



**Authority for advance  
rulings in indirect taxes**

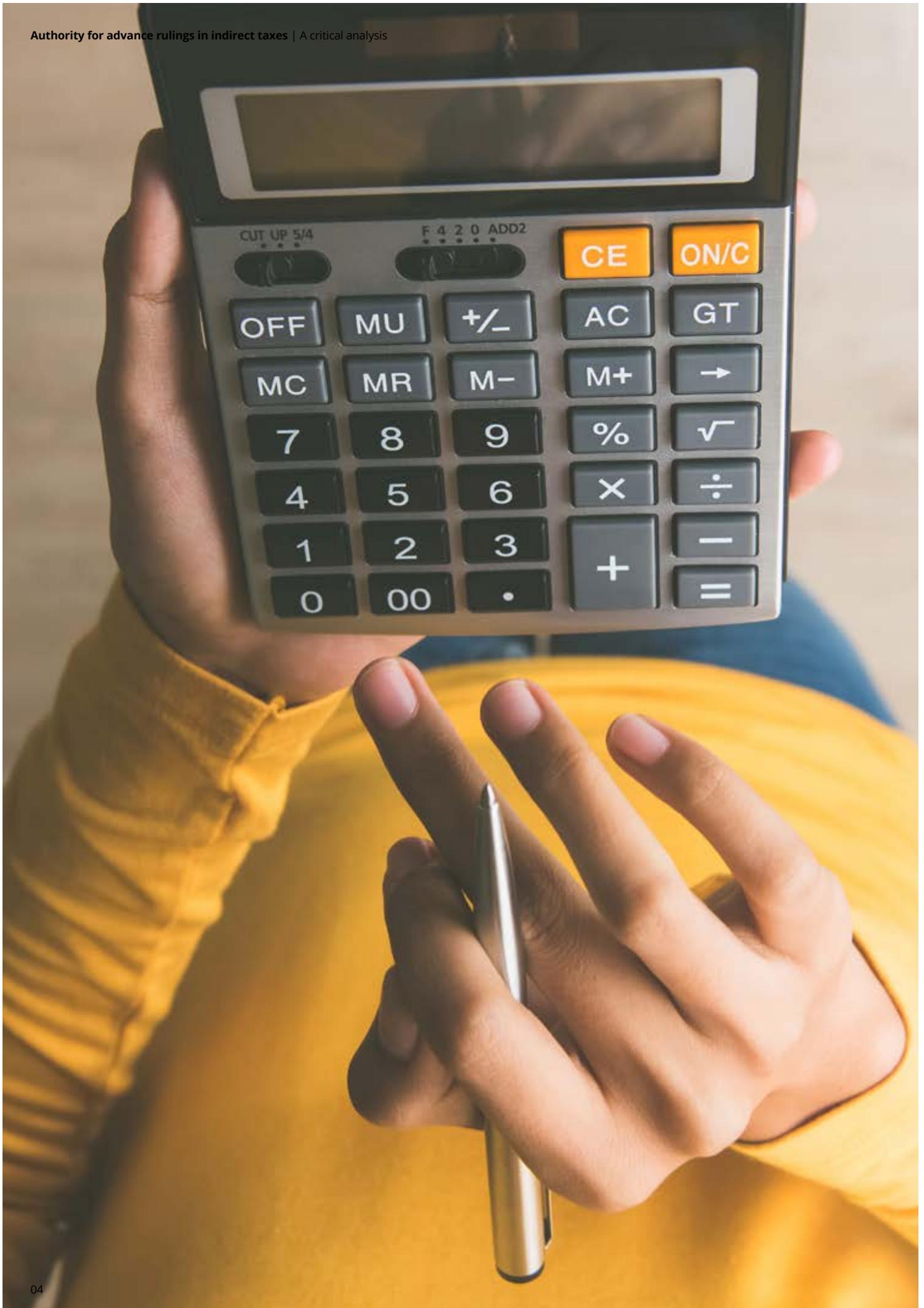
A critical analysis

Deloitte Tax Policy Paper 3  
For Private circulation only



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# Authority for advance rulings in indirect taxes – A critical analysis

Deloitte is pleased to announce the release of its white paper on the advance ruling authority in relation to indirect taxes in India. This paper discusses the evolution of the advance ruling mechanism in India, attempts a critical analysis of its functioning and, in the light of the experience gained, explores measures that could enhance its effectiveness.

This white paper draws on Deloitte's extensive international knowledge, experience of the Authority for Advance Rulings (AAR), and best practices in the operation of such arrangements. It also analyses the present working of the AAR in India. We trust that the recommendations provided in this white paper will be useful for you and tax authorities for making the AAR scheme more effective for taxpayers.

Deloitte remains committed to being a knowledge-driven organisation. We aim to develop cogent thought papers, which look at topical issues and deliver useful insights. If you want deeper insights on any or all of the topics we have presented in this paper, please do not hesitate to contact us.



## Executive Summary

Certainty and predictability in taxation are two critical enablers for creating a climate conducive for economic growth. Uncertainty in taxation not only leads to increased costs for businesses but also has a damaging effect on the economy as it discourages further investments.

An advance ruling mechanism goes a long way in providing certainty to taxpayers. Advance ruling is broadly defined as a written opinion or decision by an authority empowered to render the decision with regard to the tax consequences of a transaction or proposed transaction or legal provision. According to global practices, the

advance ruling mechanism encompasses public and private rulings. While public rulings represent the administration's interpretation of a particular provision that affects a large number of taxpayers, private rulings are issued pursuant to an application made by a taxpayer on the interpretation of a provision on specific transactions.

In the Indian context, public rulings represent orders and circulars issued by the tax department. To provide private rulings, the AAR is established. The facility to obtain advance ruling was initially restricted to only non-residents. In view of joint ventures and subsidiaries

of foreign companies, etc., proposing, to undertake business transactions in India and the felt needs of the domestic industry, the AAR's scope was expanded, wherever required, to make it investor friendly.

The mechanism for seeking private rulings or advance ruling has also continued in the goods and services tax (GST) regime. The AAR is now set up for each state separately. The authority comprises one officer each, not below the rank of joint commissioner, from the central administration and the concerned state administration. There is also an appellate forum created in the form of the Appellate Authority for Advance Ruling (AAAR). The forum comprises the state GST commissioner and a nominated chief commissioner under central GST (CGST). Therefore, the AAR and the AAAR now function as an extended arm of the GST department.

In the erstwhile indirect tax regime, the AAR's use was limited for a variety of reasons. Unlike earlier, AARs in the GST regime have witnessed a brisk inflow of applications and the rulings appear to be getting issued in a prompt manner. However, it seems the expeditious disposal of the applications is made at the cost of quality of the decisions. In most decisions, a distinct revenue bias is apparent. Often the rulings are cryptic and do not analyse the relevant provisions in detail.

A wide divergence in interpretation of the same legal provision by different state AARs on similar facts creates compliance challenges for businesses and defeats the vision of "One Nation One Tax". To address this issue, the GST Council proposed the creation of a centralised appellate authority in its meeting dated 22 December 2018. The

authority will provide advance rulings to deal with cases of conflicting decisions on the same issue by two or more state appellate advance ruling authorities. The details around the constitution and functioning of such an authority are yet to be announced.

However, given the dissatisfaction amongst taxpayers, setting up a centralised appellate authority by itself may not be a satisfactory solution as this proposal fails to address concerns related to the quality of the advance rulings issued at the first stage.

This paper argues that the government can look at the following options to make the advance ruling mechanism more effective, efficient, and taxpayer friendly:

- Make the AAR and AAAR independent national-level mechanisms outside the purview of tax administration. This would help these mechanisms gain greater taxpayer confidence. The AAR should have a sufficient number of benches at multiple locations to ensure that it provides taxpayers easy access to rulings. This could solve the issue related to the timely delivery of advance rulings, which was missing in the pre-GST regime.
- If the above-mentioned option is not feasible, the AAR can be functionally independent. Its composition could be upgraded by ensuring adequate staffing and resources, and inducting more senior-level and experienced officers as members. Further the appellate mechanism should be independent of the department.

The reform on these lines will go a long way in providing taxpayers with certainty in taxation and increase investors' confidence in India at a global level.



## Background

Benjamin Franklin once said that in this world nothing can be said to be certain, except death and taxes. It is certain that the tax will be levied. How it will apply in the given circumstances is often uncertain on account of disputes around the interpretation of applicable laws between taxpayers and the tax administration, leading to unintended consequences for taxpayers. This is especially true in the contemporary world, which is in a state of continuous flux due to rapid technological changes and globalisation. These have brought in complexity in the economic, business, and regulatory environments, leading

to a high level of uncertainty in the tax environment.

It cannot be gainsaid that certainty and predictability in taxation are two critical enablers for the creation of a climate conducive for economic growth and investor friendly environment in an economy. Uncertainty in taxation and the resultant tax disputes could have a damaging effect on the economy as they tend to inflict costs on businesses and deviate from the tax system's main goal (to sustain a robust revenue stream for the government). An unpredictable tax environment also makes long-term

investment decisions difficult, making an economy unattractive for investors. An effective advance ruling mechanism goes a long way in mitigating the risks associated with uncertainty for taxpayers. It is consequently essential for making an economy attractive to international investors.

