



## EDITORIAL ANALYSIS

**Time: 10 min**

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### Most Favoured Nation approach

**Syllabus: GS2/ India & Foreign Relations, International Organisations & Groupings  
In News**

- The Supreme Court clarified that the **most favoured nation (MFN) clause** in a tax treaty is not automatically triggered and has to be notified separately by the central government.

#### About the 'Most Favoured Nation' status

- **About:**
  - The World Trade Organization's 164 members commit to **treating other members equally** so they can **all benefit from:**
    - each other's lowest tariffs,
    - highest import quotas and
    - fewest trade barriers for goods and services.
  - This **principle of non-discrimination** is known as most favoured nation (MFN) treatment.
- **Origin:**
  - The most-favoured-nation (MFN) principle is a cornerstone of the multilateral trading system conceived after World War II.
- **Exceptions:**
  - There are some exceptions, such as when members strike bilateral trade agreements or when members offer developing countries special access to their markets.
- **Countries outside the WTO:**
  - For countries outside the WTO, such as Iran, North Korea, Syria or Russian ally Belarus, WTO members can impose whatever trade measures they wish without flouting global trading rules.
- **Removal of MFN status:**
  - There is no formal procedure for suspending MFN treatment and it is not clear whether members are obliged to inform the WTO if they do so.
  - India suspended Pakistan's MFN status in 2019 after a suicide attack by a Pakistan-based Islamist group killed 40 police.
    - Pakistan never applied MFN status to India.

#### Significance of MFN

- **Rules-based framework:**
  - It seeks to replace the frictions and distortions of power-based (bilateral) policies with the guarantees of a rules-based framework where trading rights do not depend on the individual participants' economic or political clout.
  - Rather, the best access conditions that have been conceded to one country must automatically be extended to all other participants in the system.
- **Increases free trade:**
  - The Most Favoured Nation clause increases trade creation and decreases trade diversion, essentially encouraging more free trade between countries.
  - It allows more efficient outcomes since the lowest cost producers can export goods to areas with the highest demand without government intervention.
- **Equal treatment of disadvantaged countries:**
  - The Most Favoured Nation clause allows smaller countries to participate in advantages that they may not normally receive since they are overlooked among the large global trade players.
  - The clause helps the small countries to negotiate favorable trade terms that they normally would not receive.
- **Access to a bigger market:**
  - The nation's industries can enhance their goods by catering to this sizable market.

### **Key Highlights of SC's Ruling**

- The Supreme Court has held that **notification under the Indian Tax Laws** is mandatory **to give effect to any Indian tax treaty**, or any **Protocol** that changes its terms or conditions, that has the **effect of altering the existing provisions of law**.
- The Apex Court has pronounced that **to invoke** the beneficial provisions of a **tax treaty pursuant to the MFN clause**, India is required to specifically issue a notification to this effect.
  - Absent a specific notification reflecting consequential amendment, MFN provisions cannot be invoked.
- **Outcome:**
  - This is a significant ruling in the context of interpreting Indian tax treaties. Given that the decision was pronounced by the apex court, it will be regarded as the law of land and binding on all parties.
  - The SC decision is likely to affect claims that nonresident taxpayers have made regarding restrictive source taxation of interest, royalties, fees for technical services, dividends, etc.
  - The ruling rightfully depicts India's Most Favoured Nation approach.

## Challenges

- **May lead to dishonest business practices:**
  - Sometimes, nations provide financial aid to their native industry without checking the fundamental values of the business.
  - Thus, supported businesses can export their goods for low prices.
  - In addition, dumping is a practice that can get a country into an issue with the WTO.
- **Same benefits to all nations:**
  - Another MFN status disadvantage is that the nation must provide the same trade benefits to all other MFN agreement's members or the WTO.
- **High import taxes for developing nations:**
  - The WTO has received reports from developing nations stating that they continue to deal with tariff peaks on goods like textiles, clothes, and fish products.
- **Challenge for India's case:**
  - The beneficial treatment of dividends varies across the treaties.
  - It is more generally available to all investors in a treaty with one nation, whereas for others, restrict the rate to five per cent for investments of more than 10 per cent in the capital and 15 per cent otherwise.
  - The tax department must clarify the exact tax treatment before its application.

## Way ahead

- As economic realities change, relations among countries must also adapt.
  - For now, the circular and SC decision clarify India's treaty approach to MFN.
- There is however a need for periodic review of tax treaties, especially with respect to their economic benefits, and the enforcement of anti-abuse measures.

### Mains Practise Question

[Q] What does Most Favoured Nation status mean? Does it have any relevance today? analyse India's position on this .