Chapter 28

Pakistan

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28.1. Tax treaty disputes: The current landscape

Pakistan has so far signed 65 full-scope tax treaties that are in force – extensively covering the Asian, European, and North American continents[1] to facilitate cross-border movement of capital, technology and expertise. Non-residents operating in Pakistan occasionally become entangled in tax disputes with the Federal Board of Revenue (the tax administration or FBR). These disputes arise out of both a misplaced application of domestic tax law as well as the misinterpretation or misapplication of tax treaty provisions. To settle such disputes, Pakistan not only allows non-residents economically active in its jurisdiction full access to its judicial system, but also provides for additional dispute resolution mechanisms in its tax treaties to ameliorate hardships. Like elsewhere too, non-residents in Pakistan have unlimited access to domestic dispute resolution mechanisms, from the first appellate forum to the last (the Supreme Court).[2]

A non-resident taxpayer – whether litigating an issue of application of domestic tax law or an applicable treaty – may, as a first step, approach the forum of the Commissioner (Appeals), under section 127 of the Income Tax Ordinance 2001 (the Ordinance). If the Commissioner of Inland Revenue or the taxpayer feels aggrieved by the order passed by the Commissioner (Appeals), either of them may file an appeal to the Appellate Tribunal Inland Revenue (the Appellate Tribunal).[3] Although the Appellate Tribunal is the final authority on facts, any question of law emerging from the judgment of the Appellate Tribunal may be appealed to the High Court.[4] A judgment of the High Court may then be appealed to the Supreme Court under article 185(3) of the Constitution.[5]

1. Some noteworthy countries with which Pakistan has yet to sign tax treaties include India and Russia in Asia, Argentina and Brazil in South America, and Australia.
2. This unrestricted access to the judicial system is also available to non-residents from non-treaty countries without any discrimination.
3. PK: Income Tax Ordinance, 2001, sec. 131 [hereinafter ITO 2001].
4. Sec. 133 ITO 2001.
5. PK: Constitution art. 185(3): "An appeal to the Supreme Court from a judgment, decree, order or a sentence of a High Court ... shall lie only if the Supreme Court grants leave to appeal".

Moreover, a non-resident person is able to pursue the additional route of alternative dispute resolution mechanisms.[6] By means of advance rulings, the tax law provides another convenient and free-of-cost opportunity specifically to non-residents for the determination of tax liability prior to the implementation of a transaction.[7] Advance rulings are issued by the tax administration/competent authority, but on behalf of the Commissioner of Inland Revenue. Thus, if a non-resident taxpayer has made "a full and true disclosure of the nature of all aspects of the transaction relevant to the ruling, and the transaction … proceed(s) in all material respects" as set out in the non-resident's application, the ruling will be "binding on the Commissioner with respect to the application to the transaction of the law as it stood at the time the ruling was issued".[8]

However, for unidentified reasons, an advance ruling does not appear to be a preferred option among non-residents intending to enter Pakistan, as in the more than 15 years during which the provision has been in place, only nine rulings have been issued.[9] The scope of the rulings that have been issued to date is also quite limited, as most –if not all – of them deal with issues such as the determination of tax liability of certain transactions, the receipt of a payment as a result of a merger, the performance of seismic data processing services, and "payments for sales in Pakistan without having a permanent establishment".[10] Likewise, a taxpayer may lodge (i) a plaint against grievances under section 7 of the Federal Board of Revenue Act 2007,[11] to the Chairman of the Federal Board of Revenue and (ii) a representation to the Federal Tax Ombudsman, who may step in to respond to all instances of hardship and maladministration, respectively.[12] These cost-effective and quick mechanisms for redress of complaints and resolution of issues are equally available to non-resident persons operating in Pakistan, whether from a treaty or a non-treaty jurisdiction.

Most of the 65 Pakistani tax treaties do include article 25 ("Mutual Agreement Procedure") or an equivalent provision under a different number or title.[13] It has been argued that:

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6. Sec. 134A ITO 2001.
7. Id., at sec. 206A.
8. Id.
9. *See* www.fbr.gov.pk.
10. G.M. Michielse, *Tax Provisions and the Global Economy*, in *The Role of Taxation in Pakistan's Revival* p. 235 (M.R. Cyan & J. Martinez-Vazquez eds., Oxford U. Press 2015).
11. PK: Federal Board of Revenue Act, 2007, sec. 7.
12. PK: The Establishment of the Office of Federal Tax Ombudsman Ordinance, 2000.
13. The Pakistan-United States Tax Treaty, which was signed in 1957, for example, does not include an article on the MAP or its close equivalent.