The scale of disputes between taxpayers and the government at all levels of administrative and judicial hierarchies is an unpopular feature of the Indian tax landscape. The dimensions of this problem are large enough to have attracted the attention of the authors of the country's Economic Survey (the Survey). The survey sets the context for the central government's annual budget for 2018<sup>1</sup>. One can do no better than to quote from the opening lines of Chapter 9 of the Survey:

“The government’s efforts to make business and commerce easy have been widely acknowledged. The next frontier on the ease of doing business is addressing pendency delays and backlog in the appellate and judicial arenas. These are hampering dispute resolution and contract enforcement, discouraging investment stalling projects, hampering tax collections but also stressing taxpayers and escalating legal costs. ....”

The Survey's analysis of six prominent appellate tribunals that deal with high-stake commercial matters revealed two patterns. It notes, “First, there is a high level of pendency across the six tribunals, estimated at 1.8 lakh cases. Second, pendency has been rising sharply over time. .... Compared to 2012, there is now a 25 percent increase in the size of unresolved cases. The average age of pending cases across these tribunals is 3.8 years.”

The Survey makes another important observation that, “creation of tribunals at different points in time did not alter pendency at five High Courts of the country not their ability to deal with other economic cases. .... While the volume of economic cases is smaller than other case categories, their average duration of pendency is arguably the worst of most cases, nearly 4.3 years for 5 major high courts. The average pendency of tax cases is particularly acute at nearly 6 years per case... The overall impact of rising pendency at Appellate Tribunals, High Courts and the Supreme Court, coupled with injunctions and other blunt instruments, has led to spiraling legal expenses of Corporate India.”

The Survey further observes, “Pendency, arrears and delays are not just a feature of courts and tribunals, but also the Tax Departments and their multi-layered process.”

In relation to indirect taxes, the Survey notes, “As of the quarter ending March 2017, a total of 1.45 lakh appeals were pending with the Commissioner (Appeals) of Central Excise and Service Tax Appellate Tribunal (CESTAT), High Courts, and the Supreme Court, together they were valued by the department at INR 2.62 lakh crore. Together, the claims for indirect and direct taxes stuck in litigation by the quarter ending March 2017 amounted to nearly INR 7.58 lakh crore, over 4.7 percent of the GDP.”

<sup>1</sup>Economic Survey 2017-18, Ministry of Finance, Government of India.

The Survey also notes that the government's success rate in litigation was very low as shown by the following figures.

**Petition rate and success rate of the tax department, as on 31 March 2017**

| Direct Tax Cases |              |               | Indirect Tax Cases |               |
|------------------|--------------|---------------|--------------------|---------------|
| Court            | Success Rate | Petition Rate | Success Rate       | Petition Rate |
| Supreme Court    | 27%          | 87%           | 11%                | 63%           |
| High Courts      | 13%          | 83%           | 46%                | 39%           |
| ITAT/CESTAT      | 27%          | 88%           | 12%                | 20%           |

Source: Economic Survey 2017-18

In Chapter 5 of its report<sup>2</sup>, the Tax Administration Reform Commission (TARC) had pointed to the low success rate of the department as below:

**Disposal of dispute cases for CBEC**

| Appellate Authority    | Name of Party | 2010 - 11 |              | 2011 - 12 |              | 2012 - 13 |               |
|------------------------|---------------|-----------|--------------|-----------|--------------|-----------|---------------|
|                        |               | Total     | In favor     | Total     | In favor     | Total     | In favor      |
| Supreme Court          | Department    | 388       | 16 (4.1)**   | 394       | 30 (7.6)     | 239       | 29 (12.1)     |
|                        | Taxpayer      |           | 12 (3.1)     |           | 24 (6.1)     |           | 45 (18.8)     |
| High Court             | Department    | 3,516     | 238 (6.8)    | 5,207     | 336 (6.5)    | 3,453     | 245 (7.1)     |
|                        | Taxpayer      |           | 731 (20.8)   |           | 2,976 (57.2) |           | 1,788 (51.8)  |
| CESTAT                 | Department    | 6,582     | 482 (7.3)    | 5,682     | 383 (14.3)   | 8,260     | 690 (8.4)     |
|                        | Taxpayer      |           | 1,922 (29.2) |           | 1,762 (31.0) |           | 4,423 (53.5)  |
| Commissioner (Appeals) | Department    | 20,149    | 1,062 (5.3)  | 22,381    | 1,709 (7.6)  | 30,609    | 1,622 (5.3)   |
|                        | Taxpayer      |           | 6,865 (34.1) |           | 6,546 (29.2) |           | 18,436 (60.2) |

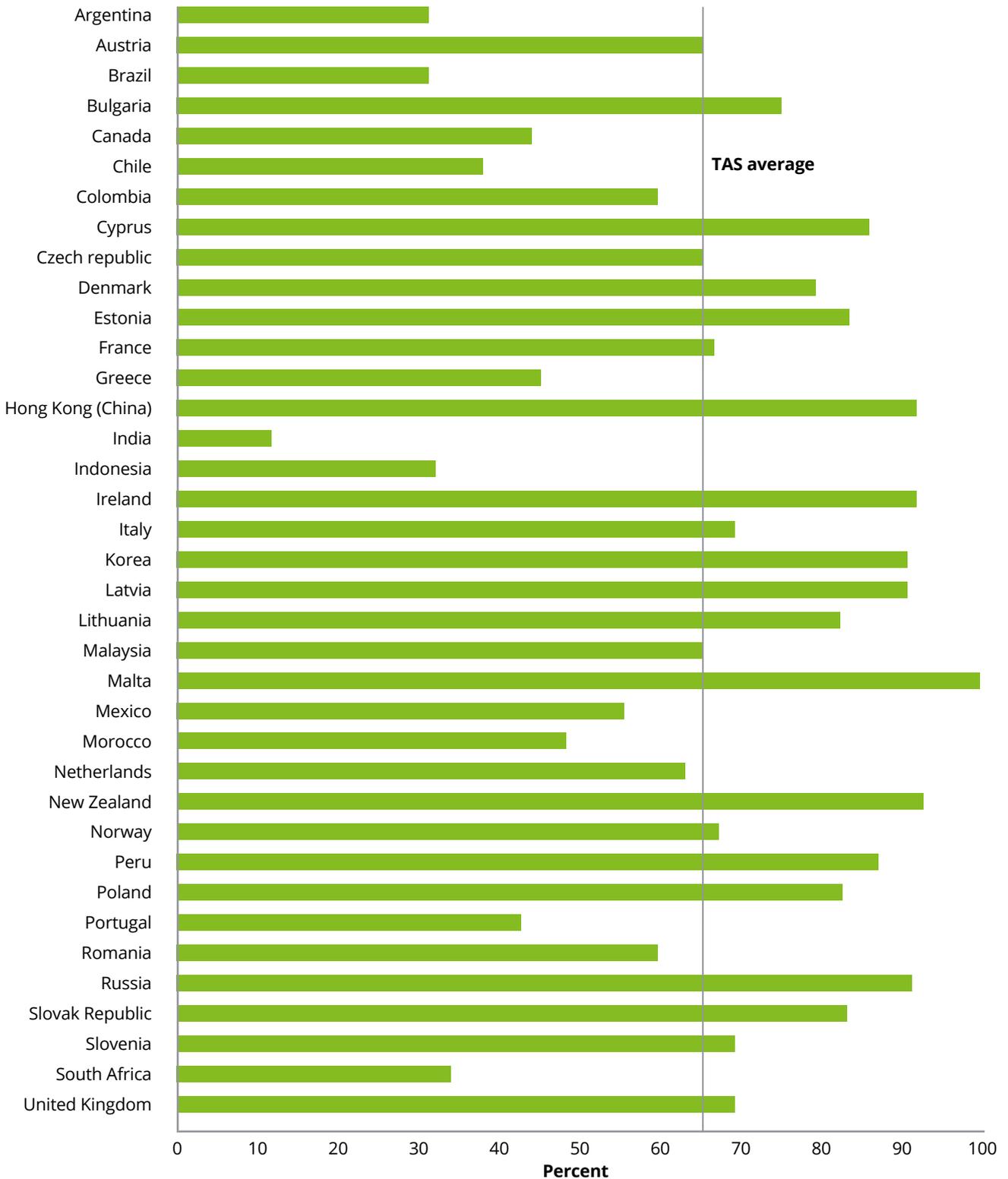
Source: First report of the Tax Administration Reforms Commission released on 30 May 2014

The table shows that there has been negligible improvement in the department's performance either in relation to the magnitude of disputes or success rate.

<sup>2</sup>Tax Administration Reform in India – Spirit, Purpose, and Empowerment, First Report of TARC submitted on 30 May 2014

Compared to others, the Indian tax administration has the lowest success rate among the countries surveyed in Tax Administration, 2017 (shown in the chart below):

**Percentage of cases resolved in favour of the tax administration, 2015\***



Source: Tax Administration 2017, Comparative Information on OECD and Other Advanced and Emerging Economies Published on 29 September 2017

\*The data for India are for the year 2014.

