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International Tax disputes-A Study of Factors responsible and Remedies

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I. Introduction

Every country requires treasure to run the economy and also to meet the contingencies.

Taxes, in any country are the source of revenue which would take care of the treasury in times of difficulty. "Taxes should not be in a way to penalize the public, but should be soft in nature in levy and collection **Kautilya 350-275B.C"Arthasashtra" https://www.ancient.eu/Arthashastra/ .**Any country's growth and development is indicated by the timely payment of taxes by the people earning income. This would also create the wealth in the country. India's taxes are always levied on the fiscal procedures which is supported by strong laws governed by CBDT. But the growing trade and economies opening up has lead to increase in job opportunities across the countries which is leading to movement of people from one country to another for their earnings. This is giving rise to complexities in taxability of their incomes. Any income would be taxed in the hands of resident country where the source of income arises. Income earned in one country could be taxed by another country. This would give rise to Double Taxation.InIndia, Article 246 of the Indian Constitution distributes the legislative powers regarding taxation between Parliament and State legislature for levy of taxes earned in India. According schedule VII list I entails only the parliament to make laws, List II entails the state to make the laws, List-III entails both Parliament and state to make laws relating to taxes. There are strong rules relating to domestic taxation in India. But the legislations at the international level to levy tax on international transactions due to absence of legislature at the international platform. However, part IV of the Indian Constitution in its Directive Principles of State Policy includes specific provisions, covering international law and treaty obligations in Article 51: The state shall endeavor to- (a) Promote international peace and security
(b)maintain just and equitable relations between nations:
(c) foster respect for international law and treaty obligations in the dealings of organized people with one another; and
(d) encourage settlement of international disputes by arbitration[1].
1.Aspects of International Taxation-A study: Fiscal Laws Committee ICAI
In the absence of legislations relating to the taxation of international transactions, Treaties would enable the countries to come to consensus about the taxability of the income in a country. A treaty is defined under Article 2 of Vienna convention of 1969, as an agreement where by two or more state establish or seek to establish a relation ship between themselves governed by international law.[2]

Significance of the study:
With growing complexities in the transactions across the globe, the need for knowledge of their taxability also gains prominence, which is based on international tax rules between various countries. The countries are obliged to follow the treaty provisions, failing which, the countries have to experience the international tax disputes, which need to be resolved amicably within the ambit of treaty provisions.
Scope of the study:
The scope of the study is related Indian context about the tax disputes,factors leading to various disputes and settlement of tax treaty disputes.
Objectives of study:
The study is based on three objectives viz.,
1. To study the factors responsible for international tax disputes
2. To study the loopholes in the tax agreements
3. To study the resolutions in bridging the gap in implementing the tax treaties.
Methodology of the study:
The methodology involved is collection of data through secondary source through OECD websites, UN treaty websites, Fiscal committee site, income tax web site…

Limitations of the study:
1. Study is based interpretations of the secondary data
2. Accuracy is limited to the interpretations of the statute

2.Starke's International Law; Eleventh edition
3. Fiscal laws Committee, ICAI

II. Review of Literature

Countries are obliged to adopt treaties and implement cross border transactions. This gains prominences when countries are part of treaties at international level. A treaty is understood in common terms as " a formally concluded and ratified agreement between independent nations[3.]

Treaties in the area of tax are made for the benefit of the nations also the tax payers, which might help in Double taxation. Double Taxation is income earner is taxed in their resident nation and also in the country where the income is earned. This discourages the countries in cross border transactions by way of technology exchange or capital assets purchase or investments in other countries. Avoidance of double taxation helps in increasing the flow of funds from one country to other and also serves source of increase in revenue to developing countries. Taxation should not discourage the investment flow into a country. To this extent the tax neutrality has to be encouraged amongst member and non member countries of treaties. According to Fiscal Committee reports Tax neutrality has standards in the areas of :

1. Capital-export neutrality
2. Capital-Import neutrality or foreign competitive neutrality
3. National neutrality.

Capital export neutrality: explains about the tax neutrality in the area of investment in the home country or overseas investment. Tax has no influence on the investments. In the absence of the tax treaties the investor might have to pay tax in both countries. With the intervention of tax treaty there is no difference for the investor whether he invests in his home country or invests overseas.

Capital import neutrality: In the absence of a tax treaty, if any company is receiving benefit from overseas company, the recipient company has to pay tax in their country and the country in which they are exporting the benefit. If there is a treaty between two countries about tax neutrality and if one country would exempt in its land based on jurisdictional tax neutrality more companies would cross overseas in expanding business and marketshare

National neutrality: gains importance when tax paid in one country is deducted while paying taxes in another country because of agreements or treaties between the countries. These agreements are called as Double Taxation Avoidance Agreements. In order to encourage free movement of goods and services from one countries many countries are entering into Double Taxation Avoidance Agreements. India has 103 International Tax treaties and majority of them are functional.

