACo taxable in Source State

Full FOA – Entire profits with respect to direct sale of Aluminum Products and Cars by ACo taxable in Source State
A Co. is engaged in the manufacturing of Packaging Materials and Pharma Products in Residence country.

A Co. has PE in India for sale of Pharma Products. This PE also negotiates sale of Packaging Materials.

A Co. directly sells the Packaging Materials to the Customers in Source country.

Limited FOA – Only profits as attributable to the extent of activity of negotiation of Packaging Materials.
The expression ‘same or similar’ has not been defined in any tax treaties

Dictionary meaning could be a good guide

‘Same’ - resembling in every aspect / Identical

‘similar’

Oxford - of the same kind in appearance, character, or quantity, without being identical

Law Lexicon – Partial resemblance and may also denote same in all essential particulars

Custom laws – “although not alike in all aspects, have like characteristics....”

<table>
<thead>
<tr>
<th>Items of comparison</th>
<th>Whether criteria of similarity satisfied</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer &amp; Copying machines</td>
<td>No</td>
<td>Both are office machines but they are designed for different purposes</td>
</tr>
<tr>
<td>Copying Machines &amp; Scanners</td>
<td>Yes</td>
<td>Almost inter-changeable products</td>
</tr>
</tbody>
</table>
Same or Similar – Case Study

Similar Goods as commercially interchangeable and under the same brand name

Not similar business activities as functions differ
Clifford Chance – Mumbai Tribunal (SB) - Service Providers

Mumbai Tribunal held:

- Directly attributable to PE – explained in Article 7(2) - PE be treated as separate and distinct enterprise

- ‘Profits indirectly attributable to PE’ – Defined in Article 7(3)
  - Active part in negotiating, concluding or fulfilling contracts
  - Article 7(3) is unambiguous

- Meaning given in UN convention is materially different from provisions of Article 7(1) of Indo-UK treaty - no need to rely on meaning given under UN Convention

- Profits apportioned to activities of other parts of enterprise cannot be treated as profits indirectly attributable to the PE

Facts

- LLP UK rendered legal consultancy services in connection to various projects in India
- LLP UK did not have Office / branch in India
- Services were rendered from outside India as well as within India
- Personnel of LLP visited India to render such professional services
**Roxon OY - Mumbai Tribunal - Supply of Equipment and Services**

**Mumbai Tribunal held:**

- Article 7 of India Finland DTAA based on UN Model Convention which envisages
  - Direct sales by an enterprise covered by ‘force of attraction rule’ only when enterprise has a PE for selling goods and direct sales by enterprise is same or similar kind of goods
  - Installation PE thus to be excluded – ab initio
- Profits earned on supply of equipment cannot be said to be attributable to PE as installation PE comes into existence after supply of equipment
  - Question of taxing such profit does not arise unless PE was set-up
  - Even otherwise, no part of equipment supply profit can be attributed to PE if supply is at arm’s length
  - Profit on sale of equipments not taxable in India

**Facts**

- **F Co.** was assigned turnkey contract for sale of equipments and erection, commissioning, installation and training by **I Co.**
- **F Co.** supplied equipment directly to **I Co.**
- **F. Co.** sent employees for erection, commissioning, installation and training which constituted installation PE in **India**

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**Diagram:**

- **F Co.**
  - Supply of Equipments (Finland)
  - Employees sent for Erection, commissioning and training (India)
- **I Co.**
  - Employees sent for Erection, commissioning and training
“9(1) The following incomes shall be deemed to accrue or arise in India:

All income accruing or arising, whether directly or indirectly, through or from business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India.

Explanation 1. For the purposes of this clause

(a) In the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India; …”

Arguably, no force of attraction under the Act – Do ‘force of attraction’ rules under the Indian tax treaties become meaningless?
Most Favored Nation
Due to MFN clause, the beneficial clause as provided in third state Treaty shall apply to granting and beneficiary state Treaty.

