

TAX DISPUTE RESOLUTION MECHANISMS IN INDIA AND COMPARATIVE ANALYSIS WITH UK

-Rohan Wadhwa*

Introduction

For any economy, one of the most difficult challenges is to manage its taxpayers effectively. In recent times, the government's approach to treating taxpayers has changed from merely a source of revenue to more customer centric. Over the years, especially after the implementation of the LPG policy in 1991, various kinds of taxes have been introduced by the government, resulting in an increased number of taxpayers. However, for India or any developing country, one of the herculean tasks is to have an efficient Tax Dispute Resolution Mechanism (TDRMs). Tax dispute resolution mechanism for any country includes the institutions (judicial and administrative) and the procedure established by law to readdress the problem¹. There is a direct correlation between (TDRMs), taxpayer compliance and tax revenue leakage². An efficient tax dispute resolution mechanism yields greater taxpayer compliance and a reduction in tax revenue leakage. This paper will analyse the tax dispute resolution mechanism, particularly in India. The adversarial system which India follows has further acted as a clog in having a swift and efficient TDRMs, with inordinate delays and substantial expenses involved³. Recently the government has set up a tax administration reform commission; this paper will analyse the recommendations and check how can they improve the TDRMs. This paper will comparatively analyse Indian tax dispute resolution mechanism with that of the United Kingdom and conclude with suggestions to improve the Indian tax administrative regime.

* Rohan Wadhwa is a student at Jindal Global Law School, O.P. Jindal University.

¹ Koos, Edward, Tax Dispute Resolution Mechanisms in Developed and Developing Countries: An Analysis of Factors that Affect Dispute Mechanism Design and Functionality (24th June 2014). Available at SSRN: <https://ssrn.com/abstract=2458765>

² Ibid

³ Govind S and Varanasi Samira, "Dispute Resolution in Tax Matters: An India -U.K. Comparative Perspective" http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research_Articles/Dispute_Resolution_in_Tax_Matters.pdf.

Dispute Resolution Mechanism in India

In India, the governing law and the procedure established by law which governs every taxpayer is prescribed by the Indian Income Tax Act, 1961. In India, every taxpayer is legally bound to self-assess his/her total income and file income tax return under section 139 to income tax authorities within a stipulated period. After the filing of ITR is complete, it proceeds to the respective Assessing Officer (AO) within its jurisdiction. Once the A.O. receives the ITR, it may either accept it or reject it and pass an assessment order within section 143 of the I.T. act. If the taxpayer is not satisfied with the assessment order, he may file for an appeal before the Commissioner of Income Tax (Appeals) under section 246 of the I.T. act. After accepting the appeal, the commissioner of Income-tax (Appeals) shall provide for a fair hearing to the taxpayer.

Furthermore, after considering all the relevant information may either modify, alter or enhances A.O.'s order. Under section 253 of the I.T. Act, appeals from CIT(A) lies to Income Tax Appellate Tribunal (ITAT) from either the taxpayer or the taxing authorities if aggrieved. The (ITAT) is a quasi-judicial body which consists of a member from the judiciary and an accounting member. The ITAT is the final body which indulges into fact-findings of any respective appeal. After this appeal only lies to High Court under section 260A of the act and finally to honourable Supreme court under section 261 of the I.T. act. However, appeals to High courts and Supreme courts have a limited scope to scrutinise only the 'substantial issue of law'. In the case of transfer pricing, the procedure remains similar. The taxpayer is bound to furnish information about their tax liability to "Transfer Pricing Officer" or Assessing Officer. The order issued by the TPO or A.O. can be challenged before the Dispute resolution Panel under section 144C of the I.T. act. DRP is a collegium of three Commissioners of Income-tax. One of the advantages which DRP routes offer is that such appeals have to be finished within nine months from the end of the month from the date of Assessing Officer's order. The second advantage of taking the route of DRP is that once an order is passed the Income-tax authority cannot prefer an appeal to ITAT, and now no further enquiry into facts can be taken place. Appeal from the order of DRP lies to the high courts and then finally to Supreme Court. The scope of appeals to High Courts and Supreme Courts are limited to the question of law and not into factual enquiries.

Reasons for tax Disputes

1. Assessing Officer

- Assessing Officer is the first level of dispute resolution in the chain of dispute mechanisms. However, it is due to their approach that the majority of disputes are caused. Assessing Officer's boxed in approach to cumulate all the cases at the end of the financial year, which results in deterioration of the quality of assessment. As a result, assessment orders are often found to be faulty as it fails to consider relevant evidence⁴.
- Assessment orders are mostly non-speaking orders, and it lacks judicial discipline based on the ground that the authorities have decided to file appeals to high courts or Supreme court.
- The target-based approach by the Assessing officers⁵. Really high and arbitrary demands by the revenue authorities often result in an irrational assessment. Incentive policy of A.O.s and target linked performance of A.O.s exerts immense pressure on them to exceed the assessment value to generate revenue. This results in the extortive approach of the A.O.
- A.O.s are not well trained to the useful and proper knowledge management system. Lack of specialisation often results in the poor quality of assessment.

