TAX DISPUTE RESOLUTION IN INDIA
TRENDS AND INSIGHTS

FROM OUR CEO

It is said that nothing is certain but death and taxes. To this, many add the certainty of litigation on tax matters. As tongue in cheek as this may seem, it is not entirely without basis. This has particularly been true in the Indian context with its low compliance track record and a proliferation of tax disputes.

Having said this, there are several changes underway in the tax world today, that promise to radically alter not only the nature of tax disputes, but also the way in which these will need to be dealt with. For instance, disputes around the taxation of digitalized businesses, anti-abuse rules and complex transfer pricing issues are likely to dominate the time and attention of both taxpayers as well as the tax authorities. Over time, changes in the administrative set up may likewise lead to a focus on value based, rather than volume-based assessments on all matters.

How does a taxpayer adapt to this changed environment? Will it be business as usual, or is there a need for a changed approach to tax risk management and resolution of tax controversies? Should the focus shift to risk mitigation, or does the environment only require a taxpayer to reorient his attention towards newer areas of controversy? Will the traditional modes of dispute resolution continue to be effective going forward, or will newer mechanisms take prominence?

This publication attempts to capture certain key trends and insights in tax dispute resolution, that will help taxpayers take larger decisions on some of the key issues outlined above. We hope you will find this useful, and as always, I welcome your comments and suggestions

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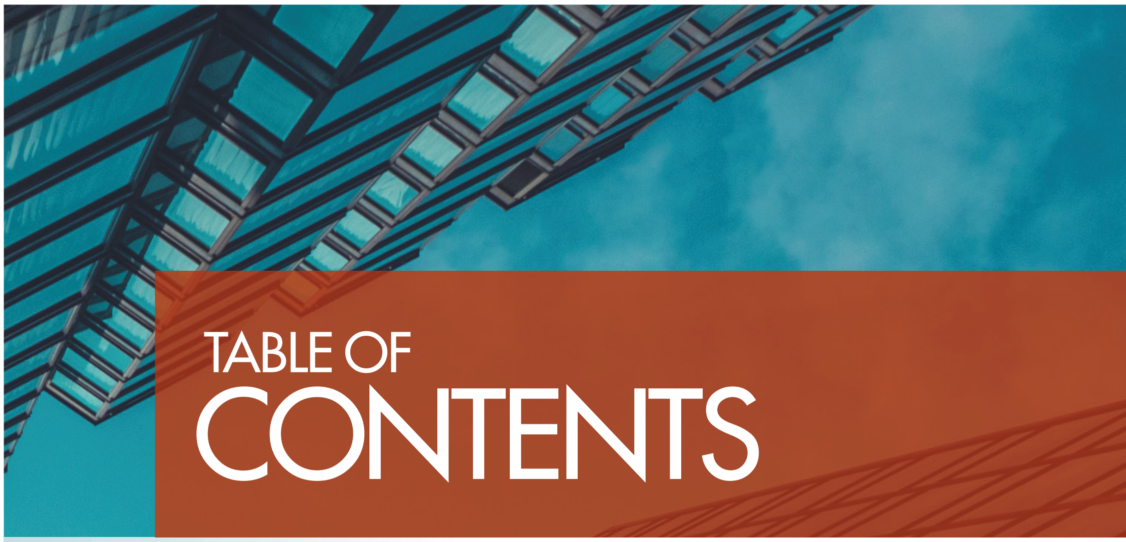

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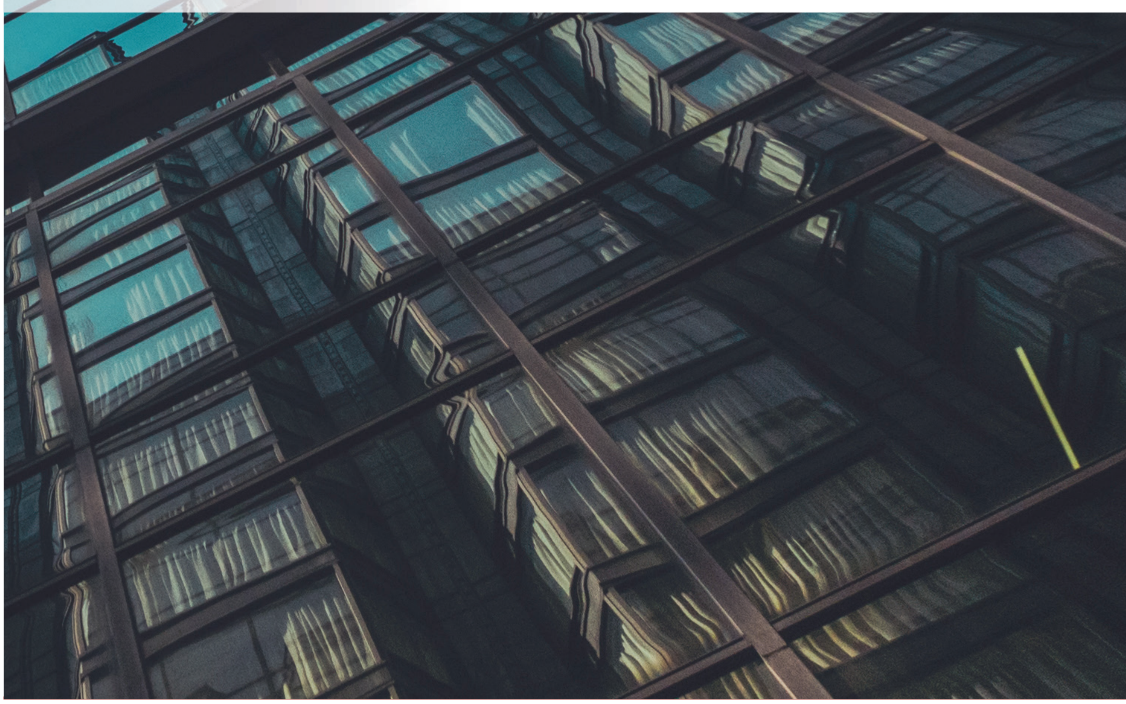


An introduction to the present landscape

The domain of a tax function of an organization typically comprises of the following aspects:

Compliance

Dispute Resolution

Planning

Process / Policies

Supporting Business

Supporting Mergers and Acquisitions

Historically in India, tax dispute resolution has been a key focus area for the overall tax function. This arises due to a combination of factors, which include adventurous taxpayers, an aggressive enforcement climate as well as delays and long pendency in the dispute resolution hierarchy.

The traditional litigation process in India (hierarchy-wise) is outlined below:

- Tax officer
- Commissioner (Appeals)
- Income Tax Appellate Tribunal
- High Court
- Supreme Court.

