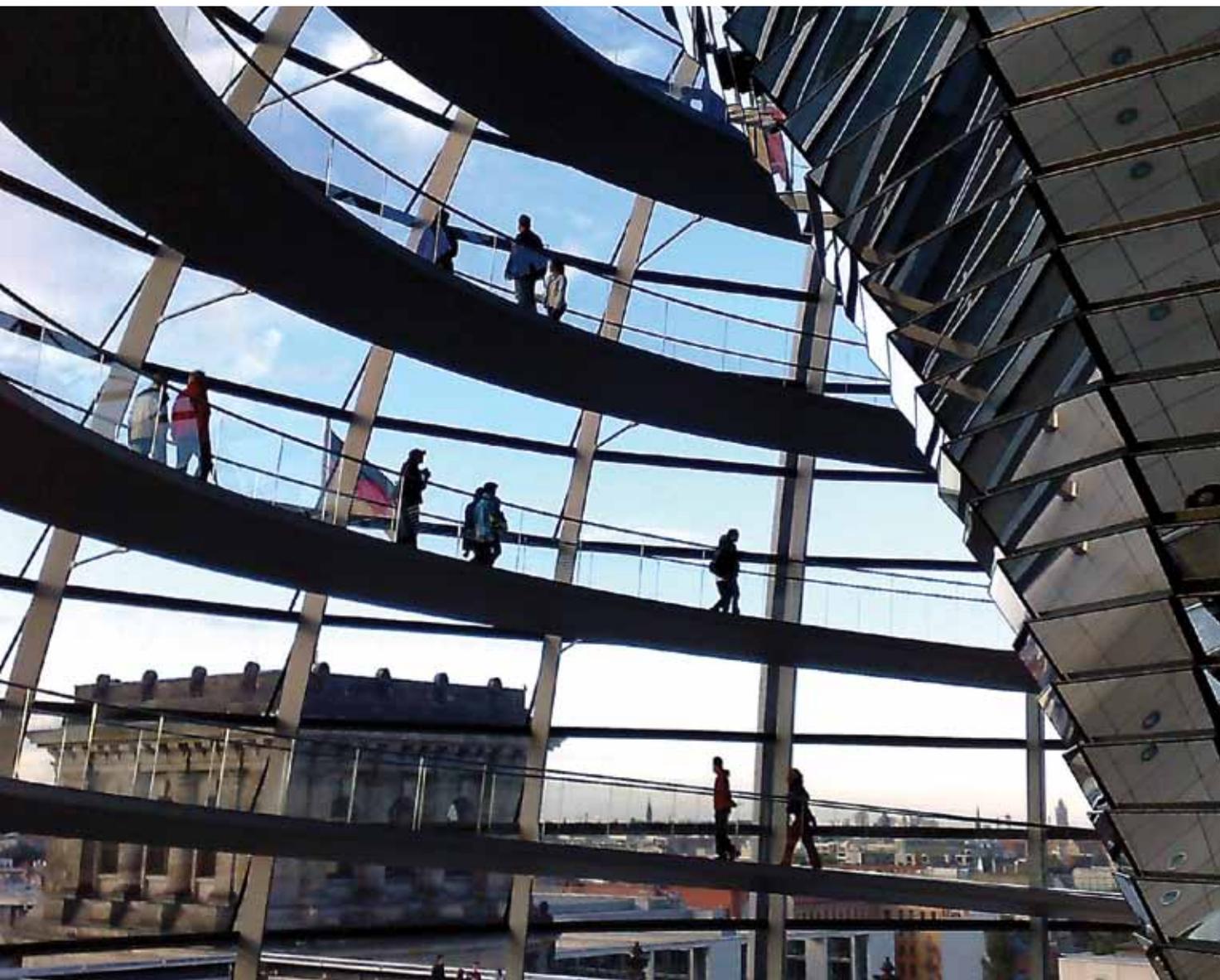


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# *Navigating tax controversy in India*

October 2014



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## ***Preface***

A quick glance at the backlog of cases at all levels of the Indian tax dispute resolution machinery highlights the inadequacy of the present set-up and the dire need for reforms.

It would not be incorrect to say that tax administration in India has so far followed what is internationally termed as the 'adversarial approach' while the world is moving towards a 'collaborative approach' or 'co-operative approach'. There is need to think beyond the conventional adversarial approach and capitalise on the relationship between the taxpayer and the revenue department. Interactions with taxpayers should be with the aim that disputes don't arise in the first place. If inevitable, machinery needs to be put in place to resolve them speedily, without clogging the system.

One reason for the massive build-up of tax disputes in India is that many provisions in Indian tax laws suffer from poor drafting and are amenable to multiple interpretations. Stakeholder participation in the drafting stage is close to non-existent. To add to complexities, changes are made every year during the annual Budget.

India has lagged behind in embracing global best practices in tax dispute resolution. Though the government has in the past set up committees to examine various aspects of tax administration, the dispute resolution aspect has largely remained untouched by reforms.

The objective of this white paper is to conduct an "as is" study of Indian tax dispute resolution and the alternate dispute resolution machinery to highlight areas of improvement in the existing set-up. The intent is to draw stakeholder attention to the urgent need to pursue and campaign for the long overdue reforms.

India is today at the cusp of a major growth initiative. Given the changes around the globe and our aspiration to provide an attractive investment climate it is important to align the dispute resolution system with trends in global tax controversy. There is need for reflection and introspection on what ails the system and how to improve it.

The aim of this white paper is to spur action on that.



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## Message

In today's global tax environment, there are a number of major forces now influencing a wide range of activities, processes, and perceptions of stakeholders worldwide – tax authorities, legislative bodies, non-governmental entities, taxpayers, and civil society around the globe. These key forces are creating megatrends in global tax controversy. As this article points out, India is not immune to these emerging megatrends.

The number and size of audits, exams and inquiries are dramatically increasing worldwide. Despite the OECD's call for coordinated action by nations in addressing base erosion and profit shifting, individual countries are not waiting for consensus to be reached and are acting unilaterally by engaging in a range of activities – from the use of aggressive audit tactics to the promulgation of new legislation or policies and procedures, as well as the implementation of other measures intended to protect their respective tax bases. Developed and emerging countries are also taking divergent positions on the interpretation of historical international tax standards. The arm's length standard (arguably one of the most important concepts in international taxation) is under pressure, with some nations adopting positions openly inconsistent with the decades-old principle. Moreover, the debate continues as to whether tax administrations should have the authority to recharacterize bona fide arrangements and to disregard legal entities and binding agreements. Individual countries, including India, are feeling the adverse effect of these movements in global tax controversy. In this unstable environment, it is inevitable that pressure will mount on the use of alternative dispute resolution options as a means to resolve tax disputes in a cooperative manner. Tax administrations and other stakeholders will need to think creatively about new ways to resolve tax disputes without formal litigation, which can be lengthy and costly, with uncertain results. But, not all tax disputes can be resolved by administrative dispute resolution options. Increasingly, the use of litigation in certain territories is viewed as a necessary option in key areas of tax controversy, particularly where the risk of double taxation is prominent. Indeed, as discussed in this paper, India is experiencing an unprecedented increase in litigation, which is compounded by the massive backlog of tax disputes, thereby resulting in the need for significant reform in alternative dispute resolution options.

Without a doubt, emerging megatrends in global tax controversy will continue to shape the tax environment in India. Now, more than ever, it is necessary to keep an eye on these megatrends, paying particular attention to how actions worldwide will impact taxpayers and other stakeholders in India well into the foreseeable future.



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# Direct Tax litigation in India

### 1.1 Historical backdrop

In the pre-Constitution era, the Government of India Acts prohibited any interference by the high courts in revenue matters, in the exercise of their original jurisdiction (Section 106 of the Government of India Act, 1919 and section 226 of the Government of India Act, 1935). However, the revenue enactments had provisions whereby the jurisdiction of the high courts could be invoked for the interpretation of statutes (e.g. section 15 of Income-tax Act, 1918; section 66 of Income-tax Act, 1922; section 57 of Indian Stamp Act, 1899).

In certain decisions<sup>1</sup>, the Supreme Court observed that this jurisdiction was a purely advisory one and not for seeking relief. It has been pointed out that in discharging its basic duty to decide the question of law, the court has to look into the facts on which the question of law arises. It has an implicit and ancillary power to interpret any question of fact that is essential to determine the question of law which arises.

Apart from the constitutional limitation on the high courts as aforesaid, the Income-tax Act (old Act) itself precluded all civil courts from entertaining any suit to alter any assessment made under the old Act or any suit for damages against any officer of the government for any acts done by him or her under the old Act in good faith. The Income-tax Act, 1961 (the Act), retains these characteristics of revenue legislation, but the basic pattern has changed on account of three important factors:

- Bar on the high courts against dealing with revenue matters was removed by the Constitution. (Proviso to Article 225)

- The Constitution declared that no taxes shall be levied or collected save by the authority of law (Article 265) and conferred power in the widest terms possible, on the high courts and the Supreme Court to issue writs and orders to prevent any manner of illegality or impropriety (Article 226 and 32).
- Right was conferred on the taxpayer to test in courts the very validity of the provisions of revenue law on the touchstone of the fundamental rights guaranteed by the Constitution.

The result of these far-reaching changes has been that the high courts and the Supreme Court are no more mere advisors on specific points on which their opinion is sought, but have been given the vital role of seeing that revenue laws are enacted in accordance with the Constitution and also that all acts and powers under the enactments are exercised in accordance with the statute and with due regard to the principles of natural justice<sup>2</sup>.

The phenomenal increase in tax litigation has been possible after the above structural change in constitutional provisions. Further, a study has shown that the level of litigation, in general, increases with the level of economic and human well-being in a society<sup>3</sup>. That also explains the sharp rise in litigation in India in general and tax litigation in particular.

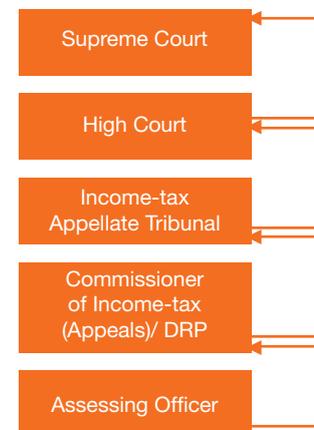
Currently, in India, grievances and disputes can be redressed in the following ways:

- Using administrative fora [Assessing Officer (AO), Commissioner of Income-tax (CIT), Commissioner of Income-tax - Appeals (CIT(A)) and Central Board of Direct Taxes (CBDT)] and their powers under the Act, such as rectification, revision, reassessments, etc.
- Approaching quasi-judicial tribunals and judicial authorities acting in their appellate jurisdictions
- Using alternative dispute resolution (ADR) mechanisms provided for under the Act, viz. Settlement Commission (ITSC), Dispute Resolution Panel (DRP), Authority for Advance Rulings (AAR), Advance Pricing Agreements (APA) and in Double Taxation Avoidance Agreements (Tax Treaties) through Mutual Agreement Procedures (MAP).

Though we are yet to see their wide use, there is a possibility that ADR mechanisms under the general law, viz. arbitration, mediation, conciliation, negotiation, compounding and settlement, etc. could also be used to resolve tax disputes.

### 1.2 Existing structure

The Act provides for a five-tier appellate hierarchy for resolving conflicts between the revenue department and taxpayers.



1. *Vasantlal & Co (C) v CIT (1962) 45 ITR 206, New Jahangir Vakil Mills Ltd v CIT (1959) 37 ITR 11 and CIT v Scindia Steam Navigation Co Ltd (1961) 42 ITR 589*

2. *Sampath Iyenger's Law of Income Tax, 11th Ed., Vol 8, pp 13025-6*

3. *Eisenberg, Theodore; Kalantry, Sital; and Robinson, Nick, 'Litigation as a Measure of Well-Being' (2012). Cornell Law Faculty Working Papers, Paper 99*

### 1.2.1 Assessing officer

All disputes arise at the stage of the AO. This also includes the Centralised Processing Centre and the Transfer Pricing Officers (TPO). The AO examines the return of income filed by a taxpayer, and frames the assessment by applying the provisions of the Act. The Act and the general principles of natural justice mandate that the AO gives the taxpayer adequate opportunity of being heard in case he or she disagrees with the quantum of income and tax declared by the taxpayer or certain positions adopted in the return of income. It is during the course of the assessment, where the taxpayer is expected to provide necessary clarifications to the AO, that the points of dispute arise or potential disputes are averted through explanations and clarifications. This way, the AO is also the first level of dispute resolution. If upon the completion of assessment, the taxpayer is dissatisfied with the assessment framed by the AO, he or she is entitled to approach the next level of normal dispute resolution, who ordinarily is the CIT (A). In certain circumstances, the taxpayer can also approach the jurisdictional CIT seeking a revision of the assessment order.

The AO has a timeframe of two years [three years where transfer pricing (TP) assessment is involved] of the assessment year to complete the assessment.

The following problems in assessment orders and at the assessment stage are considered to be the root causes of major tax litigation.

- **'Boxed-in' approach:** AOs tend to bunch cases towards the end of the deadline, thereby requiring them to rush to complete the assessment. This takes a toll on the quality of the assessment. As a result, the assessment order drawn up is often found to have failed to consider relevant evidences or without dealing adequately with evidences on record.
- **Defects in taxpayers' response:** Accounting systems are often not geared to meeting exacting standards of reconciliation and reporting demanded in today's tax assessments. A major portion of tax disputes are thus based on lack of appreciation of facts, which could have easily been avoided had the accounting system of taxpayers been more robust.
- **Assessment orders are often non-speaking,** lack judicial discipline (on pretexts such as 'Department

has decided to file appeal with the Supreme Court") or misinterpretation of judicial precedents.

- **Arbitrary or irrational demands are raised** because of the revenue target-linked performance evaluation and incentive policy of AOs. Immense pressure on the tax administration to collect revenue (which may not be there) results in the extortive approach of the AO. The quality of decision (assessment order) is not a parameter for the evaluation of the AO's performance.
- **AOs often do not have adequate access** to a proper and effective knowledge management system, case referencing, etc. Lack of specialisation among AOs often adversely affects the quality of decision.

### 1.2.2 Commissioner of Income-tax (Appeals)

The CIT(A) functions under the administrative control of the Ministry of Finance. In an appeal against an order of assessment, the CIT(A) may confirm, reduce, enhance or annul the assessment. As in the case of the AO, the CIT(A) is required to conduct hearings and duly consider the arguments of both the taxpayer and the AO. The law prescribes that the CIT(A) hears and decides an appeal within a period of one year from the end of the financial year in which the appeal is filed.

