

ALTERNATE DISPUTE RESULTION MECHANISM
TO MINIMIZE LITIGATION AND INCREASE IN
REVENUE REALIZATION

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1. INTRODUCTION:

ADR refers to an alternative way of solving disputes, which differs from the traditional appeals mechanisms and involves negotiation. The essence of ADR is that a third party is brought in with the agreement of both parties, either to determine the dispute (arbitration) or to facilitate bilateral agreement (as an expert, or through mediation. ADR can involve procedures that are more flexible and less burdensome for the taxpayer as well as being more cost effective for the tax administration. The main concerns relating to ADR are the principles of legality and equality of taxation. ADR must be designed to work better and more swiftly in public interest and not become a channel for relaxing compliance with the law.

Some tax law provisions are open to different reasonable interpretations. If a particular ambiguous provision involves numerous cases, litigation may be appropriate so as to arrive at a general resolution of the ambiguity. On the other hand, isolated cases might more efficiently be dealt with through ADR, as long as both parties are ready to find a reasonable solution. In tax cases often the question is about interpreting a number of items of evidence. In these cases ADR can successfully substitute for litigation. Therefore, especially appropriate for an ADR approach are those cases where there is a dispute on facts and evidence produced and different opinions on factual determination can be reasonably defended.

2. THE STATE OF THE PROBLEM

A certain degree of tax litigation is inevitable in any developing economy. However, a tax dispute in India may take up to 12-20 years to attain certainty.

SUPREME COURT (5-8 YRS)

HIGH COURT (4-5 YRS)

CESTAT (3-4 YRS)

COMMISSIONER
(1-2 YRS)

COMMISSIONER(APPEALS)
(1-2 YRS)

AC/DC
(1-2 YRS)

JC/ADC
(1-2 YRS)

After an order is passed by the adjudicating authority, the aggrieved party, which can be the department also, has an option to go in appeal. There are a lot of cases which are pending at the appellate stage. Cases pending at appellate level:

Appellate Authority	FY 2011-12	FY 2012-13	FY 2013-14
Supreme Court	2,863	3,081	3,273
High Court	14,695	15,113	14,880
CESTAT	53,583	62,163	69,541
Commissioner (Appeals)	27,825	33,225	34,421

As can be seen from the table above a huge number of cases are pending at the appellate stage. This not only locks up a significant amount of revenue but also creates a lot of uncertainty in the minds of the taxpayer. However a deeper analysis of the pattern of the outcome of the judgments reveals that a lot of cases are decided in the favour of the revenue payee.

DISPOSAL OF CASES

Appellate Authority	Name of Party	2011-12		2012-13		2013-14	
		Total	In favour*	Total	In favour*	Total	In favour*
Supreme Court	Department	236	30	177	29	145	43
	Taxpayer	158	24	62	45	97	77
High Court	Department	1236	336	840	245	722	275
	Taxpayer	3971	2,976	2613	1788	2582	1,944
CESTAT	Department	1624	383	1806	689	2438	521
	Taxpayer	3385	1,762	6453	4423	7219	4,552
Commissioner (Appeals)	Department	2258	1,709	3543	1,622	3314	1,586
	Taxpayer	12901	6,546	27266	18636	30955	21262

*Remanded cases are taken as appeal allowed in favour of the taxpayer.

Success Rate of Departmental Appeals: in %

Appellate Authority	2011-12	2012-13	2013-14
Supreme Court	12.7	16.4	29.7
High Court	27.1	29.1	38.0
CESTAT	23.5	38.1	21.3
Commr (Appeals)	75.68	45.7	47.8

The above table clearly shows that the success rate of a departmental appeal at various levels, above and including CESTAT, has varied from 20-30 percent on an average. In other words, in more than 70 percent of the cases, the view of the department or the grounds on which the demand was sought to be imposed by the adjudication authority was not accepted. This does provide support to the theory that matters at the adjudication level are often decided without any real analysis of the issue on merits; with fear of loss of revenue / increase in revenue collections being the driving factors.

