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# EY Tax Alert

Uttarakhand HC ruling on validity of alternative dispute resolution mechanism under the ITL



## Executive summary

This Tax Alert summarizes a recent ruling of the Uttarakhand High Court (HC) in the case of Hyundai Heavy Industries Ltd. (Taxpayer) (Civil Writ Petition No. 1778/2010) on the issue of validity of the Dispute Resolution Panel (DRP) provisions of the Indian Tax Laws (ITL). The Taxpayer had filed a petition challenging the validity of the provisions as, according to the Taxpayer, the appointment of the jurisdictional Commissioner of Income Tax as a DRP member created a bias and conflict of interest. The HC observed that a bias cannot be established merely because one of the members of the DRP is also a jurisdictional Commissioner in the Taxpayer's own case. It was held that there is no conflict of interest as the doctrine of necessity makes it imperative for an authority to carry out its statutory functions and mere potential of bias against one of the members of the DRP will not render the constitution of the DRP under the ITL unconstitutional. The HC, however, held that as the likelihood of real bias exists, the Commissioner should not adjudicate on the case. Furthermore, the HC directed the Central Board of Direct Taxes (CBDT) to ensure that a jurisdictional Commissioner is not nominated as a member of the DRP.

## Background and facts

- ▶ The ITL introduced an alternative dispute resolution mechanism under which tax disputes relating to foreign companies and transfer pricing disputes could be referred to a DRP, a collegium comprising three Commissioners of Income Tax,

which is empowered to issue binding directions, within a specified time limit, to the Tax Authority. The CBDT nominates three Commissioners of Income Tax to the DRP in accordance with the prescribed rules.

- ▶ The Taxpayer, a Korean company, was engaged in the business of offshore engineering construction and power projects in India. The Taxpayer, which was aggrieved by certain action of the Tax Authority, approached the DRP and filed its objections.
- ▶ During the pendency of the DRP proceedings, the Taxpayer gathered that one of the members of the DRP was the Commissioner having jurisdiction in the Taxpayer's own case and who was involved in its tax proceedings.
- ▶ The Taxpayer objected before the DRP to the constitution of the collegium since there was a conflict of interest on the part of the jurisdictional Commissioner. Without considering the Taxpayer's objection, the DRP upheld the Tax Authority's orders.
- ▶ Aggrieved, the Taxpayer filed a writ petition before the HC challenging the constitution of the DRP and the *vires* of the ITL provisions relating to DRP and related rules. The Taxpayer appealed that the provision should be read down so that there is no conflict of interest.

## Issue for consideration

Whether the DRP provisions of the ITL and related rules are *ultra vires* and whether the provisions should be read down so that there is no conflict of interest.

## Taxpayer's contentions

- ▶ The function of the DRP was judicial in nature. For effective administration of justice, the DRP was required to have certain autonomy, impartiality and fair play in the discharge of its judicial functions.
- ▶ Where a jurisdictional Commissioner is appointed to the DRP, his/her independent-mindedness and impartiality gets colored by his/her regular statutory functions as a Tax Authority. The jurisdictional Commissioner exercised supervisory/directory functions in getting the orders for the tax proceedings of the Taxpayer and now, as a member of the DRP, he/she would be examining the validity of the same orders. This conflict of interest is in violation of the principle of natural justice, *vis-à-vis*, the rule against bias enshrined in the dictum '*nemo iudex in sua causa*' which means that no one can be judge in his/her own cause.
- ▶ The DRP rule that provides for the constitution of the members of the DRP is inherently flawed as a jurisdictional Commissioner, if appointed as a member of the DRP, can make the independence of the DRP questionable.

- ▶ The rule is wholly arbitrary and *ultra vires* to the Indian Constitution. It should be read down to ensure that the jurisdictional Commissioner is not nominated as a member of the DRP so that its functioning remains independent and unbiased.
- ▶ Based on the factual averments by the Tax Authority that the Commissioner supervising orders in the Taxpayer's case and the DRP member were different persons, there exists no personal bias.
- ▶ Principles of natural justice and the doctrine of *nemo iudex in causa sua* are subject to the 'doctrine of necessity'. [SC in UOI v Tulsiram Patel (AIR 1985 SC 1416)]. Under the 'doctrine of necessity', if the choice is between allowing a biased person to act or to stifle the action altogether, the choice must fall in favor of the former as it is the only way to promote decision-making. [SC in Election Commission of India and another v. Dr. Subramaniam Swamy and another (1996) 4 SCC 104].

