Switzerland suspends its unilateral application of the most-favoured-nation clause in the protocol to the double taxation agreement between Switzerland and India for dividends

In new double taxation agreements, India has agreed to a 5% tax on dividends instead of the 10% agreed with Switzerland. As a result, Switzerland has adopted the lower rate on the basis of the most-favoured-nation (MFN) clause. However, India interprets the MFN provision differently and does not apply it. In order to restore the reciprocity of the agreement, Switzerland will revert to the previous rate of 10% from 1 January 2025. This measure will not affect the free trade agreement between the two countries or Swiss investments in India.

Switzerland and India have concluded the agreement of 2 November 1994 for the avoidance of double taxation with respect to taxes on income (DTC IN-CH)[1]. It was revised by the amending protocols dated 16 February 2000 and 30 August 2010.

Article 11 of the amending protocol dated 30 August 2010 contains a so-called most favoured nation clause, which stipulates that if, after the signing of the amending protocol dated 30 August 2010, India under any convention, agreement or protocol with a third State which is a member of the OECD, limits its taxation at source on dividends, interest, royalties or fees for technical services to a rate lower than the rate provided for in DTC IN-CH on the said items of income, the same rate as provided for in that convention, agreement or protocol on the said items of income shall also apply between Switzerland and India as from the date on which such Convention, Agreement or Protocol enters into force.

Following the signing of the amending protocol dated 30 August 2010, India concluded two new double taxation agreements with States which are now OECD members, in which it granted lower rates with respect to dividends. These are the agreement of 26 July 2011 between the government of the Republic of India and the government of the Republic of Lithuania for the avoidance of double taxation with respect to taxes on income and on capital and the prevention of fiscal evasion (DTC IN-LT) and the agreement of 13 May 2011 between the government of the Republic of India and the Republic of Colombia for the avoidance of double taxation with respect to taxes on income and the prevention of fiscal evasion (DTC IN-CO).

Article 10, paragraph 2, letter a DTC IN-LT provides for a residual tax rate in the source State of 5% of the gross amount of dividends if the beneficial owner is a company (other than a partnership) that directly owns at least 10% of the capital of the company paying the dividends. Lithuania joined the OECD on 5 July 2018.

In a statement published on 13 August 2021, the Swiss competent authority indicated that, on the basis of the most favoured nation clause between Switzerland and India, Lithuania's accession to the OECD had had the effect, retroactively to and including 5 July 2018, of replacing the residual tax rate in the source State for dividends from qualifying shareholdings from 10% to 5% in the context of relations between India and Switzerland.

Article 10, paragraph 2 DTC IN-CO provides for a general residual tax rate of 5% in the source State. Colombia joined the OECD on 28 April 2020.

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[1] Classified Compilation 0.672.942.31

In the statement published on 13 August 2021, the Swiss competent authority indicated that, on the basis of the most favoured nation clause between Switzerland and India, Colombia's accession to the OECD had had the effect, retroactively to and including 28 April 2020, of replacing the residual tax rate in the source State for dividends from 10% to 5% (dividends from qualifying participations and so-called portfolio dividends) in the context of relations between India and Switzerland.

The statement of 13 August 2021 confirmed that Indian tax residents receiving dividends from Swiss sources could, for dividends falling due on or after 5 July 2018 and 28 April 2020 respectively, subject to the conditions set out in the DTC IN-CH, claim the benefit of the above-mentioned treaty and claim a refund of the withholding tax in accordance with the procedures laid down.

In addition, the statement of 13 August 2021 specified that, in the event that reciprocity regarding the interpretation of the most-favoured-nation clause was not guaranteed by the Indian competent authority, the Swiss competent authority would reserve the right to reverse the unilateral application of the most favoured nation clause and to readjust the treaty rates applicable to income accruing from 1 January 2023.

It has decided not to change this interpretation in respect of income falling due in 2023 and 2024.

In 2021, the Delhi High Court[2], hearing a case brought by a taxpayer resident in Switzerland, upheld the application of the residual tax rates after taking into account the most favoured nation clause. However, the Indian Supreme Court, in a decision dated 19 October 2023[3], reversed the lower court's decision and concluded that, on the one hand, the application of the most favoured nation clause provided for in the DTC IN-CH was not directly applicable in the absence of "notification" in accordance with Section 90 of the Income Tax Act and that, on the other hand, the use of the indicative present tense in para. 5 of the Protocol to the DTC IN-CH (third State which *is* a member of the OECD) had to be interpreted as being limited to the member states of the OECD at the time the Protocol was signed. It thus follows from the Court's findings that the subsequent accessions of Colombia and Lithuania to the OECD are, according to the Indian side, without effect on the application of the most favoured nation clause in DTC IN-CH.

On the basis of the Indian Supreme Court ruling, the Swiss competent authority acknowledges that its interpretation of para. 5 of the Protocol to the IN-CH DTA is not shared by the Indian side. In the absence of reciprocity, it therefore waives its unilateral application with effect from 1 January 2025. Accordingly, income accruing on or after 1 January 2025 may be taxed in the source State at the rates provided for in the DTA IN-CH regardless of the application of para. 5 of the Protocol to the DTA IN-CH.

As a result, the claim for refund of Swiss withholding tax by Indian tax residents and the claim for credit of foreign taxes by Swiss tax residents under the Federal Ordinance on the crediting of foreign taxes deducted at source[4] (see also Ordinance 1 of the Federal Department of Finance Ordinance on the crediting of foreign taxes deducted at source[5]) remain guaranteed, under the conditions provided for in treaty law and domestic law, at the following rates:

- For dividends due from and including 1 January 2025, the residual tax rate in the source State is limited to 10%;

The position adopted by the Swiss competent authority in its statement of 13 August 2021 remains applicable for income accruing during the 2018-2024 tax years.

Berne, 11 December 2024

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[2] Dehli High Court: Nestle SA vs. Assessing Officer [W.P.(C) 3243/2021]
[3] Supreme Court of India: Assessing Officer Circle (International Taxation) vs Nestle SA [Civil Appeal No 1420 of 2023]
[4] Classified Compilation 672.201
[5] Classified Compilation 672.201.1