The report adds the rider that it is for the first time that litigation data has been summarised in this way and further reporting is required before drawing any conclusion. Despite the rider, it is reasonable to say that the data reflects the broad standing of India relative to the tax administrations surveyed.

Overall the data paints a picture of unproductive litigation that exacts a toll in terms of increasing costs on the business and industry, thereby disrupting the business climate in the country.

There is no single antidote for controlling disputes and litigation. This challenge demands a multi-pronged strategy

encompassing key legislative, policy level, and operational responses from the government. A detailed discussion on these aspects lies outside the scope of this paper. However, an effective advance ruling mechanism constitutes an institutional measure that can prevent avoidable disputes and give a high degree of certainty to taxpayers. This enables taxpayers to take investment decisions on sound business grounds. Hence, a robust advance ruling mechanism is now regarded as an important element of taxpayer services across the world.

The role and functioning of the AAR in India needs to be examined in the context mentioned above.





# Advance ruling mechanism – history and global practice

As the onus to assess and pay taxes correctly is placed on taxpayers, self-assessment has almost become the universally preferred paradigm of tax legislation. In case of any error in assessment, taxpayers are required to pay interest and penalty as appropriate. Correspondingly, it is now accepted as an important responsibility of governments to provide certainty and transparency in tax laws, reduce uncertainty, and boost taxpayers' confidence in the taxation system. The Organisation for Economic Cooperation and Development (OECD) conducted a survey of tax administrations of OECD and other emerging economies<sup>3</sup>. The survey notes that consistent with

the taxpayers' right to be informed and assisted, most countries now offer taxpayers advice on how they interpret the law they administer. Rulings are an important area where administrations can not only provide effective service but also assist in improving certainty in the tax system. Administrations can do so by guiding taxpayers how they can interpret law in particular situations. An effective ruling system is now acknowledged to be one of the pillars of a well-performing tax administration. The tables below give a snapshot of the ruling mechanism in the countries surveyed by OECD during its survey of tax administrations.

<sup>3</sup> Tax Administration 2017, Comparative Information on OECD and Other Advanced and Emerging Economies Published on 29 September 2017

**Table A.115. Rulings and specific services**

| Ruling                       | Rulings provided to taxpayers |      | Public rulings |      |         |      | Private Rulings |      |         |
|------------------------------|-------------------------------|------|----------------|------|---------|------|-----------------|------|---------|
|                              |                               |      | Issued         |      | Binding |      | Issued          |      | Binding |
|                              | 2014                          | 2015 | 2014           | 2015 | 2014    | 2015 | 2014            | 2015 | 2014    |
| Argentina                    | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Australia                    | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Austria                      | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Belgium                      | ●                             | ●    |                |      |         |      | ●               | ●    |         |
| Brazil                       | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Bulgaria                     | ●                             | ●    | ●              | ●    |         |      | ●               | ●    | ●       |
| Canada                       | ●                             | ●    | ●              | ●    |         |      | ●               | ●    | ●       |
| Chile                        | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| China (People's Republic of) | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Colombia                     | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Costa Rica                   | ●                             | ●    | ●              | ●    |         |      | ●               | ●    | ●       |
| Croatia                      | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Cyprus                       | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Czech Republic               | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Denmark                      | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Estonia                      | ●                             | ●    |                |      |         |      | ●               | ●    | ●       |
| Finland                      | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| France                       | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Germany                      | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Greece                       | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    |         |
| Hong kong (China)            | ●                             | ●    | ●              | ●    |         |      | ●               | ●    | ●       |
| Hungary                      | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Iceland                      | ●                             | ●    | ●              | ●    |         |      | ●               | ●    | ●       |
| India                        | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    |         |
| Indonesia                    | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Ireland                      | ●                             | ●    | ●              | ●    |         |      | ●               | ●    |         |
| Israel                       | ●                             | ●    |                |      |         |      | ●               | ●    | ●       |
| Italy                        | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Japan                        | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Korea                        | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Latvia                       | ●                             | ●    |                |      |         |      | ●               | ●    | ●       |
| Lithuania                    | ●                             | ●    |                |      |         |      | ●               | ●    | ●       |
| Luxemburg <sup>4</sup>       | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Malaysia                     | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |

|                |                |                       |      |      | Charging of fees for specific services (other than rulings) |                        |      |      |
|----------------|----------------|-----------------------|------|------|---|------------------------|------|------|
| Subject to fee |                | Subject to fee limits |      |      | Time limit (BD=Business days)<br>CD= Calendar Days)         |                        |      |      |
| 2015           | 2014           | 2015                  | 2014 | 2015 | 2014  | 2015                   | 2014 | 2015 |
| ●              |                |                       | ●    | ●    | BD 66   | BD 66                  | ○    | ○    |
| ●              |                |                       | ●    | ●    | CD 28   | CD 28                  | ○    | ○    |
| ●              | ●              | ●                     | ●    | ●    | D   | D                      | ○    | ○    |
|                |                |                       | ●    | ●    | BD 90   | BD 90                  | ●    | ●    |
| ●              |                |                       | ●    | ●    | CD 360  | CD 360                 | ○    | ○    |
| ●              |                |                       | ●    | ●    | BD 10   | BD 10                  | ○    | ○    |
| ●              | ● <sup>1</sup> | ● <sup>1</sup>        | ●    | ●    | BD 45-90  | BD 45-90               | ●    | ●    |
| ●              |                |                       |      |      |   |                        | ●    | ●    |
| ●              |                |                       | ●    | ●    | D   | D                      | ○    | ○    |
| ●              |                |                       | ●    | ●    | Variable  | Variable               | ○    | ○    |
| ●              |                |                       | ●    | ●    | D   | D                      | ○    | ○    |
| ●              | ●              | ●                     | ●    | ●    | BD 60   | BD 60                  | ○    | ○    |
| ●              |                |                       | ●    | ●    | BD 90   | BD 90                  | ○    | ○    |
| ●              |                |                       |      |      |   |                        | ○    | ○    |
| ●              | ●              | ●                     |      |      |   |                        | ○    | ○    |
| ●              | ●              | ●                     | ●    | ●    | CD 60   | CD 60                  | ○    | ○    |
| ●              | ●              | ●                     |      |      |   |                        | ○    | ○    |
| ●              | ●              | ●                     |      |      |   |                        | ○    | ○    |
| ●              | ●              | ●                     |      |      |   |                        | ○    | ○    |
| ●              | ●              | ●                     | ●    | ●    | CD 60   | CD 60                  | ○    | ○    |
| ●              | ●              | ●                     | ●    | ●    | BD 42   | BD 42                  | ○    | ○    |
| ●              | ●              | ●                     | ●    | ●    | CD 30-60  | CD 30-60               | ●    | ●    |
| ●              | ●              | ●                     | ●    | ●    | BD 30   | BD 30                  | ●    | ●    |
|                | ●              | ●                     | ●    | ●    |   |                        | ○    | ○    |
| ●              |                |                       | ●    | ●    | D   | D                      | ○    | ○    |
|                |                |                       | ●    | ●    |   |                        | ●    | ●    |
| ●              | 2              | 2                     | ●    | ●    | CD 90-180 <sup>3</sup>                                      | CD 90-180 <sup>3</sup> | ●    | ●    |
| ●              |                |                       | ●    | ●    | CD 120  | CD 120                 | ●    | ●    |
| ●              |                |                       |      |      |   |                        | ●    | ●    |
| ●              |                |                       |      |      |   |                        | ○    | ○    |
| ●              |                |                       | ●    | ●    | BD 22   | BD 22                  | ●    | ●    |
| ●              |                |                       | ●    | ●    | CD 60   | CD 60                  | ○    | ○    |
| ●              | ●              | ●                     |      |      |   |                        | ○    | ○    |
| ●              | ●              | ●                     | ●    | ●    | BD 60   | BD 60                  | ○    | ○    |

**Ruling**

|                 | Rulings provided to taxpayers |      | Public rulings |      |         |      | Private Rulings |      |         |
|-----------------|-------------------------------|------|----------------|------|---------|------|-----------------|------|---------|
|                 | 2014                          | 2015 | Issued         |      | Binding |      | Issued          |      | Binding |
|                 | 2014                          | 2015 | 2014           | 2015 | 2014    | 2015 | 2014            | 2015 | 2014    |
| Malta           | ●                             | ●    |                |      |         |      | ●               | ●    | ●       |
| Mexico          | ●                             | ●    | ●              | ●    |         |      | ●               | ●    |         |
| Morocco         | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Netherlands     | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| New Zealand     | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Norway          | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Peru            | ●                             | ●    |                |      |         |      | ●               | ●    | ●       |
| Poland          | ●                             | ●    | ●              | ●    |         |      | ●               | ●    |         |
| Portugal        | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Romania         | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Russia          | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Singapore       | ●                             | ●    |                |      |         |      | ●               | ●    | ●       |
| Slovak Republic | ●                             | ●    |                |      |         |      | ●               | ●    | ●       |
| Slovenia        | ●                             | ●    | ●              | ●    |         |      | ●               | ●    | ●       |
| South Africa    | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Spain           | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Sweden          | ●                             | ●    |                |      |         |      | ●               | ●    |         |
| Switzerland     | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| Turkey          | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    |         |
| United Kingdom  | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |
| United States   | ●                             | ●    | ●              | ●    | ●       | ●    | ●               | ●    | ●       |

● Yes ○ No

D: Data Not Available

01. Canada: There is no fee levied for ruling to goods and services tax.

02. Israel: Only for rulings on mergers and acquisitions.

03. Israel: Only for rulings regarding transfer pricing, mergers and acquisitions and encouragement laws.

For all other matters there is no time limit.