3. OBJECTIVE:

The ultimate objective of a good Alternative Tax Dispute Settlement strategy is to:

- a) reduce costs,
- b) maximize revenue flows as quickly and efficiently as possible and
- c) improve customer experience.

Of late, private settlement of disputes has generated a lot of interest. This is more so in highly technical areas of tax law, where parties are likely to favour an informed resolution of disputes over one that is necessarily impartial; even as Courts continue to provide precedents on the basis of which dispute resolution can take place outside the courts.

4. FORMS AND TYPES

ADR might adopt multiple forms and can be classified from different points of view.

- 1) Cooperative approach to taxpayers.
- 2) Resolving disputes by negotiation
 - (a) Conciliation/Mediation

(b) Settlements

(c) Arbitration

4.1 Cooperative approach to taxpayers.

Such a co-operative approach generally involves engaging with the taxpayers so as to understand shared interests, including the aversion of major tax risks so as to provide for cost-free resolution of disputes on both sides. Such an approach has generally guaranteed more certainty and is more likely to create a level-playing field between the taxpayers and the revenue authorities. It is based on transparency and trust from both sides. From a cost efficiency point of view, enhanced cooperation is specifically appropriate for the largest taxpayers due to their reduced number, the amounts usually involved and their greater capacity to challenge tax administration decisions.

4.1.1. Cooperative approach Pre-SCN

The first endeavor of any tax administration should be to minimize disputes by exploring various means from the stage of filing of returns till the dispute is formalized. Dispute originate from the examination of the documents filed by the company in various fora: at the stage of Audit, Preventive Action or Scrutiny of return. The dispute could be either dispute on fact or dispute on interpretation of law (Acts, Rules, Notifications)

4.1.1.1 Creation Of Apex Technical Committee

In a substantial number of cases, the dispute is on interpretation of law i.e. either a provision of the Act, Rules, or Notification. There are large number of field offices and officers across the country. These Officers interpret the law in their own way and issue the SCNs. These notices are litigated until all the avenues are exhausted.

There is no effective mechanism for swift and effective communication between CBEC and the field formation to verify whether the interpretation taken by the field officer is correct or not, before initiating the dispute. An Apex Technical body/Committee need be constituted under the CBEC which should be competent to give advice to the field officers on issues which involves interpretation of law. There can be expert groups to assist the Apex body on sub topics. An IT based application may be implemented on the existing hardware model of ICEGATE or any other similar such platform. The field officers should be able to place the commonly raised dispute points on such a forum. The Apex body should examine the issue and advice the field officer as to whether the interpretation is correct or not. If the interpretation is not correct the SCN should not be issued and the issue closed and an advisory issued for all other officers.

AC/JC/Commissioner should be permitted to refer independently to the Apex body, with copy to Commissioner/Chief Commissioner, but without routing through them. The present hierarchical escalation of issues to CBEC is too slow and time consuming and is actually acting as a deterrent for the field officers to raise relevant issues. The response of CBEC is also poor at present.

4.1.1.2 Conciliation Meeting

Currently there is no institutionalized discussion procedure with the Assessee before issue of the SCN. Department goes ahead with the findings of Audit/Preventive and issues the SCN. There should be a system of discussion with the assessee to know his view on the issue. In many cases the issues can be resolved through discussion and exchange of ideas and view points which is free and fair, either by the assessee accepting the Departmental view or Department dropping/reducing the demand. If both parties engage in a meaningful dialogue, the dispute on

facts and evidence can be narrowed down or fully settled. Such a procedure would help to reduce the litigation at SCN stage itself. In respect of dispute over law also a meaningful dialogue may reduce the scope of dispute. If both parties do not agree on interpretation of law, it should be referred to the Apex Technical body for advice before issue of SCN. Such a conciliatory meeting may be made mandatory above a certain threshold.

4.1.1.3 Pre filing technical Advice

An efficient tax administration should extend a helping hand for assesses which are fairly compliant and have a strong emphasis on going by the book. The department may consider opening Technical Advice Centers in major cities where such interaction can take place and majority of the issues can be sorted out at the pre-filing stage. Issues on which the assesses seeks help should be clarified as soon as possible and with a cooperative and workshop like atmosphere.