As an alternative to the Commissioner (Appeals), certain taxpayers (foreign companies or taxpayers in whose case transfer pricing adjustments are made) have the option of approaching the 'Dispute Resolution Panel', which is a collegium of three Commissioners of Income-tax. The Dispute Resolution Panel route offers some key advantages, which include:

- The taxpayer's objections to the draft assessment proposed by the Assessing Officer will be decided in a time-bound manner (nine months from end of the month from date of Assessing Officer's order).

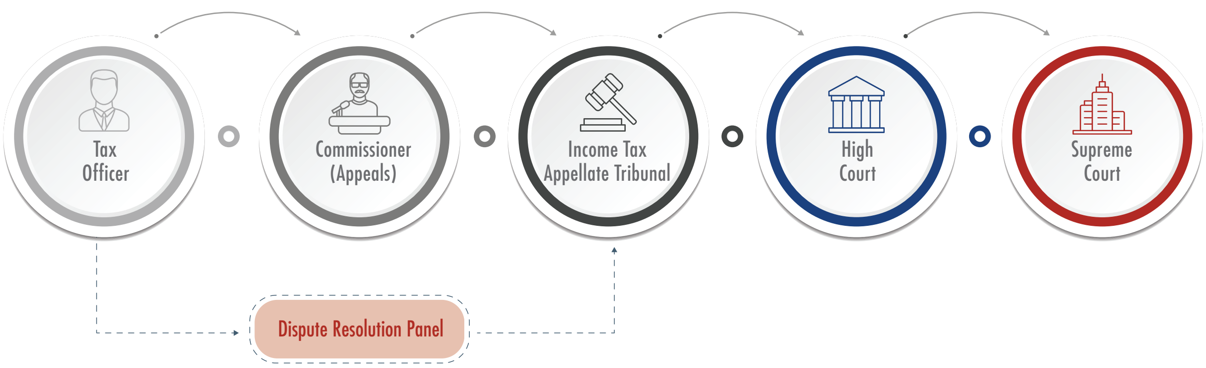
- The tax authorities do not have the right to prefer an appeal to the Income Tax Appellate Tribunal against an assessment finalized on the basis of the Dispute Resolution Panel's order i.e. on points that are decided in favour of the taxpayer.

- The tax demand does not fructify till the time the matter is decided by the Dispute Resolution Panel.

Despite these advantages, the decision on whether to approach the Commissioner (Appeals) or the Dispute Resolution Panel requires a careful consideration of various factors and trends on a case by case basis.

The entire litigation process in India is diagrammatically depicted below:

Flow chart depicting litigation hierarchy



As mentioned above, the increased importance of tax dispute resolution in an Indian context arises from the significant delays in the appellate process. The table below provides a sense of the quantum of direct tax litigation in India at various levels as on 31st March 2017 as per Central Action Plan 2018-19 and Economic Survey 2018:

Fora	Number of cases pending	Tax amount in litigation
Commissioner (Appeals)	328,173	Refer note below
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

Note: At the Commissioner (Appeals) level, the corresponding tax amount is Rs 6.38 lakh crores as on 31 March 2018 with 321,843 cases pending.

Currently, India does not have a formal mechanism in the statute for settlement of disputes other than approaching the Settlement Commission (in certain limited circumstances) or the Mutual Agreement Procedure (MAP).

Recent trends and learnings

Over the last two decades, India has contributed extensively to the evolution of international tax jurisprudence. A very large number and variety of issues on international tax tend to be litigated in India, and the body of caselaw emerging from the Income Tax Appellate Tribunal and the Courts is significant.

Typical international tax issues that dominate the tax litigation dispute landscape in India include characterization of receipts as fees for technical services/ royalty, determination of existence of a Permanent Establishment (PE) [i.e. taxable presence] in India, issues surrounding profit attribution to a PE and transfer pricing related aspects.

Some key areas which are assuming greater importance in the context of managing tax risks and resolving litigation in India are discussed in the ensuing paragraphs.

Emerging issues in the context of an increasingly digitialised economy

In recent times, there has been a significant upsurge in e-commerce transactions resulting in evolution of a 'virtual' global market place. Despite the work done by Organisation for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting Project (BEPS) Action 1: Addressing the Tax Challenges of the Digital Economy, taxation of digital economy remains one of the most uncertain tax aspects of a multinational business today. In fact, much of the OECD's work on taxation of digital economy is far from over - which it has delegated to its Task Force on the Digital Economy (TFDE) due for completion shortly. In the interim, we have seen quite a few countries (including India) coming up with and implementing tax policies to bring digital transactions within their tax net. In parallel, disruptive technologies and digital business models such as the sharing economy continue to advance at a colossal pace that is exacerbating policymakers' challenges. With more and more multinationals deploying new digital business models that unsettle traditional trade flows and strain existing tax regimes around the world, the OECD viewed its work on taxation of digital economy as critical to the global economy – so much so that it proclaimed that "the digital economy is the economy itself". Typical tax issues surrounding the digital economy include the following:

- In the absence of any global consensus on updating the traditional source/residence-based nexus rules to address challenges thrown by an increasingly digitalized economy, more and more countries, including India are seeking to fit income streams for digital businesses into the definitions of royalty or fees for technical services, in order to assert source-based taxing rights. These definitions were obviously not designed keeping many of the newer digitalized business models in mind, and as a result the interplay between these traditional allocation rules and new business models leads to much uncertainty and litigation. Such disputes also tend to be highly fact driven based on differences in the nature of the goods / services and the legal arrangements. As a result, most judicial pronouncements on this topic tend to be of limited precedential value in other cases, which then have to be agitated from the ground up.
- The creation of a taxable nexus in India is also an area that has become quite controversial in recent times, particularly in the context of highly digitalized businesses. For instance, the tax authorities have taken the position (as part of India's reservations to the OECD Model Commentary) that a website can under certain circumstances constitute a PE in India. This is an area that could see some litigation over the coming years.
- India has also introduced unilateral measures in connection with the digital economy which could also lead to some disputes and controversy. In 2016, India introduced an 'Equalisation Levy' on payments for online advertisements. This levy is not part of India's income-tax framework and is therefore not affected by treaty provisions. In 2018, the concept of 'Significant Economic Presence' was introduced in Indian domestic tax law which could potentially have ramifications for every non-resident doing 'business with India' (and not just doing business in India). But unlike the Equalisation Levy, this will not prevail over tax treaties, and it is expected that taxpayers who are resident in countries whose treaties have traditional definitions of a PE should not be affected by this.