The law also provides that the CIT(A) may, before disposing off any appeal, make such further enquiries as he or she may think fit or direct the AO to make further enquiry and report back the result. This is necessary to accord equal opportunity to both litigants. Ironically, this provision has led to large-scale build-up of cases with the CIT(A). The AO as per the directions of the CIT(A) has to examine the points on which the inquiry has been sought afresh and submit the results of his or her examination to the CIT(A) through a report known as the Remand Report. At times, there is considerable delay in finalising this report. This in turn causes delay in the issuance of the appeal order by the CIT(A).

At times, the CIT(A) is transferred mid-year, leading to de novo hearing by the new CIT(A). In most cases, the time limit prescribed to complete the appeal is not followed. The quality of the orders issued by the CIT(A)s is not considered as one of the parameters for their performance evaluation.

There is tendency on the part of the tax administration to file appeals against the orders of the CIT(A) in favour of taxpayers, without giving due importance to the merits of the case. Often guidelines for filing appeals to the Income-tax Appellate Tribunal (ITAT) against the CIT (A) orders are flouted and cases are filed before the ITAT in a routine manner.

#### Statistics relating to pendency of cases before CIT(A) is as follows<sup>4</sup>:

	FY 2013-14	FY 2012-13	FY 2011-12
Number of cases decided by the CIT(A)	87,770	85,049	75,518
Number of cases pending before the CIT(A) as at FY end	215,174	199,390	230,616
Amount locked up in appeals pending as at FY end (in crore INR)*	287,443	259,556	244,182

\*INR 1 crore ~ USD 162000

Recently the CBDT has created over 240 new posts of the CIT (A) to speed up the disposal of pending cases<sup>5</sup>.

4. Ministry of Finance, Department of Revenue, Annual Report 2013-2014, p. 196

5. Huge litigation in Income Tax department: CBDT creates over 200 new posts, Press Trust of India, 11 August 2014

### 1.2.3 Dispute resolution panel

The DRP has been discussed in detail in para 1.3.1.

### 1.2.4 Income-tax Appellate Tribunal (ITAT)

Depending on the outcome at the CIT(A) or DRP stage, the taxpayer or the revenue department, whoever is aggrieved, has the option of approaching the next level of dispute resolution, being the ITAT. The ITAT is the final fact finding authority in the dispute resolution chain. A decision of the ITAT is typically binding on the revenue department and all the taxpayers within its jurisdiction, unless there is a subsequent contradictory decision of a higher authority (e.g. Special Bench, High Court, etc.). The law prescribes a timeline of four years for the ITAT to hear and decide an appeal, starting from the end of the financial year in which the appeal is filed. ITAT is under the administrative control of the Ministry of Law and Justice.

### 1.2.5 High court

At the state level, the high court functions as the highest judicial forum and enjoys administrative, supervisory and appellate jurisdiction and superiority over subordinate courts and tribunals within its territorial jurisdiction. The high court has the constitutional duty of enforcement and protection of fundamental rights within its territorial jurisdiction through the issuance of writs. It also has the power of judicial review, whereby it is, inter alia, empowered to declare a law unconstitutional. Under section 260A of the Act, an aggrieved party in a tax dispute may approach the high court only on a substantial question of law<sup>6</sup>.

### 1.2.6 Supreme Court

The Supreme Court, with its seat at New Delhi, is the apex judicial forum in India bestowed with original, appellate and advisory jurisdiction. It also enjoys plenary powers, inter alia, under Articles 32 and 136 of the Indian Constitution. Plenary power implies power in absolute terms not riddled with any statutory or constitutional limitation other than the judicially evolved self-imposed restrictions, under which such powers are exercised by the court.

One of the most significant aspect of the powers enjoyed by the Supreme Court under the Constitution is couched in Article 141 which provides that the law

declared by the Supreme Court is binding on all courts and tribunals, within the territory of India. The law declared by the Supreme Court is constitutionally recognised as the law of the land. Under section 260B of the Act, an aggrieved party in a tax dispute may approach the Supreme Court only on a substantial question of law. In practice, parties generally take the route of appealing to the Supreme Court under Article 136 as 'Special Leave Petition'.

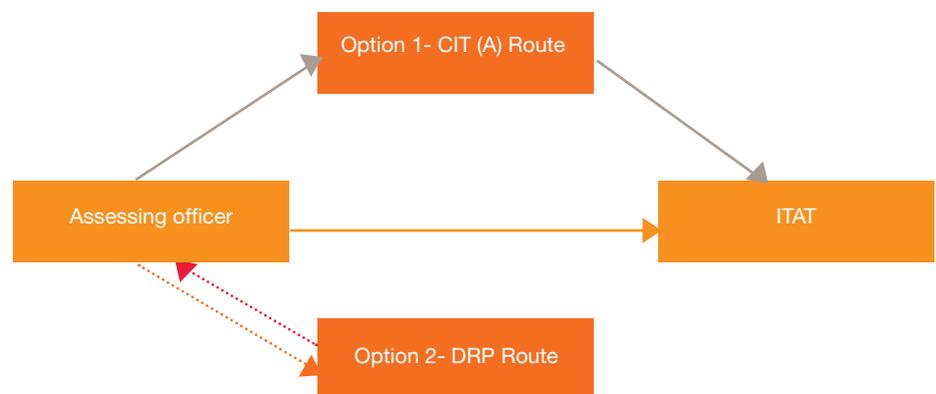
## 1.3 Alternative dispute resolution mechanisms

### 1.3.1 Dispute resolution panel<sup>7</sup>

The DRP consists of a collegium of three CITs or Director of Income-tax (DIT) appointed by the CBDT. The CIT or DIT, in addition to their regular administrative duties, carry out the functions of the DRP. The DRP has the mandate to guide the AO in deciding cases where the addition involves TP or cases of foreign companies. The AO passes a draft order and within a month, the taxpayer has to either approach the DRP or inform the AO that the draft order is acceptable as final. In case of the latter, the taxpayer

can approach the CIT(A). In case of the former, the taxpayer disputes the draft order before the DRP and the DRP has to decide within nine months whether the AO's draft order is fine or whether it needs to be amended. The AO passes a final order based on the directions of the DRP. The taxpayer may further dispute such final order before the ITAT. By a recent amendment, the revenue department has also been given the power to dispute such order before the ITAT.

The DRP is a form of ADR and was introduced by the Finance Act, 2009. The DRP was introduced as a panel between the AO and the appellate forum. The advantage of approaching the DRP is that the taxpayer does not have to pay the taxes until the DRP had given its ruling and passed it to the AO. The taxpayer, if aggrieved, could appeal to the ITAT, thereby compressing the time taken for it to move to a higher appellate forum.



6. To be 'substantial', a question of law must be debatable, not previously settled by the law of the land or a binding precedent, and must have a material bearing on the decision of the case, if answered either way, in so far as, the rights of the parties before it are concerned. The word 'substantial' as qualifying 'question of law', means having substance, essential, real, of sound worth, important or considerable. It is to be understood as something in contradistinction with technical, or no substance or consequence, or academic merely. As a matter of law, if the appraisal of the evidence by the trial court suffers from a material irregularity or is based on inadmissible evidence or on conjectures or surmises, the appellate court is entitled to interfere with a finding of fact. - Santosh Hazari v. Purushottam Tiwari [2001] 251 ITR 84 (SC)

7. Shown as 'alternative' because taxpayer may opt for approaching DRP instead of CIT(A)

At present, the CBDT has constituted DRPs at select cities, viz, Delhi, Mumbai, Ahmedabad, Pune, Chennai, Kolkata, Bangalore and Hyderabad.

The traditional dispute resolution mechanism in place prior to the introduction of the DRP, which involved an appeal to the CIT(A), was time-consuming. While the law prescribes a time limit of one year from the end of the financial year in which the appeal was filed for its disposal, it was only a recommendatory time limit and not a mandatory one. Most appeals take about three to four years for being disposed of by the CIT(A), as the pendency of cases at this appellate stage was quite large.

The formation of the DRP was a positive step towards providing a mechanism for facilitating the expeditious resolution of TP and other international tax related disputes on a fast-track basis. The mandatory time limit of nine months allowed to the DRP to pass its order, clearly indicated that the intent was to fast-track the redressal of tax disputes and, at the same time, reduce the number of cases moving into the subsequent stage of appeals and litigation.

However, it has been observed that the DRP rarely affirmed a position different from the one proposed by the AO. Statutorily too, the powers of the DRP are constrained vis-à-vis the powers of the CIT(A). The DRP does not have the power to annul or set aside the draft assessment, nor can it work out a compromise or arbitrate in a dispute. It works on the draft assessment order. Hence, there have been questions on whether the DRP can give its ruling on a new issue. Absence of independent experts within the DRP, tight timelines for the filing of objections by a taxpayer and the fact that the DRP is available to only limited categories of taxpayers i.e. cases of international taxation and those of TP reduce its sheen as an ADR forum. The credibility of the DRP as an effective ADR forum received a major setback when a provision was introduced in the Finance Act, 2012, which enabled the CIT to challenge the DRP's directions. This, in a way, meant that the department was challenging its own order.

### 1.3.2 Settlement commission

The Income Tax Settlement Commission (ITSC), manned by senior departmental officers is a quasi-judicial body which has

been in existence since 1976. This body is the result of the recommendations of the Direct Tax Enquiry Committee set up under the chairmanship of Justice KN Wanchoo, the retired Chief Justice of the Supreme Court of India. The prime objective of setting up the ITSC was providing a mechanism for one-time settlement of taxes to evaders or unwitting defaulters and, thereby, avoiding endless litigations.

Initially, the ITSC was set up in Delhi, which is known as the principal bench and, thereafter, additional benches were set up in Mumbai, Kolkata and Chennai. More benches are proposed to be set up in future. The Chairman of the ITSC is appointed by the central government and is the presiding officer of the Delhi bench. Taxpayers can disclose an undisclosed income before the ITSC, which was not taxed earlier. Terms of the settlement can be reached with the income tax department through this forum, with the objective of avoiding tax litigation and settling cases so as to collect the revenue expeditiously.

The settlement applications filed by taxpayers go through preliminary and final acceptance by the ITSC. Subsequently, opportunity is provided to the income tax department for enquiry or investigation of the case, and taxpayer is also entitled to provide its submission against the objections of the income tax department raised during the course of enquiry or the investigation. After hearing both the parties, the ITSC decides the issue and determines the final income. The process, in aggregate takes 18 months to conclude. The order of the ITSC is final and binding on the taxpayer as well as the income tax department. However, writ petitions can be filed by either party before the high courts, if the order is contrary to the legal principles.

Over the past years, the ITSC has successfully settled tax disputes. As per the statistics released by the ITSC in its official website, in FY 2010-11, the ITSC disposed of 400 cases, in which, against the aggregate returned income of 206 crore INR, the aggregate amount of income settled was 595 crore INR, which is 187% above the aggregate returned income.

The Indian government has also realised the importance as well as potential of the ITSC in effective tax dispute resolution. In the Finance Act 2014 the scope of ITSC proceedings have been widened

substantially. Earlier, a taxpayer was not entitled to approach the ITSC where its cases were pending for reassessment before the tax officer or in cases where the matters were set aside by the ITAT. However, in view of the amendment made in the statute in the Finance Act 2014, now these cases are also covered under the ambit of the ITSC proceedings. Currently, availing the ITSC route is a once in a lifetime opportunity for the taxpayers.

One of the most important advantages of approaching the ITSC is that it has the power to provide immunity from penalty and prosecution to the taxpayer, if the taxpayer makes full and true disclosure before the ITSC and co-operates in the proceedings. This forum is also gaining popularity amongst taxpayers since time bound resolution of tax disputes can be achieved through this mechanism, which in the normal appellate course takes substantially higher time. However, increase in the number of cases and the limited number of benches has so far adversely affected the time taken to settle cases.

There are certain other pre-conditions for approaching the ITSC, that is, disclosure of additional income on which tax payable exceeds 1 million INR, pre-payment of such taxes, etc. Further, disputes relating to withholding tax matters are presently not covered under ITSC proceedings. It is expected that considering the increasing tax disputes on withholding tax matters these proceedings will also be brought within the ambit of the ITSC in the near future.

### 1.3.3 Authority for Advance Rulings

The primary driver for setting up of the AAR was to make it possible for non-residents, or for residents entering into transactions with non-residents, to ascertain the income tax liability in advance, and thus enable certainty, and avoid long-drawn and expensive litigation.

The AAR was created as an independent adjudicatory body to be chaired by a retired judge of the Supreme Court. It exercises its judicial power to issue binding rulings, with a view to mitigate uncertainty in applying tax laws to a transaction or a proposed transaction, and to give an opportunity to a foreign investor to structure the deal keeping the tax implications in mind. It has complete powers of a civil court, to give its rulings in respect of specific questions of law or fact.

Till recently, only a non-resident or certain

specified categories of residents could obtain binding rulings from the AAR on income tax issues arising out of any transaction or proposed transactions. Effective from 1 October 2014 a resident taxpayer can also approach the AAR for a ruling on any transaction undertaken or proposed to be undertaken. AAR rulings are binding on the revenue and on the taxpayer (applicant) in respect of the transaction, in relation to which the ruling had been requested. The ruling can however be challenged before the courts at the instance of either the revenue or the applicant, as part of a constitutional remedy.

With a time limit of six months for issuing a ruling, from the date of the application, the AAR is expected to offer a speedy and reasonably certain resolution on issues. It can also decide whether an arrangement entered into or proposed to be entered into by a resident or non-resident meets the test of 'impermissible avoidance arrangement' (under the General Anti Avoidance Rules).

However, the following issues have been observed in the working of the AAR:

- The importance of the AAR as an effective dispute resolution forum has been questioned during the last few years as parties to the dispute resorted to constitutional remedies against otherwise binding rulings of the AAR.
- Its scope is restricted, for example (i) it can decide on the taxability of transactions that have been undertaken or proposed to be undertaken. The meaning of the phrase 'proposed to be undertaken' is disputed. Does it cover a 'what-if analysis' by a taxpayer? (ii) it cannot decide on a question which is 'already pending' before any income tax authority or the ITAT. What constitutes 'already pending' is intensely debated and litigated (iii) The AAR often decides an issue before the event has happened. Its decision is subject to the limitation that the tax consequence

will depend ultimately on exact facts as well as circumstances obtaining in the case, and if such facts and circumstances differ from what was described in the application the answer will also differ.