Indian Income Tax Act 1961 provides for sec 90 and 91 for international taxation. International Taxation follows two models UN model and OECD(Organisation for economic cooperation and Development)Model of treaties.

Many countries follow either UN model or OECD model or at times combination of both. When there is a dispute between the nations on the model to follow, consensus between the nations have to be gained in adopting the models for tax treaties. There are two modes of taxing the overseas income.viz., 1.source of income.2.residential status of the earner, according to Fiscal laws committee[4]. UN model emphasis on source of income for taxability as against OECD model supports residence basis for taxability of incomes on various sources. DTAA's of India are generally a mix of both source taxation and resident taxation. The mode to be adopted is based on the bargain between the nations entering into tax treaty. The treaty between the nations can be accepted by the Courts in the respective countries only when such treaty has received the sanction of the Constitution of the countries which are party to such treaties. Once such treaty receives the sanction of the Constitution, even the nations' courts have to respect according to ***Shah J. Megan bhai Vs. UOI AIR 1969 SC 783***, which emphasizes and insists the treaty implementation with a foreign nation[5].This citation also explains the power to legislate is conferred on Parliament by entries 10 and 14 of List 1 and VII schedule. This supports that the Central Government is empowered to enter into Double Taxation Avoidance Agreements.

Income Tax Act ,1961 has provided many sections from section 5 onwards as provisions to tax non residents, who might take advantage of tax neutrality on ground of national neutrality.

The advantange of tax treaty is understanding between the nations which nation is foregoing and which nation is benefitting and sharing in losses and benefits between the nations. International Fiscal Association in 38th Congress in Buenos Aires has resolved that the source system of taxation is preferable against the residential status. However, this may work to the disadvantage of developing countries with lesser economic resources. Therefore most of the treaties are the combination of residential status and source based form of taxation. In recent times, the concept of Permanent Establishment and source based taxation is becoming almost obsolete and is moving more and more towards a residential staus based taxation. However, source based form of taxation and permanent establishment have not lost their relevance in the international taxation treaties as according Fiscal committee review. Permanent Establishment (PE) is a fixed place of business which generally gives rise to income or value-added tax liability in a particular jurisdiction. The term is defined in many income tax treaties and in most European Union Value Added Tax systems.

Yitzhak(Isaac) Hazaari (1972) The tax systems of all capital-exporting countries (usually refferred to as "developed countries") provide for unilateral relief measures to cope with the problem of double taxation. In his study he contends that, however, that the problems of international taxation are better solved by the use of tax treaties than through the unilateral promulgation of national laws. Experience has shown that while tax treaties may not necessarily be optimal, they do represents satisfactory accommodation of conflicting tax claims. The substantive problem of taxation as it affects the MNE may involve not only "overlap" but also "underlap". "Overlap" refers to the situation where the MNE is taxed on the same income by more than one jurisdiction, and as a result the total tax burden is greater than it would have been if the income had been earned in a single country. On the other hand, double taxation "underlap" refers to the situation where the MNE conducts its operations to avoid substantial taxation by any jurisdiction.

As was also stated in **OECD draft (1997) "**OECD model tax treaty", goal of treaty is to remove the obstacles that double taxation presents to the development of economic relations between two countries.

John A Townsend.(2001)The focus of his article is not the importance of or even correctness of the issue resolved in NatWest. Rather, this article uses NatWest as an entre into broader issues of tax treaty interpretation. He tries to analyse the importance of cross border and interpretation of tax treaties with relation to tax implementation In National Westminster Bank, PLC v. United States' ("NatWest"), the Court of Federal Claims handed the Internal Revenue Service a stunning defeat based on the court's interpretation of the United States-United Kingdom treaty. The treaty requires that a resident of one treaty state' ("residence state") doing business in the other ("host state") through a permanent establishment (PE) must compute its host state tax using "the Separate Enterprise Construct."4 The question in NatWest was whether, under the Separate Enterprise Construct, the tax payer could treat intracompany advances from the home office and non-U.S. branches to its U.S. branch (a PE) as loans and deduct the "interest" against the PE's U.S. tax. The advances had been booked by the PE as loans to it on a separate profit center accounting basis. The court held that the Separate Enterprise Construct of the treaty required the Service to honor the loans, and thus the taxpayer could deduct the interest in computing its U.S. tax. In so holding, the court held that the treaty trumped the U.S. law, as interpreted in regulations, which would have limited the taxpayer's opportunity to distort its U.S. PE's debt relative to its worldwide debt.6 The Service views the treatment required by the regulations as important to curb artificial reductions in the U.S. tax base.Very large amounts of tax are at issue.' Although the NatWest court limited its holding to financial institutions, other British financial firms doing business in the United States through a PE will qualify for this relief if the decision stands. Moreover, financial firms resident in other treaty partner states and doing business in the United States through a PE may qualify for relief, for the Separate Enterprise Construct is common in U.S. treaties. Fiscally, therefore, the decision is important