From a taxpayer's perspective, special attention needs to be paid to assess potential risks on this front, after considering the latest judicial precedents, changes in law (e.g. significant economic presence concept) etc. In case if concluded transactions are impacted by subsequent decisions, the taxpayers should pro-actively focus on defense mechanisms which may include a detailed analysis of business models to evaluate the applicability of existing jurisprudence.

Transfer pricing litigation

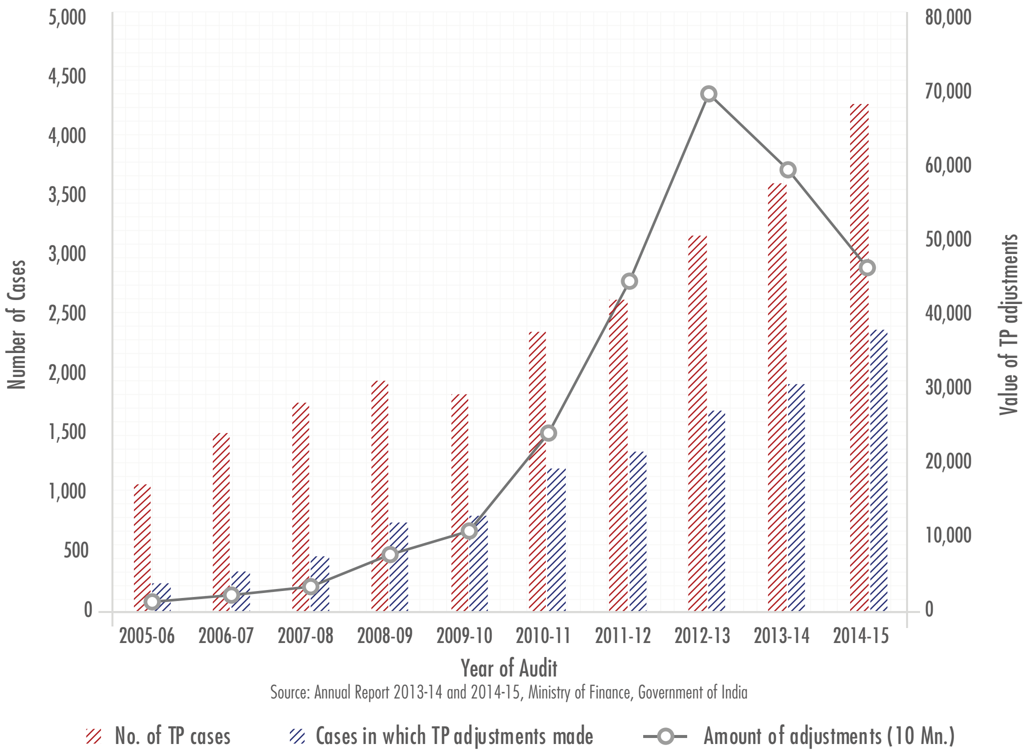
Transfer pricing rules were introduced in India from 1 April 2001. The liberalisation reforms in 1991 and changing global business structures lead to increased cross border transactions, which necessitated the need for introducing special provisions relating to avoidance of tax under Chapter X of the Income-tax Act, 1961 (Act).

The initial years of transfer pricing witnessed significant litigation, partly due to it being a new area for both taxpayers as well as the tax authorities.

As the learning curve on this subject improved, the trend in disputes began to change. Tax authorities started aggressively scrutinising international transactions entered between Indian residents and non-resident taxpayers with their multinational group companies. Disputes proliferated across industries, and covered issues ranging from simpler topics on comparability to more complex economic concepts on recharacterisation, marketing intangibles, location savings, management charges, cost sharing agreements, financial transactions etc.

The landscape of transfer pricing litigation in India over the years is depicted below:

Transfer pricing disputes in India



Source: Annual Report 2013-14 and 2014-15, Ministry of Finance, Government of India

Year	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Amount of adjustments (multiple of 10 million)	1,220	2,287	3,432	7,754	10,908	24,111	44,532	70,016	59,602	46,466
Number of transfer pricing cases	1,061	1,501	1,768	1,945	1,830	2,368	2,638	3,171	3,617	4,290
Cases in which transfer pricing adjustments made	239	337	471	754	813	1,207	1,343	1,686	1,920	2,353

Although recent years too witness their fair share of adjustments, past learnings, better trained officials and the introduction of global best practices and dispute resolution avenues by the Government have led to increased maturity in the transfer pricing litigation landscape.

Today, the Indian government is cognizant of the huge monetary stakes and has recognized the need for greater certainty on transfer pricing matters. This has led to various initiatives, that include:

i. Improved compliance frameworks (increasing the threshold for maintenance for transfer pricing documentation)

ii. Aligning Indian TP regulations to global standards by moving away from the mean to other statistical measures and use of single year data

iii. Introduction of the advance pricing agreement (APA) in 2012 (discussed in greater detail in the paragraphs below)

iv. Introduction of risk-based assessments to change the focus from volume based to value-based assessments

v. Introduction of the safe harbour norms, which is a viable option for small and medium sized taxpayers (despite it not being very successful due to high rates issued).

It may be relevant to mention here that several taxpayer friendly outcomes from the Income Tax Appellate Tribunals and higher courts (High Courts and Supreme Court) on key economic concepts has also provided assurance to taxpayers on the transfer pricing front.

The APA programme and its progress

Taxpayers can enter into an APA for a maximum five years going forward and four years of past period (under roll-back). Accordingly, taxpayers can obtain certainty from a transfer pricing perspective for a maximum of nine years (including roll-back). APA was introduced in India in 2012 and roll-back provisions were introduced in 2015. The taxpayer can prefer a multilateral/ bilateral or unilateral APA. Presently, India is accepting bilateral APAs even in the absence of Article 9(2) in the relevant tax treaty dealing with corresponding adjustment.

Tabulated below is a summary of APAs filed in India as per the APA Annual Report 2017-18 released by Central Board of Direct Taxes in August 2018:

Financial Years	2012-13 to 2017-18
Unilateral APA	821
Bilateral APA	164
Total APA	985

Tabulated below is a summary of APAs signed by India:

Financial Years	2013-14 to 2017-18
Unilateral APA	199
Bilateral APA	20
Total APA	219

Of the 985 APA applications, 82 APAs (including 16 bilateral) have been disposed-off due to other reasons e.g. withdrawal of applications, merger of multiple applicants. Out of the APAs signed, 108 have roll-back provisions.

