INTERNATIONAL TAXATION: INDIAN PERSPECTIVE ON DISPUTE RESOLUTION MECHANISM

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The International Taxation with the seamless trade and economy world over has gained a great footage and importance in all tax jurisdictions and more so in a vast and democratic economy like that of India, where throwing open all the borders with economic reforms of 1991 onwards, the benefits and problems of international taxation, both have engaged the tax governance in the country and the Judiciary, being one important part of the State in India could not naturally remain aloof to this burning topic. In an International Conference like the present one, where various international trade and economic issues are being discussed,

As the august gathering may be aware that India is not a signatory to the OECD Convention and not even VIENNA Convention on Law of Treaties in this field but follows it as a source of customary international law & the Model OECD laws and UN Model of International Taxation Laws and a special Chapter X and Rules have been enacted by Indian Parliament in Indian Income Tax Act, 1961 & Rules, which is now sought to be replaced by Direct Tax Code, which is yet to take birth and is in embryonic position as of now and with the almost simultaneously envisaged birth of GST and DTC in 2015-16, the laws relating to International Taxation are likely to take a flight towards the more reformed and Tax Payers' friendly atmosphere which only can invite FDI from MNCs for the development of a growing economy like that of India. The provisions of GAAR (General Anti Avoidance Rules) enacted in India have also been postponed till 1st April, 2016 for their application on the popular demand of international players and big corporations, who wish to invest in a huge market and economy like India and want comparatively hassle free tax administration, which India has so far been struggling to provide but Government after Government, irrespective of their political shades and party manifestos have assured the international corporate giants, better tax administration in our country and the present Government in office, all the more so is trying its level best to strive for providing such

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atmosphere so that with huge investments from abroad the country's economy can really take off for the larger good of its citizenry.

The issue relating to Transfer Pricing and Permanent Establishment in tax jurisdiction is a large area generating much of the litigation in our country and about 40 benches of Income Tax Tribunals all over the country already have found their hands full with this kind of litigation in the realm of taxation and a large percentage of that already spilling up to the dockets of Supreme Court and 24 High Courts of the country. It is well, nay, known and realized fact that our court system is overloaded with case loads and, therefore, dealing with the highly specialized subject like International Taxation has been storming the dockets of the court system and despite high respect for our constitutional courts all over the world and a very genuine and fair work discharged by Income Tax Tribunals in this regard, somehow the feeling of delays & long periods taken in the resolution of disputes in this field cannot provide a very congenial and collaborative atmosphere for inviting investment from abroad and, therefore, a constant exercise is required to be undertaken in this regard.

Since there is always the other side of the coin, the huge economy like India has to ensure that the State also gets a fair and reasonable revenue by way of tax out of the international transactions taking place in our country and the problem of **`Base Erosion and Profit Shifting' (BEPS)** does not haunt the economy and the tax administration and State is left with an expectant yawn only waiting for its fair share. The constitutional objects and spirit has to tamper and paint the tax laws so that in the name of getting FDIs and international investments, the expected tax revenue on a fair and reasonable interpretation of tax laws even though based on international conventions like OECD and UN Model Conventions is not allowed to be eroded. The recent **G-20 conference in December, 2014 in Australia** has recognized this problem of BEPS as a serious issue for G-20 countries and OECD has also come out with an action plan for ensuring & for taking coordinated action against BEPS. The developing economies are torn between the need to design robust tax system attractive to international investment, while simultaneously meeting their own revenue goals.

The latest world bank study on **DO BUSINESS 2014** Ranks**'** India at a dismal low of 158 in "Ease of Paying Taxes" out of 189 countries as against BRICS countries like China at 91,

Russia at 112, Brazil at 130 and many OECD countries like South Korea at 8, Sweden at 13 and Mexico at 48.