Nature of Bilateral/ Multilateral Treaties
Trade, Investment, Tax
Concept of MFN Clause and Indian Tax Treaties

Extends similar benefits to one country as extended to certain other countries

In a MFN situation, generally, one of the contracting states (say India) to the Double Tax Avoidance Agreement (“Tax Treaty”) grants the residents of the other contracting state (say Netherlands), the same beneficial treatment made available by it (that is, by India) to the resident of a third country (say Sweden) with whom it has entered into a Tax Treaty.

- **Netherlands**
  - Treaty with MFN clause

- **Sweden**
  - Treaty signed later on with more beneficial clause relating to Royalties and FTS

- **India**
  - Due to MFN clause, scope and rate as provided in India – Sweden Tax Treaty shall apply to India-Netherlands Tax Treaty

Contd…
Concept

General meaning under International Trade:

It is a treatment which is extended by a country (say A) to another Country (Say B) which is not less favorable than the treatment extended by A to a third country (say C)

MFN under Tax Treaties

Situation where there is equal treatment of two non-resident taxpayers by the Country of Source

Generally used in DTAAs when countries are reluctant to forgo their right to tax some elements of income

More favorable tax treatment negotiated with another country - automatically apply / re-negotiated

The object of the MFN clause is twofold:

- To guarantee that no discriminatory treatment when compared with a third Country
- To offer a better treatment because of a favorable change in policy

Treaty-based and not unilaterally available
**Concept**

- MFN clauses can be observed in a number of tax treaties, though not in all.

In most cases, MFN clauses in tax treaties are not general, but are restricted to particular aspects of international taxation.

If MFN treatment was a general principle (based on customary international law), the contracting states would not have to agree on it in their tax treaties.

The limitations on the scope of the existing MFN clauses vary to such an extent that a particular (“habitual”) content of MFN clauses cannot be deduced.

However, the GATT, GATS and NAFTA are well-known and important examples of multilateral trade agreements, and they all contain a general MFN clause, obliging the signatories to afford MFN treatment to the citizens of the other signatories.

**Applicability of MFN**

- Requirement to re-negotiate certain provisions where India would grant more beneficial treatment in a later treaty signed by it with another country (E.g. Switzerland Philippines)

- Requirement for India to notify the other state that the conditions for MFN clause becoming applicable have been met and for it to issue a notification for applicability of the exemption or lower rate to apply (E.g. Finland)

- Silent as to the procedure to be followed for MFN to apply – hence applicable immediately (E.g. France)

**MFN in tax treaties is regarded as an exception**
Example of Most Favoured Nation (‘MFN’) clause in Indian DTAA:

In respect of Articles 10 (Dividends), 11 (Interest) and 12 (Royalties and Fees for Technical Services) if under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, or fees for technical services 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, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention.
Benefit of more favorable rate and restricted scope granted to other countries is extended to existing DTAA

- Lower tax rate
- Narrowing scope
- Allow ability of deduction / expenditures

Generally MFN clause is provided in the protocol to Tax Treaties
Concept of MFN Clause and Indian Tax Treaties

Normally benefit under MFN clause is restricted to a specific group like Organisation for Economic Co-operation and Development ("OECD") countries or developing countries.

Some of the Indian Tax Treaties having MFN clause are as under:

- OECD Member States
  - Belgium,
  - France,
  - Hungary,
  - Netherlands,
  - Norway,
  - Spain,
  - Sweden,
  - Finland
  - Swiss Confederation,
  - United Kingdom and
  - Israel

- Non-OECD Member States
  - Kazakhstan,
  - Philippines,
  - Saudi Arabia and
  - Sri-Lanka
Specific Country-wise MFN Clause

India – Belgium Tax Treaty

MFN clause in the Protocol:

“If under any Convention or Agreement between India and a third State being a member of the OECD which enters into force after 1st January, 1990, India limits its taxation on royalties or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in the present Agreement on the said items of income, the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under the present Agreement with effect from the date from which the present Agreement or the said Convention or Agreement is effective, whichever date is later.”