The Indian APA programme has been considered as largely successful and has led to a significant reduction in transfer pricing litigation. The success of the APA programme may be largely attributed to the non-adversarial approach of the APA field officers and their willingness to negotiate with taxpayers on issues, which may have judicial precedents or are currently litigative. APAs are currently the most viable alternative for taxpayers who do not wish to engage in protracted transfer pricing litigation in India. The average time for completion of an APA and rollback has been around 30 to 40 months based on the complexity of the issue and timeliness of responses filed by taxpayers.

About 65% of the vista of transactions and issues covered by the APA pertain to service transactions e.g. software development, IT enabled services, engineering drawing and design and knowledge process outsourcing services. Incidentally, pricing of IT, ITES, KPO transactions had comprised bulk of the transfer pricing disputes in India (in terms of volume), wherein taxpayers had been faced with high margin, entrepreneurial companies used as comparable for captive service providers during regular transfer pricing audits. The APA programme has not only provided more amenable mark-ups for these services but also addressed ancillary issues relating to treatment of specific items of cost, location savings, possibility of attribution of profits towards PE. The remaining 35% of APAs comprise more complex transfer pricing issues e.g. royalties, attribution of profits to PE, provision of guarantees, marketing intangibles, transfer of legal rights of brands etc. Unlike APAs for services where the primary contentions related to pricing of low risk service providers, these issues mostly involved taxpayers who were entrepreneurial and bore the vagaries of market volatility. Therefore, these issues require a profound analysis of the facts and business nuances of individual applicants to ultimately determine their transfer pricing policy.

Since the Indian Transfer Pricing Regulations are not as elucidative as Australian Tax Office Guidelines or the US 482 Regulations, the traditional transfer pricing dispute resolution forums have been compelled to rely on quality of evidentiary data compiled during early stage audits and legal jurisprudence. This often hampered judicial authorities from addressing issues based on prudent transfer pricing principles. Consequently, entrepreneurial taxpayers were required to toe the line based on precedents set in case based on largely dissimilar facts.

The APA programme has allowed taxpayers to move away from the prevailing broad-brush approach resorted by tax authorities and other dispute resolution forums on these issues. Taxpayers have now been able to meticulously articulate their facts and business nuances in APAs to defend their rationale for transfer pricing policy.

An evidence of such pragmatism has been experienced recently in India's first bilateral APA between India and Switzerland where the profit split method was applied to achieve a variable royalty model under a non-integrated principal structure. The inability to adopt a classical principal structure in India owing to exchange control regulations has led to a different transaction model in the form of a non-integrated principal structure being adopted. It being the first of its kind especially since the competent authorities of both sides have agreed on a non-integrated principal structure.

The success of the APA programme should allow other taxpayers who have not filed an APA to evaluate APA as a viable option to obtain certainty from a transfer pricing perspective. While the taxpayers who have obtained an APA, should focus on the next leg of APA strategy i.e. to ensure the conditions specified under APA, are satisfied.

Advance rulings

The Authority for Advance Rulings (AAR) is a quasi-judicial body primarily set-up to ascertain the income-tax/ withholding tax liability on transactions in advance, thus, providing certainty and avoiding protracted litigation. A non-resident taxpayer or a resident taxpayer undertaking a transaction with a non-resident (dealing with non-resident's taxability) may approach the AAR. Rulings of the AAR are binding on the taxpayer (i.e. the Applicant) and the tax authorities in respect of the transaction for which the ruling is sought. However, it may be potentially be challenged before the High Court, and eventually the Supreme Court at the instance of either party. Over the years, there has been an increased number of taxpayers preferring to go down the path of the AAR. Domestic AARs though permissible in cases of certain large transactions have not yet seen widespread use.

Statutorily, the AAR is required to pronounce its decision within six months from the date of the application. However, on account of a large back-log of cases and vacancies, the timelines to obtain a ruling is generally delayed. To counter this, apart from the current bench in New Delhi, the Government has set-up additional benches of AAR in Mumbai as well as Bangalore.

With the increased number of benches of the AAR, the taxpayers should expect the rulings to be pronounced in a shorter time span, although considering the pendency, it may yet take a few years before the AAR can be in a position to dispose of cases within the statutory period of six months. Nonetheless, the AAR is an option which could be explored by the taxpayers in order to obtain certainty and avoid protracted litigation. However, a detailed feasibility study needs to be undertaken for the same based various factors (e.g. complexity involved, state of readiness of the taxpayer), before going down this route.

Bilateral investment treaties and international arbitration

This is a non-traditional approach to dispute resolution that has recently been invoked in respect of tax disputes arising out of the retrospective amendments made to section 9(1)(i) of the Act.

Bilateral investment treaties usually contain several obligations assumed by countries on a bilateral reciprocal basis in respect of investments in a country made by investors of the other country. The objective of these treaties is to provide protection to foreign investors in a host country. The key feature of such treaties is that they expressly provide for the obligations assumed by a host country to be directly enforced by a foreign investor through arbitration.

The obligations assumed by a host country under an investment treaty do not typically directly deal with tax issues. Therefore, claims relating to tax are typically made on the ground that the action of the host state is violative of the investors' right to fair and equitable treatment i.e.:

- The levy /assertion of tax has frustrated the legitimate expectations (based on the legal framework and specific representations made) that were taken into account by the investor at the time of making the investment.
- The levy / assertion of tax is clearly unfair, discriminatory, improper, and discreditable having regard to generally acceptable standards at an international level.

This is undoubtedly a high bar to cross and limits the ability of a taxpayer to invoke an investment treaty for most routine disputes. It is therefore also not suitable as an alternative to the normal dispute resolution process.

There are very few cases involving claims made under an investment treaty for tax disputes, and these too are yet to be concluded. It is the stated position of the Government that investment treaties do not apply to tax matters. This issue is likely to be considered in ongoing arbitration matters, and the decision could have significant value as a precedent in ongoing cases.

Government's initiatives in relation to tax dispute resolution

Over the past few years, the Government has undertaken several initiatives to reduce litigation. These include:

- Circulars issued by the Central Board of Direct Taxes (CBDT) clarifying the tax position on several controversial issues.
- Circulars issued on topics at a nascent stage [such as General Anti-Avoidance Rule (GAAR)] in the form of "frequently asked questions" for clarifying tax implications.
- Stakeholder views sought via draft Circulars on certain topics (e.g. place of effective management) prior to issuance of final Circulars.
- Monetary threshold (i.e tax effect) for the tax authorities to prefer an appeal to the next appellate authority has been substantially increased as follows:

Fora	Monetary threshold i.e. tax effect
Income Tax Appellate Tribunal	Rs 2 million
High Court	Rs 5 million
Supreme Court	Rs 10 million

The above initiatives of the Government will certainly go a long way in reducing litigation on many issues.