> the mutual agreement procedure (MAP) is of fundamental importance to the proper application and interpretation of tax treaties, notably to ensure that taxpayers entitled to the benefits of the treaty are not subject to taxation by either of the Contracting States which is not in accordance with the terms of the treaty.[14]

In fact, the importance of the MAP is heightened in the post-BEPS environment. BEPS Action 14 is fully geared "to strengthen the effectiveness and efficiency of the MAP process", by minimizing "the risks of uncertainty and unintended double taxation by ensuring the consistent and proper implementation of tax treaties".[15] The OECD/G20 BEPS Project, its outcomes and the body of recommendations, has placed the international tax system in a state of flux. With tax administrations – particularly those in developing countries – trying to truly and fully comprehend the various dimensions and implications of the BEPS Project, and roll out the OECD's implementation strategies and timelines, some taxpayers are increasingly tentative, apprehensive and edgy.

In the Pakistani context, although the post-BEPS OECD Transfer Pricing Guidelines[16] are to be applied prospectively, the taxpaying community that is likely to be affected by those Guidelines is going through a phase of uncertainty. One expected outcome of the country-by-country reporting which was to go into effect in July 2018 is anticipated to increase the number of tax disputes. In the Pakistani context, the bulk of tax disputes arise from within the BEPS purview and its various pillars. In all fairness, Pakistan's current system of tax treaty dispute resolution is functioning below par. This is because of two reasons. First, there are no specialized bodies, authorities or courts that deal with international tax disputes – including transfer pricing issues. Second, the existing tax court judges are hardly trained in the latest developments in international tax issues. As a result, there have been instances of "bad case law" in the realm of international taxation.

28.2. Dispute resolution under a MAP: State of the art or fundamentally broken?

Pakistan has already put in place elaborate mutual agreement procedure (MAP) rules in Rule 19D of the Income Tax Rules 2002.[17] These Rules are

14. OECD/G20, *Making Dispute Resolution Mechanisms More Effective – Action 14: 2015 Final Report* p. 15 (OECD 2015), Primary Sources IBFD.
15. Id., at p. 9.
16. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2017), Primary Sources IBFD.
17. PK: Income Tax Rules, 2002, Rule 19D [hereinafter ITR 2002].

broadly in line with the United Nations Model Tax Convention (UN Model) (sans arbitration), and the Commentary thereon on relevant points. The fact that the MAP, in the Pakistani context, is rarely resorted to by taxpayers, casts a question mark over its status as favourite – or even an acceptable – tax dispute resolution mechanism. The disfavour of the MAP may have been brought about by, among others, the reluctance of the competent authority to resort to or invest in this particular mode of dispute resolution. The government's lack of preference for the MAP is also evidenced in the fact that no statistical information is compiled and placed in an accessible public domain. In fact, critical information on MAP cases as regards their number, duration, outcome, and even "win or lose" ratio is jealously guarded. The overall approach of the competent authority – as in most areas of tax administration – is to keep things secret, rendering situational analysis and knowledge creation an arduous option. The MAP is performed as a "behind closed doors" inter-governmental process with little or no involvement of the taxpayer. Improvement of the MAP is a part of the "minimum standard" outcome of the implementation of OECD/G20 BEPS reports. Alas, the improvements have not yet been implemented, and Pakistan – like so many other developing countries – is moving cautiously on this front. Pakistan's peer review in this respect is scheduled for 2020.

In Pakistan, the MAP is generally not considered to be an effective, preferred or state-of-the-art tool for resolution of international tax disputes. The two reasons for such a poor perception of the MAP could be a sheer lack of commitment to it by the competent authority, and conversely a greater faith among non-resident taxpayers (and their advisors) in the standard tax court system. The only way the situation could drastically improve is through high-degree, high-level commitment to the MAP and a corresponding allocation of pecuniary resources for this purpose. The tax administration does not yet appear to be fully ready for arbitration. This may be because of a lack of adequately skilled manpower and/or Pakistan's experience with arbitration under bilateral investment agreements and free trade agreements.