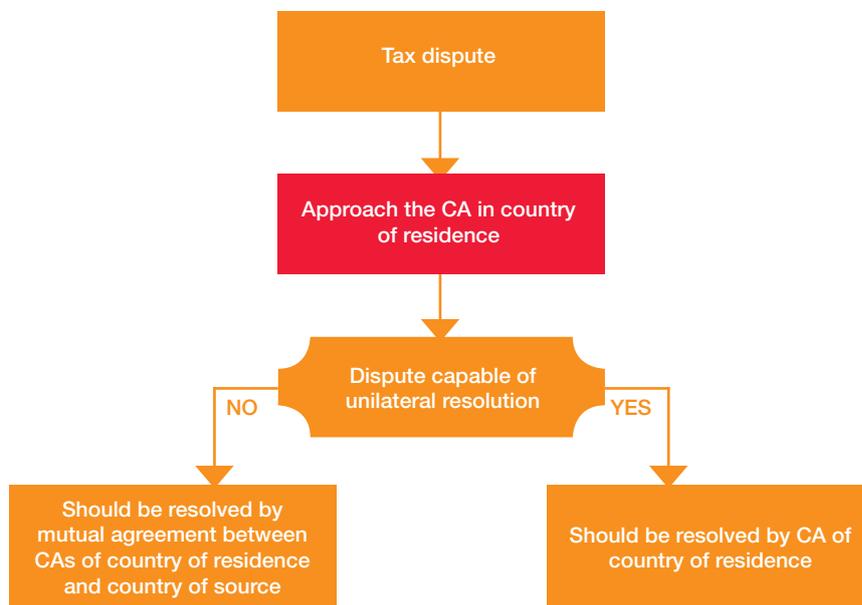
- The present functioning of the AAR has often been criticised for inordinate delays and inconsistency in decisions.
- There are delayed appointments of the chairman or member(s) of the AAR.
- The AAR is not mandated to give out 'public rulings', thus significantly limiting its utility and precedence value of rulings pronounced.

### 1.3.4 Mutual Agreement Procedure

Most of the tax treaties that India has entered into with various countries, contain special provisions relating to MAP for eliminating double taxation and resolving conflicts of interpretation of the provisions of the tax treaty. The MAP article within the tax treaty allows the competent authority (CA) in governments of the contracting states to interact with the intent to resolve tax disputes between a resident of a contracting state and the government of the other contracting state.

Under this scheme, the taxpayer is entitled to approach the CA of their country of residence to invoke a MAP. Thereafter, CAs of both the jurisdictions convene a meeting (without the taxpayer's presence) and try to resolve the dispute through mutual agreement. Based on the MAP resolution, the taxpayer has an option to accept the agreement reached by the CAs, or decline it, and continue litigating as per the remedies available under the domestic law. Provisions relating to the MAP in most tax treaties do not compel CAs to reach an agreement and only oblige them to use their best endeavors to resolve the disputes either unilaterally or bilaterally. The MAP route can be pursued by taxpayers simultaneously with the domestic dispute resolution process. Further, it is pertinent to note that the MAP is applicable to a specific taxpayer. The details of resolutions reached are not available within the public domain and cannot be used as a precedent by other taxpayers. Within the Indian scenario, most MAP cases are with the US, the UK, Japan and a few other European countries.

### Mutual Agreement Procedure



The disadvantages of MAP are that there are no prescribed time lines for conclusion of the proceedings. The entire exercise is carried out by the CAs without any participation by taxpayer. The taxpayer's involvement is only at the discretion of the CA. There is no surety that there is going to be a resolution. Thus, proceedings can end in a deadlock. Resolution under the MAP is only for issues raised for a particular year. Hence, repetitive procedure is required for subsequent years. Further, stay of demand is only possible in case of the US, the UK and Denmark (under the tax treaty entered into by India with those countries).

It has also been felt<sup>8</sup> that the other limitations of the MAP include the following:

- Bureaucratic overhang comes in the way of successful negotiation of MAP outcomes between the CAs of the two negotiating countries.
- The present MAP is not sufficiently transparent. Record of discussions in the MAP is not made public.
- Another limitation that constrains the success of the MAP process is the time limit prescribed in Article 25 of the model convention (that is, three years) for invoking the MAP remedy.

### Time limit for invoking MAP remedy in Indian tax treaties.

Indian Tax Treaty with	Time limit
Brazil	Within five years of the date of receipt of notice of the action
Australia	Within three years from the first notification of the action giving rise to taxation not in accordance with treaty
US	Within three years of the date of receipt of notice of the action
Italy	Within two years from the date of the assessment or of the withholding of tax at the source, whichever is the later
Canada	Within two years from the first notification of the action
UK	No time limit prescribed in the tax treaty

### 1.3.5 Advance Pricing Agreement mechanism

APA is an agreement between a taxpayer and a taxing authority on an appropriate TP methodology for a set of transactions over a fixed period of time in the future. The APA process is divided into four distinct phases: pre-filing meeting, filing of the APA application, preliminary processing of the APA application and negotiation and finalisation. The APA regime was introduced in 2012 with

a view to reducing TP litigation. The regime has been designed to embrace global best practices and is intended to provide the much needed certainty to multinational enterprises operating in India. APA mechanism has seen a surge in applications filed by taxpayers. According to media reports, close to 400 APA applications have been filed so far, with an overwhelming response in the second round in March 2014 and till date, agreements have been reached in five cases. Details of these are not publicly available.

### The APA process



The APA shall be valid for such tax years as specified within the agreement, which in no case shall exceed five consecutive tax years. In the Finance Act, 2014, a provision has been made to 'roll back' the APA and make it applicable to up to four past years. The APA shall be binding only on the person and the CIT (including income tax authorities subordinate to him or her) in respect of the transaction, in relation to which the agreement has been entered into. The APA shall not be binding if there is any change in law or facts having a bearing on such an APA.

A set of preliminary guidelines released by the CBDT reveals multiple approaches to the APA programme, that is, unilateral, bilateral and multilateral. APAs can be executed for a continuing international transaction, or for a proposed international transaction. The outcome of a signed APA is binding on the taxpayer and the revenue authorities. The taxpayer, however, has the option of withdrawing from the process before the APA is executed.

The APA mechanism is still at a nascent stage and its implementation is yet to be tested in the Indian context.



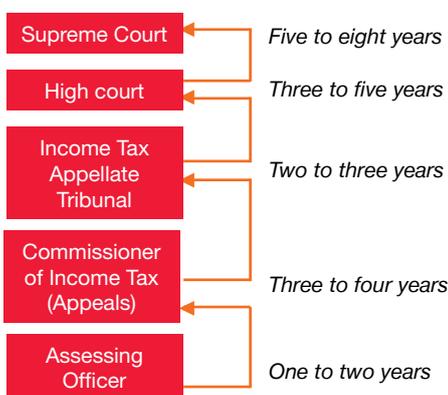
### 1.3.6. Overview of ADR forums in India

Particulars	DRP	ITSC	AAR	MAP	APA
<b>Who can approach</b>	<ul style="list-style-type: none"> <li>Cases where TP adjustment is proposed</li> <li>Foreign companies</li> </ul>	Any taxpayer	Any taxpayer (effective 1 October 2014)	Any taxpayer who feels that it has not been taxed in accordance with the relevant tax treaty	Any taxpayer
<b>When</b>	Variation proposed by the AO not acceptable	Case is pending and the taxpayer wants to disclose the income not disclosed earlier before the tax officer	<ul style="list-style-type: none"> <li>Determination of tax liability in case of transaction undertaken or proposed to be undertaken</li> <li>Determination as to whether an agreement is an impermissible avoidance agreement</li> </ul>	Taxation is not in accordance with the provisions of the concerned tax treaty	Taxpayer wants to enter into an international transaction, needs to firm up arm's length price or manner in which ALP is to be determined
<b>Restriction on the number of times a taxpayer can approach</b>	For all draft assessment orders	One time	No restriction	No restriction	No restriction
<b>Personal hearing to the taxpayer</b>	Provided	Provided	Provided	Not provided	Provided
<b>Time limit for issuing an order or a direction</b>	Nine months	18 months	18 months	No prescribed time lines	No prescribed time lines
<b>Finality of the verdict</b>	<ul style="list-style-type: none"> <li>Direction binding on the AO</li> <li>Appeal for the order passed by the AO after taking into account that DRP directions lies with the ITAT. Both the taxpayer as well as the tax department can appeal</li> </ul>	Order is final and binding on the taxpayer and the revenue department. However, writ petitions can be filed by any of the parties before the high courts	Binding on the revenue and on the taxpayer in respect of the particular issue on which ruling requested. However, both the revenue and the taxpayer can approach the high court to seek a constitutional remedy	Binding on the taxpayer and the revenue only if the taxpayer gives his or her acceptance to the results of the MAP process	Signed APA is binding on the taxpayer and the revenue

## 1.4 Time taken to decide cases

Unprecedented increase in litigation and backlog of cases have resulted in long delays in the administration of justice. In the Budget 2014-15 speech, Finance Minister Arun Jaitley had said that a tax demand of more than USD 65 billion is under dispute and litigation before various Courts and Appellate authorities.

Increasing backlog of cases at all levels indicates the inadequacy of legal apparatus in India, and the need for reform in dispute resolution. The dispute resolution infrastructure is characterised by inadequate number of courts, benches and judges, inordinate delay in filling up vacancies and low judges-to-population ratio (14 per million<sup>9</sup>). Almost 25% of vacancies for the posts of judges are attributable to procedural delays<sup>10</sup>. The approximate time taken at each appellate level is as follows:<sup>11</sup>



Thus dispute arising at the assessment stage may take between 12 and 20 years before it attains finality at the Supreme Court level. However, in recent times, even this has not been seen as final, because of many instances of retrospective amendments which undo the impact of a court decision.

Recognising the need for an emerging economy to have a tax system that would reflect best global practices, the government has set up a Tax Administration Reform Commission (TARC) under the chairmanship of Dr Parthasarathi Shome. The TARC would review the application of tax policies as well as tax laws, and recommend measures to strengthen the capacity of India's tax system. It would work as an advisory body to the Ministry of Finance. It has a 12-point agenda spanning issues from improving human resource practices of the tax administration teams to deepening and widening the tax and taxpayer bases.

The TARC submitted its first report titled 'Tax Administration Reforms in India-Spirit, Purpose and Empowerment' dated 30 May 2014 which has highlighted the following as some of the main causes of long drawn litigations between taxpayers and the tax administration in India:

- The Ministry of Finance is responsible for making and amending laws on direct taxes and indirect taxes. The two boards issue notifications or

circulars on a need basis to supplement the primary legislation. This often leads to ambiguity and inconsistency in its application. In the absence of clear administrative guidelines in the context of such interpretative issues, tax officers inherently have to exercise their individual discretion in addressing matters.

- Lack of stakeholder participation at the time of law making and legal drafting.
- Provisions are capable of multiple interpretations.
- The absence of a reliable economic model capable of making meaningful revenue projections, budget revenue targets are set in the most rudimentary fashion and, subsequently, not revised to reflect the changing performance of the economy. Consequently, there is immense pressure on the tax administration to collect revenue.
- There is neither an articulated strategy nor a cohesive and structured approach that aims to reduce disputes to the minimum and enhance the confidence of taxpayers by improving the quality of decisions.
- Most of the retrospective amendments have been introduced to counter interpretation in favour of the taxpayer upheld earlier by the judiciary. An overnight change in the interpretation of a provision, which earlier held ground for decades, provides scope for tax officials to rake up settled positions.

### Statistics relating to tax litigation at various levels

Direct Tax	FY 2011-12		FY 2012-13		FY 2013-14	
	Pendency as on 1 April 2011	Appeals instituted during the FY	Pendency as on 1 April 2012	Appeals instituted during the FY	Pendency as on 1 April 2013	Appeals instituted during the FY (upto December 2013)
ITAT	30,999	20,865	31,299	21,993	31,914	16,131
High Court	34,812	5,720	29,129	6,725	31,844	5,867
Supreme Court	5,740	1,202	5,844	868	5,865	524

Source: Ministry of Finance, Department of Revenue, Annual Report 2013-14

9. 'Managing Tax Disputes in India – Key Concepts and Practical insights', 2013, 1st Ed, published by Lexis Nexis- Butterworths and BMR Advisors  
10. *ibid*

11. In certain jurisdictions, the time taken for deciding appeals has been observed as follows:

- By the CIT (A): Six to eight years
- By the high court: Eight to 10 years

# CBDT circulars and instructions

The CBDT functioning as part of the Department of Revenue under the Ministry of Finance has the responsibility to administer the income tax law in India. It executes this responsibility, inter alia, through instructions and circulars for the guidance of income-tax authorities. Apart from administrative guidance, the CBDT regularly provides guidance on interpretation of the provisions of law. Such interpretations are binding on the income-tax authorities. This means, that such an interpretation may not be accepted by a taxpayer, who then disputes it. Such a dispute can be resolved not before the level of the ITAT, since the DRP and the CIT(A) function under the administrative control of the CBDT, and cannot go against CBDT's direction. The ITAT, on the other hand, functioning under the Ministry of Law and Justice, may decide a case even going against a CBDT circular. High courts and the Supreme Court are also not bound by a CBDT circular. A CBDT circular is supposed to explain the law, but cannot go against the law, and neither can it establish a new law. However it may tone down the rigour of the law<sup>12</sup>.

Over the years, several CBDT circulars have played a stellar role in objectively clarifying the law, bringing about the much needed certainty in tax administration<sup>13</sup>.

Recently, as an administrative measure, the CBDT in its instruction<sup>14</sup> issued to all the Chief Commissioners of income-tax (CCIT), took cognisance of the tardy and slow progress in the disposal of appeals by the CIT(A) across the country. The CBDT noted that the nationwide disposal of appeals was an average of 312 per CIT(A) for the year 2011-12. At the relevant point of time, there were approximately 244 officers discharging the role of the CIT(A).

Some of the significant instructions and circulars aimed at reducing litigations are as follows:

- **CBDT instruction no 05/2014 dated 10 July 2014**

The CBDT has issued its Instruction no. 05/2014 dated 10 July 2014,

revising the monetary limits for filing of appeals by the department before the ITAT, high courts as well as the Supreme Court. This instruction has been issued as part of the measures for reducing litigation. It will apply to cases of appeals filed on or after 10 July 2014. This instruction lays down that appeals shall not be filed in cases where the tax effect does not exceed the monetary limits given hereunder

Forum	Threshold (INR)
Before the ITAT	400,000
Under section 260A before the high court	10,00,000
Before the Supreme Court	25,00,000

It has also been clarified that an appeal should not be filed merely because the tax effect in a case exceeds the monetary limits prescribed above. Filing of appeal in such cases is to be decided on merits of the case.