There are a few other developments on the tax disputes space that a taxpayer should stay abreast with. These include:

Leveraging on technology

A key trend witnessed in recent days is the use of artificial intelligence/ data analytics by the tax authorities to detect cases of tax evasion and non-compliances. With the use of technology, risk profiles of taxpayers created, trends analyzed, potential audit issues flagged-off and higher-risk cases identified for deeper investigation.

Going forward, it is anticipated that use of technology will only increase, thereby improving the efficiencies of the tax authorities to identify red-flags. Considering the above, the taxpayers should be pro-active in terms of (1) reconciling data under various filings/ sources, (2) identifying focus areas of the tax authorities upfront and taking precautionary measures in advance.

E-assessments

Going forward, the assessments/ audits will be conducted as 'e-assessments' and the need to have in-person hearings are being done away with, to some extent. Notices will be issued by the tax authorities electronically and the taxpayers are required to upload responses on the Income-tax department's portal.

This a major change in the manner in which assessments will be conducted by the tax authorities. Importantly, the taxpayer has an option to request for in-person hearings in case a show-cause notice is issued contemplating an adverse view.

As mentioned above, this is a complete revamp of the assessment/ audit process. Considering this, it is important for the taxpayer to focus on the overall assessment strategy e.g. ensuring all relevant facts/ documents are placed on record during the assessment/ audit and at the critical stage request for an in-person hearing to ensure there is no disconnect with the tax authorities in terms of their understanding of the facts. It may be noted that in the absence of such request, the taxpayer may have a challenge taking a plea of natural justice/ lack of opportunity to provide details. The taxpayers need to closely monitor the assessment/ audit proceedings in line with the strategy devised.

Increase in tax compliances

On account of various measures introduced by the Government (such as demonetization, Goods and Service Tax (GST), reporting of financial transactions), there has been an increase in the number of income tax returns filed. During financial year 2017-18, number of income-tax returns filed by the taxpayers increased to 68.4 million (26% increase from the immediately preceding year). Out of this, number of new income-tax filers are 9.95 million.*

A large number of foreign companies, typically, have been earning fees for technical services/ royalty income from India on which taxes have been withheld and such foreign companies may not have a taxable presence in India. There has been an increase in the number of foreign companies (earning fees for technical services/ royalty) filing their tax returns in India. This has been a result of the Government's effort's from data mining from withholding tax returns filed by the payers and issuing notices to the respective recipients.

It is anticipated that the Government would continue its efforts to widen the tax base.

* Press Release dated 20 April 2018 issued by Ministry of Finance, Government of India

Insights

Key insights from a dispute resolution perspective in India are outlined below:

Global Mergers and Acquisitions (M&A)

In the last few years, there have been several large global acquisitions/consolidations around the world and this trend is likely to continue in the future. The importance of tax in M&A simply cannot be understated. Careful attention to tax issues at an early stage in the M&A process can help minimize future tax uncertainty and litigation. Proper attention to tax policies, systems and litigation also remains crucial to the overall success of M&A deals, and can be usefully leveraged to add value, reduce costs and manage risks. Businesses need to be cognizant of key tax developments relating to M&A as well as several tax and regulatory issues that often arise in the context of M&A transactions involving India.

In this regard, one of the most far reaching changes in the Indian tax landscape pertain to introduction of indirect transfer provisions in the Indian tax laws.

The tax law was amended in 2012 to retrospectively tax capital gains arising from transfer of shares or interest in a foreign company/ entity, if such shares or interest derives (directly or indirectly) value 'substantially' from assets located in India (commonly referred to as the indirect transfer provision). The threshold for 'substantially' represents at least 50% value of all assets owned by such foreign entity. This retrospective amendment was brought about to overturn the Supreme Court's decision in the case of Vodafone International Holdings B.V.

Reporting obligations have been cast on Indian concerns (through or in which assets in India are held by foreign companies/entities deriving value substantially from assets located in India) to furnish prescribed information and documents relating to the determination of income arising from indirect transfers. The Rules broadly require the Indian concerns to report details of immediate holding company/intermediate holding company/ultimate holding company, holding structure, agreement for transfer of asset, financial statements of the foreign company/entity, information of business operations, personnel, finance/properties, audit reports, etc. of the foreign entity, details of payment of tax outside India, etc. within a specified timeframe. Stringent penal provisions are applicable for non-reporting.

This reporting requirement poses significant challenges to multinational companies on account of factors such as evaluating implications under complex tax rules and availability of information/ documents with the Indian entity within the limited timeframe. This is further aggravated with such transactions being multi-jurisdictional as a result of which these issues may require evaluation in several jurisdictions.

There have been several high profile litigation matters in India dealing with indirect transfer issues arising out of global deals. There is a need for taxpayers to closely evaluate the implications of these global M&A from an indirect transfer perspective and take necessary measures to identify and mitigate litigation risks. A strategy in this regard would entail an assessment of:

- Trigger and applicability of indirect transfer provisions
- Availability of tax treaty benefits
- Valuation of global assets vis-a-vis Indian assets
- Compliances to be undertaken including reporting requirements.

Given the retrospective nature of the amendment, impact of indirect transfer provisions on past transactions too needs to be critically examined.

The early days of indirect transfer provisions, characterized by wide ranging charging provisions coupled with a near absence of exemptions, machinery and computational provisions appears to be at an end. Suitable exemptions to mitigate the rigor of these provisions are being introduced and computational aspects such as valuation have been clarified. This is undoubtedly a very welcome step, and will go a long way in providing certainty to taxpayers. However, the practical application of these provisions will continue to throw up more challenges.

GAAR

GAAR is a wide-ranging legislative measure intended to combat aggressive tax avoidance. Since virtually all business decisions have tax implications in today's world, it follows that GAAR will radically affect the decision-making process across levels in organizations. GAAR is effective from 1 April 2017. But that does not mean that taxpayers were at liberty to adopt aggressive measures to reduce their tax burdens before then. Tax authorities and Courts historically applied certain broad anti-avoidance rules that targeted sham transactions (i.e. transactions conducted with an element of deceit so as to conceal its true nature) and 'colourable devices' (i.e. resorting to dubious means to obtain a tax benefit). These however were largely fact-specific, ad hoc, and involved the application of a 'smell' test.

GAAR, on the other hand, empowers the tax authorities, to not only target sham transactions and colourable devices, but also to counteract the abusive elements of arrangements that are otherwise legally valid. Historically, 'substance' in the form of movement of funds, presence of employees, premises, local expenditure etc. were strong defenses against allegations that an arrangement was a 'sham'. This is not necessarily the case under GAAR, where the focus is on 'purpose' (i.e. whether the arrangement was entered into with the main purpose of obtaining a tax benefit?), rather than only 'substance' (whether the arrangement really happened the way it is said to have happened).

