

## Board for Advance Rulings and Tax Certainty

*Taxation, in one or other form, has been consistent companion of business. More than two centuries back Benjamin Franklin said that, "in this world, nothing is certain except death and taxes". This being so, the quest has been to have a tax system under which, as said by Chanakya in the Arthashastra, government should collect taxes like a honeybee, which sucks just the right amount of honey from the flower so that both can survive. Now, the question is what the qualities of a good tax system should be. Adam Smith identified fairness, certainty, convenience and efficiency as the four canons of taxation. Undoubtedly, all four are important, but for businesses it is "certainty" of a tax system which is a necessity for making any long term business plan. With changes in the way business is conducted due to changes in technology, looking for certainty is not easy. In such a scenario, business wants clarity of the tax liability based on the tax law existing at the time of the planning the business. As tax provisions, majorly, are given to differing interpretations disputes arise*



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*leading to uncertainty. These have given rise to demand for advance rulings by tax authorities. Several countries have adopted one or multiple ways of advance rulings. India introduced Authority for Advance Rulings (AAR) in 1993 which was received by all with a lot of expectations. It sought to provide certainty to non-residents interested in investing in India, and at the same time wanted to avoid any tax litigation. However, expectations are more. Finance Bill, 2021*

*proposes to amend the provisions with aim to pronounce timely rulings to taxpayers. The article discusses the proposed changes in light of international experiences and suggests measures that can make the new scheme more effective and efficient. Read on...*

### Types of Advance Rulings

Advance ruling is broadly defined as written opinion/ decision by an authority empowered to render it with regard to the tax consequences



of a transaction or a proposed transaction or a legal position. The global best practice for advance ruling encompasses two types of rulings:

- **Public Ruling** – It represents the administration’s interpretation of particular provisions of law that effect a large number of taxpayers and are issued in the form of interpretative ruling or clarifications. They bind the tax officers but not taxpayers who can resort to the remedies provided under law where they disagree with the ruling. The Central Board of Direct Taxes (CBDT) issues Circulars, Frequently Asked Questions (FAQs), etc. under this category.
- **Private Ruling** – These are specific to a taxpayer and specified transactions. These are issued on specific request by a taxpayer. The objective is to provide support and a greater level of certainty to the taxpayers. The system of advance rulings are examples of such rulings.
- **Oral Rulings** - An oral ruling is a form of legally binding advice give over the phone to taxpayers who are individuals. This is prevalent in Australia.<sup>1</sup> It gives opinion of the Australian Tax Office on how a provision of the law applies to an individual in relation to their specific circumstances. Generally, oral rulings are given on areas of the law such as personal income tax or the Medicare levy.

## International Experience

### Timeline

Aa common feature present in almost all systems of advance rulings is a defined timeline for issuing the rulings. Mostly, it is less than one year. The position in some of the countries are as follows:

Less than 3 months: United Kingdom (30 days); Austria (2 weeks to 1 year. However, under the Express Answering System time taken is not more than 3-4 week); Belgium (1-3 months);

Less than a year: Denmark (typically, 6-8 months); France (6-9 months)

### Constitution of Authority

The constitution of authorities differs from country to country. In most of the countries the authority works under the tax department and manned by the officers. For example, in Japan Advance ruling authorities are part of the tax authorities and not a separate body. Similarly, the authority in South Africa and Malaysia is part of the tax department. The position in the Netherlands is interesting. Originally, the tax inspector was giving the ruling. The position changed in 1991 when the issuance of advance rulings in respect of certain international transactions has been centralised at a one-stop-shop within the tax authorities. This has further been modified after reforms in 2001 and 2004. The Netherlands has one of the most efficient, robust and open system of advance rulings.



Accordingly, a new chapter was inserted by the Finance Act, 1993, in the Income-tax Act, 1961 (“ITA” or “the Act”), creating the AAR scheme in order to provide certainty, avoid needless litigation in respect of transactions involving non-residents in India.

The most interesting set up is in Sweden, where the members and deputies are appointed by the government who are tax experts with experience from various business areas such as courts, authorities, universities, etc.