However, the tax administration historically has tended to rely on the alternative dispute resolution mechanism. The alternative dispute resolution option has been made available under section 134A of the Ordinance. Section 134A(1), a *non obstante* provision, provides as follows:

> Notwithstanding any other provision of this Ordinance, or the rules made thereunder an aggrieved person, in connection with any matter pending before an Appellate Authority, may apply to Board for the appointment of a committee for

> the resolution of any hardship or dispute mentioned in detail in the application except where prosecution proceedings have been initiated or where interpretation of question of law having effect on identical other cases.[18]

Section 134A(2) empowers the tax administration to appoint an alternative dispute resolution committee within 2 months of receipt of an application by a taxpayer in this regard. Most recently, the tax administration appointed alternative dispute resolution committees for all major cities of the country.[19] It might not be out of line to conclude that alternative dispute resolution is not a widespread phenomenon in the arena of international tax dispute resolution in Pakistan. Currently, a parliamentary debate is underway regarding improvements to the alternative dispute resolution system and legislation in this regard is expected in the near future.[20]

28.3. The experience with arbitration in international tax disputes

On 15 July 2011, Pakistan promulgated the Recognition and Enforcement (Arbitration Agreements and Foreign Arbitral Awards) Act 2011 (the Foreign Awards Act). The Foreign Awards Act is essentially an adaption or ratification of the United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards of 1958 (the UN Convention), which provides "that foreign judgments and awards by or between the nationals of contracting states are to be enforced without questioning the validity of the same except on the grounds explicitly provided for in the Convention".[21]

The Foreign Awards Act provides that:

> a party to a foreign arbitration agreement against whom legal proceedings have been brought in respect of a matter which is covered by the arbitration agreement may, upon notice to the other party to the proceedings, apply to the court in which the proceedings have been brought to stay the proceedings in so far as they concern that matter.[22]

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18. Sec. 134A(1) ITO 2001. Subsequently, alternative dispute resolution mechanism was implemented by means of Rule 231C ITR 2002.
19. A total of 15 alternative dispute resolution committees were formed by means of FBR Notification S.R.O.60(I)/2018 of 25 Jan. 2018.
20. The improvements that are being contemplated in the alternative dispute resolution system are summarized in the final section of this chapter.
21. RIAA Barker Gillette, *A Study of the Arbitration Law Regime in Pakistan* p. 2 (RIAA Barker Gillette 2015).
22. Id., at p. 6.

Thus, once such an application has been made, the court must refer the parties to arbitration in accordance with the foreign arbitration agreement unless it gathers that the arbitration agreement was ab initio void, inoperative or incapable of being performed. This is a significant shift, as prior to the Foreign Awards Act, the court before which legal proceedings were brought against a (foreign) party to an arbitration agreement had absolute discretion as to whether to stay the proceedings before it or refuse it in totality. It was maintained that: "a party having entered into an agreement after having full knowledge of its consequences cannot be allowed to defeat the arbitration clause".[23] The Supreme Court of Pakistan unequivocally held as follows:

> The Court's approach should be dynamic and it should bear in mind that unless there are some compelling reasons, such an arbitration clause should be honoured as generally the other party to such an arbitration clause is a foreign party. With the development and growth of international trade and commerce and due to modernization of communication/transport systems in the world, the contracts containing such an arbitration clause are very common nowadays. The bargain, that follows from the sanctity which the Court attaches to contracts, must be applied with more vigour to a contract containing a foreign arbitration clause. We should not overlook the fact that any breach of a term of such a contract to which a foreign company or person is a party, will tarnish the image of Pakistan in the comity of nations. A ground which could be a contemplation of party at the time of entering into the contract as a prudent man of business cannot furnish basis for refusal to stay the suit under section 34 of the Act. So the ground like, that it would be difficult to carry the voluminous evidence or numerous witnesses to a foreign country for arbitration proceedings or that it would be too expensive or that the subject-matter of the contract is in Pakistan or that the breach of the contract has taken place in Pakistan, in my view cannot be a sound ground for refusal to stay a suit filed in Pakistan in breach of a foreign arbitration clause contained in contract of the nature referred to hereinabove. In order to deprive a foreign party to have arbitration in a foreign country in the manner provided for in the contract, the Court should come to the conclusion that the enforcement of such an arbitration clause would be unconscionable or would amount to forcing the Plaintiff to honour a different contract, which was not in contemplation of the parties and which could not have been in their contemplation as a prudent man of business.[24]

