

Switzerland withdraws MFN status from India

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Switzerland Withdraws 'Most Favoured Nation' Status for India

Context: Switzerland has announced the **suspension of the Most Favoured Nation (MFN) clause** in its **Double Taxation Avoidance Agreement (DTAA)** with India, effective **January 1, 2025**.

What is the Most Favoured Nation (MFN) Clause?

- **MFN Principle:** The MFN clause is a principle in international treaties, including tax agreements, ensuring **equal treatment** for all parties involved.
- **Equal Treatment:** If a country offers **favorable tax rates** or conditions to one partner, it must extend those same benefits to all other treaty partners.
- **No Favoritism:** The clause ensures no country is treated **less favorably** than others in matters of trade or taxation.
- **WTO MFN Application:** MFN is a core principle under:
 - **WTO's General Agreement on Tariffs and Trade (GATT),**
 - **General Agreement on Trade in Services (GATS, Article 2),** and
 - **Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).**

Exceptions to MFN:

1. **Free Trade Agreements (FTA):** Countries can form FTAs that apply preferential treatment to member nations, **excluding others**.
 2. **Special Access for Developing Countries:** Developed nations may allow **special market access** for developing countries.
 3. **Unfair Trade Measures:** Barriers can be raised against products perceived to be traded **unfairly**.
 4. **Limited Discrimination in Services:** Under strict conditions, **discrimination in services** is permitted.
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India-Switzerland MFN Clause

- Switzerland granted **MFN status to India** under its **DTAA**, signed in **1995** and amended in **2011**.

What is Withholding Tax (WHT)?

- **Definition:** WHT (also called **retention tax**) is the tax deducted at the source by a payer (resident or non-resident) when making specified payments, such as **rent, commission, or salary**.
- **Income Tax Act, 1961:** The applicable **WHT rate** is determined under the **Income Tax Act** or the DTAA, **whichever is lower**.
- **Non-Resident Taxation:** Non-residents are taxed on **Indian-sourced income**, including:
 - **Interest, royalties, and fees for technical services** paid by residents,
 - **Salaries** for services rendered in India, and
 - Income arising from a **business connection** or **property in India**.
- **WHT Rate:** Tax is withheld at **10%** of the value of **benefits** or **perquisites** arising from business or professional activities.

Why has Switzerland Suspended the MFN Clause?

1. 2023 Nestlé Case:

- Swiss company **Nestlé** sought a refund on **withholding tax** paid on dividends, citing the **MFN clause** under the India-Switzerland DTAA.
- The issue arose due to lower tax rates granted to countries like **Colombia** and **Lithuania** after they joined the **OECD**.

2. OECD Provisions:

- Switzerland argued that the **lower rates** applied to India **automatically** under the MFN principle.

3. Supreme Court Judgment:

- The **Indian Supreme Court** ruled that such adjustments require **formal notification under Indian law** and cannot be applied automatically.

4. Switzerland's Response:

- Following the ruling, Switzerland decided to **suspend the MFN clause** in its tax treaty with India.

Impacts of MFN Suspension

1. Higher Tax Liabilities for Indian Companies:

- Indian companies receiving dividends from Switzerland will face **increased tax rates**, rising from **5% to 10%**.

2. Impact on Swiss Investments in India:

- Swiss companies receiving dividends from Indian subsidiaries will continue to face a **10% withholding tax**, which aligns with the existing **India-Switzerland DTAA**.

3. No Impact on EFTA Investments:

- Investments from the **European Free Trade Association (EFTA)** remain unaffected, as the **10% withholding tax rate** already applies.

4. Other DTAA Benefits Remain:

- Indian companies operating in Switzerland can continue to claim benefits such as **tax relief on royalties** and **technical service fees**.

5. Potential Re-Evaluation of MFN Clauses:

- Other countries may reconsider the **MFN clause** in their tax treaties with India, particularly if **similar legal rulings** occur elsewhere.

What Lies Ahead?

- **Aligning Treaty Partners:** Ensuring clarity, predictability, and stability in the interpretation and application of tax treaties is critical.
- **Proactive Negotiations:** India must engage in discussions with treaty partners to **harmonize interpretations** and **safeguard Indian firms' interests** abroad.