**The term tax effect means:**

- Difference between the tax on the total income assessed and the tax that would have been chargeable, had such a total income been reduced by the amount of income in respect of the issues against which appeal is intended to be filed.
- Tax will not include any interest thereon, except where chargeability of interest itself is in dispute. In case the chargeability of interest is the issue under dispute, the amount of interest shall be the tax effect.
- In cases where the returned loss is reduced or assessed as income, the tax effect will include notional tax on disputed additions.
- In case of penalty orders, the tax effect will mean quantum of penalty deleted or reduced in the order to be appealed against.

The AO shall calculate the tax effect separately for each assessment year in respect of the disputed issues in the case of every taxpayer. If, in the case of a taxpayer, the disputed issues arise in more than one assessment year, appeal, can be filed in respect of such assessment year or years in which the tax effect in respect of the disputed issues exceeds the monetary limit specified. No appeal shall be filed in respect of an assessment year or years, in which the tax effect is less than the monetary limit specified. In other words, appeals can be filed only with reference to the tax effect in the relevant assessment year.

**Committee for indirect transfers**

The CBDT, vide an order dated 28 August 2014, has constituted a committee for approving the taking up for scrutiny, any past indirect transfer cases by AOs.

Where any AO considers that any income is deemed to accrue or arise in India before 1 April 2012 through the transfer of a capital asset situate in India, in consequence of the amendments introduced with retrospective effect then, before proceeding with any action in relation to the said income, the AO shall seek prior approval of the committee. This will be done if either of the following conditions are satisfied:

- No proceeding of assessment or reassessment in relation to the said income is pending
- No notice for proposed assessment or reassessment in relation to the said income has been issued
- No proceeding under section 201 of the Act (concerning deduction of tax at source) is pending, or no notice for initiation of such proceeding has been issued in relation to the said income

The committee will examine the proposed action of the AO and, after providing an opportunity to the taxpayer, take a decision on the proposed action. The AO shall thereafter proceed in accordance with the directions of the committee.

12. *JCIT v. Indian Steamship Co Ltd* : 129 Taxman (Mag) 158 (Kol)

13. Circular 23 of 1969, for instance, covering many aspects of international taxation has benefitted innumerable taxpayers over the years before it was withdrawn in 2009; Instruction No. 1829 of 1989 providing guidelines on taxability of non-residents engaged in execution of power projects on turnkey basis (withdrawn in 2009), etc.

14. CBDT instruction F no 279-M-73-2012-ITJ dated 25 October 2012

# Stay of demand proceedings

Currently, where an AO passes a draft order, the taxpayer may approach the DRP, who then must decide on the draft order within nine months. Thereafter, the AO passes the final assessment order within a period of one month. This 10 month period is a respite from paying the demand since no demand can be enforced on the basis of the draft order. On the other hand, if the taxpayer accepts the assessment order as a final order, the demand arising pursuant thereto must be paid within 30 days, unless he or she applies for a stay of demand, till disposal of appeal and the AO grants it. However, the legal provision for a stay of demand is shrouded in controversy. AOs are not disposed to granting stay. Though the CIT(A) has the plenary power to grant a stay, in practice, such power is seldom exercised. As a result, the taxpayer has to take recourse to the stay of demand petition before the ITAT. The ITAT can grant stay of demand for a maximum period of six months, and may extend the same by further period of six months provided that the delay in disposal of the case is not attributable to any fault of the taxpayer. However, in 2008 a provision has been introduced limiting the power of the ITAT to grant stay for a maximum period of three hundred sixty five days even though the default is not attributed to the taxpayer.

Filing the writ application is also a method available to taxpayers to seek stay of recovery of demand. But this is a constitutional provision where the taxpayer must prove the violation of his fundamental right before the high court will grant a stay. This is by no means easy.

Under the MAP, with certain countries there is provision for a stay of demand based on bank guarantee to be furnished by the taxpayer.

Though there is no legal provision for any minimum payment before applying for stay of demand, in practice, most authorities (whether AO, the ITAT or courts) insist on the payment of certain percentages of the demand upfront, which may vary between 10 and 50%. Often, the entire demand is asked to be liquidated in a staggered manner. Insistence on payment of demand or even a part of the total demand before deciding the appeal, causes burden on the cash flow of the taxpayer and renders the appeal nugatory to that extent.



# Dispute resolution mechanisms under the Civil Procedure Code

Five ADR processes are provided for within the Civil Procedure Code, 1908, in India: arbitration, conciliation, mediation, negotiation and settlement. In addition, under the corporate and tax laws some offences can be settled by compounding. Arbitration and conciliation have been spoken of in the recent Vodafone dispute, and in a few other high-profile disputes, but nothing of note has transpired.

Several common law countries at most follow arbitration and conciliation in civil (non-revenue) disputes. Mediation and negotiation are not the preferred ADR routes, since they are voluntary, and result in non-binding outcomes.

### ADR processes

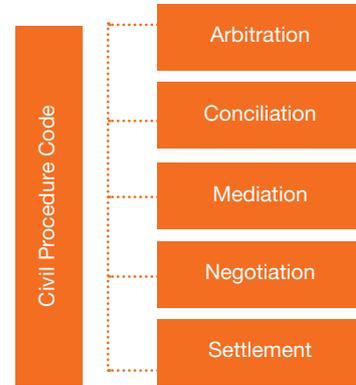
- Arbitration**  
Arbitration is an adjudicatory process where a decision is reached by a neutral third-party arbitrator(s). Once a dispute is referred to arbitration, it is normally not referred back to the court by the parties involved, unless the process fails. The arbitration award is binding on the two parties and is enforceable as a decree delivered by a court. Arbitration awards derive their legal enforceability from the Arbitration Act.
- Conciliation or mediation**  
Conciliation, another ADR mechanism, is non-adjudicatory in nature. The parties can attempt conciliation on the invitation of one of the parties.

In contrast to arbitration, disputes referred to conciliation do not go out of the domain of the court process permanently. If there is no amicable settlement, the matter could revert to the court, which would proceed with the trial after framing issues. But if the matter is settled through conciliation, the settlement agreement will have the same status and effect as if it were an arbitral award and be enforceable as a decree of the court.

In the case of conciliation, if followed in tax dispute, the taxpayer as well as the tax administration would agree, a priori, on the terms of settlement, whereas in arbitration, the two parties would have almost no involvement in the process, and the decision is of the arbitrator(s). Thus, the arbitration process is akin to the judicial process without it being that formal and rigorous in legal detail. In conciliation, the conciliator makes recommendation(s) which help shape the settlement agreement, whereas in arbitration, the arbitrator(s) imposes a decision on the parties through an arbitral award. Thus, arbitration involves greater intervention while in conciliation, the conciliator merely assists the parties in building a positive relationship.

It may be noted that arbitration is more time-consuming and an elaborate process as compared to conciliation. Both the processes, however, would need statutory backing in the respective tax laws on direct and indirect taxes. This would allow taxpayers to access conciliation and arbitration with the tax administration, and the consent of the tax administration would not be required. One option would be to have a separate chapter in the respective Acts providing for a statutory ADR. The US Internal Revenue Service (IRS) has a similar statutory ADR mechanism<sup>15</sup>.

- Negotiation**  
In negotiation, parties resolve disputes based on an a priori course of action to serve mutual interests. Negotiation is confidential in nature.
- Settlement**  
The settlement commission is a formal mechanism of settlement enshrined in the Act. This has been discussed in para 1.3.2.



15. Section 7123 of the IRC requires the IRS to prescribe procedures by which a taxpayer or the Office of Appeals may request non-binding mediation on any issue unresolved at the conclusion of appeals procedures, or unsuccessful attempts to enter into a closing agreement under section 7121 or a compromise under section 7122. Section 7123 also requires the IRS to establish a pilot programme by which a taxpayer and the Office of Appeals may jointly request binding arbitration for any issue unresolved under the same circumstances. The Arbitration Board Operating Guidelines have been notified. A public document explaining the arbitration process under the IRC explains concepts of fast track mediation, fast track settlement, mediation and early referral. All these are ADR means available under the US IRC. For a MAP case to go to an arbitration panel, the US tax treaties require that the relevant taxpayers agree to arbitration and the release of their information to the arbitrators. They also require that both the taxpayers as well as their authorised representatives make certain agreements regarding confidentiality of the arbitration process. Arbitration provisions exist in some tax treaties that the US has signed. For example, the US-Germany tax treaty has recently been modified to include mandatory arbitration in certain circumstances. The CAs of the US and Belgium have signed a Memorandum of Understanding to provide guidance under which the US-Belgian arbitration procedure will operate.

# Some of the litigated issues

### Indirect transfers

The Supreme Court, in the case of *Vodafone International Holding B.V.*<sup>16</sup>, held that the transfer by a non-resident to another non-resident shares of a foreign company holding an Indian subsidiary does not amount to transfer of a capital asset situated in India. Accordingly, gains arising from such a transfer were not taxable in India. To undo the effect of this decision, provisions relating to taxation of indirect transfers were inserted in the Act by the Finance Act, 2012 with retrospective effect. It was provided that shares of a foreign company would be deemed to be situated in India if the value of such shares is derived substantially from assets in India.

The government rationale for introducing these provisions is based on the doctrine that the source country has the taxation right on the gains derived from offshore transactions, where the value is attributable to the underlying assets in the source country. Recently, the government has also created a high-level committee to examine the cases where the AO proposes to tax indirect transfers.

The provisions, as currently worded, are still ambiguous on points such as what constitutes 'substantial', what proportion would be taxable in India, whether cost step up would be available, etc. The recent judgment in *Copal*<sup>17</sup> has provided some clarity on the threshold for constituting 'substantial'.

### Section 14A: Whether income is mandatory

Section 14A of the Act provides for disallowance of expenditure in relation to income not 'includible' in the total income. There has been a controversy as to whether disallowance can be made under section 14A even in those cases where no tax exempt income has been earned in a financial year.

The tax department is of the view that the legislative intent of section 14A is to allow only that expenditure which is relatable to the earning of income, and it therefore follows that the expenses which are relatable to earnings of exempt income

have to be considered for disallowance, irrespective of the fact whether any such income has been earned during the financial year. Their view is that the usage of the word 'includible' in the law also indicates that it is not necessary that the exempt income should also be included. The Allahabad, Gujarat, Punjab and Haryana high courts have of late taken a different view.

### Section 40(a)(ia): Whether covers only closing provisions

Section 40(a)(ia) of the Act provides for disallowance of expenses on which tax have not been deducted at the source. The wording of the section gives an impression that it should apply only to those expenses that remain payable and not to those that already stand paid. Some of the appellate authorities have decided according to this view. While others have decided and the revenue authorities always maintain that this provision would cover not only the amounts which are payable as at the year-end but also to all items of expenses on which there was default in deducting tax at source. Thus, their view supports that the term 'payable' would include 'amounts which are paid during the previous year'.

### Characterisation of payments for tax withholding

There has been extensive litigation on whether any payment made to a non-resident is taxable in totality or any proportion thereof needs to be taxed. Determination of the exact proportion to be taxed, has also posed problems for taxpayers. There have been disputes on the characterisation of a payment as business payments, royalty or fees for technical services, interest, other income and reimbursements.

### Gift of shares pursuant to corporate restructuring

Section 47 of the Act contains a list of transactions which are not subject to tax on capital gains. One of them is on

the transfer of a capital asset under a gift, will or an irrevocable trust. There has been litigation centred on whether the benefit of this exclusion extends to transfer of shares by a company without consideration. The debate is whether a company being an artificial entity can gift, gift being commonly understood to be associated with natural love and affection. The term 'gift' being not defined in the Act, what meaning then, should be assigned to it? Can the meaning in the erstwhile Gift Tax Act 1958 or Transfer of Property Act, 1882 be used? Would the TP provisions apply to such transfers? Effective 1 June 2010, section 56(2)(viiia) has been inserted in the Act, to tax partnership firms and closely-held companies when they receive shares of any closely-held company without consideration or for inadequate consideration.

### Taxation of royalty income

The taxation of royalty payment to the non-resident has been one of most litigated issues in India. There has been contradictory rulings as to whether the payment for software is a payment for copyright (and thus, is royalty in nature) or for a copyrighted article. Separately, there have been ruling favourable to the taxpayer on the issue of taxability of payment for satellite transponder charges and equipment royalty. Finance Act 2012 has introduced amendment with retrospective effect from 1 June 1976 to override such favourable rulings. Apart from justification for retrospective effect of these amendments, the taxability under the Tax Treaty remains an open-ended question. These matters are pending before the Supreme Court.

16. *Vodafone International Holdings v Union of India*, judgment dated 20 January 2012

17. *DIT v Copal Research Mauritius Ltd WP(C) 2033/2013*, High Court of Delhi

# Transfer pricing litigation in India

With increase in cross-border trade post liberalisation of the economy, TP has been an area of focus both for multinational enterprises (MNEs) and the Indian tax administration due to its direct linkage with revenue earning ability for both sides. A detailed TP regime was introduced in India more than a decade ago and since then the TP landscape has changed in many ways. The Indian TP regulation has its lineage from international guidelines issued by the Organisation for Economic Cooperation and Development (OECD) and other international guidelines on the matter.

The level of economic interest of both MNEs and tax administration in cross-border inter-company transactions, developing and growing phase of the economy and nascent TP regulations in India have led to increased tax controversies in the country. The business environment has seen tax controversies in TP moving up from computational errors in arithmetic margins, selection of the most appropriate TP methods, selection of comparables, internal versus external comparability and segmental versus entity level analysis to issues comprising of characterisation of the parties to the contract, selection of appropriate tested party, evaluation of functional, assets and risks analysis, marketing intangibles, management cross charges, royalty payments, intra-group services, location savings, benchmarking of financial instruments and its taxability from a TP perspective, issues of allowing taxpayers risk adjustments and attribution of profits to permanent establishments, etc.

India, in the recent past, has seen some of the largest tax controversies which have been closely monitored around the globe by MNEs, tax administrations, policymakers and international tax organisations. Later, this has also been followed by series of retrospective amendments which have created uncertainty in the minds of taxpayers. Half of the TP cases audited by the tax administration in India undergo TP adjustments each year.