In another judgment of the Supreme Court, it was asserted that:

> … arguments regarding public policy and expensiveness of the arbitration taking place in London as ground for stay of suit are no longer tenable in light of

23. PK: HC Sindh, *Manzoor Textile Mills Ltd. v. Nichimen International U.K. Ltd.*, PLD 2000 MLD 641.
24. PK: SC, NLR 1990 Supreme Court J 70, note by Mr Justice Ajmal Mian.

> the observations of the Supreme Court of Pakistan. … There is no doubt some expense is involved in litigation but that is true anywhere in the world. In the present suit, the plaintiff has filed a suit for more than USD 1 million and it is reasonable to expect to incur some expenses in the event of a dispute. Further, there is no restriction imposed by the State Bank of Pakistan on remittance of foreign exchange for any lawful purpose at any time and with the availability of modern devices such as teleconferencing facilities, evidence may be recorded easily anywhere in the World under the supervision of the arbitral body.[25]

Thus, foreign arbitral awards falling within the confines of the Foreign Awards Act are recognized and enforced in the same manner as judgments and decisions of courts in Pakistan. The recognition and enforcement of foreign arbitral awards now cannot be refused except in accordance with the provisions of the UN Convention on Recognition and Enforcement of Foreign Arbitral Awards.

Pakistan's experience with arbitration in international disputes has not been very good, and it constantly weighs on the state while entering into any new international commitments that involve arbitration. With a view to promoting foreign direct investment, Pakistan has signed several bilateral investment agreements over a period of 50 years, starting with the first bilateral investment agreement with Germany in 1959,[26] through the recent bilateral investment agreement signed with Turkey in 2012.[27] Most existing Pakistani bilateral investment agreements "contain clauses providing for International Centre for Settlement of Investment Disputes (ICSID) arbitration to resolve any disputes with foreign investors and the government of Pakistan".[28] Likewise, Pakistan has also signed quite a few free trade agreements, and the number of disputes that continue to crop up from time to time are keeping the state on its toes. Aggressive and energetic media readily give it a political twist, construing these cases and adverse awards as a failure of the government.

Over the past few years, Pakistan has lost some important cases in international arbitration, two of which are summarized below.

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25. PK: SC, *Eckhardt & Co. v. Muhammad Hanif*, PLD 1993 SC 42.
26. The Pakistan-Germany bilateral investment agreement was later revised in 2009, but has not yet entered into force.
27. The Pakistan-Turkey bilateral investment agreement signed in 2012 is set to replace the earlier bilateral investment agreement signed in 1997, but has not yet entered into force.
28. A. Ghouri, *Pakistan's Policy on I.C.S.I.D Arbitration*, The Express Tribune (14 Oct. 2017).

In the *Reko Diq Project* case, the World Bank's arbitration tribunal (ICSID), on 20 March 2017, ruled against Pakistan in relation to the unlawful denial of a mining lease for the Reko Diq (gold-cum-copper) Project to M/s Tethyan Copper Company (TCC) – a Chilean company. Briefly, in 1993, one of Pakistan's provincial governments (Baluchistan) entered into the Chagai Hills Exploration Joint Venture Agreement with BHP, an Australian company. BHP sold its stakes to TCC. Later, in 2011, the Baluchistan government refused to grant the requisite mining licence to TCC. In January 2013, the Supreme Court of Pakistan, when hearing a constitutional petition against the federal government's decision to lease out the Reko Diq district declared the agreement void because it was in conflict with the country's laws. TCC approached the ICSID, citing breach of contract. The ICSID denied Pakistan's final defence against liability and confirmed that Pakistan had violated several provisions of its bilateral investment agreement with Australia, where TCC was incorporated, and announced to proceed towards determination of the liability, which could be in the vicinity of USD 500 million.[29] The liability determination proceedings are underway and likely to be finalized in 2018.

