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IS ARBITRATION THE NEW FUTURE OF CROSS-BORDER TAX DISPUTES?

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INTRODUCTION

As the world opened its door to globalization, the dependence of national economies and markets on each other intensified significantly with time, exerting pressure on international tax regulations established over a century ago. When income is earned across jurisdictions, questions often arise regarding which country has the right to tax it. This overlap frequently results in tax being levied more than once on the same income, creating obstacles for global trade and investment.

Eradicating avenues for cross-border tax avoidance and evasion, together with the effective prevention of double taxation, is essential for establishing an international tax system that fosters economic growth and a robust global economy. To address these issues, legal and procedural frameworks such as tax treaties and dispute resolution mechanisms have evolved. Among these, arbitration has emerged as a significant tool in resolving international tax disputes, offering a binding and neutral avenue when traditional negotiations fall short. This article explores the principles of cross-border taxation, the development and implementation of arbitration and highlights India's proactive approach in incorporating arbitration into its international tax regime.

THE BONE OF CONTENTION: SETTING A CONTEXT

Each nation has its own tax laws and regime, which are applicable on the domestic income and profits of its nationals. Issue arises when income and profits are generated across borders, the foremost question that follows is which country's tax laws will be applicable on a natural or juristic person with respect to the revenue generated outside the country of residence. That is where the concept of cross-

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border taxation comes into play. In order to understand the principles of International Taxation, it is crucial to be aware of the following terms and concepts:

DOUBLE TAXATION

As the name suggests, double taxation simply means when taxes are levied twice on the same source of income. Income may be subject to taxation in the nation of origin and subsequently taxed again upon repatriation to the home country. Double taxation can occur in two cases:

- A. International Double Taxation: It occurs when tax is paid on the same foreign income in two separate jurisdictions.
- B. Corporate Double Taxation: When corporations and their shareholders pay taxes separately on the same profit.

International Double Taxation may render foreign commerce prohibitively costly to undertake.

SOURCE VS RESIDENCY DEBATE

The concept of double taxation has its genesis in the 'source vs residency' debate. Let us say A, an Indian resident, generates a certain income in the USA and, as per the source-based approach since the source of income is in the USA, its tax implications arise in the USA. This is known as source-based taxation. The residency approach on the other hand stipulates tax implications arising in the country of residence, in the aforementioned illustration, as per the residency-based approach the income or profit of residents of India is taxable in India regardless of where such income or profit is earned. This consequently leads to double taxation.

DOUBLE TAXATION TREATIES/ DOUBLE TAXATION AVOIDANCE AGREEMENT

To mitigate the concern of double taxation, many nations have ratified treaties to prevent double taxation or avoidance of taxes known as the Double Tax Treaties or Double Tax Avoidance Agreement (DTAA) to facilitate cross border trade, these agreements are usually bilateral agreements wherein the two participating countries concur that either the income shall be taxed exclusively by one nation or both nations will impose taxes on income according to their respective taxation regulations or the tax paid by the taxpayer in one country may be claimed as a credit for settling tax obligations in the other country. Where there is no bilateral agreement in place with the other country, relief may be

provided by the home country. However, dispute arises when neither of the two reliefs are accessible to the assesses.

SCOPE OF ARBITRATION IN INTERNATIONAL TAX DISPUTES

Integrating the complex conceptual intricacies of tax legislation and contract law within an arbitration framework, tax arbitration has emerged as a distinct and specialist category of conflict resolution within international taxation principles. There are a few universal models that lay down a framework for dispute resolution in cross border tax disputes. The OECD (defined below) model has been largely adopted by different countries on the basis of suitability to jurisdiction.

The Organisation for Economic Cooperation and Development (OECD), which is a global policy forum that promotes policies to improve the economic and social well-being of people around the world has framed OECD Model Tax Convention on Income and on Capital which has been used as a basic document of reference for the negotiation, interpretation, and application of tax treaties since 1963. In addition to it, the OECD brought in action its Base Erosion Profit Shifting Initiative (BEPS) Action 14 in 2015. Article 25 of the OECD Model Tax Convention (OECD, 2014) offers a mechanism for competent authorities of contracting states to resolve interpretation or application disputes on a mutually agreed basis, independent of domestic legal remedies. The mutual agreement procedure (MAP) is crucial for applying and interpreting tax treaties. It ensures that taxpayers receiving benefits are not taxed beyond the terms of the treaty by either Contracting State.

The BEPS Action Plan's Action 14 measures aim to enhance the efficacy and efficiency of the MAP process. To reduce confusion and inadvertent double taxation, tax treaties are consistently implemented and issues surrounding their interpretation or application are resolved through mutual agreement procedures.

OVERVIEW OF MAP

As per the map guidance 2020 released by the central board of direct taxes “mutual agreement procedure (map) is an alternate tax dispute resolution mechanism available to the taxpayers under the dtas for resolving disputes giving rise to double taxation or taxation not in accordance with dtas. Map can help in relieving double taxation either fully or partially”.