The **disputed amount of tax revenue** involved at various levels of income tax disputes resolution system was estimated at **INR 4367 Billion** as on **31st December, 2011**, a significant increase from **INR 2436 billion** estimated as on **31st December, 2010** as against net direct tax collection for the **F.Y.2011-12** estimated only at **INR 4940 billion**. A quick review of these figures gives a dismal picture of almost the same amount of revenue which is generated also involved in dispute resolution system from top to bottom in our country and, therefore, something very serious appears to be wrong at the bottom level of tax assessments in our country, which only gives rise to the appellate remedies and approaches to the constitutional courts by the aggrieved parties.

The settlement of tax disputes through the process of negotiations prevalent in most of the countries is absent in our country. As trade investments have taken international character, the tax disputes that arises from such activities have likewise increased internationally. The recent case of Vodafone decided in 2011 by the Supreme Court and retrospective amendment in Income Tax Law to undo that judgment in 2012 has attracted a large criticism from various quarters and the State was almost made the eschew its own legislation by promising the tax administration contrary to its own retrospective legislation.

There is thus, a dire need to look at the **Alternative Dispute Resolution (ADR) Mechanism** even for the resolution of international tax disputes which mechanism, ADR, we frequently adopt for other civil and criminal disputes also. The tax laws in India currently provide for ADR Mechanism like **Settlement Commission, AAR (Authority for Advance Rulings)** and **Advance Pricing Agreement** and even **MAP (Mutual Agreed Procedure)** in international taxations but the same have not proved very effective & cure all for settling these kinds of disputes. While mediation is an example of **facilitative procedure** adopted as ADR, **arbitration and expert determination** are examples of **determinative process** other than Judicial and Tribunals determination. In our country, almost all the mechanisms are simultaneously working, as if against the clock, to make sincere efforts for resolution of the

international tax disputes and an amalgam of legislative, judicial and ADR system is yet to attain a major success.

Suggestions for Judicial Process

It would be better if a committee of three officials of Commissioner of Income Tax level pass the assessment orders in the field of international taxation instead of a single authority and the panel of such three officials should constantly interact on an academic basis so that the policy decision and controversial issues, with the exchange of information and data from the data bank, are constantly updated and uniform views on various issues can be maintained throughout the country. Leaving discretion to a single authority in such high stake matters is not at all advisable as it only opens flood gates for litigation and approach to the higher appellate authorities & constitutional courts, which should be curtailed at the initial level itself, as far as possible.

Similarly, in the constitutional courts of the country also, it can be recommended that a panel of tax expert Judges is made, say for example 30 Judges from 24 High Courts may be picked up for such panel. In our country, we have 8-10 Chartered Accountants turned into Judges, various Judges have long standing experience of being standing counsel for the Income Tax Department and some Judges would have held Tax Benches in the respective High Courts for long period and they can provide such a panel of about 30 Judges. A scheme of fixed term deputation for formation of Three Judges benches in four High Courts operating in Metros like Mumbai, Delhi, Chennai & Kolkata, where tax disputes relating to international taxation mostly arise and are to be decided frequently, can be sent on rotation basis and such Judges drawn from various High Courts can be asked to decide such cases sitting in dedicated benches in an expeditious manner in such four High Courts. Such Tax Judges can & should also have constant interaction & updates of litigations and issues and even policies of the State with their weekend sessions in National Judicial Academy at Bhopal at least once in a month. Instead of permanent transfer of such

expert Judges to such Metro High Courts, if a scheme of fixed period temporary transfers or deputations can be evolved, if necessary, even with a constitutional or statutory amendment, for meeting this urgent need for the development of international tax jurisprudence in the country and providing an authoritative pronouncement on the various issues arising in the field of international taxation, where both the sides of the coin can be examined in greater details and depth, for the guidance & binding interpretations for the lower authorities in the Income Tax department. We should really come out to make such novel approaches & efforts, because it cannot be over emphasized that without the authoritative and final determination of various issues by the High Courts or Supreme Court of the Country with the increasing volume of litigation in various forums created by the Income Tax Laws of the country, whether in determinative judicial process or facilitative process of ADR finality on such issues cannot be achieved and in the conferences of these kinds, such issues require public debate so that the legislative efforts can be accelerated to provided for such solutions.