In the *Rental Power Project (RPP)* case, on 18 September 2017, the ICSID announced an award of USD 700 million in favour of M/s Karkey Karadeniz Elektrik Uretim AS M/s (M/s Karkey), a Turkish company that constructs and operates rental power plants (RPPs), in a damages suit brought against Pakistan. The facts of the case are that M/s Karkey was awarded a USD 560 million contract for power ship operations in Pakistan to overcome a spiralling power crisis. The contract signed was for 5 years, but it ran into trouble after charges of corruption were levelled by the opposition parties. After the Supreme Court ruled against the government in the *RPP* case in February 2013, M/s Karkey filed a suit for damages against Pakistan. Earlier, under the Supreme Court's directions, efforts to reach an out of court settlement with M/s Karkey were ceased.[30]

Pakistan has so far entered into only two bilateral tax treaties that provide for arbitration as one of the prescribed dispute resolution mechanisms. The first time Pakistan signed a tax treaty with an arbitration clause was in its treaty with Kazakhstan. Article 25(4) of the applicable Pakistan-Kazakhstan Income Tax Treaty provides as follows:

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29. M. Haider, *World Bank Tribunal Rules against Pakistan in Reko Diq Project Case*, Dawn (21 Mar. 2017).
30. R. Sajjad Ahmad, *The Disaster of International Arbitration of RPPs*, The Express Tribune (22 Sept. 2017).

> If any difficulty or doubt arises as to the interpretation or application of this Convention cannot be resolved by the competent authorities pursuant to the previous paragraphs of this Article, the case may, if both competent authorities and the taxpayer(s) agree, be submitted for arbitration, provided that the taxpayer agrees in writing to be bound by the decision of the arbitration board. The decision of the arbitration board in a particular case shall be binding on both States with respect to that case. The procedures shall be established between the States by notes to be exchanged through diplomatic channels. After a period of three years after the entry into force of this Convention, the competent authorities shall consult in order to determine whether it is appropriate to make the exchange of diplomatic notes. The provisions of this paragraph shall have effect after the States have so agreed through the exchange of diplomatic notes.[31]

It appears that activation of the arbitration provision was contingent upon both states establishing procedures by exchange of notes through diplomatic channels after a 3-year period following the date of entry into force of the treaty. As no such diplomatic exchange of notes has taken place, the provision has not yet been applied.

The next time an arbitration provision was included was in the treaty with Hong Kong in 2017.[32] The provision is a standard text based on article 25 of the OECD Model Tax Convention on Income and on Capital (OECD Model).[33] It is yet not clear if the inclusion of OECD Model Article 25 in the Pakistan-Hong Kong tax treaty is indicative of a considered and deliberate shift in policy or whether it is merely a one-time experimental adventure, although the former appears to be a less plausible scenario. Pakistan has signed the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the Multilateral Instrument, MLI) but purportedly, without opting for Chapter VI (mandatory arbitration). Given Pakistan's unpleasant experience in international arbitration (particularly with the ICSID) in non-tax arbitration, the decision-making structures are excessively cautious, particularly when the tax dispute arbitration directly involves the *state*. Traditionally, as mentioned, the MAP has not been a preferred means of tax dispute resolution for non-resident taxpayers in Pakistan; they appear to trust the legal system more than administrative channels.

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31. Pakistan-Kazakhstan Tax Treaty (1995).
32. Pakistan-Hong Kong Tax Treaty (2017), in force (in Pakistan) by means of Notification/S.R.O.08(I)/2018, dated 2 January 2018.
33. *OECD Model Tax Convention on Income and on Capital* (15 July 2014), Treaties & Models IBFD.

28.4. The new framework for arbitration in tax treaty matters

The arbitration law pertaining to domestic arbitration in Pakistan is now very well settled, with consistent sanction from the superior courts in the last six decades.[34] The ratification of the New York Convention in 2006, as well as promulgation of the Foreign Awards Act helped provide international investors with a familiar arbitrational jurisdiction.[35] As mentioned, Pakistan has so far signed only two tax treaties that include an arbitration provision. In its most recent treaty negotiations with countries such as Croatia, Ethiopia, Moldova and Senegal, an "arbitration" clause has come up for discussion. However, due to capacity constraints, recent adverse pronouncements by the ICSID and other forums, and the additional costs associated with the process, arbitration has yet to be recognized as a robust and vibrant tax dispute resolution mechanism.