Some of the currently litigated issues are discussed as follows:

- **Marketing intangibles:** The tax administration's view point on the issue is that Indian companies are overspending on marketing and brand promotion activities related to marketing intangibles owned by its overseas affiliates which warrant a reimbursement of such spent, which is over and above the bright line limit, and a mark-up on such expense as a compensation for this intra-group service being rendered by the Indian affiliate. The taxpayer's viewpoint inter-alia is that the nature of the spent and the conduct of Indian companies should be looked upon from a standpoint of each entity's characterisation (i.e. whether it is a limited risk distributor, risk bearing distributor, licensed manufacturer, etc.) and based on the functions performed, asset owned and risk borne by each taxpayer on a case-to-case basis instead of a bright line test being applied to all cases using a single yardstick for all taxpayers.
- **Management cross charges:** The tax authority at the field level has come down severely upon the issue of payment of management cross charges and disallowed these expenses as not being a tax expense, thereby determining the economic value to be nil. The plea of taxpayers, who have maintained robust documentation substantiating the receipt of benefit from such payments, and the commercial expediency to incur such expenses, has been largely disregarded at the initial level of audit scrutiny. Though we have seen some encouraging and positive rulings at the ITAT level, the issue remains at large and the onerous documentation requirements is leaving little room for a conducive tax environment for MNEs.
- **Compensation for captive service providers and development centres:** Service providers have been involved in the most protracted litigation with the tax administration especially at the initial level of audit proceedings. The first level of TP audit of taxpayers has seen disregard of entity characterisation of captive service providers, selection of entrepreneurial companies earning high margins as comparables, disallowing risk adjustments to the taxpayer in spite of comparability differences between entrepreneur entities for which data is available in the public databases vis-a-vis the risk mitigated taxpayer (i.e. the tested party). Circulars issued by the tax administration for contract R&D centres have imposed onerous documentation requirement to establish that such taxpayers do not perform economically significant people functions, do not bear economically significant risks and are not capable of deploying economically significant assets, including non-routine intangibles assets. India has seen large contract R&D centres facing high pitched litigation by applying profit-based TP methods.
- **Royalty payments:** Such payments have been widely questioned by tax authorities in India alleging no benefit to the Indian affiliate, adopting different methodologies to value the technology rights and the brand name and questioning the need for making such payment on a year-on-year basis. This scrutiny has increased many-folds, especially post the discontinuance of automatic approvals under foreign exchange rules for making royalty payments. Such payments have been largely targeted to arrest any excessive foreign remittance through such a mode. Taxpayers subject to scrutiny of royalty payments include but are not limited to technology-intensive companies in the telecom, automobile and IT sector.

- **Share valuation:** This controversy was first brought up in India in a case where the tax administration alleged that an Indian company (I.Co.) had undervalued the shares at the time of its issuance. The amount attributable to the value by which shares were underpriced was re-characterised as a loan granted by I.Co. to a foreign company (F.Co.) and a secondary adjustment was made imputing interest income as a receivable in the hands of I.Co. This high-pitched assessment has been in the news around the globe and is being astutely opposed by taxpayers, especially questioning the jurisdiction of tax administration to re-characterise the under valuation of shares as a loan and imputing notional interest thereon as a secondary adjustment in absence of specific provisions to bring such transactions within the tax net of the Act.

The introduction of applicability of TP to specified domestic transactions and compliances under the New Companies Act will only increase the rigour of tax compliances and litigation in India.

All such controversies and the huge stakes involved therein have also brought along a more matured tax litigation regime with the introduction of DRP mechanism, APAs, Safe Harbor Provisions, faster disposal by higher appellate bodies. In current times DRP is taking a more considerate view, especially after revenue being extended the right to appeal against findings of the DRP.

Taxpayers are now looking forward to opening up of discussions between India and US CAs which will expedite the negotiation process not only between these two countries, but will also set the tone for pending CA discussions on MAP and bilateral applications pending under APA regime. There is also hope that bilateral treaties between India and several countries are also amended to introduce Article 9 (2) similar to India-US tax treaty and enable them resolve disputes through ADR mechanism.

To conclude, the changing times of TP litigation in India have given several options to taxpayers to minimise their tax issues and help businesses focus on their core areas of doing business in India.

### **Bombay High Court decision in Vodafone exempting share premium from taxability**

Vodafone India Services Pvt. Ltd. ('Vodafone India') issued 289,224 equity shares to its foreign holding company at a price of Rs. 8,519 per share. This value was derived according to the methodology provided in Capital Issues (Control) Act,

1947. The Revenue authorities held that Vodafone India ought to have issued shares at a price of Rs. 53,775, worked out according to the Net Asset Value method taking Vodafone India's audited balance sheet as on 31 March 2008 as base and adjusting thereto for transfer pricing additions made in Vodafone India's assessment. The shortfall in premium to the extent of Rs. 45,256 per share was considered as deemed loan advanced by Vodafone India to its foreign holding company. This was added to Vodafone India's income. Interest on the deemed loan amounting to Rs. 883 million was also added to Vodafone India's income. Vodafone India filed writ petition in the High Court of Bombay.

The logic of the Transfer Pricing Officer in assessing as above was the following;

1. Issue of shares to foreign holding company is an international transaction under the law. Capital financing and business restructuring are specifically covered in the definition of international transaction. The fact that the transaction is reported in Vodafone India's Accountant's Report further supports the contention.
2. By issuing shares to holding company at lower premium Vodafone India subsidised the price payable by the holding company. The subsidy is a loan extended by Vodafone India to its holding company and such loan would have bearing on the profit of Vodafone India in terms of interest.
3. Transfer Pricing provisions constitute a separate code by themselves. The effect of this is that even if not specifically included in the definition of income, capital account transaction such as share issue could constitute income. These provisions also constitute the charging provisions under which the hidden benefit in a transaction can be brought to tax.
4. Foregoing of premium amounts to extinguishment/ relinquishment of right to receive fair market value and therefore amounts to 'transfer' as defined in the income tax law.
5. Not receiving arm's length price on issue of shares resulted in lesser premium being garnered, which, in turn, results in less liquid funds being available for reducing debts or for investment in business. The amount not received could have enhanced its potential income. Therefore, the share premium foregone has impacted potential income.

Vodafone India rebutted with the following arguments:

1. Transfer pricing provisions are anti-avoidance measures. The essential condition for invocation of transfer

pricing rules is that there must be income arising in an international transaction. Issue of shares is not a transaction where income arises; hence it is not a situation where transfer pricing provision can be invoked.

2. The word 'income' has to be understood as defined in the law; capital account receipts cannot be considered as income unless it falls in the purview of capital gain, for which, an essential condition is 'transfer' of property. Issue of shares is creation of property, not transfer of property.
3. If share premium allegedly not charged can be brought to tax as income it does not explain why share premium actually charged has not been brought to tax.
4. The assumption that share premium allegedly foregone would have been invested in the business to yield returns is not a relevant consideration. No tax can be levied on the basis of guesswork, assumption or conjecture.
5. The law in fact provides that share subscription received in excess of fair market value is 'income'. It does not provide that what is not received is also income.

The High Court of Bombay found merit in Vodafone India's arguments and allowed the writ.

The crux of the High Court judgment is the following;

1. Transfer pricing rules are machinery provisions to arrive at the arm's length price of a transaction between associated enterprises. These rules do not enhance the scope of the substantive charging provisions, which are constituted of sections 4 (basis of charge), 5 (scope of total income), 15 (Salaries), 22 (Income from House Property), 28 (Profits and Gains of Business), 45 (Capital Gain) and 56 (Income from Other Sources). Income arising from international transactions between associated enterprises must satisfy the test of income under the law and must find its home in one of the above heads, i.e. charging provisions. Issue of shares fails to qualify in this test.
2. Transfer pricing is not about taxing notional income. The entire exercise of determining the arm's length price is only to arrive at the real income earned; the correct price of the transaction, shorn of the price arrived at between the parties on account of their relationship (as associated enterprises). Share issue at premium does not give rise to any real income, so as to be subject to transfer pricing.

# Some novel legal doctrines

### Legitimate expectation

According to this doctrine, a person may have a legitimate expectation of being treated in a certain way by an administrative authority even though he or she has no legal right in private law to receive such a treatment. Such expectation may arise from a promise or from the existence of a regular practice, which the applicant can reasonably expect to continue and be adopted in his or her case also.

However, a person who bases his or her claim on the doctrine of legitimate expectation, in the first instance, has to satisfy that he or she has relied on the said representation, and the denial of that expectation has worked to his or her detriment. If his or her expectations are belied, the court or tribunal may intervene and protect him or her by applying principles that are analogous to the principles of natural justice and fair play in action. In such cases, the court may not insist on the administrative authority acting judicially, but may still insist that it acts fairly.

All the same, the doctrine is not of universal application under all circumstances and where there exists overriding considerations on the grounds of public interest. In such cases, the court will be justified in refusing relief though the doctrine is found applicable to the case and the applicant has been put to hardship on account of breach of the doctrine. Following this principle, courts in India have refused to give relief, even in cases where the doctrine was applicable: on the ground that the security of the state was involved or that the doctrine cannot override legislative power or that public interest required that no relief be given to the complainant.

### Promissory estoppel

As per the principle of the promissory estoppel, where one party has by his or her word or conduct made to the other party a clear and unequivocal promise or representation, which is intended to create legal relations or affect a legal relationship to arise in the future, knowing or intending that it would be acted upon by the other party, and it is in fact so acted

upon by the other party, the promise or representation would be binding on the party making it, and he or she will not be entitled to go back upon it, if it would be inequitable to allow him or her to do so, having regard to the dealings which have taken place between the parties.

The objective of this doctrine is to avoid or prevent a detriment to the party asserting the estoppel by compelling the opposite party to adhere to the assumption upon which the former acted or abstained from acting. This principle has been evolved on the principles of equity.

In the Indian context, the government cannot claim immunity from the doctrine of promissory estoppel. However, if it can be shown by the government that having regard to the facts as they have transpired, it would be inequitable to hold the government or public authority to the promise made by it, the court would not raise an equity in favour of the promisee

and enforce the promise against the government. The doctrine of promissory estoppel will be displaced in such a case, because on the facts, equity would not require that the government should be held bound by the promise made by it. But the government must be able to show that in view of the facts as have transpired; public interest would not be prejudiced.

### Prospective overruling

The doctrine of prospective overruling originated in the US. This doctrine aims at overruling a precedent without causing a retrospective effect. The objective being to avoid reopening of settled issues and also prevent multiplicity of proceedings. This in nutshell means that all actions prior to the declaration do not stand invalidated. Traditionally in India, when a precedent is overruled, the overruling operates retroactively. This is based on the premise that law is deemed to have been always



so from the beginning. In a case of prospective overruling, when a precedent is overruled the new decision is kept totally prospective. Court may also specify the date when the declaration shall come into effect thereby not disturbing the decisions taken before such a date. This ensures that there is a smooth transition. In India, the doctrine of prospective overruling was for the first time adopted in the *Golaknath* case<sup>18</sup> where it was held that it can be applied only by highest court of the country, that is, the Supreme Court since it has the constitutional jurisdiction to declare law binding on all courts in India.

### **Plea bargaining**

Plea bargaining is a concept that originated in the US and is known as 'non-contendere' which means 'I do not wish to contend'. It is a plea where the defendant neither admits nor disputes a charge. It serves as an alternative to a pleading of guilty or not guilty.

In India, plea bargaining has been introduced by the Criminal Law Amendment Act, 2005. A new chapter XXI A on plea bargaining was introduced in the Criminal Procedure Code, 1973. Broadly it involves pre-trial negotiations between the accused and the prosecution,

where the accused pleads guilty in exchange for certain concessions by the prosecution<sup>19</sup>. This typically includes negotiations either to reduce sentence or seriousness of charge.

In India, plea bargaining is not available to an accused if he or she has been charged with offences punishable with death, life imprisonment or a term exceeding seven years, or the offence affects the social-economic condition of the country or has been committed against a woman, or a child below the age of 14 years. In the Indian context, it has been introduced as a means of disposing accumulated cases causing delay in justice and to address the problems of under trial prisoners.

### **Forum non conveniens**

Forum non conveniens is a Latin term which means 'a forum which is not convenient'. This concept originated in Scotland. This doctrine is employed when the court chosen by the plaintiff, that is, the party suing, is inconvenient for witnesses or poses an undue hardship on the defendants. It is mostly common law legal doctrine whereby courts may refuse to take jurisdiction over matters where there is a more appropriate forum available to the parties. It is a discretionary power of courts to refuse to hear a proceeding that has been brought before it. Courts will refuse to take

jurisdiction over matters where there is a more appropriate forum available to parties. Forum non conveniens applies between courts in different countries and between courts in different jurisdictions within the same country. Some of the factors that are taken into account by courts while deliberating on this issue are hardship to defendant, location of witness and evidence, cost of proceedings, state of related proceedings in other jurisdictions and the relative burdens on the court systems, etc. Perhaps the time has come in India to press into action some of these novel legal doctrines as part of a new approach to tide over the mounting litigation.



18. *I C Golaknath v State of Punjab* AIR 1967 SC 1643

19. In 2007, *Sakharam Bandekar* case became the first such case in India where the accused, *Sakharam Bandekar* requested lesser punishment in return for confessing to his crime (using plea bargaining). However, the court rejected his plea and accepted CBI's argument that the accused was facing serious charges of corruption. Finally, the court convicted *Bandekar* and sentenced him to three years imprisonment.

# Cooperative or collaborative model of tax administration

In international tax terminology, there is usage of the terms 'collaborative approach' or 'co-operative approach' of tax administration. This is currently being considered by many jurisdictions as the right approach to follow for improving the efficacy as well as efficiency of tax administration. For example, the recently published Base Erosion and Profit Shifting (BEPS) report of the OECD notes 'a clear trend in relationship between tax administrations and large businesses away from a purely adversarial model towards a more collaborative approach.'

It seems the 'collaborative or cooperative approach' is an essential ingredient of the 'non-adversarial tax administration'. The question is how does the 'non-adversarial' approach differ from the traditional 'adversarial' approach? The adversarial approach is all about each party (taxpayer and tax administration) acting in a sequence of action and reaction, where the tax administration questions and the taxpayer answers. As against this, the cooperative approach capitalises on the relationship between taxpayers and the revenue. At each step there is interaction, in a spirit of enquiry, between the taxpayer and the tax administration, with the objective that any major issue is agreed and closed beforehand within the legal parameters.

### The following are instances of the symbiotic relation between tax administration and taxpayers in other countries:<sup>20</sup>

#### Chile

At times of liquidity crisis, the revenue may modulate advance tax demands to closely approximate to the taxpayer's final tax liability. In countries such as Chile, advance tax payable is pegged to a percentage of the current year sales, with provision for downward adjustment if preceding year's sales were below certain threshold. Accelerating the issuance of refunds is an essential element of this programme.

#### Singapore

The financial crisis that hit east Asia in 1997 raised concerns in the Inland Revenue Authority of Singapore (IRAS) that the liquidity problem associated with the crisis could lead many companies to accumulate large amounts of tax arrears. Accordingly, the IRAS established a special programme to give eligible taxpayers extra time to pay their tax liabilities. The IRAS officials believe that the special debt programme helped improve taxpayers' perception of the fairness of the tax system, leading to better compliance.

