

# India's Bid to Settle Tax Disputes Draws Multinational Interest

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- Companies can avoid India's drawn-out litigation
- Popular previous 2021 deal raised \$6.3 billion

Multinationals are considering taking up India's one-time offer to settle long-running tax disputes with the government, lured by the promise of not paying interest or penalties.

They're also looking at the deal as a way to end costly, long-running disputes in a timely manner. A recent high court order in favor of American firm Western Union took more than 18 years.

"Foreign multinationals are doing it to buy peace and to reduce their list of litigation, which is disproportionate to their size of operations in India," said Gaurav Mehndiratta, partner and national head, corporate and international tax for KPMG in India.

Taxpayers have until Dec. 31 to accept the government's offer, called Direct Tax "Vivad Se Vishwas" Scheme—from "dispute to trust"—which was announced in the federal budget in July and came into effect Oct. 1.

The VsV program allows taxpayers to pay 100% of a disputed tax amount but forgives interest and penalty charges if the deal is taken up by Dec. 31, according to an Oct. 13 circular from the Central Board of Direct Taxes. If the deal is taken up after Dec. 31, the amount payable is 110% of disputed amount.

The VsV program aims to reduce spending on income tax litigation, generate government revenue and save taxpayers time and resources, avoiding a "long-drawn and vexatious litigation process," according to the circular.

A similar tax VsV deal was offered in 2020. The government collected 536 billion rupees (\$6.3 billion) and settled around 147,000 disputes at the time, according to a government statement.

"Many corporate taxpayers, multinational companies are looking at the option," according to Tarun Arora, India transfer pricing leader at Deloitte.

Mehndiratta said the VsV deal makes sense from a cost-benefit point of view for many international companies, where India represents a small portion of their revenue.

Several members of the US-India Strategic Partnership Forum, which has a network of 400 plus companies, are considering taking up the deal, especially when litigation costs and uncertainty outweigh any potential gains from going through the courts, said Shweta Kathuria, senior director at the forum.

“For such cases, the scheme’s promise of timely resolution and relief from penalties and interest is particularly attractive,” she said.

## **MFN Clause**

Corporations affected by adverse rulings related to the most-favored nation clause are also likely to take join the VsV program, practitioners said.

The so-called MFN clause in India’s tax treaties with members of the Organization for Economic Cooperation and Development (OECD), allows taxpayers of member countries to apply the most favorable tax rates available to any OECD country.

Multinational companies including Nestle SA of Switzerland and others had applied a lower rate for withholding dividends that was available to countries like Lithuania and Slovenia.

However, India’s income tax department contested this saying that Lithuania and Slovenia had not been OECD members at the time India entered into tax treaties with them.

The Supreme Court in a ruling last year agreed with the tax department that the MFN clause with respect to these countries wouldn’t become applicable unless the government issued a separate notification about it, which it hasn’t.

The ruling has made Nestle and other taxpayers liable to pay pending taxes and interest.

“For them it is a sweet spot,” said Mehndiratta. These taxpayers can pay off the pending tax amount without any interest, he said, if they take up the VsV scheme offer.

Some taxpayers may hope to overturn the Supreme Court decision through a larger bench, but others may feel its a lost cause and opt for VsV, said Vijay Iyer, EY India transfer pricing leader.

“At least you’ll save on interest and penalty, so let’s just close the matter,” said Iyer.

## **Limits of Program**

The VsV offering has some limitations that are likely to keep some taxpayers from using it, said practitioners.

If there are multiple disputes on different tax issues pending in the same assessment year, the deal requires the taxpayers to settle all of them. They can’t be broken up, Arora explained.

Not all corporations will want to go for this option, as the taxpayer may want to fight on an issue of principle or because the total disputed amount is too high, he said.

“There are reservations, especially for cases involving significant amounts or matters of principle where accepting a settlement might set an unfavorable precedent,” said Kathuria.

In addition, Arora said that international companies are disinclined to opt for VsV for transfer pricing issues for several reasons. One key element is that in some issues of principle, taxpayers are awaiting a verdict from the Supreme Court, which will define how that subject is taxed in years to come.

“On fundamental issues where taxpayers feel that a SC court decision is pending, they don’t want to go and settle as then they’re going to be out of options,” said Arora.

He expects more taxpayers to apply for settling direct income tax issues instead.

However, while the VsV program is likely to help bring down the number of disputes, tax practitioners agreed that it isn’t a long-term solution.

“From the long term point of view, the litigation system and the cycle has to be shortened,” said Arora.

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