The MLI, in Chapter VI, lays down a whole new legal framework for tax treaty arbitration, although it is optional. Pakistan signed the MLI but reportedly it has not opted to include Chapter VI, which prescribes arbitration. It appears that in the foreseeable future, Pakistan might not be ready to embrace mandatory arbitration as a means of tax dispute resolution. As part of the China-Pakistan Economic Corridor, China is investing approximately USD 65 billion in infrastructure and communications projects. In order to further facilitate Chinese companies operating in Pakistan, Pakistan has put in place a premium package and instituted a special working group to resolve their tax disputes.[36] It has been argued that the special working group can only help Chinese companies in overcoming administrative hurdles and would not be able to circumvent or accelerate judicial proceedings. Other non-resident taxpayers have voiced their concerns and insinuated that preferential treatment afforded to taxpayers from a particular jurisdiction is discriminatory in nature, provides an uneven playing field and creates ill will.

Apparently, the chief reason behind Pakistan's hesitation to opt for Chapter VI is a flurry of cases that Pakistan recently lost in arbitration at the international level – with a few others being in pipeline. It has been argued that the reason why Pakistan faces international arbitration cases

34. PK: Arbitration Act, 1940 [hereinafter Arbitration Act 1940].
35. PK: Ministry of Law & Justice, The Recognition and Enforcement (Arbitration Agreements & Foreign Arbitral Awards) Act, 2011.
36. S. Sarfraz, *Tax Issues of Nine Entities: F.B.R, S.A.T China to Set up Joint Working Group*, The Business Recorder (14 Jan. 2018).

is its inability to develop a uniform law for the standardizing of contracts and the choice of arbitral frameworks.[37] Moreover, there is "no reward and punishment mechanism for the preparation of contracts, selection of dispute settlement mechanism in contracts and the negotiation strategies where the public-sector entities readily agree on international arbitration without input from experts".[38] Likewise, in the absence of transparency, public sector contracts tend to become embroiled in political controversies, which not only adversely affects the country's image as an investment destination and impacts bilateral economic relations, but also incurs additional costs to be borne by the public treasury. The phenomenon appears to have shattered the confidence of Pakistan's bureaucratic machine dealing with international economic relations.

In a nutshell, Pakistan does not yet appear to be ready to walk into the MLI-prescribed overwhelmingly arbitrational mechanism for tax dispute resolution. Pakistan's policy on reservations is highly bureaucratized, kept secret and not debated publicly. Furthermore, no input was sought from non-governmental stakeholders at the time of signing the MLI, and the reservations made have not been released into the public domain.

28.5. The players in arbitration: Arbitrators, competent authorities, taxpayers and their advisers

As the Pakistan tax administration presently does not allow or promote arbitration as a mechanism for tax dispute resolution, various questions in this section can be addressed by gathering responses from the non-tax arbitrational environment created by an interplay of the Arbitration Act and the Foreign Awards Act. A tax dispute arbitration in an international context inevitably stems from a MAP, in which a taxpayer would have had to play a key triggering role before the process advanced to an arbitrational – and thus, inter-governmental – process. As the existing non-tax arbitrational environment in Pakistan admits independent opinion arbitration, it is understandable that the disputants are heard adequately and have an active role to play throughout the process. The same legal processes are likely to apply to tax dispute arbitration if and when allowed and implemented.

In Pakistan, it is not possible to distinguish between the competent authority, the head office of the tax administration and the field offices – all of which

37. K. Kiani, *Reasons Why Pakistan Loses International Arbitration*, Dawn (13 Nov. 2017).
38. Id.

are intrinsically intertwined vertically. Apparently, there is no arbitration capacity and there is no resolve to invest in building it. It has been averred that "Pakistan has been unable to develop its own specialized pool of experts in arbitration and contract writing despite a recent rise in the number of cases".[39] Under the prevailing non-tax arbitrational framework in Pakistan, arbitrators are selected through mutual consent and agreement. If there is no agreement between the parties, the court may also appoint an arbitrator(s) or umpire, as the case may be. There are no predefined eligibility criteria for arbitrators, although they are supposed to have sector-specific orientation, knowledge, and awareness of the prevailing law and procedures, and must enjoy an unblemished reputation of impartiality.

