Tax litigation and the twin tools solution

What is the issue?

- The authors of the Economic Survey of 2017-18 articulate people's frustrations of delayed and, hence, denied justice.
- This malaise could find a solution in the twin tools of forensic economics and technological leveraging.

What is the story behind?

- The claims for indirect and direct tax stuck in litigation by the quarter ending March 2017 amounted to over 4.7% of GDP.
- As per the Economic Survey, there has been an upsurge by 25% in the number of cases stuck in various appellate fora.
- This upsurge is caused despite the simplification of the law, setting up of new tribunals and separate tax benches in the Supreme Court.
- The Survey points out that the success rate of tax departments at all levels of appeal (appellate tribunals, high courts and the Supreme Court) for both direct and indirect tax litigation is under 30%, and is declining.
- As per the Comptroller and Auditor General of India, the **poor success rate is because of the poor quality of adjudication orders**.

What source is used to evaluation of quality?

- **Tax Administration Reform Commission (TARC)** evaluates the reason for the poor quality of adjudication orders and unnecessary filing of appeals by tax departments.
- It was set up by the government in 2014 and produced four reports that analysed the poor functioning of dispute resolution institutions.
- According to it, the **reason** for the poor quality of adjudication lies in the **revenue bias of adjudicating officers (AOs)**.
- The report mentions that the mentality of AOs is affected by the process of review in tax departments, as they're viewed with suspicion by the reviewing officers if they decide a case in favour of the taxpayer.

What is the impact of the reviewing power?

- It provides the authority to examine orders passed by subordinate officers

with a view to determining their ‘legality and propriety’.

- But, the TARC has reported that the primary consideration that weighs with revisionary authorities is the tax effect of the order.
- This, coupled with the perceived fear of vigilance and audit, has fuelled the tendency to pass pro-revenue orders without regard to merit and concerns of legality and propriety, forcing taxpayers to appeal.
- The second TARC report mentions that there is a marked absence of judicial discipline and respect for the model, which results in excess of avoidable disputes.
- The major reason for mounting tax litigation is the trust misalignment between supervisory and subordinate officers/principal-agent.

What are the litigious effects from the government standpoint?

- The Economic Survey 2017 shows that many infrastructure projects have been impacted because of stay orders that were pending for an average of 4.3 years.
- Since project costs were predominantly debt-financed, in all likelihood project costs had increased by close to 60%.
- Studies on the litigious effects on the taxpayer have suggested that litigation adversely affected SME investment in plant and machinery.

How forensic economics a solution?

- Effective interventionistic strategies require the understanding of the economic damages caused by frivolous litigation on taxpaying firms.
- Forensic economics enables the understanding of hidden behaviour. In our case, it will be the behaviour of firms that are subjected to litigation.
- The focus of forensic economics is with respect to **economic loss calculations**.
- It is a simple framework, only that the expert is required to proffer opinions that fall within a reasonable degree of certainty or probability.
- In our case, it could be a regression analysis of litigation costs and investments in capital goods by the SME.

What is the solution to this burden on both the state and its taxpayers?

- **Evaluation of dispute resolution officers** based on the quality of their orders evaluated for fairness and observance of judicial discipline.
- **Peer reviews by panels of selected officers** known for their expertise and fairness.
- **TARC-identified global best practices** worthy of adoption are,
    1. Setting up of a dedicated organisation for dispute management.

2. Establishment of an ‘enhanced relationship’ arrangement between taxpayers and the tax administration.
3. Issuance of binding technical guidance notes by tax administrations.
4. Adoption of ADR (alternate dispute resolution) techniques to resolve tax disputes out of court.

- **Addressing the trust misalignment** between principal and agent.

How artificial intelligence (AI) a solution?

- The authors suggest the use of AI for **overcoming risk-aversion** of original adjudicating authorities and **trust deficit** between AOs and their reviewing supervisors.
- Inbuilt in the repair design should be a **revenue-neutral reviewing mechanism** by supervisory authorities.
- This design should be based on a digital platform with one organisation tasked with the real-time seeding of case law accepted by tax boards.
- **AI software with prediction technology** that generates results that forecast litigation outcome can be used here.
- The software will be most effective in better-settled areas of law where there is ample relevant data.

Source: Financial Express

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