2. Commissioner of Income-tax (Appeals)

- CIT(A) functions under the administrative control of Ministry of finance. Law prescribes that CITA can before disposing of appeals remand back the case for further enquires to the A.O. This often results in delays in final disposing of the appeals. This has led to the large-scale build-up of cases with CIT(A).
- Many times, CIT(A) in the middle of the financial year is transferred, causing the appeals to be freshly heard by the new CIT(A). Time limit prescribed to dispose of the appeal is not fulfilled. Quality of the orders issues is not one of the criteria for their performance evaluation.

⁴ "Navigating Tax Controversy in India" (pwc.in October 2014)

⁵ Ibid.

- No concrete solution even after appeals disposed of by CIT(A) since revenue authorities mostly after this stage files for the appeal to ITAT if CIT(A) results in favour of the taxpayer without appreciating the merits of the case.

3. Lawmaking

- Many provisions in the tax law suffer from poor drafting, which leads to the various interpretation of the law and that in turn, creates uncertainty in the minds of the taxpayer.
- Stakeholders participation in the drafting stage is close to non-existence. However, this trend is changing now in indirect taxes with the implementation of the GST council.
- Government of India often amends law retrospectively, which results in uncertainty in law which is not suitable, especially for foreign investors. One of the prominent examples being the aftermath of the Vodafone case.

The debacle of current TDRMs

Current structure to solve tax disputes is not only time consuming but also causes financial costs. This financial cost consists of both high prices to maintain litigation and the amount of tax money which gets frozen due to such slow process. Quantum of direct tax litigation at various levels as on 31st March 2017 as per Central Action Plan 2018-2019 and Economic Survey 2018 represented by the table below:

Forum	Cases pending	Tax Amount in litigation
Commissioner Appeals	328,173	Rs. 6.38 Lakh crore as on 31 st March 2018*
Income Tax Appellate Tribunal	92,338	Rs. 2.01 Lakh crores
High Court	38,481	Rs. 2.87 Lakh crores
Supreme court	6,357	Rs. 0.08 Lakh crores

There is no doubt that the I.T. department is the most significant contributor to tax litigation. Appeals filed by the I.T. department amounted to 85% of the appeals as on 31st March 2017 with its success rate being less than 30 per cent⁶. Taking cognisance of this CBDT has taken tax litigation management very seriously. However, some steps taken by them are questionable. One of them being providing performance credit to the commissioner appeals for quality appellate orders passed by them. By this, they mean such orders passed by the commissioner appeals where he/she has enhanced the order of I.T. officer, in other words, increased the tax liability of the taxpayer. It also means penalty levied on taxpayers if additions confirmed by him/her. Many times, arbitrary and irrational demands are raised by A.O.s because they are obliged to fulfil specific unrealistic targets on which their performance appraisals are based. This only leads to more and more appeals by the taxpayers. Indian judiciary has recognised this malign intention of the I.T. department at multiple instances they have passed strictures against the income tax department. In the case of *DIT(I.T.) v. Citibank N.A.*⁷ the honourable Supreme Court observed that the Tax department has deliberately slowed down the process of filing the appeals. The Court further observed that due to such inordinate delays has caused tax leakage, and the government should be more proactive in setting up a better dispute resolution mechanism and prevent such delays. In *Sandvik Asia Ltd v. CIT*⁸ it is observed that courts should play a proactive role in order to curb down the practice of malignant fruitless appeals by the tax department placed in front of the judiciary and payment back of paid tax to the taxpayer if successful in litigation.

Transfer Pricing Litigation

Liberalisation policy of 1991 led to opening up of Indian economy for multinational corporations. This led to myriad of cross border transactions. Which paved the way for a special law for such international transactions aiming to curb tax leakages. This particular law was legislated in the form of Transfer pricing rules which were brought under chapter X of the I.T. act. Under these rules, a corporate assessee is bound to maintain records of transactions done with a related international party. The initial years of transfer pricing witnessed significant litigation, but with an increase in knowledge about the subject, the taxing authorities began to scrutinise the international

⁶ Kably L, "Views: It is Time to Solve India's Huge Tax Litigation Problem" (The Economic Times 12th March 2019) <<https://economictimes.indiatimes.com/news/economy/policy/views-its-time-to-solve-indias-huge-tax-litigation-problem/articleshow/68365053.cms>> accessed 13th October 2019

⁷ (2012) 210 Taxman 258 SC,

⁸ (2006) 280 ITR 643/150 Taxman 591 SC

transactions between Indian residents and non-resident taxpayers with their multinational group very rigorously. This resulted in disputes between the taxing authorities and international taxpayers on multiple issues like comparability, cost-sharing agreements, management charges⁹.

