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The Viewpoint

[The Viewpoint] Whither advance ruling under Income Tax law?

The stature of the new body entrusted with powers to pronounce advance rulings has been lowered, its independence has been diluted, and its rulings have become appealable.



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Published on :

05 Jan, 2022, 10:12 am

7 min read

'Prevention is better than cure' is an adage that applies equally to litigation, especially to tax litigation. Towards this end and based on several committee reports starting from Wanchoo Committee (1971) to the Choksi Committee (1978) and Raja Chelliah Committee (1993), the government eventually introduced a mechanism for advance rulings by inserting a new Chapter XIX-B in the Income Tax Act, 1961.

Accordingly, a high-level judicial body called the Authority for Advance Ruling, headed by a retired Supreme Court judge and including two high-ranking members of the Indian Revenue Service and the Indian Legal Service, came into existence. The Authority was conferred judicial autonomy and was kept outside the administrative control of the Central Board of Direct Taxes (CBDT).

Initially, its remit was limited to questions of taxation of proposed transactions brought before it by non-residents. The scope was expanded over the years to include various other categories of transactions. Its rulings were binding on the applicant and the tax department, and could not be challenged except by way of writ petitions. The Authority functioned for over 25 years, barring for periods when on retirement of its Chairmen, new incumbents could not be appointed in time.

In a surprise move, the Finance Act 2021 abolished the Authority and replaced it with an in-house body named the Board for Advance Rulings (BAR) comprising two Chief Commissioners of Income tax.

Tax certainty is a highly desirable objective acknowledged by lawmakers and sought by taxpayers. Advance rulings go a long way in providing certainty in respect of large transactions that can potentially lead to vexatious litigation. The increasing complexity of global commerce, international tax treaties and their inter-play with domestic tax laws make advance rulings a vital mechanism for foreign investors to avoid litigation and related tax costs. The tax authorities also benefit through reduced compliance workload and improved tax compliance. For these reasons, advance rulings are a common feature of mature tax systems including those in the United States, the United Kingdom, Netherlands, Germany, and most Organisation for Economic Co-operation and Development (OECD) countries.

A technical note of the International Monetary Fund (IMF) describes advance tax ruling as:

"(an) advice that a taxpayer may seek from the tax authority in relation to the application of the tax law to their particular arrangement. The ruling typically binds the tax authority in relation to the arrangement for which it is issued. As such, the taxpayer will ordinarily be protected from additional tax, penalties and interest when relying on the ruling issued. The benefit of a private tax ruling is typically personal to the taxpayer to whom that ruling is issued and is not binding on the tax authority as against other taxpayers, even if the same or similar circumstances exist."

The Handbook on Advance Rulings issued by the Authority approvingly quotes the definition of advance ruling given in the International Guide to Advance Rulings (IBFD,1997-2000) as "*a binding statement from the revenue authorities upon the voluntary request from a private person, concerning the treatment and consequences of one or a series of contemplated future actions or transactions.*"

The objective behind the introduction of Chapter XIX-B in the Income Tax Act constituting the Authority was stated by the Union Finance Ministry as under:

"(To) entrust the power of giving advance rulings to an independent adjudicatory body and to ensure further that the procedure is simple, inexpensive, expeditious and authoritative."

Section 245N of the Act defined 'Advance Ruling' to mean:

(i) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant; or

(ii) a determination by the Authority in relation to] a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with non-resident.

The scope of advance ruling was repeatedly expanded by the legislature to include various other types of transactions. For example, transactions by PSUs, specified types of transactions by residents etc. The Act required the Authority to pronounce rulings within six months of the applications. These were binding on the applicants and the tax department. Two additional benches of the Authority were created in 2014 in New Delhi and Mumbai, headed by retired High Court Judges.

Over the years, the Authority through its rulings developed a specialised jurisprudence relating to the interpretation of tax treaties and international tax issues. Barely a fraction of its rulings were challenged by way of writ petitions before High Courts and most rulings were accepted by both parties. Although the rulings did not have precedential value, these were widely reported in various law journals and referred to by High Courts and even the Supreme Court for their persuasive value. The Authority therefore enjoyed judicial stature and credibility in the eyes of potential applicants.

Dealing with the efficacy of the Authority, the Finance Ministry in its Annual Report for 2019-20 stated that:

"The functioning of the Authority has been found to be very useful particularly to the non-resident entities doing business in India. In view of the growing number of applications, two new benches of the Authority one at Delhi for National Capital Region and the other at Mumbai has been set up."