Benefits from Tax Treaties concluded with OECD member States only

Covers only Royalties and FTS

Contd…
Specific Country-wise MFN Clause

India – Belgium Tax Treaty

Applicable with effect from the effective date of the respective Tax Treaty

Summary of India – Belgium Tax Treaty Position

<table>
<thead>
<tr>
<th>Particulars</th>
<th>1999-2000</th>
<th>Revised</th>
<th>Remarks for triggering MFN clause</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royalties</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scope</td>
<td>Broad</td>
<td>Restricted</td>
<td>Sweden (AY 1999-2000)</td>
</tr>
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<td>Rate for copyrights, patents, etc.</td>
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</table>
India – France Tax Treaty

MFN clause in the Protocol:

“In respect of articles 11 (Dividends), 12 (Interest) and 13 (Royalties, fees for technical services and payments for the use of equipment), if under any Convention, Agreement or Protocol signed after 1-9-1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate of scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items income shall also apply under this Convention, with effect from the date on which the present Convention or the relevant Indian Convention, Agreement or Protocol enters into force, whichever enters into force later.”

Benefits from Tax Treaties concluded with OECD member States only

Applicable with effect from the date of entry into force
## India – France Tax Treaty

### Summary of India – France Tax Treaty Position

<table>
<thead>
<tr>
<th>Particulars</th>
<th>1996-1997</th>
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<td>Dividends</td>
<td>15%</td>
<td>10%</td>
<td>Germany (AY 1998-99)</td>
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<td>Interest</td>
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India – Netherlands Treaty

“If after 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.”

- MFN triggered only if other OECD country favored
- Applied immediately
- MFN for restricted scope as well as lower rate of taxation
### India – Netherlands Tax Treaty

#### Summary of India – Netherlands Tax Treaty Position

<table>
<thead>
<tr>
<th>Income Stream</th>
<th>1990-1991</th>
<th>Revised</th>
<th>Remarks for triggering MFN clause</th>
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</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>15%</td>
<td>10%</td>
<td>Germany (AY 1998-99)</td>
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Contd…
India – UK Tax Treaty

MFN clause in the Tax Treaty:

“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”

MFN clause on Article 7 on deduction of certain expenses

Contd…
The competent authorities of the Contracting States shall initiate the proper procedure to review the provisions of Articles 12 and 13 (Royalties and fees for technical services, respectively) after a period of five years from the date of entry into force of this Convention. However, if under any Convention or Agreement between India and any third State which enters into force after 1-1-1995, India limits its taxation at source or Royalties or Fees for Technical Services or Interest or Dividends to a rate lower or a scope more restricted than the rate or scope provided for in this Convention, 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 with effect from the date on which the present Convention comes into force or the relevant Indian Convention or Agreement, whichever enters into force later.

**MFN triggered only if any other country favored after 1-1-1995**

Based on DTAA with Finland, Malta, Portugal, restricted scope applies – taxable only if it "makes available" technology

**MFN for restricted scope as well as lower rate of taxation**

No Notification but still valid to claim benefit as Protocol automatically provides the same
MFN in Indian DTAAAs

India – Switzerland Treaty

If after the signature of the Protocol of 16th February, 2000 under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD India should limit its taxation at source on dividends, interest, royalties or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in this Agreement on the said items of income, 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.

MFN triggered only up on re-negotiation of India-Switzerland

Cannot be applied without formal amendment to DTAA and notification thereof
### MFN with respect to Fees for Technical Services

<table>
<thead>
<tr>
<th>No</th>
<th>Country</th>
<th>Rate / Scope Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Spain</td>
<td></td>
</tr>
</tbody>
</table>
|    |          | ▪ **FTS Rate reduced from 20% to 10%** because of USA, UK and Germany DTAA(s)  
|    |          | ▪ **Scope of FTS is restricted as ‘Make available’ clause under Canada and Portugal DTAA(s) applies**  
|    |          | ▪ **DPS will be excluded** from the purview of FTS because of Swiss, Germany and Sweden DTAA(s)  |
| 2  | Netherland | ▪ DPS will be excluded from the purview of FTS because of Swiss, Germany and Sweden DTAA(s)  |
| 3  | France   | ▪ Scope of FTS is restricted as ‘Make available’ clause under USA and UK DTAA(s) applies  
|    |          | ▪ DPS will be excluded from the purview of FTS because of Swiss, Germany and Sweden DTAA(s)  |
## MFN with respect to Fees for Technical Services