A taxpayer may submit a MAP request when it believes that the acts of the tax authorities of one or both treaty partners lead to taxation that is inconsistent with the applicable DTAA. MAP cases pertain to cross-border double taxation, which may manifest as juridical double taxation (the same income taxed twice within the same entity across two distinct countries) or economic double taxation (the same income taxed in the hands of two separate entities).

Furthermore, the BEPS initiative includes mandatory binding arbitration to Action 14 under Article 25 of the OECD convention, which previously only allowed for mutual agreement. Mandatory binding arbitration requires both nations' competent authorities to initially negotiate the dispute through MAP. If the matter cannot be resolved within two years, the taxpayer can request binding arbitration. Arbitration occurs after the MAP fails to resolve the issue.

CHALLENGES FACED BY ARBITRATORS IN INTERNATIONAL TAXATION DISPUTES

The foremost challenge in cross-border alternate dispute resolution is the enforceability of awards or settlements. Although arbitration awards are typically binding, enforcement may pose challenges if one party declines to comply or if the dispute involves parties from nations that are not signatories to international treaties, such as the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Secondly, in numerous international conflicts, ascertaining the applicable national law and the jurisdiction competent to adjudicate the matter can be intricate where there is no DTAA in place. The parties may disagree on the applicable legal framework or jurisdiction, resulting in conflicts of law.

Moreover, during arbitration, parties from different countries may find it difficult to communicate and negotiate due to cultural differences. Misunderstandings or a deadlock may result from parties'

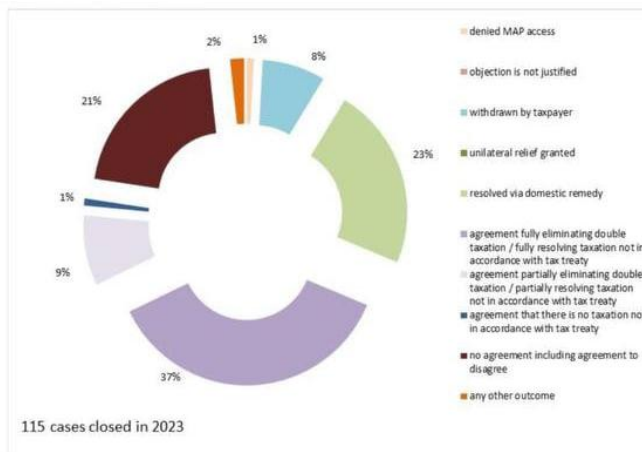
different approaches to conflict resolution, expectations, and communication styles. One cultural norm may favour conciliatory methods, while another may place a premium on direct discussion and confrontation. Similarly, if the people involved do not speak the same language, a linguistic barrier may further complicate matters. To ensure a seamless process, arbitrators should be knowledgeable about the intricacies of international communication and cultural sensitivity.

INDIA'S TAKE ON ARBITRATION IN CROSS BORDER TAX DISPUTES

Section 90 of the Income Tax Act, 1961 covers the bilateral relief agreement between countries. This section provides that the Central Government can enter into an agreement with any other country or countries of the world in order to avoid double taxation. Section 91 of the Act covers the provision of unilateral agreements in which no agreement has been established between two countries.

India has a large network of tax treaties with over more than 90 countries. As per the MAP Guidance released by Central Board of Direct Taxes almost all DTAA's entered into by India have the MAP Article and it provides an additional dispute resolution mechanism to taxpayers in addition to those available under the domestic laws of India. India offers broad and accessible avenues for MAP to its taxpayers who are dissatisfied with the decisions or actions of foreign tax authorities from treaty partners, particularly when such decisions or actions, in the taxpayer's view, lead or will lead to taxation that contravenes the applicable DTAA's.

The procedure for application for MAP has been laid down in rule 44G of the Income-tax Rules, 1962. The following figure sourced from OECD database reflects the MAP outcomes of India in the year 2023. Out of a total of 115 cases the majority cases i.e. 37% deal with complete elimination of double taxation or fully resolving taxation not in accordance with tax treaty but through alternate dispute resolution method, which is comparable with the number of cases closed in 2022, indicating a steady approach.



CONCLUSION

As cross-border economic activity expands, disputes arising from the overlapping tax claims of different jurisdictions have become increasingly common. These disputes often stem from the dual application of source-based and residency-based taxation, leading to the issue of double taxation. To address this, countries have entered into DTAAs, supported by procedural frameworks such as the OECD's MAP framework.

While MAP facilitates negotiation between tax authorities, it is arbitration that provides a structured, binding, and impartial mechanism when such negotiations fail. Arbitration thus forms a critical link in the international tax dispute resolution system, ensuring that unresolved MAP cases do not result in prolonged uncertainty or unfair double taxation. The integration of arbitration into international tax treaties, particularly under BEPS Action 14, reflects a growing recognition of its importance in maintaining the integrity of tax treaties and ensuring taxpayer rights.

India's adoption of arbitration within its MAP framework under Rule 44G, and an attempt at resolution of a majority of its MAP cases in 2023, underscores the increasing nexus between arbitration and international taxation. In this context, arbitration is not merely an alternative to litigation but is a foundational tool that strengthens global tax cooperation, ensures compliance with treaty obligations, and fosters investor confidence in cross-border trade.

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