### Binding Nature

The position regarding the binding nature varies from country to country<sup>2</sup>. In most of the countries such as Portugal, Spain, Germany, Denmark, etc. it is binding on tax authorities, but not on taxpayers. In Austria it is binding neither on tax administration nor on taxpayers. In Italy, it is not binding on tax administration, while in Luxembourg it is not binding on tax administration only in case of change in law. If the rulings are not obtained in “good faith” or incorrect or incomplete information is

<sup>1</sup> [https://www.ato.gov.au/General/ATO-advice-and-guidance/ATO-advice-products-\(rulings\)/Oral-rulings](https://www.ato.gov.au/General/ATO-advice-and-guidance/ATO-advice-products-(rulings)/Oral-rulings) (accessed in February 2021)

<sup>2</sup> [https://www.accountancyeurope.eu/wp-content/uploads/Advance\\_tax\\_rulings.pdf](https://www.accountancyeurope.eu/wp-content/uploads/Advance_tax_rulings.pdf)(accessed in February 2021)

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provided by taxpayer then in many jurisdictions the rulings are not binding.

## Tax Disputes and Need for Authority for Advance Rulings (AAR) – Position in India

As of March 2018, there were approximately 1,39,221 direct taxes cases under consideration at the level of ITAT, High Courts and Supreme Court. Just 0.2% of these cases constituted nearly 56% of the total demand value; and 66% of pending cases, each less than ₹ 10 lakhs in claim amount, added up to a mere 1.8% of the total locked-up value of pending cases as can be seen from Table 1.

**Table 1** - Amount (INR billion)

Financial Year	Commissioner of Income Tax (Appeals) CIT(A)		ITAT		High Court		Supreme Court	
	No of cases	Amount	No of cases	Amount	No of cases	Amount	No of cases	Amount
2014-15	232,126	3,839	37,506	1,455	34,281	377	5,661	46
2015-16	258,898	5,162	32,834	1,359	32,138	1,614	5,399	70
2016-17	290,227	6,112	37,968	1,438	38,481	2,878	6,357	80
2017-18	304,000	5,185	37,353	2,350	39,066	1,960	6,224	118
2018-19	339,000	5,628	92,205	NA	38,539	1,365	4,425	744

(Source: Report of the Comptroller and Auditor General of India, for the year ending March 2019 Pages 11 and 12)

The Economic Survey, 2017-18 highlighted poor success rate in appeals filed by the government. Table 2 shows that though tax department is the biggest litigator (more than 85% cases

are filed by the department) the success rate of the Department in Direct Tax cases at all three levels of appeal – ITAT, High Court and Supreme Court is low (under 30%).

**Table 2**

Courts	Success Rate	Petition Rate
Supreme Court	27%	87%
High Courts	13%	83%
ITAT	27%	88%

(Source: Economic Survey 2017-18, Ministry of Finance)

Tax litigation in India has not been a winning proposition, creating disincentive. This was appreciated by various Committees constituted by the government. Finally, while

Provincial Act or Government Companies for an issue related to computation of income pending before income tax authority and to other residents for determining tax liability for

a transaction with non-resident. In 2014, the scope was further expanded to include resident taxpayers where the tax liability in respect of a transaction exceeds 100 crore rupees.

delivering the Budget Speech for 1992, the then Finance Minister accepted need for the Authority for Advance Ruling. Accordingly, a new chapter was inserted by the Finance Act, 1993, in the Income-tax Act, 1961 (“ITA” or “the Act”), creating the AAR scheme in order to provide certainty, avoid needless litigation in respect of transactions involving non-residents in India. In 2000, the government extended the jurisdiction of the AAR to Public Sector Undertakings established under Central, State or

Further, with the introduction of provisions of General Anti Avoidance Rules (GAAR) in the Indian statute, the Government has yet again expanded the scope of AAR to include that all taxpayers (i.e., residents and non-residents) may seek advance ruling on whether an arrangement undertaken is an impermissible avoidance arrangement or not. These changes of widening the ambit of application eligible for AAR is a clear reflection of its serious intent and growing popularity.



**Section 245R(6)** provides that the AAR shall pronounce rulings within six months of the receipt of application.



The Memorandum to the Finance Bill, 2021 mentions that AAR is proposed to be replaced by a Board of Advance Ruling (BAR).