04. Luxembourg: Information relates to direct taxes only.

05. Romania: For certain categories of rulings there are different timeframes.

06. Russia: Private rulings are only issued in respect of transfer pricing

Source: Tax Administration 2017

|                |      |                       |      |      | Charging of fees for specific services (other than rulings) |                      |      |      |
|----------------|------|-----------------------|------|------|---|----------------------|------|------|
| Subject to fee |      | Subject to fee limits |      |      | Time limit (BD=Business days)<br>CD= Calendar Days)         |                      |      |      |
| 2015           | 2014 | 2015                  | 2014 | 2015 | 2014  | 2015                 | 2014 | 2015 |
| ●              |      |                       | ●    | ●    | D   | D                    | ○    | ○    |
|                |      |                       | ●    | ●    | BD 90   | BD 90                | ○    | ○    |
| ●              |      |                       |      |      |   |                      | ○    | ○    |
| ●              |      |                       |      |      |   |                      | ○    | ○    |
| ●              | ●    | ●                     | ●    | ●    | CD Variable, Max 180  | CD Variable, Max 180 | ○    | ○    |
| ●              | ●    | ●                     | ●    | ●    | BD 90   | BD 90                | ○    | ○    |
| ●              |      |                       | ●    | ●    |   |                      | ●    | ●    |
|                | ●    | ●                     | ●    | ●    | BD 30   | BD 30                | ●    | ●    |
| ●              | ●    | ●                     | ●    | ●    |   |                      | ○    | ○    |
| ●              | ●    | ●                     | ●    | ●    | CD 90 <sup>5</sup>  | CD 90 <sup>5</sup>   | ○    | ○    |
| ●              | ●    | ●                     | ●    | ●    | D   | D                    | ●    | ●    |
| ●              | ●    | ●                     | ●    | ●    | BD 56   | BD 56                | ●    | ●    |
| ●              | ●    | ●                     | ●    | ●    | BD 60   | BD 60                | ●    | ●    |
| ●              | ●    | ●                     | ●    | ●    | BD 180  | BD 180               | ○    | ○    |
| ●              | ●    | ●                     |      |      |   |                      | ○    | ○    |
| ●              |      |                       |      |      |   |                      | ○    | ○    |
|                | ●    | ●                     |      |      |   |                      | ●    | ●    |
| ●              |      |                       |      |      |   |                      | ○    | ○    |
|                |      |                       | ●    | ●    | CD 28-30  | CD 28-30             | ○    | ○    |
| ●              | ●    | ●                     |      |      |   |                      | ●    | ●    |

In the context of customs, the World Trade Organisation's (WTO) Trade Facilitation Agreement (TFA) mandated the establishment of a ruling mechanism as a part of trade facilitation measures. The agreement came into force on 22 February 2017<sup>4</sup>. Article 3 of the TFA requires each member to issue advance ruling in a reasonable, time-bound manner to the applicant who has submitted a written request containing necessary information. The TFA also provides circumstances in which an advance ruling can be sought. These circumstances include cases where the relevant authority can refuse to provide a ruling.

Advance ruling is broadly defined as a written opinion or decision by an authority empowered to render the decision with regard to the tax consequences of a transaction or proposed transaction or legal provision. The global best practices for advance rulings comprise the following two types of rulings:

- **Public rulings** – They represent the administration's interpretation of a particular provision of law that affects a large number of taxpayers. These rulings are issued in the form of interpretative rulings or clarifications. These rulings do not usually bind taxpayers but they bind tax officers. Taxpayers can resort to the remedies provided under law if they disagree with any ruling. They can rely on a public ruling if it is applicable to them.
- **Private rulings** – These are issued on an application by a taxpayer seeking a ruling on its tax treatment in relation to a specific transaction. The objective of private rulings is to provide support and a greater level of certainty to the taxpayer.

For example, the Australian Tax Office issues rulings in two categories—public and private. A public ruling is a binding advice on the interpretation of a provision of law, which is applicable to a category of products or class. Public rulings are not confidential and made available on the government's website. On the other hand, a private ruling sets out the way in which the commissioner of taxation considers how a tax law applies or would apply to a taxpayer in relation to an identified arrangement. The private ruling issued to taxpayers is accompanied by an explanatory note, a sanitised version of which is published online. Any information that would reveal the identity of taxpayers or other persons involved in the transaction, or constitute a breach of confidence, is removed before publication.<sup>5</sup>

Similarly, the South African Revenue Service (SARS) inter-alia issues two types of rulings—binding private and binding class. Binding private ruling is an advance tax ruling issued in response to an application that states how the commissioner would interpret and apply the provisions of the tax laws to a specific proposed transaction. Binding class ruling is also an advance tax ruling issued in response to an application that states how the commissioner would interpret and apply the provisions of the tax laws to affected class members in relation to a proposed transaction.<sup>6</sup>

Overall, Tax Administration 2017 reports that all 55 countries surveyed used some form of ruling system and an overwhelming majority of the countries issued both the public and private rulings.

This paper is primarily concerned with the latter as the focus is on the functioning of the AAR, which has been

<sup>4</sup>[https://www.wto.org/english/tratop\\_e/tradfa\\_e/tradfatheagreement\\_e.htm](https://www.wto.org/english/tratop_e/tradfa_e/tradfatheagreement_e.htm)  
[https://www.wto.org/english/tratop\\_e/tradfa\\_e/tradfa\\_e.htm#III](https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm#III)

<sup>5</sup>[https://www.ato.gov.au/General/ATO-advice-and-guidance/ATO-advice-products-\(rulings\)/](https://www.ato.gov.au/General/ATO-advice-and-guidance/ATO-advice-products-(rulings)/)

<sup>6</sup><http://www.sars.gov.za/Legal/Interpretation-Rulings/Pages/Advance-Tax-Rulings-ATR.aspx>

set up to deliver private rulings. As for public rulings, it may be mentioned in passing that while the tax legislation in India does not use this terminology, the legislation does include provisions that enable the two boards, Central Board of Indirect Taxes and Customs (CBIC) and Central Board of Direct Taxes (CBDT), to issue orders, instructions, etc., to subordinate officers. These rulings are binding on officers as held by courts. The relevant provisions are contained

in Sections 119 of the Income Tax Act, 1961; 37B of the Central Excise Act, 1944; 151A of the Customs Act, 1962; and now Section 168 of the CGST Act, 2017. These have been used to issue clarifications that have broadly the same effect as public rulings mentioned above. In this regard, some areas have a substantial room for improvement. However, this is a separate topic of discussion that is outside the scope of this paper.





# Introduction of advance ruling mechanism in India

## **Establishment of advance ruling mechanism under central indirect taxes**

Under the chairmanship of Dr K.N. Wanchoo, the Direct Taxes Enquiry Committee recognised the need for providing an advance ruling system in 1971. The Wanchoo Committee recommended the establishment of a system of advance rulings, particularly in cases involving foreign collaboration, etc. The aim of establishing the system was to give advance rulings to taxpayers or prospective taxpayers that would considerably reduce workload on the

department and decrease the instances of disputes and controversies. Subsequently other committees commissioned by the government (such as the Choksi Committee and the Chelliah Committee) also recommended establishing an authority for advance ruling to provide certainty to taxpayers.

With the launch of economic reforms in 1991, and the requirement to attract foreign investment, the need to set up an advance ruling mechanism gained traction and the scheme was announced by the then Finance Minister

Dr Manmohan Singh in the annual fiscal budget of 1992. In his budget speech, he explained the objective of the scheme:

“Having regard to the complexities in tax laws, I have been receiving representations that the Government should give advance rulings whenever a taxpayer has doubts about the tax liability in respect of intended transactions. This practice obtains in a number of countries. There are certain practical difficulties in implementing such a suggestion. However, in the interest of avoiding needless litigation and promoting better taxpayer relations, a scheme for giving advance rulings in respect of transactions involving non-residents, is being worked out.”

The implementation of advance ruling in the Income Tax Act, 1961 laid the foundation for an advance ruling mechanism in the indirect tax regime. In his budget speech of the year 1998, the then finance minister announced the establishment of the AAR for customs and central excise on the lines of the AAR for direct taxes. The necessary legislation was introduced by amendments to the Customs Act, 1962 (chapters VB) and the Central Excise Act, 1944 (chapter IIIA) through the Finance Act, 1998. The

scheme was extended to service tax by adding Chapter VA in the Finance Act, 1994 through Finance Act, 2003.