#### Australia

The Australian Tax Office cash economy strategy provides for a balanced set of measures to improve compliance in the cash economy, including communication measures, incentives to encourage self-service, targeted assistance, strategic alliances with key industry associations to identify compliance problems arising from various factors such as ambiguous laws, complex forms and procedures, unreasonable time limits and develop working solutions. The revenue closely collaborates with software manufacturers so that accounting software packages comply with all tax obligations

#### New Zealand

The New Zealand Internal Revenue Department launched an industry partnership programme in February 2002 to implement a relationship-based approach to tax administration that would help SMEs in selected cash economy industries to comply with their tax obligations. Partnerships were formed with some 15 industries. It was seen for five partnership industries that the programme had raised tax return filing rates and lowered tax arrears in the industry groups.

#### South Africa

In January 2009, SARS and the Banking Association of South Africa signed an accord that establishes a framework for coordination between the parties in order to improve levels of tax compliance, discourage unlawful tax avoidance arrangement and enhance services.

These instances highlight that good tax administration has to be founded on a spirit and form of partnership between the taxpayer and the tax administrator.

# Litigation on tax deduction at source

The effort put in by the Government of India in maintaining a set-up to administer a system of tax deduction at source (TDS or withholding) and defending in the courts of law disputes arising out of the regime are perhaps without peer in any other country.

There is a law that provides payers should deduct tax at source and pay the same to government accounts within stipulated time frames. It also requires periodic filing of returns on the tax withheld. A separate wing in the tax administration deals with TDS. They periodically audit returns and any default is reprimanded by making the defaulter pay up the tax (or shortfall) that was not deducted, the interest thereon as well as the penalty. Also, in course of assessments, the AOs also contend that certain payments have been made without deducting tax and such payments are disallowed while computing the taxable income. The expenditure is allowed as a deduction only after the deductor pays the TDS to the government.

The law on TDS administration is fraught with uncertainty. While there is a seven-year limit for the administration to examine TDS defaults on payments to residents, there is no corresponding time limit with respect to payments to non-residents.

There is no clarity on the tax treatment of the amount of default that is made

good by the deductor. There is endless dispute over characterisation of payments, given that some payments are liable to TDS whereas some are not. For example, disputes abound on issues such as whether discount allowed to the dealer is in the nature of commission (commission is liable to TDS whereas discount is not). The dispute is more pronounced in payments to non-residents because several such payments apparently qualify for not being subject to TDS (whether due to absence of a permanent establishment for business payments, or characterisation difference between the Act and the tax treaties, etc).

Further, in case of payments to non-residents, even if the payee has paid the tax in its own assessment there is no provision to provide relief to the deductor, unless the deductor himself pays the tax to the government.

The provisions seem more stringent because TDS is merely a method of collecting tax from the person to whom the payment is being made. The deductor is merely acting as a collection agent for the government. Though for this service, the deductor does not receive any remuneration from the government but he does face serious consequences at the slightest default.

All these reasons make TDS a hotbed of litigation in India.



# Recommendations

### 10.1 General

#### Simplification in law

There is a need to have a fresh look at the existing Act. The Direct Taxes Code was proposed keeping this objective in mind. However, its controversial provisions overshadowed the entire exercise. The need of the hour is to examine the Act in detail and identify the provisions which have outlived their utility or are litigation prone. Appropriate steps, then need to be taken, to sort out these issues. Also, in general, the language of the Act needs to be simplified and made user friendly. There should be regular stakeholder consultations on the issues of tax disagreements and tax law changes.

Further, each rule, regulation and other tax policy measure such as exemptions should be reviewed periodically to see whether they remain relevant under the changed economic and business scenario. While drafting tax laws, it should be ensured that inputs from specialists in related fields such as economics, statistics and operation research are obtained. To minimise potential disputes, clear and lucid interpretative statements on contentious issues should be issued regularly.

#### Use of technology

The use of technology during tax audits by the department should be enhanced. Hearing in all tax cases by personal presence should be avoided. Notices from the department and the submissions of the taxpayer can all be issued/ filed electronically. The key documents required can also be furnished through e-mails, which will help significantly cut down costs both in terms of time and money.

The accounting software used by the taxpayer can be approved by the tax department. As an instance, currently during most audits the AOs demand reconciliation between the expenses incurred and tax withholding filings. Under most ERP systems used today, it is difficult to obtain such reconciliation. Use of this approved software will benefit both the revenue authorities and the taxpayer as the revenue will have realistic estimate of what may be demanded of taxpayers in terms of documents and information and taxpayers will also be prepared accordingly. This will also enable the tax department to develop standard audit software.

#### Special Cell for cross-border tax disputes

There needs to be a special facilitation cell within the tax department to deal with cross border tax disputes. It should help and guide the non-resident taxpayers in case of tax disputes and should help in speedy resolution of cross-border tax disputes. While resolving cross-border disputes apart from tax collection, the impact on trade and investment should also be factored in. This cell can have help desks in the major trade partner countries.

#### Tax department website

The tax department website should keep flagging the arrangements and areas where there are interpretational issues, where litigation is brewing or cases that are being examined in detail. This will give taxpayers an insight into existing areas of litigation so they can avoid, as far as possible, taking litigation prone positions in their tax returns. Clarifications and statements of intent should be issued by the tax department whenever they come across a new issue or anticipate it.

#### Stable tax laws

The government should aim at providing stable tax laws. The annual exercise of making changes in the tax laws during the budget exercise should be discontinued. Whenever need is felt to make a change, it should be done after stakeholder consultation.

Retrospective amendments should be avoided, in particular those carried out to nullify judgments that might have agreed to views taken by taxpayers.

#### Global best practices

There should be a separate cell within the tax department to study global trends and best practices on a regular basis. It should then come up with recommendations to ensure that India remains a tax-competitive jurisdiction.

#### Timelines

Disputes must be resolved within prescribed timelines. The law should also prescribe the consequences of not adhering to the timelines, i.e. the case in question will lapse in favour of the taxpayer.

#### Appeals by the department

Ordinarily, an appeal should not be filed against orders of CIT(A), except where the orders are *ex-facie* perverse.

On disposal of a case by the Supreme Court or a high court, if the judgment is accepted by the department, an instruction should be issued to all authorities to withdraw appeal in any pending cases around the same issue.

#### Co-ordinated audits

There should be close coordination between direct and indirect tax officers having jurisdiction on one taxpayer. Once information is provided to one officer, it should be used by the other as well. This will be possible with the use of information technology.

#### Use of ADR processes provided under the CPC

ADR processes provided for in the CPC 1908, in India i.e. arbitration, conciliation, mediation, negotiation and settlement should be extensively used for solving tax disputes.

#### Pre-consultation

An administrative pre-dispute consultation mechanism may be setup for resolving tax disputes at the pre-notice stage through an open discussion with the taxpayer. The taxpayer and the AO should be in a position to discuss their respective positions. An amicable resolution will be possible when a common view emerges on the facts and the legal position. At the conclusion of this process, a notice or draft assessment order can be issued only with respect to unresolved issues. The points on which agreement has been reached should not be contested any further by either party.

#### Inducting more CITs/CIT(A)s and judges in the system

Infusing more number of CITs/ CIT(A)s and judges in the system can help ease the burden of quasi-judicial and judicial bodies from the recent spike in the number of cases which have travelled to higher appellate authorities.



## 10.2 Existing dispute resolution structure

### Assessing officer

The audit notices issued by the tax department should be detailed and well thought through. Adequate quality checks should be carried out within the tax department before a notice is issued to the taxpayer.

AOs should be trained to adopt a taxpayer friendly approach during audits.

The current practice of raising demands irrespective of merits should be discontinued. The process of pre-dispute consultation before issuing a tax demand notice should be put into practice.

AOs should be provided adequate infrastructure support during audits. They should be provided regular trainings. There should be standardised procedures extensively using information technology.

Reassessment should be carried out only in the rarest cases. It should not become a norm. Any assessment proceedings involve costs for both taxpayer and tax department hence, the endeavour should be that assessment itself is done in a manner that there is no need felt

for reassessment at a later point of time. Reassessment should be limited to tax evasion cases only. Also, the tax threshold for taking up a case for reassessment should be kept sufficiently high to justify the costs involved in reopening the case.

### Commissioner of Income-tax (Appeals)

The law should be changed to provide that the power of remand by the CIT(A) can be exercised only where the CIT(A) wants to get an enquiry done by the AO and not in course of routine proceedings or on matters that are based on the interpretation of law. To ensure that CIT(A)s follow this strictly, it may be provided that the remand direction be issued by the CIT(A) after approval by the jurisdictional Chief CIT.

### Income-tax Appellate Tribunal

Officers should also be given specialised training before they can represent the department.

## 10.3 Alternate dispute forums

### Dispute resolution panel

The DRP in income tax should be made a full-time panel and additional panels should be setup.

### Settlement Commission

Any taxpayer, at any stage of dispute, should be able to file an application before the ITSC for resolution when a dispute arises. Taxpayers should not be subjected to the stipulation that they can avail this facility only once in their life. Instead, the facility should be available to them as a “loop-back” at any stage of a dispute including on withholding tax.

The ITSC should invariably use arbitration and mediation methods to settle disputes. After considering both sides, the ITSC should pass the settlement order in writing which should be final and conclusive.

At present, only four benches of the ITSC are operational. The government has promised to increase this number. To improve accountability, it will be appropriate that the ITSC is manned by serving officers of the rank of Chief Commissioners.

### Authority for Advance Rulings

It is imperative to ensure that the timeline for the AAR to provide its ruling is adhered to, otherwise the very purpose of its creation gets defeated.

In Budget 2014, the doors of the AAR have been thrown open to resident taxpayers as well, which is a welcome development. The present arrangement of only one bench of AAR at New Delhi limits its accessibility to taxpayers. Budget 2014 has announced that more benches will be set up in other cities.

## Mutual agreement procedure

There should be some timelines prescribed for concluding the MAP exercise. Further, taxpayers should also be provided an opportunity to be part of the discussions between the two CAs. India may look at entering into memorandum of understanding with countries apart from USA, UK and Denmark to provide automatic protection to taxpayers from demand of taxes and penalty. Show cause notices for withholding taxes should be considered for MAP.

## 10.4 Tax deduction at source

Although substantial work has been done by the government in terms of arrangement for online payment, electronic filing of returns, electronic capturing of tax withheld data, a lot more needs to be done in terms of smoothening the operation of the system. It may be clarified in the Act, that tax paid by the defaulting deductor under section 201 as well as the interest thereon under section 201(1A) should be allowed as deduction wherever they relate to revenue expenditures.

It should also be provided in law that if non-resident has paid tax on the income on which tax was not deducted, the same shall be allowed as deduction to the deductor.

## 10.5 Transfer Pricing

The government should look at introduction of risk-based assessment of tax payers instead of existing threshold based assessment. This is in line of some of the global best practices and shall help MNEs and tax administration focus on key areas.

Though there have been amendments to the TP regulations first introduced in 2001, it may be beneficial to include specific guidelines on some of the complex and more litigated issues like intangibles, cost contribution arrangements, economic adjustments, etc.

The Safe Harbor Rules may be modified to increase their applicability to a wider base of taxpayers. There is also room for introducing more elaborate definitions of certain terms used in these rules and to further develop these rules to ensure negligible overlap in classification of activities carried out by such taxpayers.

## 10.6 Gearing up for GAAR

Broadly, GAAR is a sophisticated tool that allows the tax authority to question an arrangement if it suspects that the arrangement is designed more for obtaining tax benefit than being a real business arrangement. If it is ultimately proved that the arrangement is primarily designed for obtaining the tax benefit, the taxpayer may be visited with severe consequences, which may include recharacterisation of the arrangement, disallowance of expenses, etc.

As the law stands now, the GAAR is set to take effect from 1 April 2015. The degree of preparedness that is required both on the taxpayers' side to face, and on tax administration's side to administer, the GAAR inquiry is missing in India. It has a long way to go before it achieves this preparedness. It is imperative that the GAAR be deferred further. It is reported<sup>21</sup> that the Government is likely to take a final call on the matter only by next budget session in February 2015.

21. *Hindustan Times*, 14 September 2014

# Indirect tax litigation in India

The basic structure of grievance redressal for indirect taxes is not very different from direct taxes. Interestingly, unlike direct taxes, indirect taxes are a subject matter that concerns both the central as well as the state governments. The Indian Constitution clearly lays down the ambit of legislative powers for levying tax on various subject matters i.e. goods and services. The scope of taxation is embodied in the seventh schedule to the Indian Constitution in the Union List, State List and the Concurrent List.