If the countries have to grow and develop, flow of capital from country to country has become inevitable. This would lead to capital flight leading to the overall growth of the incomes of the country. As was rightly observed by **Ronald. B. Davies (2003)** that Model tax treaties do not require tax rate coordination, but do require that either credits or exemptions be applied to repatriated earnings. This contradict recent models with a single capital exporter where deductions are most efficient. He incorporates the fact that capital flows are typically bilateral. With symmetric countries, credits by both is the unique and efficient treaty equilibrium. This equilibrium weakly dominates the non treaty equilibrium. With asymmetric countries, the treaty need not offer improvements without tax harmonization. With harmonization, it is always possible to reach efficient capital allocations while increasing both countries' welfares only if neither uses deductions. He suggested three basic methods of double taxation reliefs are 1.deductions 2. Tax credits 3.exemptions. Under deduction method the home governments treats host taxes as a cost. Thus after host-tax-profits are taxed by the home government at the home statutory tax rate. Under credit method, the home government offers a limited credit for host taxes paid when calculating the home tax bill. This credit is limited in the sense that the home government does not rebate excess credits to the firms. Thus, if the host bill is larger than the price credit home tax liability, the firm is in an excess credit position".

This is the point where the nations have to agree upon the method of tax reliefs and model which they need to adopt. Each model has its own interpretation of their statutes and treatment of provisions for their taxability. Countries have to get better bargain for each one so that no one is losing for the other country.

At times there is also a problem of DTAAs overriding the provisions of domestic act. This is normally known as Treaty Override. The popular decision of Andhra Pradesh High court in the case **CIT Vs Visakhapatnam Port Trust(1983) 144 ITR 146(AP)** was that the High Court considered the International Law on this subject and concluded that the universal opinion is that treaty overrides the Act[6]. If there is any conflict between an income in domestic country in relation to DTAA as was in the case of CIT Vs Hindustan Paper Corporation Ltd(1994)77 Taxman 450, it was resolved that DTAA would override the provisions of the Act the extent they are more beneficial to the domestic country. In case of absence of any provisions in DTAA, the Act should be followed. Similar views have also been expressed in the case of Arabian Express Line Vs.UOI[7] There should be consensus amongst countries in respecting each other's domestic laws of taxes as the international law influences the domestic laws of that particular country. Interpretation of statutes also can be problematic in implementation of international tax treaties

In case of serious conflicts between countries about their treatment within the purview of the tax provisions and international law, there has to be a re-negotiation between the nations to the extent of utmost clarity. Till the time they are re-negotiated, it cannot be treated as treaty abuse as this would amount to be treaty shopping. In a situation where treaty shopping is legitimate or not, Supreme Court and given tacit recognition and acceptance in the decision of **UOI VsAzadiBachaoAndolan ,**the Honourable Supreme Court has held that even if it is considered as treaty shopping and amounting to unethical it cannot be prevented since, courts are obliged to interpret the law as it is[8]. It is between the countries to amicably settle issues and implement the tax treaties for the trade and development of the countries .

As it was rightly pointed by **Richard Chisik and Ronald B Davies (2004)** in his work he observed and analysedtha**t t**here is no external body that can enforce tax treaties.While he was trying to explain the irreversable nature of a tax treaty his study on FDI in relation to why the tax rates used under the tax treaties are gradually falling he considered two-way capital flows with irreversible FDI. The extent of irreversibility determines the magnitude of initial tax reductions. A treaty must be self enforcing as well as mutually beneficial. It was also emphasized in International Fiscal Laws Committee that DTAA's not being different from any other international arrangements or agreements the will be interpreted using the same manner as any other international laws .In this regard in case of any conflict of interpretation,Vienna Convention,1969 will be applicable in interpreting DTAAs. DTAAs are negotiated keeping in mind economic and trade benefits accrued to the country. Every country tries to gain over other country. In this process of gaining over other country, there are some countries declaring their part of the country or entire country as tax haven depending upon the geographical area. The countries which have declared themselves as tax havens would exist to be part of DTAAs to boost inflow of trade into their country or location. But these tax havens are posing threat to the countries in encouraging the corruption. There is a need for the countries to declare the period of tax haven due to dichotomy in countries DTAAs. The countries should come to a common DTAA in implementation.