Only non-residents were eligible to apply to the AAR initially. With joint ventures and subsidiaries of foreign companies, etc., proposing to undertake business transactions in India, the eligibility criteria was expanded. Thus, in 2009, resident public sector companies were allowed to apply for advance ruling. Further, resident public limited companies and private limited companies were allowed to apply for an advance ruling in 2011 and 2014, respectively. Subsequently, any sole proprietorship and LLP firm could apply for an advance ruling from 2015. Therefore, any taxpayer could apply for an advance ruling after 2015. In case of service tax, questions relating to the admissibility of the credit of excise duty and input services were eligible for an advance ruling from 2012 (following an amendment made through the Finance Act of 2012).

With the changes introduced in the Finance Act 2017, the AAR became common for both direct and indirect taxes, albeit separate benches consisting of appropriate members.

Under relevant provisions, the authority is required to pronounce its ruling within 90 days of the receipt of the application<sup>7</sup>.

In terms of procedure, the authority follows a two-step process: the first being the decision on admission and the second, the ruling on merits on cases that are admitted. At both the stages, the authority grants hearing to the applicant, the concerned officer, or their representatives.

#### **Advance ruling under state value-added taxes (VATs)**

The provisions of advance rulings were also implemented in the erstwhile state VAT acts. The acts provided for resolution to the probable dispute by way of the Determination of Disputed

Question (DDQ). Under the system, an assessee could approach the 'designated authority' for an issue ahead of any assessment proceeding. The concerned authority would determine the issue and thus, dealers could get guidance before the assessment. An analysis of the experience of DDQ in major state VAT acts would reveal a lack of uniformity in aspects related to grounds on which DDQs could be sought, approachability of DDQs, and the binding nature of such DDQs.

<sup>7</sup>Sections 28-I (6), 23C (6) and 96D (6) of the Customs Act, 1962, Central Excise Act, 1944 and Finance Act, 1994 respectively



## Composition and status of advance ruling authority

### Erstwhile indirect tax laws

Before the implementation of GST, the AAR was set up as a high-level independent body comprising a chairman, a revenue member, and a law member who were senior officers from the Indian Revenue Services (IRS) and the law ministry, respectively. The revenue member was required to seek retirement from his or her parent service before joining the AAR. Until 2017, only a retired judge of the Supreme Court could be appointed as the AAR's chairman. In 2014, the position of vice chairman was created and high court judges were made eligible to apply for the role. In 2017, the position

of chairman was opened to chief justices of high courts and judges of high courts with seven years of experience. Thus, the body is completely independent of the tax administration headed by CBDT and CBIC. This helped inspire confidence in the minds of applicants about the independence and objectivity of the authority's decisions.

Until the introduction of GST from 1 July 2017, the AAR mechanism was institutionally fully aligned in direct and indirect taxes. However, the introduction of GST marked a complete divergence in the two types of taxes.

Under the state VAT acts, the advance ruling mechanism was a departmental apparatus.

In case of customs, amendments done in the Customs Act through the Finance Act of 2018<sup>8</sup> envisage the creation of a separate customs authority for advance ruling. The authority will be the designated principal commissioner or commissioner of customs, from a date to be notified. After the establishment of the customs authority, the existing AAR is proposed to be converted into the appellate authority over the customs authority for advance ruling<sup>9</sup>.

### GST

GST is a major watershed in the constitutional history of India, marking a transformational change in the indirect tax landscape of the country. GST subsumes within it most of the indirect taxes at the central and state levels; the major ones being central excise duties, service tax, and VAT (barring excise and VAT on certain excluded goods, such as crude oil, petrol, diesel, and aviation turbine fuel). Before this, the Constitution divided taxing powers between the centre and states<sup>10</sup>. This led to distortions in interstate trade, challenges in establishing a common market, and cascading of taxes, affecting the competitiveness of the Indian industry.

The Constitution (One Hundred and First) Amendment, Act 2016 gave the parliament and the state legislature concurrent powers to make laws with respect to GST imposed by the union or respective state. However, the power to levy GST on interstate trade or commerce rests exclusively with the parliament. Hence, GST brings with it the concept of “pooled sovereignty” wherein both the centre and states have decided to

share their sovereignty in the matter of indirect taxation for the benefit of the national economy. Further, the Goods and Services Tax Council (GST Council), chaired by the union finance minister and comprising state finance ministers, has been created under the Constitution. The council considers GST’s key aspects, including rates, legislation, rules, and exemptions and makes appropriate recommendations to the centre and states for implementation. Consequently, the legislation, rules, and procedures at the centre and state levels are aligned by design. Certain joint mechanisms are envisaged to ensure common decisions under the CGST and state GST (SGST) laws.

The AAR is one such mechanism. It is created under Chapter XVII of each of the SGST or UTGST Acts, for the respective state or union territory and, under Chapter XVII of the CGST Act. The AAR so created is deemed to be the AAR for the purpose of CGST as well as AAR for the purpose of SGST and UTGST Act<sup>11</sup>. Thus, the AAR is now set up for each state and union territory and comprises one officer each, not below the rank of joint commissioner, from the central administration and the concerned state/ union territory administration. Unlike earlier, there is also an appellate forum, the Appellate Authority for Advance Ruling (AAAR), created under the advance ruling mechanism<sup>12</sup>. The AAAR comprises state GST commissioner and a nominated chief commissioner under CGST. Either the applicant or the concerned officer dissatisfied with an AAR ruling can lodge an appeal before the authority. Apart from hearing appeals from the AAR’s rulings, the AAAR decides references from the AAR where two AAR members differ from each other.

<sup>8</sup>Section 28EA of the Customs Act, 1962 read with provision to Section 245 – O (1) of the Income Tax Act, 1961.

<sup>9</sup>Section 28F of the Customs Act, 1962 read with Section 245 – O (1A) of the Income Tax Act, 1961

<sup>10</sup>Entry 84 and 97 of the Union List and Entry 54 of the State List

<sup>11</sup>Section 96 of the Central Goods and Services Tax Act, 2017

<sup>12</sup>Section 99 of the Central Goods and Services Tax Act, 2017

In its meeting on 22 December 2018, the GST Council approved the creation of a centralised appellate authority for advance rulings to deal with cases of conflicting decisions on the same issue by two or more state appellate advance ruling authorities.

These milestones mark a major point of departure and divergence between the direct tax regime and the indirect tax regime in relation to advance ruling. Earlier at the central level, the AAR was always a high-level body, which was independent of the tax administration. It remains so in relation to direct taxes. In relation to GST, it has become a mere arm of the administration pegged at a subordinate level in the tax administration, with its remit restricted

to the concerned state. This follows the pattern in the erstwhile state VAT regimes.

#### International practice

In terms of international practice, the advance ruling authority is usually a part of the tax administration itself. For instance, in Australia, the commissioner of taxation issues rulings. In Canada, the Canada Revenue Agency is responsible for issuing rulings and interpretations in respect of taxes and duties on goods and services. Similarly in the United Kingdom and South Africa, advance rulings are provided by Her Majesty's Revenue and Customs (HMRC) and the SARS advance tax ruling system, respectively<sup>13</sup>.



<sup>13</sup>Ibid foot note 5 and 6; <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4405/gst-hst-rulings-experts-gst-hst-legislation.html>; <https://www.gov.uk/guidance/tax-support-for-overseas-businesses-investing-in-the-uk>



## Scope of advance rulings

### Erstwhile indirect tax laws

The advance ruling under the erstwhile regime could be sought by a joint venture in India, a non-resident setting up a joint venture in collaboration with a non-resident or resident, a wholly owned subsidiary of a foreign company, or certain other notified persons (e.g., public sector units, resident companies and firms, and residents importing from Singapore) for certain specified issues. As noted earlier in this paper, the scope of advance ruling was gradually expanded from non-resident companies and joint ventures to cover resident companies

and firms. The mandate of the AAR was also expanded over time to cover most issues on which taxpayers would be interested in seeking a ruling. However, ruling could be sought only in respect of a **proposed** activity<sup>14</sup>. It could not be sought in relation to any ongoing activity. Moreover, the application was barred in two cases: 1) when the question was already pending in the applicant's case before any officer of customs/central excise/service tax, the appellate tribunal or any court<sup>15</sup> or 2) when the question was same as in a matter already decided by the appellate tribunal or any court.

<sup>14</sup>Section 28E of the Customs Act, 1962; Section 23A of the Central Excise Act, 1944; Section 96A of the Finance Act, 1994

<sup>15</sup>Section 28D of the Customs Act, 1962; Section 23D of the Central Excise Act, 1944; Section 96D of the Finance Act, 1994

This is similar to practice followed in direct taxes, where if the matter is subjudice before an income tax authority or court, it cannot be put up before the advance ruling authority. In addition to this, the Income Tax Act precludes the admission of an application for advance ruling when it involves the determination of a fair market value of any property or the authority is of the opinion that a transaction is designed for tax evasion.