4.1.2 International Models

Cooperative compliance has been adopted in different countries in different forms. There are some elements of the three form suggested above in all these countries which has been adopted to the local context and culture.

Horizontal monitoring in the Netherlands: In horizontal monitoring, taxpayers enter into a formal agreement with the Netherlands Tax and Customs Administration, which establishes a tax control framework to ensure early knowledge of tax risks. Horizontal monitoring is based on three key principles: mutual trust, understanding, and transparency. It was first piloted in the very large business segment becoming later a well established program extended to other taxpayer groups. The system

involves reciprocity: on the one hand, the tax administration commits itself to make tax compliance easier and more secure and on the other hand, taxpayers “put all their cards on the table” showing they are acting in good faith, thus minimizing exposure to penalties and interest. Because of that taxpayers need confidence that there will be a serious attempt to resolve the issues. The taxpayer voluntarily notifies the tax officer of any issues (along with relevant facts) with a possible/significant tax risk. The revenue authorities undertake to provide timely advice on tax positions. The most visible outcome of this is a reduction in the number and the sharpened rigour of tax audits as all relevant facts and tax positions are discussed in advance.

Australia has a voluntary system of annual compliance arrangements (ACAs) to build enhanced positive relationships and compliance outcomes with large business by making full and true disclosures of major tax risks. Subject to true and full disclosures, and a commitment to adhering to corporate governance principles, ACAs provide practical certainty for tax return, shortly after lodgement, subject to issues that may need further examination.

In France, a tax audit pilot was launched in 2013 with 10 large business taxpayers selected to participate and test the new programme. Under the new tax audit procedure, businesses participating in the programme would receive expedited review from the revenue authorities in the form of an opinion as to whether tax returns are compliant with the provisions of law. This was intended to bring greater transparency.

US IRS also has a programme of pre-filing agreements (PFA) for large business and international taxpayers. The programme encourages taxpayers to request consideration of an issue before the tax return is filed. This helps in resolving potential disputes and controversies *ex-ante*.

4.2. Resolving disputes by negotiation :

Conceptually there are three different ways of negotiating a dispute. These three ways may in cases form a continuum in the sense that one may lead into the other. All the different types of agreements included in the concept of ADR can be provided for outside the protest/appeals procedure as an alternative to it.

(a) Conciliation/Mediation: where both parties accept a third party intervention in the procedure to get them together in cases where it is no longer possible for them to reach an agreement on their own. This is a non binding agreement.

(b) Settlements: agreements between the tax administration and the taxpayer

(c) Arbitration: the parties agree to accept the decision made by an independent third party.

The U.S. ADR system is a good example of these mechanisms being embodied in the traditional tax procedures by means of the agreements reached between the taxpayer and the tax auditor. In any audit, whenever any disagreement remains, the IRS officials, to settle cases outside the appeals procedure, use different types of mediation techniques. When these mechanisms fail and the appeal is resorted to, the appeals official can settle the case taking into account the hazards of litigation.

4.2.1 Conciliation/Mediation: It's a process in which the parties to a dispute, with the assistance of a neutral third party, identify the disputed issues, consider alternatives, and endeavor to reach an agreement. It is a non-binding process that provides an unbiased evaluation of the relative

strengths of each party's position, giving guidance on the likely outcome should the dispute go further without a significant change in approach by one or both parties. The end result sought by these techniques is that the parties reach an agreement to terminate the dispute. Therefore, although the decision to use this kind of technique is voluntary for both parties, if an agreement is reached, it must be binding for them.

Mediation techniques are also increasingly common in the court system, as utilized in pre-trial hearings, where the judge in a tax court plays a role as mediator/conciliator. E.g. there is a pre-trial meeting between tax administration and taxpayers convened by the judge in the German tax court. For such a procedure to work there has to be a high level of convergence on issues between the department and the assessee so that the probability of resolution through a non-enforceable dialogue is mutually agreeable and beneficial. The department also needs to identify and select officers who can be entrusted with this role so that they can perform their role efficiently and have a deeper understanding of issues.