AnnetWanyanaOguttu(2009) In his article analyses how the conflict between the conflict South Africa's South Africa's CFC legislation and its tax treaties can be resolved, in order to prevent the avoidance of taxes that result from investing in offshore companies, countries often enact "Controlled Foreign Company" (CFC) legislation which ensures that the undistributed income of a controlled foreign company is not deferred, but it is taxed to its domestic shareholders on a current basis. However, the application of CFC legislation has been questioned on the basis that it contradicts some of the basic principles of double taxation treaties. In this article the salient aspects of tax treaties that are considered to be incompatible with CFC legislation are also analysed.

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5Fiscal laws committee: ICAI February, 2006
6.Fiscal laws committee:ICAI Februaru,2006
7.Fiscal laws committee:ICAI February, 2006
8.Fiscal Laws committee;ICFAI Februaru,2006

NielsJohannesen and Gabriel Zucman(2014) In this article the authors studied the policy compliance of treaties and implications on nations. "During the financial crisis, G20 countries compelled tax havens to sign bilateral treaties providing for exchange of bank information.Policymakers have celebrated this global initiative as the end of bank secrecy. Exploiting a unique panel dataset, our study is the first attempt to assess how the treaties affected bank deposits in tax havens. Rather than repatriating funds, our results suggest that tax evaders shifted deposits to havens not covered by a treaty with their home country. The crackdown thus caused a relocation of deposits at the benefit of the least compliant havens"..

There is always a risk of tax treaties not being covered under the principles of Vienna Convention,1969. A treaty formed without declaring its framework attracts problems of mis interpretation of statutes and leading to confusion in modifying the laws at the domestic laws. This might also create problems of jurisdiction due to lack of clarity.

There is also a possibility of type of treaty that could be formed between the countries. Tax treaties should always be bilateral to enjoy the maximum benefits between the countries. Any kind of complexities can be resolved between both the countries quickly as there is also a provision that unless both countries accept upon the provisions a treaty cannot be implemented in the respectives countries. The matters of confusions can be resolved with much clarity. In case of plurilateral and multilateral treaties, the countries, if raises any reservations, the matters cannot be resolved quickly and cannot be compelled to implement the treaties, as there is no compelling legal mechanism to compel the countries to follow the treaties

It is always beneficial for the nations to be a part of either of the models viz., OECD or UN before entering into treaty with any other country. Though OECD model treaty is not a multilateral treaty model, it would suggest the ways in which the nations can made multilateral treaty and ways of resolving the matters through OECD model.

The countries which are entering into treaty should be able have a common fiscal year as each country has their own fiscal year. In order to avoid the confusion and complexity, the countries should follow a common fiscal year as part of their DTAAs

The tremendous growth in the international business is also leading to complexities in the cross border taxation. Tax laws which are personal in nature to the country, are at times creating conflict amongst the nations in implementations and exchange of technology and various other areas.OECD has been actively involving itself in resolving the issues arising in the area of international taxation as unresolved issues can undermine the activities and can hinder the growth of the nations. Major areas of thrust were OECD model has developed a model for the Double Taxation avoidance agreements, transfer pricing in the exchange of technology. These are the two major areas which needed an action. Another major leap in resolving the international tax issues was development of Advance Pricing Agreements amongst multinational corporations which would exchange the technology from their subsidiary company by a parent company. And every corporate would like to work under less tax regime. While transferring the technology a proper price has to be fixed up to avoid disputes. This is determined by Advance Pricing Agreements where the governments fix up proper tax rates even before the transactions becomes effective. This method would resolve the issue of taxation as the transactions is effective only when both the parties have consented for the price of the product including tax rates. Apart from the above method MPA(Mutual Price Agreement) method is also one of the dispute settlement method arising in the international taxes, which was developed by OECD. According to this model the countries which are not part of OECD model are asked to submit their details in dealing with international transactions for better transparency of matters settlement. This would also help the countries dealing in OECD model in resolving their disputes amicably. OECD is also developing some more methods of dispute resolution techniques and trying to foster the relations in a better way.

III. Conclusion

Growing overseas business increases the complexities multifold. In the absence of an constitutional support in implementation of laws in resolving the complexities, treaty plays an important role. Countries are obliged to adopt and implement the treaties by acceding. The treaties bind the nations in exchanging the information and gaining mutually the benefits. Tax treaties have to be carefully planned and implemented at the international plat form which is aimed by treaty to have a smooth conduct of trade and business.

Two Models viz., UN model and OECD models have been actively involved in resolving the disputes formulating their techniques implementable upon the nations. OECD nations are frequently meeting in devising the techniques to resolve the issues in settling the international tax disputes.

The Governments have to think as statesmen in not allowing the countries to declare their countries as tax havens for longer period of time. This would lead to blocking of capital in one area and not getting utilized for the development of the home country.DTAAs also should emphasise the matters relating to tax havens for a specific period of time. Each country which is part of a treaty should respect each other’s laws and courts’ also will be within the purview of DTAAs in implementation in case of any conflict between domestic laws and DTAAs.

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