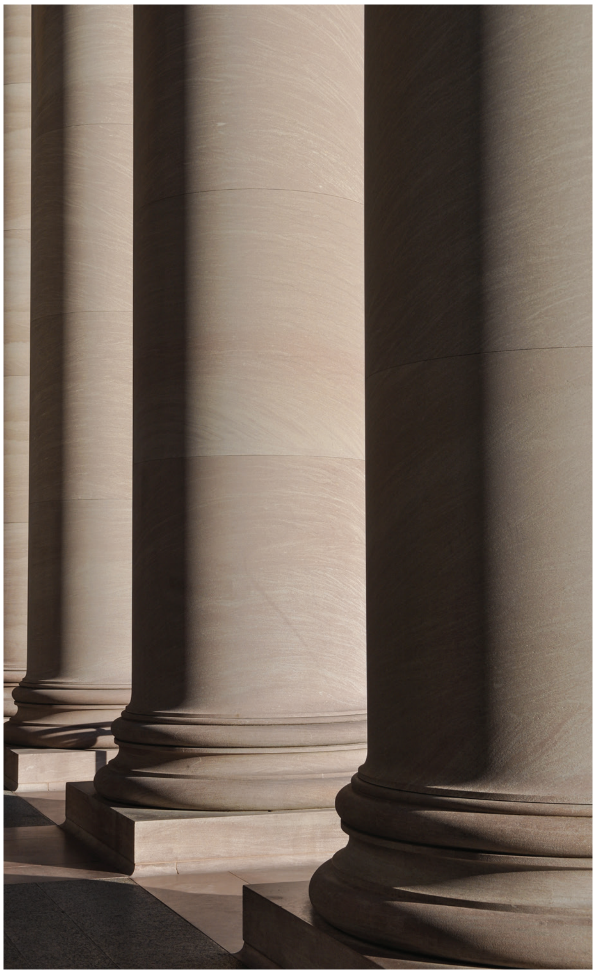
Similarly, GAAR is not restricted to cross-border arrangements, or other arrangements that involve esoteric elements. It could apply to commonly undertaken, routine day-to-day transactions as well. For instance, it could potentially be invoked in cases of corporate restructurings, funding arrangements, exit planning and other similar structures. Grandfathering provisions have been introduced in a limited way for some pre-2017 investments, but the general rule is that GAAR can extend to tax benefits arising after 2017, even if the arrangements giving rise to these benefits were undertaken much before GAAR came in.

Though the GAAR provisions are wide-ranging, it does not give carte blanche to the tax authorities to go after anything that they find distasteful. The tax authorities can invoke GAAR only when they can demonstrate that the "main purpose" of an arrangement is to obtain a tax benefit and other prescribed conditions are satisfied. De-minimis limit for applicability of GAAR is a tax benefit of Rs 30 million.

It will be interesting to observe the round of tax assessments/ audits for financial year 2017-18, which is the first year for applicability of GAAR. Above audits would be completed by September 2020 (in case transfer pricing audits are not undertaken in said cases).

GAAR radically impacts decision-making process in organisations across levels. Considering the above, organizations need to proactively focus on robust risk management framework/ policies. This ought to include aspects such as manner in which commercial rationale for transactions/ structures would be substantiated with documentation before the tax authorities.

Also, it is pertinent to note that a taxpayer can obtain clarity from a GAAR perspective by approaching the AAR.



New-age transfer pricing reporting

On account of the BEPS project, additional documentation requirements (e.g. master file, country-by-country reporting) have been introduced for multinational companies. This is keeping in mind the requirement to bring greater transparency of multinational companies' operations.

With the kind of information (e.g. revenue, profits, number of employees, income-tax paid/ accrued with regard to each jurisdiction in which the group operates) being made available to the tax authorities, the assessments/ audits is going to be a completely different ball-game. It would be interesting to observe the manner in which such information is utilised by the tax authorities during the assessment/ audit. Having said that, one thing is certain that this is going to be focus area of assessments/ audits and this could potentially open-up the next round of disputes between the taxpayers and the tax authorities.

From a taxpayer's perspective, the following aspects should be considered:

- Multinational companies may have to justify the value created by it compared to other group companies for similar transactions.
- Before submission of information, the taxpayers should have undertaken their internal assessment in terms of accuracy, risk posed (if any) and it is advisable the taxpayers build-in their defense strategy on positions adopted/ reportings undertaken.
- Local tax teams of global businesses will also have to be aware of the operations of the group at a global-level e.g. any finer points/ differentiating features involved in Indian company's transactions vis-à-vis any other group company transaction.

MAP

MAP is one of the most effective tools to prevent double taxation once the matter is in litigation. Another key advantage of MAP is that the entire tax demand can be stayed in case of few treaties (e.g. India-USA tax treaty, India-UK tax treaty) on submission of a bank guarantee.

Historically, MAP has not been very successful in India as most tax treaties do not specify timelines for resolving disputes. Also, practically speaking, this may not be the forum where a taxpayer may get full relief (e.g. entire amount being held as not taxable). Importantly, it may be noted that India has raised reservations in respect of mandatory arbitration recommendation under BEPS.

Having said that, going forward, the importance of MAP cannot be over-emphasized for resolving disputes with the increased engagement of competent authorities of different countries. One of the areas, which taxpayers should actively look at under MAP is disputes relating to profit attribution to PE.

Settlement Commission

The Settlement Commission is an alternative dispute resolution body, resolving income tax disputes. The taxpayers can disclose additional income (over and above what has been already disclosed before the tax authorities or in the tax return) in the application to the Settlement Commission. Despite some key limitations, a major advantage of the Settlement Commission route is the potentially immunity available from penalty and prosecution.

Typically, it has been observed that the Settlement Commission route is attractive in cases of taxpayers where searches have been initiated as well as for taxpayers who have earned income on a project basis. From a taxpayer's perspective, the key aspect before the Settlement Commission is full and true disclosure of facts.

Other mechanisms for tax risk management

Tax risks can also be managed/ mitigated by proactive steps undertaken by the taxpayer. In addition to the above discussions, following avenues should be explored by the taxpayer depending on the factual matrix:

Obtaining withholding tax certificates from the tax authorities

Section 195 of the Act requires taxes to be withheld on payments to non-residents, which are taxable in India. To minimize uncertainties, the parties can approach the tax authorities to determine the appropriate taxes to be withheld. Either the payer or the recipient can make an application to the tax authorities (under Section 195 or Section 197 of the Act respectively).