### GST

Under the provisions of the CGST act (and the corresponding SGST act), advance rulings can be sought by any person registered with the tax authorities or willing to obtain registration under GST laws.<sup>16</sup>

The questions related to the following can be referred to the AAR under the GST provisions<sup>17</sup>:

- a. Classification of any goods or services or both
- b. Applicability of a notification issued

- c. Determination of time and value of supply of goods or services or both
- d. Admissibility of input tax credit of tax paid or deemed to have been paid
- e. Determination of the liability to pay tax on any goods or services or both
- f. Whether applicant is required to be registered
- g. Whether any particular thing done by the applicant with respect to any goods or services or both amounts to or results in a supply of goods or services or both, within the meaning of that term

The application is not admissible if the question to be referred is already decided or pending decision in relation to the applicant in any other proceedings under the act.<sup>18</sup>

It is important to note that the scope of advance rulings has been expanded substantially by allowing an applicant to seek a ruling in respect of any transaction

<sup>16</sup>Section 95 of the Central Goods and Services Tax Act 2017

<sup>17</sup>Section 97 of the Central Goods and Services Tax Act 2017

<sup>18</sup>Section 98 of the Central Goods and Services Tax Act 2017



(including an ongoing one), rather than restricting it to a proposed transaction (as had been the case under the earlier regime). Similarly, both existing and prospective taxpayers have been made eligible to apply for the ruling.

However, a critical gap in the mandate of AAR is that questions relating to place of supply, including whether a supply qualifies as export from and import in India, are outside its scope. This is because the AAR and the AAAR are part of the SGST and CGST acts and their jurisdiction is limited to the respective states. However, the lacuna remains that an important element of tax assessment has been left without the service of advance ruling.

**International practice**

For situations where advance ruling can be sought, the international practice is mixed. While some countries provide a ruling only for a proposed transaction, other countries provide a ruling for

an ongoing transaction or transaction already executed, provided no assessment or decision has been made by revenue authorities with respect to the transaction.

For instance, the SARS provides advance rulings only in case of a proposed transaction. In Canada, a ruling may be given for ongoing issues, transactions, or any proposed transaction. However, the Canada Revenue Authority (CRA) will not issue a ruling where the request relates to a hypothetical situation or where it is unable to obtain sufficient facts from taxpayers. In such cases, the CRA may provide an interpretation of the relevant provisions of the legislation to assist taxpayers in fulfilling obligations under the law. Similarly, the United Kingdom provides advance rulings if a live transaction is executed or yet to be executed (not a hypothetical transaction<sup>19</sup>).

<sup>19</sup> Ibid foot note 14





## Binding nature of advance rulings and validity

### Erstwhile indirect tax laws

The advance rulings pronounced in the erstwhile indirect laws in India were binding on the jurisdictional departmental officers engaged in assessment and the applicant. Further, a ruling given in respect of an applicant was binding only in that applicant's case. As to the period of validity, the ruling remained valid as long as the facts, as reported in the application and the applicable law, remained unaltered. If either the law or fact changed, the ruling became void. Further, the authority had the power to recall and nullify a ruling ab initio where it came to its notice that the ruling was obtained by fraud or misrepresentation of any facts<sup>20</sup>.

Under the erstwhile indirect tax laws at the centre level, the rulings issued by the authority were final and there was no appeal provided in the act against it. This was in line with the practice followed under the direct taxes. However in *Columbia Sportswear Company vs Director of Income Tax, Bangalore* ((2012) 11 SCC 224), the Supreme Court held that the authority was a tribunal within the meaning of Articles 226 and/or 227 of the Constitution. Therefore, petitions against its rulings could be entertained by the high court. Hence, although the law provided no statutory appeal, the rulings of the AAR could be challenged before the high court and they have been challenged in some cases under the direct tax laws.

<sup>20</sup>Section 28J, 28K of the Customs Act, 1962; Section 23E, 23F of the Central Excise Act, 1944; Section 96E, 96F of the Finance Act, 1994

## GST

All features related to the binding nature of advance rulings, which were part in the erstwhile indirect tax laws, have also been seen in the GST regime. In other words, the powers, procedures, etc., of the authority are broadly same compared with the erstwhile law.

With respect to appealing against an advance ruling, in case the parties in question are not satisfied, the situation has changed with the implementation of GST. Unlike earlier, there is an appellate forum, the AAAR, created under the CGST and SGST acts. This comprises the state GST commissioner and a nominated chief commissioner under CGST. Either the applicant or the concerned officer dissatisfied with an AAR ruling can lodge an appeal before the forum<sup>21</sup>.

## International experience

The binding nature of advance rulings is in line with practices followed in most of the other tax jurisdictions, such as the United Kingdom, the Netherlands, Canada, and China. The rulings pronounced by the authority are usually binding on the tax authorities, though in some cases they may not be binding on taxpayers. For instance, in Australia and Sweden, the pronounced ruling is binding on the tax administration and the administrative courts. However, taxpayers are not bound by it. In other words, in Australia and Sweden, taxpayers can stop relying on a ruling by acting (or omitting to act) in a way that is not in line with the ruling, if the law is more favourable to them than the ruling<sup>22</sup>.

Some jurisdictions also provide an opportunity to taxpayers or the department to appeal against or review the pronounced ruling. For instance, in Australia, if applicants are dissatisfied with an advance ruling, they may ask Customs and Border Protection to

review the decision. To ensure the independence and transparency, the review is conducted by a different decision-maker. If applicants are dissatisfied with the original decision or Customs and Border Protection's review, they can apply for the decision's review to the Administrative Appeals Tribunal and further to the federal court (on the question of law). Similarly, in Canada, if taxpayers do not agree with a ruling or interpretation, they may submit a written request to the manager of the office that issued the ruling or interpretation. On receiving a written request for reconsideration, the CRA will contact taxpayers to discuss concerns. The CRA will also meet with taxpayers if requested to do so. When the office that issued the ruling or interpretation cannot resolve a taxpayer's request for reconsideration, it will forward the request to a more senior level. The CRA will confirm the outcome of the reconsideration process in writing to the taxpayer. However, some other jurisdictions, including the United Kingdom, do not provide any option to taxpayers to appeal against the ruling pronounced by the advance ruling authority<sup>23</sup>.

As to the validity period, SARS provides clarity on the impact of a subsequent change in the tax laws on a binding ruling, or a court decision issued before the change. A status ruling gives the commissioner's view regarding the following: whether or not those changes affect the binding ruling; ruling extensions that refer to an extension of the validity period of a binding ruling issued by ATR on a one-off transaction (which has not occurred during the validity period); and reconfirmation that is a re-application for a prior binding ruling issued by the ATR unit (the validity period of which has expired). Provided the facts remain unchanged, the applicant may request that the ruling should be reconfirmed for a further period<sup>24</sup>.

<sup>21</sup>Section 99 of the Central Goods and Services Tax Act, 2017

<sup>22</sup>Ibid foot note 14

<sup>23</sup>Ibid foot note 14

<sup>24</sup>Ibid foot note 6



## Timelines and costs

### Erstwhile indirect tax laws

The process of obtaining an advance ruling in the erstwhile regime was simple, inexpensive, and transparent. A modest fee of INR 2,500 was charged that was later increased to INR 10,000 in 2017<sup>25</sup>.

As mentioned before, erstwhile laws required the authority to issue advance ruling within 90 days. However, this was seldom followed by the authority.

### GST

The cost of filing an advance ruling application was kept unchanged at INR 10,000<sup>26</sup>.

In the GST regime, a 90-day time limit (from the date of receipt of the application or filing the appeal by the aggrieved party<sup>27</sup>) has been put in place for both the AAR and AAAR.

### International experience

The timelines given to authorities for pronouncing advance ruling seem to be on a higher side compared with other VAT or GST jurisdictions. For instance, in Australia, advance rulings are usually issued within 30 days from the submission of a valid application and sufficient supporting materials. Similarly, the advance tax ruling authority of

South Africa pronounces rulings within a period of 20–60 days depending on whether the issue involved is standard or complex. The United Kingdom's HMRC aims to respond to requests made by an applicant within a period of 28 days<sup>28</sup>.

<sup>25</sup>Section 28H of the Customs Act, 1962; Section 23C of the Central Excise Act, 1944; Section 96C of the Finance Act, 1994

<sup>26</sup>Section 28I of the Customs Act, 1962; Section 23D of the Central Excise Act, 1944; Section 96D of the Finance Act, 1994

<sup>27</sup>Section 98 and 101 of the Central Goods and Services tax Act, 2017

<sup>28</sup>Ibid foot note 14



## Experience of advance ruling mechanism in India

### Erstwhile indirect tax

As mentioned earlier, the advance ruling mechanism in indirect taxes was initially based on the mechanism established in direct taxes. However, the experience of the AAR in relation to the use of direct and indirect taxes by taxpayers has turned out to be quite different. On the direct tax side, the authority witnessed a large number of applications. On the indirect tax side, the use of advance ruling mechanism by taxpayers was quite infrequent. From 2017 to 2018, the authority received about 122 applications

related to indirect taxes and more than 4,000 applications related to direct taxes.