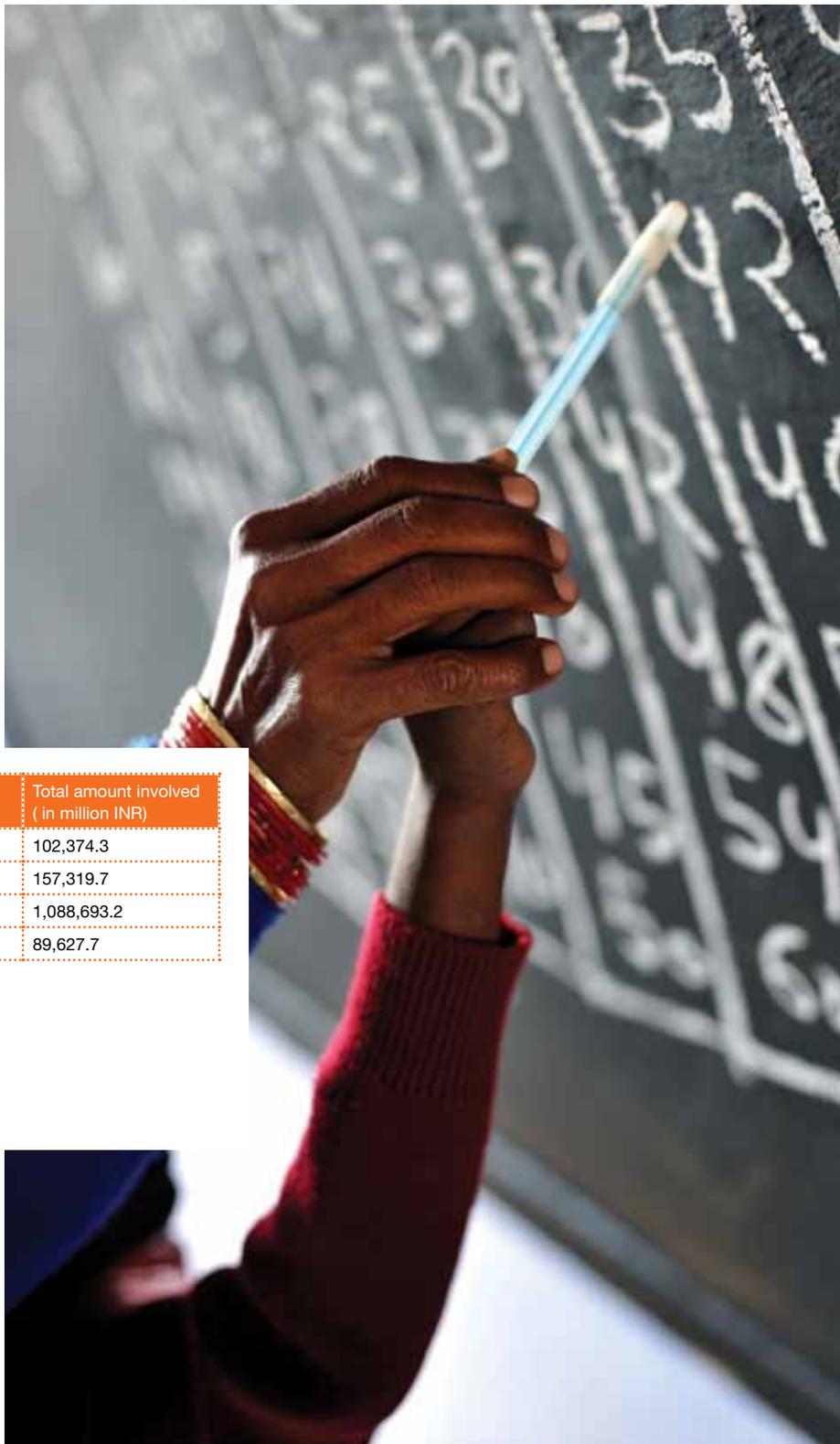
It is this demarcation in legislative powers that gives rise to numerous litigations under indirect tax laws. With constant developments in the field of indirect tax, the Comptroller and Auditor General (CAG) has expressed concerns over 1 lakh crore INR locked in pending excise and service tax litigations<sup>22</sup>.

Given the multi-layer litigation hierarchy enshrined in our laws, humongous amounts of funds are blocked in litigation. The table given below represents the number of indirect tax cases pending at various levels.

Indirect tax: Level at which case is pending, as on 31 December 2013	Total number of appeals pending	Total amount involved (in million INR)
Supreme Court	3,204	102,374.3
High court	14,515	157,319.7
CESTAT	67,575	1,088,693.2
Commissioner (Appeals)	35,432	89,627.7

Source: Annual Report 2013-14, Ministry of Finance (Budget Division)

To give an understanding of the levels and structure of litigation under various indirect tax legislations, we have divided the subject into central and state levies.



22. Page 17 of the report of the Comptroller and Auditor General of India for the year ended March 2013 [Union Government – Department of Revenue – (Indirect Taxes – Central Excise) (Compliance Audit) Report No. 8 of 2014]

## Existing structure

### 12.1 Central levies

Among the indirect taxes, customs, excise and service tax (together referred to as central tax laws<sup>23</sup>) are governed by the central government (i.e. levied, collected and administered by the central government). The hierarchy of the appellate authorities for central tax laws is similar and is represented in the diagram across.

#### Initiation of litigation

All central tax laws allow self-assessment to taxpayers i.e. each financial year is not mandatorily assessed by the tax authorities (another distinguishing factor from assessment procedure under the income-tax regime). Having said this, it is only pursuant to such inquiry; audit or an investigation that a tax position adopted by the taxpayer can be challenged by the authorities by way of a show cause notice (SCN).

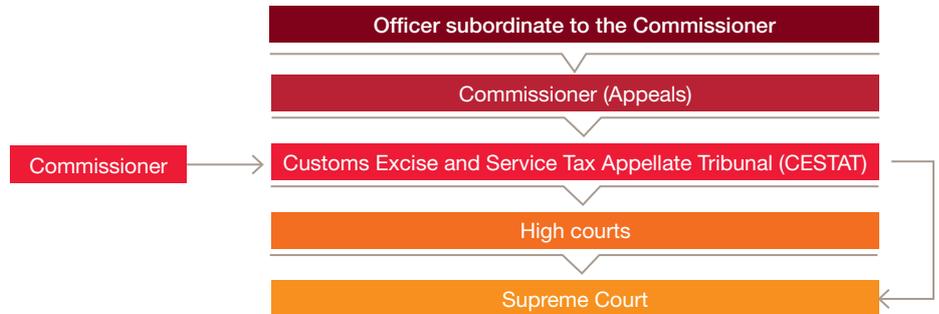
A SCN can generally be issued within 18 months from the relevant date<sup>24</sup> or a maximum of five years from the relevant date in case the authorities believe that the tax has not been paid due to fraudulent intentions, intention to evade tax etc. Complying with the principles of natural justice, the SCN gives the taxpayer an opportunity to justify why tax, interest and penalty (if applicable) should not be recovered.

SCN can be issued by any of the following officers:

- Assistant Commissioner/ Deputy Commissioner
- Commissioner/ Additional Commissioner

Depending on the submissions made by the taxpayer and the outcome of the personal hearing, the adjudicating order is passed by the concerned officer (*Order in Original*).

### Hierarchy of the appellate authorities for central tax laws<sup>25</sup>



#### Appeal to Commissioner Appeals/ CESTAT

While the appeal against the *Order in Original* passed by the Assistant Commissioner/ Deputy Commissioner lies to the Commissioner (Appeals), the appeal against the order of the Commissioner or the Additional Commissioner lies to the Customs, Excise and Service Tax Appellate Tribunal (CESTAT)<sup>26</sup>.

An appeal has to ordinarily be filed within the timelines specified from the date of receipt of the order. The timelines for appeal at various levels for central levies have been documented below:

Each jurisdiction/ Commissionerate has a Commissioner and a Commissioner (Appeals). However, the CESTAT benches are operational only in Delhi, Mumbai, Chennai, Bengaluru, Kolkata and Ahmedabad. Given the limited number of CESTAT benches currently operational in the country, the number of cases have accumulated significantly. Therefore, the central government has accepted the proposal for setting up 10 more Benches of CESTAT at Hyderabad, Chandigarh, Lucknow, Jaipur, Bhopal, Pune, Kochi, Patna, Ranchi and Bhubaneswar. The Delhi and Mumbai CESTATs are also expected to get an extra bench each.

Sr No	Order passed by	Appeal to	Time period
1	Officer subordinate to Commissioner	Commissioner (Appeals)	60 days
2	Commissioner	CESTAT	3 months
3	Commissioner (Appeals)	CESTAT	3 months
4	CESTAT	High court	180 days
5	CESTAT	Supreme Court	60 days
6	High court	Supreme Court	60 days

23. While Central Sales Tax Act, 1956 governing sales transaction between two states is a central legislation, given that the administration and collection is done by the state governments, we have discussed the same in the latter section on state levies.

24. For example, relevant date means the date of payment of tax, filing of return or the date on which tax should have been paid or return should have been filed. This is specifically defined in detail under the respective Central Tax Law.

25. An appeal can be filed to the CESTAT against the order of the Central Board of Excise and Customs. Further, the central government may refer a certain matter to the Commissioner (Appeals) as provided for in the legislation.

26. The Tribunal is a quasi-judicial body constituted in 1982 with an objective of deciding indirect tax appeals. The CESTAT was then called Custom Excise and Gold (Control) Appellate Tribunal ('CEGAT').

## Mandatory pre-deposit and hearing

Till very recently, an appeal filed against an order demanding tax, interest and penalty had to be accompanied by a stay application. The stay application was necessary to obtain a stay on recovery of the duty and penalty demanded. There were circulars providing that if a stay hearing would not be conducted within 30 days of filing the appeal recovery proceedings would be initiated. This had a great impact on pendency of matters before the appellate authorities. This resulted in the CESTAT primarily conducting stay hearings. To reduce the double burden on the CESTATs for deciding stay matters and then hearing on merits, the Union Budget 2014 introduced the mandatory payment of pre-deposit of the specified percentage of the duty demanded for filing appeals to CESTAT.

On submission of proof of payment of the pre-deposit along with the appeal, an automatic stay on the recovery of the rest of duty can be presumed. Now, the appellant will be directly granted a merit hearing. Therefore, stay has lost its importance in this context<sup>27</sup>.

## Disposal of cases

In the merit hearing, both the appellant and the respondent make detailed submissions to support their case. The appellate authority (Commissioner (Appeals) or CESTAT, as the case may be, analyses the submissions and their consonance with the relevant provisions of law. Depending on the interpretation of the appellate authority a decision is pronounced. The order is made in writing, stating the points of determination, the decision as well as reasons for the decision taken therein.

Any party aggrieved by the order can appeal to the next appellate authority (CESTAT or high court or Supreme Court, as the case may be).

## Some other important points

- It is important to note that the CESTAT is the final fact-finding body (an appeal cannot be made on the basis of the facts found by the Tribunal to the high court or the Supreme Court).
- An appeal can be preferred to the high court only for a substantial question of law.
- An appeal can be made directly to the Supreme Court against an order passed by the CESTAT for matters pertaining to classification or valuation of goods and services.
- A revision application can be filed with the central government, against an order of the Commissioner (Appeals).
- The CESTAT cannot admit a case beyond its monetary jurisdiction (a single member bench cannot entertain a case where the demand of tax or penalty involved is more than 50 lakh INR).

## 12.2 State levies

There are multiple taxes levied by state governments such as Value Added Tax, Entry Tax and State Excise Duty on manufacture of alcoholic beverages, etc. However, we have specifically discussed the litigation mechanism prescribed under the State Value Added Tax Legislations and CST.

The VAT/CST assessments are conducted year wise which is similar to the process followed under the Income-tax regime. CST assessment is conducted by the state sales tax officers, also referred to as VAT officers, following the same procedure of VAT assessments. Generally, the VAT and CST assessments for the same year are concluded simultaneously.

The VAT laws differ from state to state and are governed by state specific legislations. Currently, there are 34 VAT legislations in India (including the recent addition of the VAT legislation for Telangana). The dealer is required to provide the requisite data and necessary explanation to the assessing officer. The findings of the assessment are recorded in the assessment order along with the reasoning for the order and the amount of tax payable along with interest and penalty, if any.

The dealer may choose to accept the demand for reasons stated therein or contest the matter before the appellate authority. The hierarchy of adjudicating authorities depends on the designation of the assessing officer under the state specific legislation.

27. This does not apply to refund matters

The typical litigation structure for state levies has been mentioned in the table below<sup>28</sup>:

Sr No	Order passed by	Appeal to	Time period
1	Assessing authority	Deputy Commissioner/Joint Commissioner	60 days
2	Deputy Commissioner/ Joint Commissioner	Tribunal	60 days
3	Tribunal	High court	120 days
4	High court	Supreme Court	60 days

The limitation period to take up assessment varies from five to eight years from state to state. Limitation periods of such long durations only affirm the fact that litigation in India can take anywhere from 10-15 years to reach finality, optimistically.

The second appeal against the order passed by the Deputy Commissioner / Joint Commissioner lies to the Tribunal. Under some of the state legislations, not all orders are appealable.

The appellate authorities have the powers to confirm, reduce, enhance or cancel the assessment, remand the case (only with the Tribunal), make fresh assessment, confirm, cancel or modify the interest and penalty amount, grant stay, and determine the amount of pre-deposit.

### CST appellate mechanism for particular matters

Although the appellate mechanism for CST is the same as VAT in the state, for matters pertaining to stock transfers and consignment of goods in inter-state sale, the appellate hierarchy differs. Appeal for matters pertaining to the above mentioned transactions lies to the highest appellate authority, typically the Tribunal in the state (i.e., any authority/court established under the state sale tax law but excludes the High court) and then to Central Sales Tax Appellate Tribunal (CSTAT). The CSTAT was established to resolve dispute pertaining to inter-state sale transactions being taxed in more than one state. Before 1 March 2006 there was no mechanism to resolve such disputes and therefore, the Supreme Court suggested that a mechanism should be evolved to resolve such disputes.

An appeal should be filed before the Tribunal in the state within 60 days from the date of receipt of the order. After hearing the parties to the case, the tribunal should pass the order within six months of filing the appeal.

Appeal from the Tribunal in the state lies to the CSTAT. The appeal should be filed within 90 days from the date of receipt of the Tribunal order. After hearing the parties to the case, the order should be passed within six months of filing of the appeal.

The CSTAT enjoys all the powers given to a court under the Code of Civil Procedure, 1908. The CSTAT can also grant a stay on the order passed by the highest appellate authority in the state. Appeal from the CSTAT lies to the high court as applicable in the case of VAT.

### Supreme Court and high courts

The powers of the High Courts and the Supreme Court have already been discussed under para 1.2.5. and 1.2.6.

One of the most important powers granted in the Constitution to the high courts and the Supreme Court is the writ jurisdiction, which is a wide discretionary power. While the Supreme Court and high courts refrain from entertaining tax disputes to avoid superseding the authority and jurisdiction of the Tribunal and tax authorities. However, writs pertaining to matters involving interpretation of a question of law, failure to deliver justice, denial of fundamental right can be admitted. The procedure to file an appeal to the high courts and the Supreme Court remains the same as that for central levies.



28. This details mentioned in the table are only indicative, as the adjudication and appellate levels and the time prescribed for filing appeals differ from state to state (under the respective VAT legislations).

# Alternative dispute resolution mechanisms

The legislature under the indirect tax laws has given alternate mechanisms for settlement of disputes or obtaining clarity before a dispute arises. This section is dedicated to discuss these mechanisms.

### 13.1 Settlement Commission

The Settlement Commission was set up with an objective to settle tax disputes in a speedy and easy manner. Approaching the Settlement Commission is similar to an 'out of court' settlement for dues to avoid lengthy and costly litigation. An application to the Settlement Commission can only be made for central levies.

The eligibility of an application to the Settlement Commission will depend on the following factors:

- On the date of submission of the settlement application to the Settlement Commission, the matter should be pending before the adjudicating authority (i.e., the applicant should have received the SCN from the tax authorities but the order by the adjudicating authority should not be passed with respect to the issue raised in that SCN).
- The application should contain full and true disclosure of his liability, method of deriving the addition amount of tax liability accepted, periodic statutory returns and records filed and maintained by the applicant, the amount of additional tax liability accepted and paid by the applicant along with the other prescribed details.
- The additional liability accepted by the applicant should be above 3 lakh INR.
- In case where the dutiable goods, books of account or other documents are seized, the application should be made 180 days after the date of seizure.