A withholding certificate issued by the tax authorities under Section 197/ 195 of the Act entitles the recipient to receive income without deduction of tax or after deduction of tax at a reduced rate. Such a certificate provides a safeguard to the payer against potential tax liability on account of withholding. Having said this, such certificate is only a tentative determination (and not the final assessment, which will be undertaken by the tax authorities post-filing of tax return by the recipient).

There is no time limit prescribed in the Statute for the tax authorities to issue withholding tax certificates. However, the CBDT, issued an internal instruction to either issue or reject (citing reasons for rejection) a withholding tax certificate within one month from date of application.

This is also an effective means of managing the cash-blockage on account of higher withholding tax.

Obtaining a certificate under Section 162 of the Act (in respect of potential liability as a representative assessee).

In case a person is held to be an agent of a non-resident, he is liable to be taxed as a representative assessee of the non-resident in respect of income for which he is considered an agent. The liability of the agent in such a case is co-terminus with that of the principal non-resident. Thus, in addition to withholding tax liability, a payer could potentially be treated as an agent of a non-resident recipient and held liable to pay taxes arising to such non-resident.

The Statute, however, provides that a payer who apprehends that he may be assessed in a representative capacity may retain an amount equal to the estimated tax liability from amounts payable to the non-resident principal. Further, in case of a disagreement between the non-resident recipient and the payer on the quantum to be retained, the payer may approach the tax authorities and obtain a certificate determining the amount to be retained (pending final assessment). Importantly, the final liability of such agent (at the time of assessment) cannot exceed the amount set-out in such a certificate.

Such a certificate, thus, provides certainty to the payer as the potential liability in his capacity as an agent of the non-resident recipient. It may be noted that unlike a withholding tax certificate, which is provisional, a certificate under Section 162 of the Act conclusively determines the potential liability of the payer in respect of taxes arising to the non-resident recipient.

No objection certificate under Section 281 of the Act

In case there are pending proceedings or taxes payable by a taxpayer, any transfer of specified assets (e.g. real estate, shares) by such person could be considered as void unless such a transfer of assets is made for adequate consideration and without notice of pendency of such proceedings or taxes payable by such taxpayer or it is made with the previous permission of the tax authorities.

Given the applicability of this section directly affects the buyers title to acquired assets, exploring the possibility of obtaining a permission of the tax authorities [by way of a No Objection Certificate (NOC)] under Section 281 of the Act attains significance.

The CBDT has issued a Circular providing guidelines in respect of application and issuance of NOC under Section 281 of the Act which outlines that such application must be made at least 30 days prior to expected date of transfer. Further, timelines and manner of issuance of NOC under various circumstances is outlined.

Other aspects

Separately, in order to mitigate tax risks, especially the risk relating to potential liability arising on account of withholding tax obligations, the taxpayers generally seek indemnities, escrow arrangements or a tax insurance cover to safeguard their interests. In recent times, there has been a greater stakeholder focus on the above while closing transactions.

Indirect tax

India recently celebrated first anniversary of GST, its biggest tax reform since independence, which would be a key contributor in transforming the economic landscape of the country. The current framework subsumed majority of the indirect taxes levied by Central and State Governments like Central Excise duty, Service Tax, State Value Added Tax, Central Sales Tax, Entry Tax, Purchase Tax, Entertainment Tax, Luxury Tax, etc.

Though these laws have been subsumed, if one looks at the statistics of unsolved cases pending across judiciary and tax tribunals in the country pertaining to these legislations, there is an urgent need to take measures to reduce them and free up the judicial time.

The status of pending litigation** pertaining to indirect taxes as on 31st March 2017 as per Economic Survey 2018 are tabulated as under:

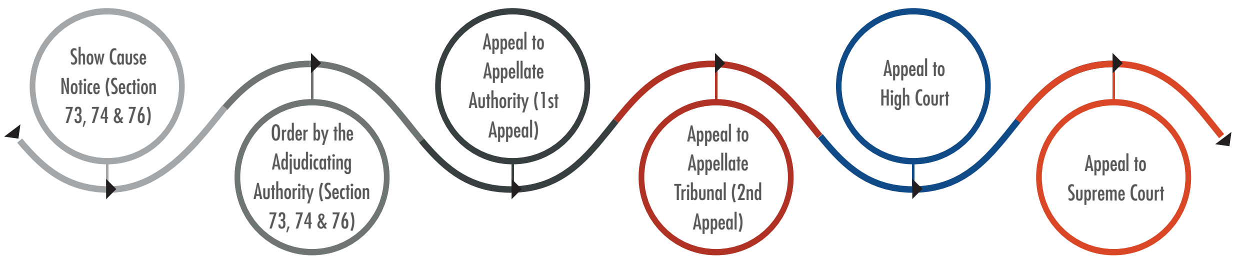
Fora	Number of cases pending	Tax amount in litigation (in crores)
Commissioner (Appeals)	44,574	13,000
Customs Excise & Service Tax Appellate Tribunal (CESTAT)	83,338	192,000
High Court	14,141	37,000
Supreme Court	2,946	20,000

**In addition, there would be pending assessment matters pertaining to erstwhile Sales Tax and VAT regime which would further add to the pending list of litigations before respective state-VAT / Sales tax authorities.

Some of the steps the Government has taken to reduce litigations are raising of monetary limits for filing appeals before CESTAT, High Court and Supreme Court, fixation of monetary limit at Commissioner (Appeals) level, revising monetary limit for adjudication of show cause notices, educate taxpayers on approaching Settlement Commission etc. Also, the tax authorities have been instructed to withdraw appeals where the amounts in dispute are below the threshold limits, except for matters involving substantial question of law. These measures are certainly a step in the right direction and are indeed very welcome. One could consider introducing schemes which can make it attractive to the taxpayer to close litigations.

Whilst the previous laws had its own share of litigations, the introduction of GST though having its advantages do not seem to suggest that the volume of litigation in the new law is going to be any different. There have been several issues on legal / interpretation side which the taxpayers are still grappling with. The issues faced comprise of transitional credits – eligibility / time limit, multiple rates reigniting classification disputes, nature of supply – whether composite or mixed, valuation issues in related party transactions, complex input tax credit provisions, determining place of supply (intra-state or inter-state), absence of guidance on anti-profiteering provisions etc. Further, taxpayers have approached the Writ Court in several matters pertaining to transitional credits, inconsistency in controls / configuration in GST portal with the GST law, procedural lapse / technological issues with respect to e-way bills compliances etc. Apart from these issues, recently the tax authorities have also started issuing show cause notices with respect to differences between GSTR 3B vs. GSTR 1, GSTR 3B vs. GSTR 2A, carry forward of cesses, etc. Thus, in the absence of required clarifications and persisting ambiguity, there has been a spurt in the litigation space with the advent of GST.