Transfer pricing is the adjustment of the price for goods and services between two related international parties. The phenomenon of price transfer is simply a method by which MNCs operating in India through their subsidiaries may have to pay lesser taxes¹⁰. For example, Maruti Suzuki is a subsidiary of Suzuki Motors Corporation Japan. In a financial year, Maruti Suzuki India earns colossal profit due to excessive sale, and now they have proper tax liability upon them. However, to prevent themselves from this tax liability Maruti Suzuki India purchases different components from Suzuki Motors Corporation Japan at higher prices. This brings down profit margin for Maruti Suzuki India and their tax liability now is reduced. However, technically revenue for Suzuki Motors, Japan is increasing, and they improve in their position. This system of transfer pricing has led to losses for India tax revenue. Further, this leads up to endless litigation¹¹.

Even though the constant effort is being made to improve the Transfer Pricing litigation in India, still there is a long way to go. In Today's time, the Indian government is aware of the importance of transfer pricing transactions and the monetary value it has on stake. This has led to various reforms such as:

1. Improve compliance mechanisms (a secure mechanism to maintain transfer pricing documentation).
2. Adopting international practices in Indian Transfer Pricing rules like moving away from mean to statistical measures and single-use Data.
3. Most importantly introduction of Advance pricing agreement
4. Introduction of risk-based assessment to change the focus from volume-based to value-based assessment.

⁹. "Tax Dispute Resolution In India" (Druv advisors)

<https://dhruvaadvisors.com/insights/files/TaxDisputesResolutionIndia_v2.pdf>

¹⁰, Jose T, "What Is Advanced Pricing Agreement?" (Indian Economy 26th February 2016)

<<https://www.indianeconomy.net/splclassroom/what-is-advanced-pricing-agreement/>> accessed 13th October 2019

¹¹ Ibid.

Advance pricing agreement as a critical solution

To avoid such manipulation tax department of India pre decides the price of different components which are being subject in a transaction between related international parties. At the beginning of the financial year, the prices of these different components will be set, leaving no space for MNCs to exploit. An advance pricing agreement is a contract between the taxpayer and taxing authorities fixing the pricing method that the taxpayer will apply in its transactions with related parties. APA was introduced in India in 2012 and roll back provisions were provided in 2015. These programs lead taxing authorities as well as taxpayers to amicably solve transfer pricing disputes in a proactive and corporative manner. APA provides certainty to taxpayers as well as tax authorities; it reduces transfer pricing litigation increases tax collection and prevents tax leakages. Such programs are useful if we look at them from the tax administration point of view since neither it is taking much government sources nor they are time-consuming. These agreements are both bindings on the taxing authorities and the taxpayers.

In India, taxpayers can enter into APA with taxing authorities for a maximum five years going forward and four years for past years under rollback. Accordingly, it provides certainty to taxpayers and authorities for nine years. The taxpayer has the option to enter into unilateral/bilateral/multilateral APA. According to the CBDT APA annual report, 2017-2018 following is the number of APAs filed in India:

Financial Years	2012-2013 to 2017-2018
Unilateral APA	821
Bilateral APA	164
Total APA	985

Below is the table of APA entered by India

Financial Years	2012-2013 to 2017-2018
Unilateral APA	199

Bilateral APA	20
Total APA	219

From the total 985 APAs, 82 APAs have been disposed of due to various reasons like withdrawal of applications, mergers of APAs. 108 APAs have rollback provisions. India's APA program is considered to be successful in curbing down Transfer pricing Litigation. The average period to complete an APA and rollback is expected to be around 30 to 40 months based on the complexity of the issues and swiftness of responses of parties. The APA program has allowed the taxpayers to move away from the uncertainty created by the transfer pricing rules since they are not as clear and cogent as Australian tax officers guide or US 482 regulations. The success of India's transfer pricing agreement program should encourage and allow other taxpayers to file for APA and to obtain certainty.