## Tax Authority's contentions

- ▶ Mere potential for bias or potential for abuse of power could not render a statutory provision unconstitutional.
- ▶ There is no conflict of interest as the person holding the office of Commissioner at the time of passing the impugned orders for initiating tax proceedings in the Taxpayer's case and the person who was appointed as member of the DRP were different. Hence, no personal bias as well as legal bias arises.
- ▶ The Commissioner was only discharging his/her statutory functions provided in the ITL and, therefore, the bias stood excluded. The principles of natural justice and fair play had not been violated and there was no conflict of interest.
- ▶ With regard to legal bias, the HC observed the following principles established by various Courts in the past:
  - ▶ The rule of natural justice can operate only in areas not covered by any law validly made. If a statutory provision, either specifically or by inevitable implication, excludes the application of the rules of natural justice, such mandate of the legislature cannot be ignored. [Supreme Court in Kraipak (A.K.) v UOI (AIR 1970 SC 150) and Swadeshi Cotton Mills Co. Ltd. v UOI (AIR 1981 SC 818)].
  - ▶ It cannot be said that the action taken by the Tax Authority pursuant to a statutory empowerment is colored by reasons of bias. The question of bias has to be decided on the facts of each case, only if the taxpayer is able to establish that the Tax Authority was, in fact, biased in the sense that he/she was involved or interested in his/her personal capacity in the outcome of the tax proceedings. [SC in UOI v Vipin Kumar Jain and others (260 ITR 1)].
  - ▶ Legal malafides or legal malice is to be distinguished from personal bias or personal malice. If the action taken by such authority is based on extraneous considerations, which are wholly irrelevant for the purpose for which power has been conferred upon it, the resultant action would be hit by the doctrine of legal bias or legal malice. [Allahabad HC in Subhash Chandra Gupta v State of UP and another (1981 7 AWC 436)].
- ▶ The tests of 'real likelihood' and 'reasonable suspicion' are really inconsistent with each other. There must be a 'real likelihood' of bias i.e., the circumstances from which a reasonable man would think it likely or probable. [SC in S. Parthasarathi v State of A.P. (1974 3 SCC 459); Metropolitan Properties Co. (FGC) Ltd. v. Lannon (1968 3 WLR 694)].
- ▶ Bias cannot be established merely because one of the members of the DRP is also a jurisdictional Commissioner. There is nothing to indicate that the jurisdictional Commissioner was interested in his/her personal capacity in the outcome of the proceedings or that the directions issued by the DRP to the Tax Authority were based on extraneous considerations.
- ▶ The Commissioner was discharging his/her statutory functions provided under the ITL. The 'doctrine of necessity' makes it imperative for the authority to carry out its statutory functions and if the 'doctrine of necessity' is not allowed full play in certain situations, it would impede the course of justice.

## HC's ruling

- ▶ The DRP provision is a beneficial piece of legislation providing for an alternative mechanism for speedy disposal of the cases of multinational companies.

- ▶ In the facts and circumstances of the case, there is no conflict of interest and mere potential of bias against one of the members of the DRP will not render the provisions of the ITL and the rule unconstitutional. However, considering the facts of the case, 'real likelihood' of bias cannot be ruled out, even if the officer is impartial.
- ▶ Hence, going by the principle that justice must not only be done but seen to be done, the concerned Commissioner should not adjudicate upon the matter. Additionally, the CBDT is directed to ensure that a jurisdictional Commissioner is not nominated as a member of the DRP.

## Comments

The DRP has emerged as an alternative mechanism for resolving international tax and transfer pricing disputes ever since it was introduced in the ITL in 2009. However, concerns have often been expressed on the autonomy and the independence of the DRP as the members are constituted by officers of the tax administration. The HC's direction in the present case that a jurisdictional Commissioner should not be a member of the DRP could help in addressing this concern in a limited way.

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