The entire litigation process under GST is diagrammatically depicted below:



*Time period for issuing order is 3 years/5 years (extended period) from date of filing annual return.

Advance rulings

As an alternate to adjudication procedure, GST law also allows a taxpayer to approach Authority for Advance Ruling (AAR) and obtain a decision in relation to supply of goods or services being undertaken or proposed to be undertaken. The applicant can approach AAR on issues pertaining to transactions whether or not amounting to supply, classification disputes, determining time and value of supply, admissibility of input tax credit, determining liability to pay tax etc. However, the ruling cannot be sought for determining place of supply (inter-state/intra-state), commenting on transitional credit etc which is beyond the purview of AAR.

As a matter of fact, so far taxpayers have approached AAR on various matters and till date more than 150 Advance Rulings are pronounced across states by the authorities. However, a closer reading of the rulings suggest there are consistency issues on principles / interpretation of law. A case in sight to discuss, whether installation of solar panels is a works contract or supply of goods so as to attract 18 percent or 5 percent. Similarly, there have been jurisdictional issues on admission of matter by AAR like transitional credits, out and out sales, high seas sales etc. Thus, there arises a need for issuing appropriate clarification by the legislature on scope and coverage of AAR. Also, in cases where the Government believes that there is an inconsistency in a ruling or an interpretation issue, then, appropriate clarification / amendment should be made on timely basis to reduce litigations. Till date, most of the AAR orders pronounced are in favor of the revenue and against the applicant. The reason could be an inherent conflict of interest as the Members appointed are from Central and State Government and such orders are passed protecting the interest of the revenue. As a principle of law, orders passed by AAR / Appellate Authority of Advance Rulings (AAAR) are binding on the applicant and the jurisdictional officer.

Recently, there have been couple of Writ Petitions filed before High Courts challenging the constitution of AAR and AAAR as it is violating the principles of judicial independence and separation of powers. Further, in terms of an Apex Court ruling in case of Union of India v. R. Gandhi, Bench of National Company Law Tribunal / National Company Law Appellate Tribunal should consist of one Judicial Member and one Technical Member or the Judicial Member should be in majority to the Technical Member. Also, the members appointed are without any judicial experience or formal training in law and are statutorily envisaged to adjudicate on issues of law. It would be interesting to closely watch the developments in this space.

Simultaneously, the Government has also been evaluating the need for revamping the AAR mechanism by setting up either a Centralized AAR or four regional authorities in the wake of contradictory orders passed by AAR in different states. Also, currently the taxpayer, having multiple GST registrations, is required to seek AAR from multiple authorities (state wise), as the ruling by one state authority is not binding on another state authority. Applying for multiple AARs from different states increases the vulnerability for the taxpayer and opens a pandora's box for businesses on what final tax position should one adopt. Thus, in order to minimize litigation, provisions should be amended to state that ruling pronounced by one authority should be binding on other states as well. Further, the law may also provide for review provisions if any state believes contrary to the view held by another authority in any state. The provisions should also be expanded to include all GST related issues within the ambit of AAR.

Separately, in addition to amending AAR provisions, the GST Council has given its nod to the formation of Goods and Services Tax Appellate Tribunal (GSTAT). Once the GSTAT starts functioning, it will bring consistency to rulings which would serve as legal precedents. Additionally, the Government may also consider introducing Settlement Commission provisions as it existed under erstwhile Central excise and Service tax regime. Further, provisions could also be amended for conducting pre-notice consultation with the taxpayers. These steps would aid in reducing the quantum of litigations.

Until now, no legislation has witnessed such an ongoing engagement by the Government. The swiftness demonstrated by the Government in bringing the required amendments through regular GST council meetings, notifications, circulars, sectoral FAQs, tweets, etc have been instrumental in resolving interpretational issues and reducing disputes. A step in the direction of reducing litigations is needed so as to minimize the costs and efforts, besides providing certainty on tax matters.


INDIA

Concluding thoughts

Today, tax has become a boardroom topic. Stakeholders in tax include not only the organizations tax teams, but also the legal, financial and business teams. Given the far reaching changes in the tax world, tax dispute resolution will continue to remain a focus area for organizations. Dispute resolution strategies will need to go beyond mere litigation, and may require an organization to consider adopting a broader framework of preventive measures and alternative dispute resolution strategies.

Dispute resolution necessarily requires a pro-active approach with well thought-out strategy and planning. The horizons should not be limited only to the traditional litigation approach. But other options explored and the pros/ cons of each option evaluated before deciding to go down a particular route. At the end of the day, the result may depend on the innovative strategies explored and approach adopted. Additionally, the documentation maintained, operating process adopted by organizations, integration across functions (as an example, this would help in bringing all relevant facts on the table upfront) and early involvement of tax experts would be relevant considerations.

Over the last few years, several major tax reforms have been introduced and it is imperative for organizations to evaluate the same and have an implementation plan (which includes identifying red-flags and taking appropriate actions) in place. Some of the key focus areas are outlined below:

- Country-by-country reporting
- Digital economy
- GAAR
- Goods and services tax
- Income-tax computation and disclosure standards and Indian Accounting Standards
- Place of effective management
- Tax treaty amendments under multilateral instruments.

The manner in which tax domain is handled by organizations would have to continuously evolve given the major tax reforms and level of information flow expected. Also, it would be interesting to consider the draft direct tax law, once the same is released by the Government and the impact of the same.

About Dhruva

Dhruva Advisors LLP is a tax and regulatory services firm, working with some of the largest multinational and Indian corporate groups. Its brings a unique blend of experience, having worked for the largest investors in India, advising on the largest transactions and on several of the largest litigation cases in the tax space. We also work closely with the Government on policy issues and with our clients on advocacy matters.

Key differentiators:

- Strategic approach to complex problems
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We believe in thinking out of the box, handholding our clients in implementing complex solutions and working towards achieving results. We have offices in Mumbai, Ahmedabad, Bengaluru, Delhi, Pune, Singapore, Dubai, Bahrain and USA. We advise clients across multiple sectors including financial services, IT and IT-enabled services (ITES), real estate and infrastructure, telecommunications, oil and gas, pharmaceuticals, chemicals, consumer goods, power, as well as media and entertainment.

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- Dhruva Advisors has been named "India Tax Firm of the Year" at International Tax Review's Asia Tax Awards for both 2017 and 2018.
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