Authority for Advance ruling

It is another innovative method evolved and implemented by the Indian government to reduce tax litigation in India. A taxpayer can apply for an advance ruling to authority on Advance ruling on the question of law or on the issue of facts in light of any international transaction undertaken or proposed to take place. AAR is a quasi-judicial body which is chaired by a retired judge of Supreme Court¹². It functions as an independent third-party body adjudicatory body. Rulings given by the AAR are binding upon both the taxpayers and the authorities. These rulings which are made are case-specific and have no precedential value. However, when similar facts are filed, earlier rulings might have persuasive value on them. The period of six months is stipulated within which such rulings have to be provided once an application is instituted. Like every institution, AAR is also grasped by administrative issues and procedural delays even then most Advance rulings are given out with final order within one year of the filing of application¹³. Rulings of AAR are binding on the parties, but aggrieved parties still have the option to appeal to the High Court, but only where there is prima facie error on the record.

¹² Supra n (3)

¹³ Supra n (6)

AAR has proved to be a viable option for international taxpayers and domestic taxpayers who usually indulge in international huge monetary transactions. AAR provides the following advantages

1. A retired Supreme Court judge makes a legalistic determination as to tax liability
2. It is a third-party intervention which provides a legal tax liability with no ulterior motive or bias.
3. It takes away the adversarial approach of the revenue department that is to increase tax collection.
4. Advance ruling reduces the red tape associated with the regular procedure in government tax departments.
5. It is swift and money-saving; usually, a ruling is given within one year, and no protracted litigation is to be maintained.

AAR recently has seen a plethora of applications which have resulted in the inadequacy of the infrastructure and resources. It lacks administrative requirement to handle these applications which are being filed in huge numbers. Government is continuously increasing the number of benches of the AAR with the view to provide rulings on the application within six months. Government apart from the bench in Delhi now has set up AAR bench in Bangalore and Mumbai. AAR is an option which could be explored by taxpayers in order to provide certainty and safeguards from conventional litigation. However, AAR dispute resolution effectiveness is questioned sometimes because disputes are resorted to constitutional remedies even after ruling on such issues have been given by the AAR. The functioning of the present AAR has been criticised for causing delays and uncertainty in providing rulings. One of the herculean tasks is to find an appropriate appointment as the chairman of the AAR¹⁴. There is an insufficiency of adequate competent judges.

TDRMs in the U.K.

In the United Kingdom, Tax dispute resolution mechanisms are quite similar to that of India. Her Majesty's Revenue and Customs is the taxing authority which scrutinises the returns filed by the

¹⁴ Supra n (4)

taxpayers. In cases where the return is rejected by the HMRC and an order is passed to alter/change tax liability, the taxpayer may prefer an appeal to First-tier Tribunal (Tax Chamber) if aggrieved. Further appeals can be filed if the parties are aggrieved to Upper Tribunal (Tax and Chancery Chambers) and then to Court of appeal and finally Supreme Court. However, the appeals preferred from the stage of Upper tribunal can only delve into point of law. In some instances, appeals may directly lie to Upper Tribunal after the determination by HMRC. Tax dispute resolution, even in the U.K., is very complicated and suffered inordinate delays due to structural complexities. However, in UK HMRC in recent times have taken a proactive role to resolve Tax Dispute Matters¹⁵. The U.K. has utilised the framework of Alternative Dispute Resolutions to curb down tax disputes and relied actively on mediation, facilitation and outside court settlement.

As a tax administrative strategy U.K. has heavily relied on Alternative Dispute Resolutions. It is important to note that HMRC has a very collaborative approach with taxpayers to resolve Tax Disputes. Like recommended in the TARC report in India UK is already treating its taxpayers as Customers. Common law countries are favouring ADR as a method because parties in certain technical cases are getting informed about the dispute and then getting resolution by an impartial third party. In February 2013 HMRC came out with Taxpayer's Charter explaining both rights and responsibilities of a taxpayer in a single accessible document. In tribunal Procedure, 2009 rules first-tier Tribunal (Tax chambers) is required to encourage parties to go for outside court settlement and consider ADR wherever it is appropriate. In 2007 HMRC launched the Litigation and Settlement Strategy which focused mainly on relationship building between various taxpaying business enterprises and the taxing authorities. Under LSS, HMRC is required to have a positive outlook in resolving tax disputed most efficiently and cost-effectively. Low risks company have been promised lesser penalties where they have made careless errors on the conditions that they will comply with conditions imposed by HMRC. This collaborative approach yields improving accountability and compliance of law as opposed to a mere collection of tax revenue. The judicial system in the past has shown positive signs of ADR. In many instances' judiciary have asked the parties to consider the option of ADR and sometimes put costs on parties where they refused ADR for no reasons. The Civil Procedure rules also mandate Courts to encourage parties to use ADR procedures to solve disputes. Under solicitors Regulations authority code of conduct 2011, solicitors are expected to explain the viability of ADR to their clients. ADR procedure provides facilitative methods where independent third-party mediators act a neutral facilitator to bring the parties on the same page. It provides for evaluative mediation where an independent third party

¹⁵ Supra n (3)

evaluates merits of the case. It provides third-party opinions which are not binding. HMRC in its report on ADR and its impacts for SMEs and individuals have made the following observation:

- The average time taken to resolve the dispute by ADR was around 61 days, and conventional litigation takes up to 23 months.
- Out of the cases which applied for ADR 58 per cent of them resolved utterly, 34 per cent were unresolved, and 8 per cent cases were partially resolved.