OECD work on resolution of International Tax Disputes

The Organisation for Economic Co-operation and Development (OECD) and Organization of large number of countries engaged in International Trade, India being not the member of OECD, has recently undertaken an exercise to develop an action plan for quicker resolution of International Tax Disputes in view of huge stakes involved therein. As per their data, in 2011, **world merchandise trade** was valued at **USD 18.02** trillion and **world commercial services exports** were valued at **USD 4.2** trillion (vide World Commerce Review, June 2012 on www.worldcommercialreview.com and the total **foreign direct investment** positions were also reported to be **USD 20.7 trillion in 2010**. In view of the significance of these cross-border flows, there is a great deal at stake for governments, as they seek to tax the income and gains these flows produce. This stake for governments is more prominent in the current economic climate, where the worldwide economic crisis and the consequential rise of government debts spur the need to protect tax bases and make sure that all taxpayers contribute their fair share of tax. International tax disputes may arise, however, when there are disagreements between countries as to how a Tax Treaty should be interpreted or applied to specific international transactions

or activities, or when a taxpayer considers that it has been subjected to taxation contrary to the terms of a Tax Treaty. Such international tax disputes most frequently arise in the area of Transfer Pricing or on the question of Permanent Establishments of the Associated Enterprises or GAAR etc., where the issues involved are complex and the stakes are high.

Article 25 of OECD Model provides for one such ADR namely, **MAP (Mutual Agreement Procedure).** Article 25 provides for a mechanism for resolution of such international tax disputes by the **method of arbitration** and under Article 25, a taxpayer may present its case to the competent authority of its country of residence when it considers that it has been subjected to taxation not in accordance with the provisions of the treaty. Whilst the MAP provides a generally effective and efficient method of revolving international tax disputes, statistics for OECD member countries show that there has been a steady increase in **MAP caseloads** over the last five years : OECD member country end-of-year inventory increased from 2,352 cases in 2006 to 3,328 cases in 2010, a rise of more than 40% and by 2013 to 4566 cases with 1210 new cases instituted in 2013 itself, the US leading the figures with 403 new cases instituted in 2013 itself & pendency of US cases at the end of 2013 being at 732 (vide OECD website data). Now, we are in 2015 and may be the figures might have doubled or more than that. Even as per the OECD study, the average number of months needed to resolve a MAP case has increased from 22.1 months in 2006 to 27.3 months in 2010. Though the OECD Model updated in 2008, has included a mandatory binding arbitration provision in paragraph 5 of Article 25 and according to which, where the competent authorities were unable to reach agreement in a MAP case within two years, any unresolved issues shall generally be submitted to binding arbitration upon the taxpayer's request. However, the OECD member countries have continued to show a certain hesitance in adopting arbitration provisions.

In 2007, the OECD presented its Manual on Effective Mutual Agreement Procedures (MEMAP) to increase awareness of the MAP process and how it should function and such MEMAP recommends 25 non-binding best practices to deal with particularities of the MAP process or procedural issues and now, after 7 years of MEMAP introduced by OECD, it may be good time to re-evaluate whether the MEMAP is a mechanism

that stimulates the implementation of swift and effective ADR by governments more so, when a rising trend of caseloads of international tax disputes are expected.

ADR in International Tax Disputes in India

As per the study conducted by a former member of Central Board of Direct Taxes (CBDT) and Senior Consultant with Indian Council for research on International Economic Relations (ICRIER) Mr. Rajiva Ranjan Singh, India has a four-tier dispute solution mechanism. If a taxpayer is not satisfied with the assessment, he/she can file an appeal before the Commissioner of Income Tax (Appeals) [CIT(A)] and thereafter, second appeal before the Income Tax Appellate Tribunal (ITAT). The third-tier of appeal lies with High Court on substantial question of law only while the findings of facts become final at the level of ITAT and the fourth and final-tier is by way of appeals before the Supreme Court of India. According to the said study, the Indian system suffers from two dis-advantages :

Time Consuming and Costly procedures because of plethora of unwarranted cases picked up for scrutiny and secondly,

(2) Anti-Taxpayer Attitude of Tax Administration. The lacking in the form of insufficient case law in international taxation to serve as judicial precedents in our country and lack of sufficient data in support of cases for determination of issues relating to Transfer Pricing are other handicaps. The different or conflicting views taken by the different authorities at different levels also gives rise to multiplicity of litigation.