The limited use of AAR in indirect tax could be initially due to the constrained reach of the AAR. The access to advance ruling was restricted to only non-residents and the mandate is restricted to a few specified matters. There is still a single bench in New Delhi. However, even with the progressive extension of the AAR's mandate, the authority did not witness a noticeable increase in applications on the indirect tax side. The

pattern also reflects the global picture where the use of advance ruling is relatively greater on the direct tax side.

However, an important issue has been the time taken for the issue of rulings. Although the statutory provisions required the AAR to deliver its ruling within 90 days, rarely if ever, was it able to adhere to this time limit and had seen an increase in pending cases, notwithstanding the low receipt of applications. The data shows that as on 31 August 2017 (GST legislation came into force on 1 July 2017), 55 applications (the earliest application filed in 2012) remained undecided<sup>29</sup>.

In its first report, the TARC had noted that among factors that hobbled the functioning of the AAR were inordinate delays, limited reach, and lack of accessibility (as there is only one bench in Delhi). It had recommended more benches headed by high court judges outside Delhi. On the direct tax side, this has been addressed legislatively to some extent by creating the position of vice chairman and making high court judges eligible for the role. Delays in the appointment of chairman and members continued to be the main reason for an increase in pending cases. With the GST legislation coming into force on 1 July 2017, the issue faced by the erstwhile AAR is largely limited now to legacy matters.

On account of its independence and relatively high stature, the AAR usually inspired a far greater trust and confidence among taxpayers than any departmental agencies. Even when the route of writ petitions was opened after the Columbia Sportswear judgment, on the indirect tax side, no petition has been filed against of its ruling in any court.

## GST

Unlike earlier, AARs in the GST regime have witnessed a brisk inflow of applications. Until November 2018, more than 663 applications seeking advance rulings were received across the country. Karnataka tops the list with 110 applications, followed by Maharashtra, Gujarat, Delhi, and Tamil Nadu. This is in sharp contrast to the pre-GST regime wherein the total applications filed under the central excise, service tax, and customs law were only about 122. This is perhaps a reflection of both the complexity and newness of the GST legislation. Further, appeals filed before the Appellate Authorities for Advance Ruling were about 30 until November 2018 with Maharashtra witnessing the maximum number of appeals<sup>30</sup>.

Although the AAR mechanism is only a little over a year old, a large number of rulings have been issued across the country and the early trends of the decisions are not entirely encouraging.

By and large, decisions are now seem to be delivered in a timely fashion, much quicker than under the erstwhile AAR. It is becoming rapidly clear that the gain in terms of timeliness is more than offset by the decreasing quality of rulings. In most decisions, a distinct revenue bias is apparent. A quick survey of rulings shows the large majority (almost 90 percent) have decided in favour of revenue. Often the rulings do not seem to be based on adequate analysis and a mature consideration of the issues involved. Sometimes advance ruling authorities disrupt the settled positions on the basis of perfunctory reasoning.

Another worrisome trend is a wide divergence in rulings on similar issues. A bunch of varied interpretations of the

<sup>29</sup>[http://www.cbic.gov.in/resources//htdocs-cbec/aar/present\\_status\\_of\\_the\\_application\\_as\\_on\\_31.08.2017.pdf;jsessionid=C170AF8C8E66F01C5E990F78FAFF5997](http://www.cbic.gov.in/resources//htdocs-cbec/aar/present_status_of_the_application_as_on_31.08.2017.pdf;jsessionid=C170AF8C8E66F01C5E990F78FAFF5997)

<sup>30</sup><http://gstcouncil.gov.in/mis-advance-ruling-aar> and <http://gstcouncil.gov.in/mis-appeal-orders-aar>

GST law by different state AARs on the same subject are creating compliance challenges for businesses. The absence of uniformity and consistency in interpretation puts the vision of “One Nation One Tax” at risk and poses the danger of making it a mere slogan. For instance, Maharashtra AAR<sup>31</sup>, Karnataka AAR<sup>32</sup>, and Uttarakhand AAR<sup>33</sup> have taken differing views in the context of an exemption on solar power systems. In another matter related to taxing printed advertisement materials, Telangana AAR and West Bengal AAR not only gave conflicting verdicts but also used different rationale to arrive at their conclusions<sup>34</sup>. Rulings in relation to intra-company supplies is another instance where divergent views have been taken by different AARs. In some cases, settled positions in law have been upset without proper consideration or justification. A case in point is the Maharashtra ruling relating to intermediary services. Unless remedial action is taken, the ruling poses the risk of enmeshing the Indian BPO industry in disputes and making it uncompetitive.

While such divergence has a negative impact on affected taxpayers, it can make compliance especially problematic for taxpayers who have multi-state operations and are consequently subject to multiple jurisdictions. Litigation can now arise for a particular taxpayer on the same matter in different states wherein the said states may also have contradictory views on it. This may lead to a situation wherein the same taxpayer may be compelled to follow different approaches in each state for a particular transaction.

The GST Council seems to be aware of this problem. Therefore, at the last meeting for calendar year 2018, it decided to establish a central-level appellate authority to deal with cases where divergent rulings are pronounced on the same issue by two or more state appellate authorities. The details around the constitution of this authority, the experience and level of officers pronouncing the rulings, and the mechanism to determine when a person can approach this authority are yet to be finalised. While this indicates that the government desires to avoid a situation of different tax consequences in similar facts in different states, establishing such an authority at the first level would be a preferable option. The government should instead establish a central-level advance ruling mechanism with benches throughout the country to avoid providing conflicting rulings. This has been discussed in greater detail in the “Way forward” section below.

On the whole, the experience has been in keeping with the general trend of pro-revenue decisions by tax officers. This tendency has been the bane of the tax administration in India and has resulted in widespread dissatisfaction among taxpayers, generating costly tax disputes and litigation, earning notoriety for India. It has created a perception among taxpayers that they can expect fairness and justice only from independent bodies such as tax tribunals and courts. Such a perception is fatal to ease of doing business and calls for a rethink on the design and structure of AAR if that body is to serve the purpose of its existence.

<sup>31</sup>M/s GIRIRAJ RENEWABLES PRIVATE [2018-VIL-20-AAR]

<sup>32</sup>M/s GIRIRAJ RENEWABLES PRIVATE LTD [2018-VIL-36-AAR]

<sup>33</sup>Uttarakhand AAR Order No. 07/2018-19 dated 28 August 2018

<sup>34</sup>M/s MACRO MEDIA DIGITAL IMAGING PRIVATE LIMITED [2018-VIL-72-AAR] and PHOTO PRODUCTS COMPANY PVT LTD [2018-VIL-50-AAR]



## Way forward

### GST

As mentioned before, the whole intent behind establishing the authority for advance rulings was to reduce litigation and provide certainty to taxpayers. It will succeed in achieving its purpose only when its decisions are prompt and marked by judiciousness, objectivity, and fairness. Only then it will win the trust and confidence of taxpayers as a useful and effective institution.

In the pre-GST regime when there was nearly universal dissatisfaction regarding inordinate delays in issuing rulings,

the AAR was usually respected for its independent, fair, and judicious decisions. On the indirect tax side, none of the authority's decisions faced further judicial challenge by either the department or the applicant. So far the AAR seemed to have served its purpose, although taxpayers may have felt frustrated by the delays in the process.

However, as noted above, early trends apparent from the AAR's decisions under GST do not inspire the same degree of confidence among taxpayers. Instead of preventing unwanted litigation, its

decisions are likely to fuel litigation on account of a distinct pro-revenue bias. Further, the lack of consistency is bound to inject greater uncertainty in the GST environment, defeating the purpose of creating the AAR.

This is because the authority has been converted into a purely departmental body comprising relatively junior-level serving tax officers who often have to attend to various other duties. These duties may often conflict with their responsibilities as AAR members.

As noted earlier, internationally the advance ruling mechanism is usually an integral part of the tax administration. To that extent, the AAR under the GST legislation can be said to be aligned with the international trend. However, that is where the comparison ends. In developed tax administrations, the function is usually located in a separate functional vertical with its own set of performance indicators and performance measures. These indicators and measures are congruent with its functions and the vertical is staffed by professionals with appropriate skills and attributes. That cannot necessarily be said to be the case here. If any proof of the existence of this behavioural bias is needed, it is furnished by the mushrooming of disputes and low success rate of the department in litigation. This indicates the continued existence of disputes and litigation. This tendency, coupled with an absence of accountability for erroneous or incompetent decisions, means that the functioning of the authority is also likely to be affected by a distinct pro-revenue bias. As discussed above, the early trends confirm this apprehension.

This would be true for both the AAR and the AAAR, which is an arm of the department comprising serving officers who would have this function as one among many.