4.2.2 Settlement: A settlement between a taxpayer and the tax administration requires a legal basis. The settlement binds the parties in the same way as a final court judgment, and is not subject to further challenge.

A good example of settlement practices is the work of the IRS Appeals Office in the U.S., which within the IRS has the authority to consider the settlement of tax controversies and is charged with resolving disputes, to the maximum extent possible, without resorting to litigation. Not every case referred to Appeals can be settled. For example, settlement is not permitted unless the taxpayer is able to demonstrate real uncertainty in law or fact as to the correct application of the relevant law to the case. Appeals officers focus on the evidence available in a case and have to assess the law that applies to an issue, and to resolve disputes without litigation on a basis that is fair to both taxpayer and government

and which will enhance voluntary compliance. A fair and impartial resolution is one that reflects on an issue-by-issue basis the probable result in the event of litigation, or that reflects mutual concessions for the purpose of settlement based on the relative strength of the opposing positions where there is a substantial uncertainty of the result in the event of litigation.

A formal Legal framework for settlement of cases exists in India. The operation of the body and suggestions for improvement are discussed in para 7.2

4.2.3 Arbitration: Arbitration is a process in which the parties to a dispute, submit the case voluntarily to a private arbitrator, present arguments and evidence who makes a determination. The tax administration should not be forced by the taxpayer to be subject to this procedure.

The most important question is to determine who the arbitrator should be. If it's a revenue officer in a problem resolution unit, or in a protest/appeals unit, independent from the decision-making; they can be accused of lacking real independence as they are inside the tax administration. This is the reason for the existence of the administrative bodies formally independent from the revenue agency. However, private arbitrators in tax questions can be questioned on the basis that it signifies that public law and a strong public administration is subject to the decision of a private party.

A via media can be found by way of instituting committees staffed by civil servants and by taxpayer's representatives, or representatives of different technical bodies present in the civil society (architects, engineers, accountants, etc.) headed by an ex-official of the judiciary with competence in taxation matters. These committees are most appropriate to

deal with difficult questions of fact and examination of evidence that may not have an easy answer, such as valuation questions. If these bodies are well staffed, representative, and well functioning they can avoid a fair amount of disputes

5. SOUTH KOREA AND SINGAPORE

South Korea and Singapore have got a very simple tax structure which is based on simple tax code and very few rates of taxation combined with high level of tax payer services. They have evolved a robust taxation system and relies mainly on Quality audits. The disputes take maximum 2-3 years to get resolved and numbers of disputes have been minimized by relying on a cooperative approach where the taxpayers are engaged in a meaningful discussion before a dispute arises out of the audit. The key takeaways are

- a) Simplify the tax code and revisit the sections which are causing a lot of litigation.
- b) Involve IT processes in all fields possible and provide high level of risk based facilitation to accredited clients. IT systems should be used to integrate and institutionalize information exchange between different government departments.
- c) Have a primarily audit based control which is risk based and involves the taxpayer.
- d) Aspire towards a dispute resolution system where the first appeal is heard within 6 months.

6. CONCERNS

The vagueness in practice of the procedures included within the concept of ADR leads to a concern about possible misuse. In order to minimize this problem, a certain level of formalization is needed, together with a clear definition of the cases where ADR is possible and a clear strategy and tight

governance around reaching the conclusion whether or not to negotiate or litigate.

When these mechanisms have to be used at a lower level in the organization, clear rules have to be in place as to the cases where they can be applied, the procedure to follow, and the civil servants responsible. Absent these, mediation/settlement techniques could be dangerous for the civil servant behind them as he could be liable as set down in administrative or criminal provisions.