Though the Indian Income Tax law has provided for disputes resolution mechanism by prescribing constitution of Disputes Resolution Panel (DRP) comprising of three Commissioners/ Directors of Income Tax, since such DRPs are not kept independent from the assessment authorities working in the Department there is also a trust deficit and there is always a question mark on their independence. There have been suggestions to replace the DRPs with a permanent body headed by a High Court Judge. Moreover, since the directions of the DRPs are not binding on the parties, they are usually put to challenge before the CIT(A), ITAT and then High Court or even before the Supreme Court of India. The recent Bombay High Court decision of

10th October, 2014 was against the DPR order, in the case of Vodafone India Services & High Court held that there was no deemed income on the deemed loan on the issue of shares by the Indian Subsidiary Company at an allegedly less premium to its holding company. The Attorney General has opined for not filing further appeal against this judgment. The length of time taken even on these alternative methods of dispute resolution is quite depressing. The Indian Income Tax Act, 1961 also provides for **Authority for Advance Ruling (AAR)** so that the issues of international taxpayers are resolved and decided before the actual transaction takes places. Even this mechanism has not been successful for a variety of reasons.

However, the recent assurances of the Government for refurbishing the attitude of the Income Tax Administration and converting the same into a non-adversarial tax regime and creating an investor friendly climate is a fresh breeze of air but there is an urgent need to take adequate legislative steps for providing for a time bound disputes resolution mechanism.

The Indian Government should mobilize its efforts towards introducing third generation tax reforms that focus on restructuring and modernizing the tax administration. This requires simplification of tax laws, improved infrastructure for tax administration and harmonization and integration of law and procedures across the country. Superior quality taxpayer information services, automation and standardization of procedures, avoidance of tax disputes and quick resolution of tax dispute cases. The considerable role that the use of IT can play in comprehensive automation and integration of process, data collection and analysis for formulating sound policy and enhancing taxpayer services are few of the areas where customer-centric approach towards taxpayers deserves to be taken by the State. Since, the MNEs globally have resorted to aggressive tax planning by taking advantage of DTTAs, tax havens and low-tax jurisdictions have developed across the globe and the State can ill-afford to lose its fair share of tax revenue which can be high and quite supportive for national economy, therefore, all these reforms are necessary and require urgent attention of the Government. The Government has partly resolved the problem by introducing GAAR, APA and Safe Harbour Rules and unless the field of free-economy is developed & for that more vigorous efforts are required to be taken. Unless a confident and adequate

ADR mechanism or judicial determination procedure is put in place in our country, these small measures will not completely serve the purpose.

The first Report of TARC (Tax Administrative Reform Commission) of 30th May, 2014, popularly known as Shome Committee Report, headed by Dr. Parthasarathi Shome & six other Members have also made useful suggestions for dispute resolution on direct taxes & tax reforms.

Our country should also adopt some of the International practices such as putting proposed legislation in the public domain for extensive consultation, conduct impact analyses of legal provisions both before and after legislation is enacted and bring out detailed Circulars and Manuals on Procedure with examples and illustrations to cover all possible eventualities.

Conclusion

In view of the aforesaid suggestions and analysis made, I am of the firm view that our country needs to do a lot for making proper tax reforms in the realm of International Tax Disputes and unless we do so quickly and send the message across the globe that we have really opened up our borders with all sense of responsibility, the hollow talks of inviting FDIs and trade flow from other countries will not become a reality of the day.

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