Cases where a settlement application cannot be made:

- Cases pending before the CESTAT or any court
- Case involving a pure classification dispute

- Cases relating to offences of goods specifically notified (applicable to customs only)
- Remanded matters
- Matters pending decision by the Commissioner (Appeals) (as the same is not considered as the adjudicating authority)

#### Procedure

The Settlement Commission may serve a SCN for admission of the application, within seven days of filing the application. After considering the submission of the applicant, the Settlement Commission may pass an order either admitting or rejecting the application within 14 days of issuance of the SCN.

In cases where a SCN or order is not passed, the application is deemed to be accepted.

The Settlement Commission should pass an order within nine months of filing of an appeal, on the basis of the report submitted by the concerned officer, submission made by the applicant in writing and during the hearing and all other evidences put on record. The period of deciding the application can be extended for a period of three months for reasons recorded in writing.

If the Settlement Commission fails to pass an order within nine months or the extended period of filing the application, the matter shall be decided by the adjudicating authority before which the matter was pending before the application was made.

#### Powers of the Settlement Commission

The Settlement Commission is empowered to:

- Attach property of the applicant to recover the tax dues
- Re-open a case decided within five years of the date of the decision for applications filed before 1 June 2007
- Reduce the quantum of penalty imposed
- Grant immunity from prosecution under the relevant central levy provisions
- Refer the matter back to the adjudicating officer, where in the opinion of the Settlement

Commission, the applicant has not extended the required co-operation

It is also important to note that if the applicant has approached the Settlement Commission once, the applicant is not entitled to apply for settlement of any other matter.

### 13.2 Advance ruling/determination of disputed question

Advance ruling means determination of a question of law or a fact, as mentioned in the application submitted by the applicant regarding a transaction pertaining to the applicability of central tax laws. Similarly, there are provisions for advance ruling under most of the state sales tax legislations. Under the state legislations it is generally referred to as Determination of Disputed Question (DDQ). Therefore, the option of advance ruling is available under both central and state levies.

Advance Ruling helps the applicant to get some clarity with respect to the applicability of central and state levies in advance. An application can be made with respect to the following questions:

- Classification of goods and services
- Applicability of notification
- Admissibility of CENVAT credit or set-off
- Determination of assessable valuation
- Determination of the origin of goods in case of customs
- Determination of liability to pay duties of excise on any good

Admissibility of the matter is left to the discretion of the authority. Matters pending before an officer appointed under the Central or the State Tax Law, the Tribunal or any court as well as any matter decided by the Tribunal or any court cannot be admitted.

Typically, the authority has to pronounce its ruling within 90 days of filing the application. However, practically, to obtain an advance ruling order it could take upto one to two years.

An advance ruling obtained on misstatement of facts or by fraud can be declared void. Decision of the Advance

Ruling is binding only on the applicant and the tax authorities with respect to the particular question raised by the applicant. While the objective of introducing dispute resolution mechanisms like Advance Ruling was to reduce litigation, such forums are constituted of the members from the tax departments, who continue to have a pro-revenue approach. Therefore, these forums have failed to achieve the objectives behind setting them up.

Nonetheless, such mechanism has gained popularity with the multi-national companies as they are risk averse. Recently, an amendment was made to also include resident private limited companies to the list of eligible applicants.

### **13.3 Representations**

Indirect tax laws do not provide for filing representation with the central government or revenue departments. However, there has been a growing trend of trade bodies, industrial associations and conglomerates filing representations with the central government regarding industry specific indirect tax grievances such as high tax rates for a specific product, grant of exemption, clarity of interpretation of a particular clause, retrospective or prospective applicability of a particular provision, etc.

These representations have been received well by the central government, as we have observed that the Central Board of Excise and Customs (CBEC) has issued notifications and circulars in response to the representations made.

### **13.4 Goods and Service Tax**

With regular announcements regarding the efforts to introduce Goods and Service Tax (GST), there has been a lot of speculation around what will be the indirect tax litigation structure under the new regime. In the absence of draft legislation in the public domain, it is difficult to comment on how the litigation structure will change under the GST regime.



# Recommendations

Having discussed the shortcomings and the existing hurdles in the litigation machinery, some measures that have been taken to improve the current situation are as follows:

- The CBEC has proposed to set up additional CESTAT benches across India.
- The central government has introduced mandatory payment of pre-deposits to remove an extra level of litigation i.e. stay proceedings.
- Benefit of advance ruling has been extended to private companies.
- Online filing of service tax refund claims

The following provisions are desirable:

- Just as timelines have been prescribed to finalise assessments, to decide applications filed before the Settlement Commission etc. similarly, timelines should be prescribed to dispose cases at all levels of litigation. This will facilitate faster disposal of cases. The government can even explore prescribing consequences for not disposing off the cases within the prescribed time lines.
- There is a need to improve quality of assessments. The AOs should be trained to conduct assessments in a way that the fact finding is conclusive and final. This will reduce the frequency of cases being remanded back to the AOs by the higher appellate authorities like the CESTAT and High Court for *de novo* adjudication.
- The Government received a positive response on floating the Voluntary Compliance Encouragement Scheme (VCES) for service tax compliance. Such schemes are mutually beneficial to the taxpayers and the government

and can be introduced from time to time for compliances under various indirect tax legislations.

- There appears to be a lack of synergy within various departments of the tax authorities. For example, the anti-evasion and audit departments of service tax department conduct separate investigations for the same taxpayer. This results in duplication of work and wastage of time. The tax department should develop a database where the observations of the tax department are documented and can be referred to by all its units. This will reduce workload for both the taxpayer and the tax authorities.



## Experience of other countries

### Italy

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The Italian Revenue Agency (IRA) is normally entitled to deal with any kind of tax issues within its areas of competence in settlement procedures. There are no restraints in dealing with withholding tax matters.

As far as Advance Rulings are concerned, they may be issued as a reply to formal queries submitted to the IRA to obtain clarifications on the correct interpretation of a specified tax provision. A request for an advance ruling may be accepted only when clarification is sought with respect to a tax provision that satisfies the following:

- Interpretation is objectively uncertain
- Relates to the state (and not local) taxes
- Applied to a real (not hypothetical) and personal case

Among the different types of advance rulings, the interpretative ruling ('ordinary' ruling pursuant to article 11 of the Taxpayer Bill of Rights, law no 212/2000), can be filed by every taxpayer, resident or non-resident. The request should be backed by actual and personal facts. Objective uncertainty occurs in case of generic or no official interpretation available (circular letters, resolutions, etc.) that may be applied to the taxpayer's specific case.

The IRA is empowered to either notify a private letter ruling or pronounce a collective ruling pursuant to article 11(4) of the Taxpayer Bill of Rights. The latter is required to be promptly published on the website; therefore, it is a public ruling which provides all taxpayers with guidance on facts that fall within its scope.

The IRA is required to render its ruling within 120 days from the request, except for APAs (180 days, pursuant to article 8 of the Provision adopted by the Revenue Agency Director on 23 July 2004).

### Singapore

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#### Singapore Legal System (as it relates to tax appeals)



#### Key aspects

- There is a separate Individual Income Tax Division which is responsible for end to end administration of individual income tax. This includes serving taxpayers, assessing and collecting tax and ensuring compliance for all employees, self-employed, unincorporated businesses and non-resident individuals. This division also handles withholding tax administration for individual taxpayers. Similarly, there is a Corporate Tax Division responsible for the end-to end administration of income tax for companies, charities, bodies of persons; Betting Duty, Private Lotteries Duty, Casino Tax and Trust. This division also handles withholding tax administration besides serving taxpayers, assessing and collecting tax and ensuring compliance.
- Settlement of demand by tax authorities (AO): Demand raised by the AO is generally paid fully by the tax payers even if they challenge the order of AO in appeal. In certain cases, the AO has the discretion to stay the demand on the request of the tax payer.
- There is a separate department in the tax office called the Tax Policy and International Tax Division, which is responsible for providing technical advice in the formulation of tax policies and the fair application of tax laws. It reviews tax policies, initiates tax rules changes, and safeguards Singapore's economic interest through tax treaty negotiations and resolution of international tax issues.

- Another department known as the Law Division provides legal opinions on the application of tax laws, drafts legislations and other legal documents and represents the tax officers in legal proceedings.
- Draft legislature is vetted by the Attorney General Chambers. The Law Minister is appointed by the Prime Minister from the elected members of Parliament. The Supreme Court (comprising the Court of Appeal and the high court) functions as an independent judiciary and its judges are not under supervision of the Law Minister.
- Policy matters are decided by the Ministry of Finance in consultation with IRAS.
- Appointments, transfers and promotions in the tax department are decided internally within the tax authorities.
- The Commissioner is appointed by the government.
- Advance Ruling mechanism is also available. Rulings are not binding on tax payer but binding on the revenue. The tax payer can take different view in tax return but it has to mention the ruling of AAR in the return. Therefore litigation remains in such cases. Rulings are not publicized and are not appealable.
- APA can be unilateral or bilateral.
- Tax incentives are mainly sponsored by the different economic agencies.
- The legal system is similar to that in the UK.

## Australia

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### Introduction

- The tax disputes landscape in Australia is continually evolving due to a number of recent trends and focus areas. The current issues arising for Australian taxpayers stem from global developments such as the OECD focus on addressing BEPS issues, and a push towards global information sharing with the G20 promoting global tax transparency.
- Key recent trends in tax disputes include an increased focus to minimise the cost and impact of litigation through ADR mechanisms such as mediation, conciliation and early neutral evaluation to resolve matters. In recent times there has been a decline in the number of cases progressing to litigation, and in general tax disputes being resolved more quickly.

### BEPS

- In connection with Australia's role as the President of the G20 in the global BEPS debate, there have been a number of public announcements on the part of the Treasurer and the Commissioner of Taxation (Commissioner) advising of a commitment to engage in audits of multi-national corporations in the information technology sector.
- The Commissioner has advised of a commitment that Australia will double its efforts in respect of global technological companies. This commitment has been demonstrated in the commencement of the International Structuring and Profit Shifting (ISAPS) program involving 66 taxpayers at present. Additionally, the Commissioner will publically disclose key taxation information for large businesses with over \$100 million in total income.

- Australia's focus on global transactions and cross-jurisdictional arrangements is coupled with a recent re-write of its TP legislation and amendments to the General Anti-Avoidance Rule. It has been observed that the Australian Taxation Office (ATO) is increasingly ready to apply the Australian TP rules to cross-border disputes. The TP disputes are however, difficult to litigate in the context of the expense associated with the briefing of expert witnesses to provide expert evidence and the likelihood of TP cases being highly fact-intensive (and therefore not precedential in nature).

### Independent review function

- A recent initiative aimed at timely resolution of tax disputes is the Commissioner's introduction of the Independent Review process for large taxpayers. The Independent reviewers (who are separate from the ATO compliance team) conduct a full technical and merits review of the ATO audit position prior to the issuing of assessments.

### Roadmap to dispute resolution

- Where a taxpayer is dissatisfied with an assessment, the taxpayer may lodge a formal notice of objection with the ATO disputing the assessments. The timing, grounds and procedure are governed by Part IVC of the Taxation Administration Act 1953 (TAA).
- There is no prescribed time limit for the ATO to determine the objection, however if no decision is made within 60 days of (i) the date of filing the objection, or (ii) the day on which the Commissioner receives information relating to the objection pursuant to a written notice, the taxpayer may invoke section 14ZYA of the TAA requiring the ATO to make an objection decision within 60 days of that notice.

- If the objection is disallowed, the taxpayer may appeal to the Federal Court or to the Administrative Appeals Tribunal (AAT), i.e. proceed to litigation. Both the Federal Court and the AAT provide for matters to be referred to ADR including mediation.

### Mediation and ADR

- The perceived trend of the ATO in recent times has been to seek to settle an increasing number of matters through a range of ADR mechanisms, particularly in respect of long-standing “legacy” disputes. The willingness of the ATO to engage in ADR has been across all stages of the dispute – from the earlier audit stage, the objections stage and also once proceedings have been initiated in the Federal Court or in the AAT.
- The ATO has indicated that it aims to resolve disputes earlier in order to reduce costs associated with litigation, and therefore reduce the cost of resources dedicated towards the management of disputes. Additionally, it has been observed that the ATO has communicated its intention to reduce the amounts that it expends on litigation by engaging in the early and efficient resolution of matters in dispute. Also litigation being heard in the courts is declining – with a greater number proceeding to ADR prior to a Court hearing.
- In relation to the precedential nature of matters that are the subject of a tax dispute, the Commissioner has advised that:

“[W]e want to free up the courts to review the most strategically important issues.”

### Review of ATO’s management of tax disputes

- There has been an increased focus on external inquiries in respect of the ATO’s management of tax disputes, and the architecture of the system has been closely scrutinised. In July this year, PwC Australia made submissions to both the Inspector General of Taxation (IGT) and the House of Representatives Standing Committee on Tax and Revenue, on the current Review into the ATO’s Management of Tax Disputes.
- The key theme of the submissions was that the independence, objectivity and expertise of the ATO in dealing with disputes need to be strengthened and consistently applied. A key recommendation in the submission was for further structural separation of the review and appeals function within the confines of the existing ATO.



# Abbreviations

Accredited Clients	ACP
Alternative Dispute Resolution	ADR
Advance Pricing Agreement	APA
Assessing Officer	AO
Authority for Advance Ruling	AAR
Base Erosion and Profit Shifting	BEPS
Central Board of Direct Taxes	CBDT
Central Board of Excise and Customs	CBEC
Central Sales Tax	CST
Comptroller and Auditor General	CAG
Commissioner Income-tax (Appeals)	CIT (A)
Chief Commissioners of Income-tax	CCIT
Customs, Excise and Service Tax Appellate Tribunal	CESTAT
Dispute Resolution Panel	DRP
Double Taxation Avoidance Agreement	Tax Treaty
Goods and Service Tax	GST
Inland Revenue Authority of Singapore	IRAS
Indian Revenue Service	IRS
Indian Rupee	INR/Rs.
Income -tax Act 1961	The Act
Income-tax Appellate Tribunal	ITAT or the Tribunal
Multinational Enterprise	MNE
Mutual Agreement Procedure	MAP
National Tax Tribunal	NTT
Onsite Customs Post Clearance Audit	OSPCA
Organisation for Economic Cooperation and Development	OECD
Tax Policy and Analysis Unit	TPA unit
Transfer Pricing	TP
Transfer Pricing Officer	TPO
Tax Administration and Tax Administration Reform Commission	TARC
Show Cause Notice	SCN
South Africa Revenue Service	SARC
Settlement Commission	ITSC
Value Added Tax	VAT

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