7. INDIAN SCENARIO:

7.1 Advanced Ruling:

A taxpayer can obtain an advance ruling from the Authority for Advance Rulings (AAR) on a question of law or fact in a transaction that has been undertaken or is proposed to be undertaken. The AAR is essentially a quasi-judicial body chaired by a retired judge of the Hon^{ble} Supreme Court of India and functions as an independent, third-party adjudicatory body. All rulings made by the AAR are binding on both the taxpayer as well as the revenue department. Although these rulings are specific to each case and have no precedential value, they do have mild persuasive value when similar facts are encountered. The law mandates that all applications must be disposed of within 3 months from filing. Although procedural delays and administrative issues have extended timelines, most advance ruling applications are disposed of with final order within 1 year from filing of the application. Where the taxpayer or the revenue authorities are aggrieved by the ruling of the AAR, it can be challenged before the High Court by way of a writ petition, but only where there is error apparent on the face of the record.

Taxpayers would prefer going to the AAR at the first instance owing to the following factors:

- a. A legalistic determination is made by a judicial mind i.e. a retired Supreme Court judge.
- b. The adversarial approach of the revenue department that is focused on increased tax collection is avoided.
- c. The red-tape associated with regular procedure is avoided.
- d. As opposed to 10-20 years if the regular procedure is followed, a binding ruling is generally obtained within 1 year.

AAR has of recent faced a backlog of cases owing to change in its composition and lack of administrative capacity to handle the volume of applications that are being filed. This is more so owing to the fact that an advance ruling can be applied for in case of both proposed and existing transactions.

7.2 Settlement Commission

The Settlement Commission is a statutory body set-up inter alia to facilitate speedy settlement of specified types of cases and as an alternative to the normal appeal process. The Settlement Commission has power to grant immunity to the taxpayer from infliction of fine and penalty once tax payer makes a true and full declaration of his duty/tax liability. No application is entertained by the Settlement Commission where cases are pending before the CESTAT or any court. Further, no appeal lies against an order passed by the Settlement Commission except in certain situations where a writ petition can be filed to the High Court under Article 226 of the Constitution of India.

The basic objective of setting up of the Settlement Commission is to expedite payments of taxes and duties involved in disputes by avoiding

costly and time consuming litigation process and to give an opportunity to taxpayers to come clean by making a true and proper disclosure on payments that they have not made in the past. While the Settlement Commission is an efficacious DRM in cases of taxpayers who admit to tax liabilities, the Settlement Commission has not evoked the intended response either in quantum or in repute as approaching this authority per se implies non-compliance on the part of the taxpayer. As on November 30, 2012 there were around 133 cases which were pending settlement before the Settlement Commission for excise and customs involving tax quantum of Rs 886 crore approximately.

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As per Sec 32 O 1 of CEA, if settlement commission imposes any penalty on an Applicant on the ground of concealment, he is not allowed to approach the commission for the second time. The word "Concealment" has been interpreted by various benches as concealment of duty liability from the Central Excise officer. The Explanation to Section 32O(1)(i) as inserted vide the Finance (No.2) Act,2014 w.e.f. 6-8-2014 reads as under:

“Explanation – In this clause, the concealment of particulars of duty liability relates to any such concealment made from the central excise officer

The definition of concealment should not be so restrictive. The legal limitation of approaching the Settlement Commission only where the applicant has received a show cause notice and only for prescribed issues in order to include a wide range of applicants may be considered to expand the number of people approaching the Settlement Commission. The Settlement Commission should act as part of taxpayer services, and be made available to the taxpayer to settle disputes at any stage even after the SCN is adjudicated and is pending before an appellate forum. Accordingly a provision may be made for withdrawal of the appeal. There should also be an increase in the number of benches of the Settlement Commission.

8. SUMMARY AND WAY FORWARD:

The following is a summary of potential measures, which along with institutionalizing system for mediation and arbitration would reduce the number of tax disputes.