<table>
<thead>
<tr>
<th>No</th>
<th>Country</th>
<th>Rate /Scope Change</th>
</tr>
</thead>
</table>
| 4  | Belgium | ▪ Scope of FTS is restricted as ‘Make available’ clause under USA and UK and Portugal DTAA s applies  
▪ DPS will be excluded from the purview of FTS because of Swiss, Germany and Sweden DTAA s  
▪ The words 'including the provision of services of technical or other personnel' are missing in France DTAA which restricts the scope of FTS under Belgium DTAA |
| 5  | Sweden  | ▪ Scope of FTS is restricted as ‘Make available’ clause under Canada and Portugal DTAAs applies |
Mere fact that French Insurance Co. is obliged to pay on happening of contingency does not mean it endorsed credit facility to French Insurance Co.

French Co. not liable to exemption under article 12(3)(b) of the Treaty however entitled to MFN clause in the Tax Treaty.

In view of MFN clause, the interest payable to French Co. not taxable in India – Reference taken from India-Ireland and India-Hungary Treaty.

Hence Indian Co. is under no obligation to deduct tax at source.

Facts

- Indian Co. entered into agreement for purchase of aircraft from French Co.
- French Insurance Co. insured the credit facility to be extended by French Co. to Indian Co.
- Indian Co. executed the promissory note covering principle and interest in favor of French Co.
Harmonious interpretation

• The ‘make available’ clause in the FTS Article under the India-USA and India-Portuguese tax treaties, is applicable to India-France tax treaty in view of MFN clause in India-France tax treaty – *DDIT v. IATA BSP India* [2014] 46 taxmann.com 150 (Mum)

• Interest payable to French resident on loan insured by specified French corporation is not taxable in India in view of MFN clause under French tax treaty as compared to Canada, Hungary and Ireland tax treaty - *Poonawalla Aviation Private Limited* [2011] [AAR No. 953 of 2010] (AAR)

• Interest payable to Swedish resident on loan guaranteed by specified Swedish corporation is not taxable in view of MFN clause under Sweden tax treaty deriving benefit from the Ireland tax treaty - *Idea Cellular Limited* [2012] 206 Taxman 238 (AAR)

Restrictive interpretation

• AAR denies benefit of MFN clause under India-France tax treaty with respect to ‘make available’ clause. AAR observed that as per the Protocol, the restrictions are on the rates and ‘make available’ clause cannot be read into it - *Steria (India) Ltd.* [2014] 45 taxmann.com 281 (AAR)

• Managerial services provided to the Indian company are taxable as FTS in spite of MFN clause under the French tax treaty. Since USA tax treaty does not cover managerial services, make available clause is not applicable to such services - *Mersen India Private Limited* [2012] 20 taxman.com 475 (AAR)
Case Study : 1

XYZ Co., a tax resident of Belgium enters into a contract with ABC Co. for rendering consulting service

ABC Co. is a tax resident of India

The income earned by XYZ Co. is chargeable to tax in India as the same would qualify as FTS

In case of FTS, tax rate provided under India – Belgium Tax Treaty is 20%

Applicability of MFN clause

Due to presence of MFN clause in India – Belgium Tax Treaty, the tax rate applicable will be 10% based on subsequent Tax Treaty entered into between India and Sweden
Case Study: XYZ Co., a tax resident of Netherlands enters into a contract with ABC Co. or use of commercial equipment

- ABC Co. is a tax resident of India
- The income earned by XYZ Co. is chargeable to tax in India under Article 12 of India-Netherlands Tax Treaty as Royalty
- Due to presence of MFN clause in India – Netherlands Tax Treaty, the scope of Article 12 is restricted