## Features of Existing AAR

The provisions regarding AAR are in Chapter XIX-B of the Act. It runs from section 245N to 245V. AAR has one Principal Bench in Delhi, one bench in NCR and one bench in Mumbai. AAR consists of a Chairman and various Vice-Chairmen, revenue member and law members. The principal bench consists of Chairman, one revenue member and one law member. The other benches consist of one Vice-Chairman, one revenue member and one law member, each. A bench cannot function, if the post of Chairman or Vice-Chairman is vacant. As per Section 245-O of the Act, persons eligible for appointment as Chairman of AAR are retired Judges of the Supreme Court, retired Chief Justice of a High Court or a retired Judge of a High Court who has served in that capacity for at least seven years. Similarly, the person eligible for appointment as Vice-Chairman are retired judges of a High Court.

Section 245R(6) provides that the AAR shall pronounce rulings within six months of the receipt of application. However, it has been observed that in several occasions rulings

were issued much beyond the time limit of six months. The disposal rate of AAR was 80% in FY 2006-07. From FY 2010-11 onwards the disposal rate came down abysmally low within the range of 6% to 23% during the period FY 2010-11 till FY 2017-18.

Section 245S of the Act makes the rulings binding on tax administration as well as on taxpayer who had sought it and

taxpayers. It is, also, proposed that an appeal to High Court can be filed by the taxpayer as well as tax administration. The appeal shall be filed within sixty days from the date of the communication of such ruling or order. On the date of notification of BAR provisions, all the pending applications before AAR will be transferred to BAR. Comparative provisions are summarized below:

Particulars	Authority of Advance Ruling (AAR)	Board of Advance Ruling (BAR)
Introduced	Finance Act, 1993	Finance Bill, 2021
Applicability of Ruling	Binding on both parties i.e., applicants and tax department	Neither binding on applicant, nor on tax department
Member	Chairman (Retired SC/HC judges) Vice chairman (Retired HC judges) One Law Member One Revenue Member	Two members each being officer of not below the rank of Chief Commissioner
Appeal against Ruling	No appeal is possible against the ruling of the AAR. Only remedy available is to file writ petition with the HC, which is a constitutional remedy.	Ruling of BAR will be appealable before the HC

is non-appealable. In reality, both tax administration and taxpayers take the matter to High Courts of law under the writ provisions of the Constitution of India.

## AAR - Changes Proposed by the Finance Bill, 2021

The Memorandum to the Finance Bill, 2021 mentions that AAR is proposed to be replaced by a Board of Advance Ruling (BAR). It is proposed that the Central Government shall constitute one or more BAR for giving advance rulings. Each such Board shall consist of two members, each being an officer not below the rank of Chief Commissioner of Income Tax. The advance ruling will neither be binding on tax administration nor on

## Concerns and Remedies

A perusal of the existing provisions regarding AAR shows that it has all the desirable features of a good



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system – it consists of members who are independent of the tax department, it makes the rulings binding on taxpayers as well as the tax administration and has prescribed a time limit of six months for the issue of rulings. It is to be seen how well the proposed changes are going to bring in a system providing

certainty to taxpayers.

Timeline and certainty are the two areas of concerns to be taken care by the proposed amendments in order to increase the effectiveness of advance ruling facility. As has been mentioned earlier, globally, within 3-6 months rulings are issued by the authorities. Similar timeline should be prescribed in India, too. If there is any delay on the part of taxpayer or there is any specific request by taxpayer for delaying the ruling that time may be excluded while computing the timeline.

So far as certainty is concerned the proposed changes may not meet the objective of reducing litigation and providing certainty to investors in India.

With right of appeal to the tax department as well as to taxpayer, the BAR would work as a normal litigation body and not a “Dispute Prevention” body. A shorter time frame for obtaining a final resolution under the normal litigation process, would facilitate foreign or domestic investors.

Government may consider borrowing the concepts of advance rulings from Advance Pricing Agreement (APA) scheme, which has been very successful in bringing down transfer pricing disputes in India. A conciliatory approach adopted by tax administration and taxpayers have inclination and capabilities to reach a mutually beneficial dispute resolution. ■■■