1) Creation Of Apex Technical Committee and Electronic Platform: In a substantial number of cases, the dispute is on interpretation of law i.e. either a provision of the Act, Rules, or Notification. There are large number of field offices and officers across the country. These Officers interpret the law in their own way and issue the SCNs. These notices are litigated until all the avenues are exhausted. There is no effective mechanism for swift and effective communication between CBEC and the field formation to verify whether the interpretation taken by the field officer is correct or not, before initiating the dispute. An Apex Technical body/Committee need be constituted under the CBEC which should be competent to give advice to the field officers on issues which involves interpretation of law. There can be expert groups to assist the Apex body on sub topics. An IT based application may be implemented on the existing hardware model of ICEGATE or any other similar such platform. The field officers should be able to place the commonly raised dispute points on such a forum. The Apex body should examine the issue and advice the field officer as to whether the interpretation is correct or not. If the interpretation is not correct the SCN should not be issued and the issue closed and an advisory issued for all other officers. AC/JC/Commissioner should be permitted to refer independently to the Apex body, with copy to Commissioner/Chief Commissioner, but without routing through them. The present hierarchical escalation of issues to CBEC is too slow and time consuming and is actually acting as a deterrent for the field officers to raise relevant issues. The response of CBEC is also poor at present.

2) Explore whether there are rules leading to a substantial volume of disputes that can be replaced by bright-line rules that would be easier to apply. There should be greater harmony and convergence in application of tax laws and points of lesser clarity should be immediately flagged and addressed at a national level. (para 4.1.1.1).

3) Conciliation Meeting : Currently there is no institutionalized discussion procedure with the Assesses before issue of the SCN. Department goes ahead with the findings of Audit/Preventive and issues the SCN. There should be a system of discussion with the assesses to know his view on the issue. In many cases the issues can be resolved through discussion and exchange of ideas and view points which is free and fair, either by the assesses accepting the Departmental view or Department dropping/reducing the demand. If both parties engage in a meaningful dialogue, the dispute on facts and evidence can be narrowed down or fully settled. Such a procedure would help to reduce the litigation at SCN stage itself. In respect of dispute over law also a meaningful dialogue may reduce the scope of dispute. If both parties do not agree on interpretation of law, it should be referred to the Apex Technical body for advice before issue of SCN. Such a conciliatory meeting may be made mandatory above a certain threshold. (para 4.1.1.2)

4) There should be adequate mechanism to provide pre-filing support to taxpayers. The Technical Advice Centers may provide taxpayers authoritative guidance on various provisions of tax laws that have potential to create disputes. Pre-filing support is intended to help taxpayers plan their business in advance and avoid disputes. These forums can deliver rulings within a specified period of time on questions submitted by taxpayers, which will help taxpayers file their tax returns. (para 4.1.2)

5) There should be only one time period for issue of show cause notice which may be anywhere between 4-5 years without any qualification about the nature of offence.

6) Make sure that auditors are trained and encouraged to resolve disputes during the audit process. Eliminate incentives for overly aggressive assessments.

7) Ensure that the officer issuing the Show Cause Notice is not the one who adjudicates the case. Also there should be some mechanism whereby an officer who confirms demands which are not sustainable in law are cautioned. Adjudication Orders should not be subject to Vigilance Scrutiny unless there is clear evidence of illegal gratification

8) Ensure that the government's litigation strategy includes a concession of weak cases.

9) Ensure there is a good system for monitoring cases at the appeals stage. Dispute management should be a functionally independent structure with adequate infrastructural support. Officers posted in the dispute vertical must receive adequate induction training and on-the-job training on areas.

10) On disposal of a case by Supreme Court/High Court and after the department accepts the judgment, an instruction should be issued to all authorities to withdraw appeal in any pending case involving the same issue. An issue wise electronic database of important cases decided by the Courts may be made available to all the officers by the department. The database should also indicate whether the department further appealed against the order or not.

11) Authorized representatives in CESTAT from the departments should be carefully selected and given sufficient incentives and necessary

infrastructural support to perform their duties effectively. They should also be given specialized training before they are asked to appear for the department. The administration of the DR function should also be in the dispute management vertical.

12) Department should consider institutionalizing mediation and arbitration as alternate dispute resolution mechanism. Sufficient flexibility should be accorded to these institutions. Participation in the mediation process should be made mandatory in suitable cases.