**Based on subsequent Tax Treaty entered into between India and Sweden, no tax is deductible on the payment made towards use of equipment**
M/s. Decoufle s.a.r.l., France

Import of machinery and provision of installation services

Payment towards FTS

ITC Limited

France

India

Contd…
• ITC Limited imported machineries from M/s. Decoufle s.a.r.l., a tax resident of France

• M/s. Decoufle s.a.r.l., France also provides installation services to ITC Limited

• The income earned by M/s. Decoufle s.a.r.l., France argued to be chargeable to tax in India as the same would qualify as FTS

• Applicability of MFN clause

• Presence of MFN clause in India – France Tax Treaty based on Tax Treaty entered into between India and US restricts the scope of FTS.

• By applying MFN - FTS should not be taxable
## List of Some Countries with MFN Clause

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of the Countries</th>
<th>Effective date of DTAA i.e. Assessment Year</th>
<th>MFN Clause</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Belgium</td>
<td>1999-2000</td>
<td>Para 1 of Protocol</td>
<td>Due to MFN clause, scope of Royalty got restricted (India – Sweden Tax Treaty does not include payment for use of equipment) Tax Rates of Royalty / FTS also got reduced.</td>
</tr>
<tr>
<td>2.</td>
<td>France</td>
<td>1996-1997</td>
<td>Para 7 of Protocol</td>
<td>Due to MFN clause, scope of Royalty got restricted (India – Sweden Tax Treaty does not include payment for use of equipment). Tax Rates of Royalty / FTS also got reduced.</td>
</tr>
<tr>
<td>3.</td>
<td>Hungary</td>
<td>2007-2008</td>
<td>Para 4 of Protocol</td>
<td>MFN clause relates to scope and tax rate on dividend, interest, royalty and FTS</td>
</tr>
<tr>
<td>4.</td>
<td>Israel</td>
<td>1997-98</td>
<td>Para 2 of Protocol</td>
<td>Scope of FTS is restricted (India – US Tax Treaty)</td>
</tr>
</tbody>
</table>
| 5.      | Kazakhstan             | 1999-2000                                 | Para 2 of Protocol | - Due to MFN clause, scope of Royalty got restricted (India – Sweden Tax Treaty does not include payment for use of equipment)  
- Tax Rates of Royalty / FTS also got reduced |
| 6.      | Netherlands            | 1990-1991                                 | Protocol IV    | Tax rates and also the scope of Royalties / FTS are restricted by invoking MFN clause |
| 7.      | Norway                 | 1988-1989                                 | Article 13(2)  | Tax rate on FTS income is restricted |

Contd…
<table>
<thead>
<tr>
<th>Sr. No.</th>
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<th>Effective date of DTAA i.e. Assessment Year</th>
<th>MFN Clause</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.</td>
<td>Philippines</td>
<td>1996-1997</td>
<td>Para 4 of Protocol</td>
<td>MFN clause provides for giving effect of changes in Air Transport and Shipping business only if the same are entered into by Philippines only</td>
</tr>
</tbody>
</table>
| 10.    | Spain                       | 1997-1998                                   | Protocol 7            | - Due to MFN clause, scope of Royalty got restricted (India – Sweden Tax Treaty does not include payment for use of equipment)  
- Tax Rates of Royalty / FTS also got reduced |
| 11.    | Sri – Lanka                 | 1982-1983                                   | Whole Protocol        | MFN clause relates to Construction and Service PE and income from Shipping Business only |
| 12.    | Sweden                      | 1999-2000                                   | Para 3 of Protocol    | Due to Tax Treaty with Canada and Portugal, scope of FTS got restricted   |
| 13.    | Swiss Confederation         | 1996-1997                                   | Para 4 of Protocol    | Tax rate of Royalty and FTS are reduced and Scope of FTS is broaden by revising Tax Treaty |
| 14.    | United Kingdom              | 1995-1996                                   | Article 7(6)          | MFN clause provides for only for HO expenses                            |
Thank You

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