

Arbitration under India's tax treaties

—Surendra Bhargava

The globalisation has not only brought a range of new business opportunities but also the risk of double taxation. Generally the remedy to the grievances of the affected taxpayers is mired in complicated legal procedures of different countries. And it is in this situation where Alternate Dispute Resolution comes in handy. Realising this, even the revenue department is putting the ADR on firm footing by making rules governing the Mutual Agreement Procedure. The result is that more and more taxpayers are turning to ADR to redress their grievances.

Business operators are getting exposed to double taxation risk with the new opportunities in cross-border trade. Operations in the two countries give rise to different legal claims and procedures. And in this regard the alternate dispute resolution procedures are available for the affected taxpayers too, in addition of the normal appellate forums.

Of late taxpayers are increasingly resorting to the ADR. The revenue department is also putting the ADR on firm footing by making rules governing the mutual agreement procedure (MAP). However, new features need to be incorporated to bring transparency in the MAP.

India's tax treaties and ADR



India has entered into 67 comprehensive double taxation avoidance agreements (DTA). Treaties avoid double taxation in the two jurisdictions when bilateral investment and trade takes place. MAP is intended to assist taxpayers to resolve sit-

uation where they are subjected to taxation not in accordance with treaty provisions. The procedure involves more of discussion than litigation. To understand the general applicability, we may refer to the MAP article under India's DTA with USA, which is reproduced in full for the sake of convenience:

1. Where a person considers that the actions of one or both of the Contracting States result or will result in taxation not in accordance with the provisions of this convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authorities of the Contracting State of which he is a resident or national. This case must be presented within three years of the date of receipt of notice of the action, which gives rise to taxation not in accordance with the convention.
2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation, which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the Contracting States.
3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agree-

The author is a former Chief Commissioner of Income Tax. He can be contacted at s_bhargava@hotmail.com

ment any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, shall develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this Article. In addition, a competent authority may devise appropriate unilateral procedures, conditions, methods and techniques to facilitate the above-mentioned bilateral actions and the implementation of the mutual agreement procedure.



Example of such a case could be the case of a resident of a third State having a Permanent Establishment (PE) in both the Contracting States.

Scope of MAP

Various issues, which could be resolved, when

the MAP is invoked, are:

- ❖ Defining a term;
- ❖ Dual residency;
- ❖ Determination of a PE;
- ❖ Attribution of income to a PE;
- ❖ Allowance of administrative expenses in the computation of income of the PE;
- ❖ Transfer pricing difficulties arising under articles dealing with Associated enterprises; Royalties and fees for technical services;
- ❖ Advance pricing arrangements;
- ❖ Difficulties arising from changes in domestic laws of the Contracting States.

Technical Explanation under US treaty

America issues technical explanation in respect of a DTA entered by it with any country. With regard to MAP article with India, the technical explanation states, *inter alia*, the following:

- ☞ Before resorting to the MAP, the remedies available under the domestic laws need not be exhausted;
- ☞ CAs are entitled to consult each other;
- ☞ Communication between the CAs could be direct or through representatives;
- ☞ Three years time limit runs from the receipt of formal notification of the action.

Disputes which could be referred

The above provision shows that the following disputes could be referred under MAP:

1. Taxpayer considers that the actions of one or both the countries results or will result in taxation, which is not in accordance with the provisions of the DTA: **Thus, MAP could not be invoked, if the action complained is under the domestic laws;**
2. In case of difficulties arising as to the interpretation or application of the DTA; **Thus, MAP could be resorted to solve general problems affecting category of taxpayers as a group;**
3. Cases of elimination of double taxation, which have not been provided for in the DTA:

MAP Procedure

The following procedure is followed in MAP:

- 🟢 The taxpayer files application with the CA of the State of his residence;
- 🟢 In cases of non-discrimination, the application would be filed with the CA, of the country, whose national he is
- 🟢 CA may try to find out the solution itself. If not;
- 🟢 He may communicate with the other CA;
- 🟢 CAs may resolve the issue through bilateral measures.

MAP regulations

The Income Tax Department has recently framed rules on how the MAP facility could be availed. The application for invoking the MAP could be filed either by a resident or a non-resident. The application by a resident is to be filed in form 34F.

MOU under Indo-US DTA

India has entered into memorandum of understanding (MOU) with USA, notified vide instruction no. 2 of 2003 dated July, 9, 2003, on how MAP would function between India and USA. The relevant provisions are:

- i. Format of application has been prescribed;
- ii. Taxes would not only cover, tax on assessment, but also on reassessment, and also withholding tax,

THEME

- advance tax, etc;
- iii. During the pendency of MAP proceedings, the assessment and collection of taxes would remain suspended;
- iv. However, the taxpayer has to file bank guarantee for the disputed tax demand and interest;
- v. If CAs decide that no resolution of the demand is possible, the assessing officer could invoke bank guarantee;
- vi. CAs would endeavour that either the issue is resolved or the case is closed.

What one expects from the MAP, the equivalent of ADR, under Arbitration laws, is

- (a) If CAs reach an agreement, and the MAP ruling is accepted by the applicant, the ruling is binding on the taxpayer;
- (b) MAP ruling is also binding on the Tax departments of the two countries;
- (c) If the similar issue is involved in other years, the ruling of one year has persuasive value in other years;
- (d) If the similar issue is involved in case of other assesseees, the ruling has persuasive value in other cases;

The shortcomings

The above discussion and its practical application proves

that MAP suffers from the following shortcomings:

1. CAs' deliberations are confidential. The affected persons are excluded from their deliberations. For transparency and in the interest of natural justice, the applicant should be made party to the deliberations;
2. Neither there is time limit for settlement of disputes nor the solution of the dispute guaranteed; Considering that MAP is a form of ADR, the CAs should arrive at a conclusion. Like other forums and time limit fixed under Indo-US memorandum of understanding, a time limit should also be fixed under other DTAs;
3. There is considerable delay in arriving at a decision. It may be desirable to fix a reasonable time limit in the interest of all parties. ■

If more and more taxpayers resort to MAP, it is likely that sooner than later, the bilateral Competent Authorities and the concerned Governments would refine the procedure to make it not only transparent, but easy to avail and really an Alternate Dispute Resolution mechanism.

ADD