Why India should adopt mandatory arbitration procedures in its tax treaties

By Ambika, 15th December, 2018

Countries participating in Base Erosion and Profit shifting project agreed that introduction of the measures developed to address BEPS should not lead to uncertainty for taxpayers and unintended double taxation. Therefore, refining dispute resolution mechanism is a vital and integral component of the work on BEPS issues. With the above in view, the guidance in Action 14 of the BEPS Action provides for implementing “minimum standards” and “best practices” to enhance the effectiveness/ efficiency of the Mutual Agreement Procedure [MAP] process. If a tax treaty related case qualifies to be considered under the MAP the taxpayer can approach the competent authority of either of the contracting jurisdiction. Several multinational companies operating in India have protracted litigations, for transfer pricing matters. The double taxation arising from such litigation couple with extensive time taken in concluding the MAPs has been a major area of concern for the multinational companies.

The Indian revenue authorities, at several forums, have also expressed their reluctance to include arbitration within the Double Taxation Avoidance Agreement, which does not provide requisite level of comfort to the global investors. Moreover, Indian revenue authorities believe that absence of Article 9(2) in the tax treaty precludes MAPs in respect of economic double taxation (transfer pricing) and therefore, the multinational companies from several large jurisdictions have not been able to access MAP/ bilateral advance pricing arrangements. Considering the above, the guidance provided under Action 14 would be of significant interest/ relevance to such multinational company.

India has opted for bilateral notification or consultation process but not India opted for chapter VI of the multilateral instrument dealing with mandatory arbitration. India should adopt mandatory arbitration proceedings in its tax treaties because MAP has been found to suffer from several shortcomings. It does not oblige authorities to solve a dispute but merely “endeavors” to arrive at a resolution. There also is no deadline prescribed for a solution to be reached under the MAP, making it a time-consuming and cumbersome process. As a result, the taxpayer is not ensured of a satisfactory outcome even after a long, arduous, and time-consuming process. Moreover, there are many issues resulting from the complicated relationship between the MAP and domestic legal remedies.

In addition, since the MAP is considered as a dialogue between the contracting States to settle issues brought to its attention, the taxpayer legally has no status in the
proceedings and is often denied the opportunity to make any representation leading to a lack of transparency. Considering these limitations, arbitration was explored as a means of alternative dispute resolution; and to truly comprehend its benefits, it is necessary to understand exactly what arbitration entails. The concern of India regarding its sovereignty is not well placed. The arbitration process is only kicked off in the event countries fail to reach a MAP settlement in two years from the date of commencement of MAP.

The arbitrator may only select as its decision either of the proposed resolutions submitted by contracting states (along with position papers) without providing any rationale or explanation in support of its decision. Besides, countries can mutually agree on rules relating to appointment of arbitrators and the type of arbitration process, which means that they will have full control and participation in the arbitration process. For instance, countries have a right to choose one of the arbitrators and the Chair of the arbitration panel cannot be a national or resident of either of the contracting states. In any event, countries may terminate arbitration proceedings in cases where the dispute is resolved by way of MAP any time before the arbitration decision is handed down. Countries may also consider not implementing the arbitration panel’s decision if they can agree on a different resolution of disputes within three months from the date of the decision. Lastly, the third arbitrator should be appointed by the UN for better accountability and transparency.