The only hitch in the functioning of the Authority was that the pendency of applications kept on mounting, as on occasions, the Authority was non-functional due to lack of quorum as the appointments of Chairmen/members could not be made in time. The expansion of the scope of work coupled with the frequent absence of a Chairman meant that the statutory time limit of six months could not be adhered to.

The Finance Act 2021 summarily replaced the Authority with BAR, comprising two Chief Commissioners of Income Tax. It provided that the rulings of BAR will not be binding and both sides can file appeals before the High Court. A formal notification constituting three Boards for Advance Rulings was issued on September 1, 2021. These have not yet started functioning.

The reason given in the memorandum to the Finance Bill, 2021 for this change was that since only retired judges of the Supreme Court and retired Chief Justices of High Courts were eligible for appointment as Chairman, these posts remain vacant due to non-availability of eligible persons, resulting in large pendency. The memorandum throws no light as to why rules relating to eligibility qualification for appointment of Chairmen, or their retirement age could not be appropriately relaxed to address this issue.

The constitution of the BAR shows that it will not have a representative of the judiciary. Both its members will be Chief Commissioners of Income Tax, whereas the members of the erstwhile Authority used to be of the rank of Members of CBDT. Although it is not clear whether BAR will be part of the Income Tax department, it appears to be akin to an administrative authority discharging quasi-judicial functions. The provision of appeals by the applicant as well as the Commissioner of Income Tax robs the rulings of the BAR of their finality. It is therefore clear that the stature and level of the new body entrusted with powers to pronounce advance rulings has been lowered, its independence has been diluted - at least in the public eye - and its rulings have become appealable, adding to the burgeoning litigation before the High Courts.

A review of international best practices shows that the mechanism of advance rulings succeeds when the authority empowered to issue these is a high-powered, specialised, independent judicial body giving expeditious and legally binding rulings. Granting a statutory right of appeal to applicants and the tax department goes against the basic concept of advance rulings. It robs the rulings of their finality, adds an additional layer of uncertainty/time for the applicants, and increases the workload before the higher courts. The Supreme Court in *National Co-operative Development Corporation* noted the tendency of the tax department to indiscriminately take matters to courts and mentioned that the petition rate of the tax department before it is at 87%. The Court added a post-script to its judgment, stating:

“In our opinion, a vibrant system of Advance Ruling can go a long way in reducing taxation litigation. This is not only true of these kinds of disputes but even disputes between the taxation department and private persons, who are more than willing to comply with the law of the land but find some ambiguity. Instead of first filing a return and then facing consequences from the Department because of a different perception which the Department may have, an Advance Ruling System can facilitate not only such a resolution, but also avoid the tiers of litigation which such cases go through as in the present case. In fact, before further discussing this Advance Ruling System, we can unhesitatingly say that, at least, for CPSEs and Government authorities, there would be no question of taking this matter further once an Advance Ruling is delivered, and even in case of private persons, the scope of any further challenge is completely narrowed down.”

Going further, the Court underlined that the aim of the advance ruling system should be to bolster tax compliance and boost tax morale, and that it should not become another stage in the litigation process. It recommended that:

“We, thus, consider it appropriate to recommend to the Central Government to consider the efficacy of the advance tax ruling system and make it more comprehensive as a tool for settlement of disputes rather than battling it through different tiers, whether private or public sectors are involved. A council for Advance Tax Ruling based on the Swedish model and the New Zealand system may be a possible way forward.”

The constitution of BAR and related changes introduced by the Finance Act, 2021 go against some of the basic conceptual requirements of a successful advance ruling system. A cardinal objective of advance ruling systems is to enable a taxpayer proposing to enter into a large complex transaction to obtain a binding ruling *beforehand* from the tax department or from an independent outside body. The lowering of the stature of the new body will not do anything to inspire the confidence of investors/taxpayers in its

independence, particularly in respect of high value and complex international transactions.

Further, the right of appeal against rulings of BAR to High Courts given to taxpayers and the tax department will keep lingering in litigation instead of coming to a quietus quickly. Besides, it will add a new class of appeals before High Courts, where it anyway takes three years or more to decide normal tax appeals. These provisions need to be given a fresh look in light of the observations of the Supreme Court in *National Co-operative Development Corporation*.

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