Therefore in the Indian context, the AAR as it is constituted under the GST legislation is unlikely to fulfil its purpose of providing taxpayers certainty and eliminating unwanted litigation. This makes a case for redesigning and rebooting the mechanism. Any alternative design considered needs to be centred around two overriding considerations—the need for the AAR to inspire confidence among taxpayers by giving independent, competent, and judicious rulings; and the need to promote consistency in rulings across the nation. As mentioned above, the GST Council recently proposed to set up a centralised appellate authority for advance rulings in case there are divergent rulings issued by two or more state appellate advance ruling authorities. This falls short of addressing the issue at the root and provides at best only a post facto resolution. While the details around the composition and functioning of this authority are yet to be clarified, the information could lead to the reopening of settled disputes for taxpayers. For instance, the state appellate authority gives a ruling in a taxpayer's favour, while another state appellate authority pronounces a different ruling in a similar situation. In such a case, approaching the centralised appellate authority could have a negative impact on the taxpayer who holds a favourable order. Thus, while setting up the central appellate authority, the GST Council takes into account relevant factors to ensure that the creation of such an authority does not lead to additional disputes.

Given the present shortcomings of the advance ruling mechanism, the government can consider the following two options to improve the efficacy of the mechanism under the GST regime:

- I. Make the AAR and the AAAR independent national-level mechanisms outside the purview of tax administration.
- II. If this is not feasible, improve the AAR by making it functionally independent

and upgrading its composition. This can be done by hiring adequate staff, procuring resources, and inducting more senior-level and mature officers as members. This should be coupled with conferring appellate jurisdiction on an independent national-level body.

These options are discussed below.

### **A completely independent AAR mechanism**

This option would win greater taxpayer confidence. It could be similar to the existing AAR for direct taxes. The lessons to use this option need to be drawn from the experience of the AAR in its pre-GST form or under direct taxes. This will ensure that decisions are delivered on time and the institution has a high level of accessibility. Thus, the AAR should have a sufficient number of benches at multiple locations to provide taxpayers easy access to rulings.

The advance ruling mechanism can be created as a two-tier mechanism comprising the AAR and the AAAR. The AAR could be chaired by a retired chief justice of high court and should comprise members with sufficient seniority and experience. These members can come from the central and state tax administrations (technical members) as well as judicial officers and lawyers (judicial members). In addition, the membership could be opened to other professionals with appropriate experience such as chartered accountants. Serving officers selected to join the authority should be required to take retirement from their parent service to maintain the body's independence.

The Appellate AAR should be chaired by a retired judge of the Supreme Court and should have one technical member and one professional member. The technical member should be an officer

of the central GST administration who has been or is qualified to be a member of CBIC or an officer of one of the state administrations of equivalent rank. The other member could be a lawyer, chartered accountant, and similar tax professional with appropriately defined experience in the field of indirect taxation. Like in case of the AAR, serving officers should be required to take retirement from the government.

It needs to be ensured that rulings apply across the nation. This can be done by making appropriate provisions in the law. For instance, the same AAR can be created under each state GST act so that its decisions apply across states. A number of other solutions are possible. For instance, take the case of a firm that has obtained multiple registrations against a single PAN. To avoid compelling the firm to follow multiple interpretations, it can be given a choice to approach the AAR with jurisdiction over its headquarters to obtain a ruling that will apply to all its registrations across the country.

Similarly, to avoid problems arising from the divergent views of coordinate benches of the AAR, the law can provide a reference to the AAAR from the AAR, either suo motu or on application from a taxpayer, for a final verdict on the issue. The process can partly be similar to the one followed by CESTAT in relation to references to the larger bench.

### **Improving the current AAR**

In case fully independent AAR and AAAR are not created, certain changes in the current AAR mechanism are essential to make it fit for the purpose. As noted earlier, AARs members are relatively junior-level officers who are often given this responsibility in addition to numerous other responsibilities. Consequently, this function becomes a relatively low priority. AARs should be made full-fledged offices with sufficient

staff support and other resources. Members' positions should become a full-time position with officers at the commissioner level being selected and appointed. Members should also have a fixed tenure of at least three years and should be able to obtain/requisition services of experts whenever needed.

In any case, the appellate function should not remain within the department and should be vested in an external body, which has national jurisdiction. The AAR constituted under the Income Tax Act may be conferred with the appellate jurisdiction under the GST legislation. This will ensure both the independence of the authority's decisions and consistency across the nation.

For the AAR to be effective, it will need to be significantly strengthened both in terms of more vice chairmen and members, and benches outside New Delhi (in major state capitals). The revenue members can be drawn from both the central and state GST departments and should be required to seek retirement from their parent services before joining the authority to ensure independence.

The other issue that requires rethinking is the binding nature of the AAR's rulings. As noted above, although such rulings are binding on the administrations everywhere, in many jurisdictions, they do not bind the taxpayers who are free to act differently and follow the normal assessment and dispute processes. In India, they bind both taxpayers and tax officers. This was perhaps justifiable when the AAR was an independent high-level body. It is now necessary to rethink the approach and look at it particularly from taxpayers' perspective. An argument can be made that taxpayers now have the appellate remedy if they are unhappy with original rulings. However, we have already noted the main drawback, a pronounced

pro-revenue bias in decisions at all administration levels that has driven tax officers' behaviour. If both the original and appellate mechanisms are purely departmental agencies, it is unfair to bind taxpayers with a ruling that they regard incorrect and force them to appeal in courts. Taxpayers can choose to act contrary to the ruling at their own risk. This will be open to dispute for tax officers, leaving the normal remedies open to taxpayers. Therefore, there is a case for making the AAR and AAAR rulings non-binding on taxpayers as long as the mechanism continues to function as a purely departmental one. If the advance ruling mechanism is made independent of the tax administration, there would be justification to maintain the status quo in relation to the binding nature of rulings.

Both the AAR and AAAR are two-member bodies and there is a distinct possibility that a difference of opinion between members can result in a tie. While the law provides a remedy for such a tie in case of AAR through a reference to AAAR, there is no remedy if such a difference of opinion crops up between the two AAAR members. In an apparent gesture of helplessness, the law merely states that in such a case it shall be deemed that ruling cannot be given. In other words, the inability of the AAAR members to agree with each other makes the remedy provided under the act ineffective. The implication is that a ruling will be denied on a fully maintainable application because the two functionaries (charged by the law with the duty of pronouncing it) cannot agree with each other. This is an anomalous provision. While determining the authority's structure, the risk of such a stalemate should be kept in mind and the composition should be such that a difference of opinion should not make the remedy ineffective.

As noted earlier, the AAR has not been able to pronounce its rulings within the

prescribed time limits for a variety of reasons. Taxpayers have no solution for such delays. One solution can be sparing taxpayers the cost of delay when delay is not attributable to any act of omission or commission on their parts. The remedy that can be considered is waiving interest on any additional tax due from taxpayers (as a result of a ruling) for the period of delay beyond the stipulated time limit, where delay is not attributable to them.

### Customs AAR

As noted earlier, the Customs AAR has undergone transformation by the introduction of the changes in the Finance Acts of 2017 and 2018. While the former led to the creation of a common AAR for income tax, customs, central excise, and service tax, the latter created a purely departmental Customs AAR and conferred the appellate jurisdiction over the decisions of the Customs AAR on the AAR created under the Income Tax Act. Thus, one sees a third variant of the AAR in customs. Although the AAR has a purely departmental character, the appellate mechanism remains independent of the government. Compared with the AAR under GST, the AAR in customs is also placed at a much higher level in terms of the rank of its members.

The amendments made by the Finance Act, 2018 also allow any person with a valid importer-exporter code (exporting goods to India) or a justifiable cause to the satisfaction of the AAR, to apply for advance ruling. The said proposal grants wide discretionary powers to the proposed AAR to be constituted under the Customs Act (Customs AAR) to entertain any applicant with a justifiable cause to its satisfaction.

However, the Customs AAR is yet to come into existence since the relevant provisions are yet to be notified. Therefore, it is too early to offer any comments. However, it can be said that between the totally independent advance ruling mechanism and a purely departmental mechanism in the Customs AAR, the central government has attempted a kind of middle ground. The government has done so by combining a sufficiently senior-level original authority whose rulings are subject to the jurisdiction of a high level and independent appellate authority. This cannot be said to be a bad model to follow for the GST AAR mechanism (albeit with a multi-member authority) in case a fully independent AAR is not created.





# Conclusive remarks

The GST Council, which has done such an admirable job of maintaining coherence and cohesion in the GST implementation, urgently needs to turn its attention to reforming the advance ruling mechanism under the GST legislation. A glimpse of the attention could be seen in the proposal made during a meeting dated 22 December 2018. The proposal was for the creation of a centralised appellate authority to resolve cases where divergent rulings are given on similar facts by two or more state appellate authorities for advance rulings. More efforts need to be taken to make the entire mechanism effective and investor friendly. While re-assessing the efficacy of the advance ruling mechanism, the

GST Council must consider the risk of unravelling the vision of “One Nation One Tax” (that the current AAR mechanism poses) and undermining taxpayers’ faith in the tax system by providing divergent interpretations and poor-quality decisions. The council needs to show the same sagacity, wisdom, and broadmindedness it has shown in forging the political consensus for GST. It also needs to take bold measures to create an institution on which taxpayers can rely for fair and judicious rulings. This will go a long way in realising the goal to create one common national market and place India among the most competitive economies in the world.

# Acknowledgment

We thank the following subject matter experts for their contributions and inputs:

**Bela Sheth Mao**

**Yashodhan Parande**

**Divya Mahajan**

**Ronak Shah**







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