Comparative Analyses of India UK

Even though India and the U.K. share a deep legal heritage still there exists a glaring difference in the attitude of HMRC and Indian tax collecting authorities. Even though the conventional dispute mechanism is the same for both the countries, yet the U.K. has gone past the challenge of massive tax litigation. This is due to the two-pronged approach adopted by the U.K. Firstly, change in attitude towards taxpayer and its reliance of co-operating compliance as opposed to the adversarial method which focuses on finding liabilities on the taxpayer and treats taxpayer as an adversary. Secondly, heavy reliance on ADR programs to solve issues outside Court amicably and structural adaptations to provide for such third-party settlement procedures. India, in this regard, can learn from the U.K., especially in adopting co-operative approached towards the taxpayer. Obviously, due to cultural and social differences in India and U.K. mediation program functioning in India have to be changed accordingly. One of the problems which exist on the face of such a mechanism is to find a neutral third party who has the technical know-how of the subject matter. In-country like ours, which have its roots grasped in red-tapism and corruption to find such a person looks a herculean task to the author. Also, we lack structural resources and technical knowledge since the field of ADR is relatively new to our legal system.

Recommendation by TARC report for effectively manage tax disputes

1. Customer focus- Chapter 2

- Like in U.K. recommendations have been made to change the outlook of taxing authorities to view taxpayer as a customer. This creates a conducive environment for a taxing point

of view and takes away the conventional idea of the adversary. Taxpayers do not see authorities as their enemies and vice-versa.

2. Dispute Management- Chapter 5

- The report recommended that there should be separate infrastructure for dispute management.
- Certainty should be provided in the form of clear and cogent statements on contentious issues, to minimise potential disputes.
- The fundamental approach should be collaborative and solution-oriented.
- The process of consultation before dispute should be implemented before tax demand notice is given out.
- Time-bound litigation process at different stages, if not adhered to timelines consequences should pertain.
- Very Importantly jurisdiction of AAR should be provided for private rulings also. More benches of AAR should be set up in cities like Bangalore, Mumbai, Chennai, Kolkata with Principle Bench being in Delhi.
- Settlement Commission should provide services to the taxpayer to amicable solve disputes at any stage. The number of Settlement benches should be increased throughout the country.
- The fundamental recommendation that retrospective amendment should be avoided as a principle.

Recommendations for better current resolution structure

- Notices sent by the Assessing Officer should be detailed and thought through. There should be interdepartmental quality checks on the notices. The process of pre-dispute consultation should be implemented before issuing a tax notice. A.O.s should be provided with adequate training and infrastructure facilities. There should be standardised procedure heavily relying upon information technology. Reassessment should not be a practise and should be done in rare cases.

- The power remand by CIT(A) should be limited and should be used only the CIT(A) wants the enquiry to be done the A.O. and not in course of ordinary proceedings.
- Officers of the ITAT should be trained adequately, and specialised knowledge should be imparted to them before they sit on tribunal benches.
- The demand of National Income Tax tribunal for appeals directly from ITAT so that no appeal shall lie to High courts and Supreme Courts.

Conclusion

India currently is suffering from colossal tax litigation, and there is a violent breakdown of the judicial system. Taxing authorities have an adversarial approach towards taxpayer with only aim to increase tax revenue so that officers in these authorities can be promoted. There exists uncertainty in the mind of taxpayers and large MNCs which is not conducive for India's growth. The need of the hour is to threefold. Firstly, to change the focus of authorities to treat taxpayers as their customer. Secondly, to provide infrastructure to ADR programmes and encourage people to opt to move away from the conventional style of litigation and to go for outside court settlements. Thirdly, to find innovative measures like AAR and TPA to solve disputes of different kinds. Taxing authorities should keep an eye on sophisticated world practises and bring along changes in Indian dispute resolution system. This prima facie seems like a herculean task, but with Prime Minister's vision of ease of doing business; undoubtedly, active steps should be made in this field to make India an attractive destination for MNCs.