Arbitrators are understood to be above board in their conduct and ought to avoid conflict of interest situations, lest the party not agreeing to the award, challenge the same, and if proven, the arbitral award could be quashed outright. Culturally, international arbitrators are not discriminated against, and a diversity requirement could improve acceptance of an arbitration process. Timelines are set with the consent of the parties and the court as long as the timelines are in conformity with the applicable provisions of the Limitation Act 1908. Similarly, arbitrators are remunerated by the parties concerned based on their mutual consent, and if their appointments are made by the court, the parties to the dispute are to share the remuneration cost in equal proportion or based on a ratio decided by the court.

28.6. The arbitration method and decision

In Pakistan, the arbitration environment – formal, informal, judicial, quasi-judicial – stems from and is centred on the Arbitration Act 1940 (the Arbitration Act).[40] The Arbitration Act, having been promulgated during the British era, evidently fits well within the broader common law tradition. In fact, the Arbitration Act is a self-standing statute which supplies a complete scheme concerning arbitration in Pakistan and allows flexibility to the disputants to choose and decide about ancillary matters. The preamble of the Arbitration Act states that it is "to consolidate and amend the law relating to arbitration in Pakistan",[41] and to be extended "to the whole of Pakistan".[42] Because Pakistan is a federation, the Arbitration Act – after having been extended to the entire country – empowered the High Courts

39. Id.
40. Arbitration Act 1940.
41. Id., at Preamble.
42. Id., at sec. 1(2).

of the respective federative units (provinces) to frame their own adequate set of rules.[43] Indeed:

> The parties are free to choose the applicable rules of procedure to be followed by the arbitrator for the conduct of the arbitration, rules for taking the evidence, time for furnishing the final award, interim award(s), selection of arbitrator(s) and all other flexibilities that any two domestic or international parties may require to have arbitration conducted as per their mutual desires.[44]

The Arbitration Act also grants the freedom to combine more than one dispute as long as they stem from a single contract, and refer them to the arbitrators collectively, but it is not necessary that all disputes be referred to the same set of arbitrators or tribunals. In fact,

> it is at the discretion of the parties to decide whether they prefer to consolidate their disputes into a single reference; or make separate references of individual disputes to one arbitrator; or refer different disputes arising from the same contract to different arbitrators.[45]

If the law is found to be silent on a particular issue of import, the parties to the dispute are considered to be free to fill the gap through mutual agreement as long as "it does not contradict any express provision of the laws of Pakistan".[46]

The powers to grant injunction or relief still rests with the court, which may be obtained:

> by making an application before the relevant court for initiation of the arbitral proceedings and seeking the interim order to continue until the issuance of the award. The parties to arbitration are very much entitled to and the arbitrator is empowered to issue interim award(s) prior to the final arbitral award.[47]

This does not mean that the disputants cannot demand – or the arbitrators cannot announce – interim awards before the final award. Once the award is announced and signed by the arbitrator, it becomes binding on the parties to the dispute. The arbitral award under all circumstances must be in sync with the arbitrator's terms of reference – in both letter and spirit. "The award would lose its legal sanction in the case where, on admitted facts or on proof of circumstances, it is established that arbitrators overstepped their authority

43. Id., at sec. 44 ("Power of High Court to Make Rules").
44. RIAA Barker Gillette, *supra* n. 21, at p. 4.
45. Id., at p. 4.
46. Id.
47. Id., at p. 5.

or terms of reference".[48] The award would meet an identical fate if bias or favouritism is alleged and proved by either or both of the parties to the dispute. If either of the parties desires to trigger arbitral award enforcement proceedings, it may apply to the arbitrators to submit the award to the court along with all the relevant documents underlying the award. According to procedure, the court will issue notices to the parties to file any objections to the award, whereupon "the court may proceed to remit, modify, correct or issue its judgment/decree in terms of the award".[49] Once issued, the decree of the court is enforceable under law like any other decree.

The Arbitration Act, although quite a clear piece of legislation, has attained "further clarity owing to the coherent chain of judicial precedents backing the interpretational aspects".[50] In fact, a flurry of case law emerging on its various aspects has accentuated the relevance of arbitration as an effective dispute resolution tool – particularly during times when the pace of conducting business is definitely faster than the pace of conducting litigation – at least, in Pakistan. Arbitration decisions are not published in Pakistan, per se, primarily because such decisions are case-specific and do carry, under normal circumstances, precedential value. After the passage of the Foreign Awards Act, foreign arbitral awards are implementable under the force of law in Pakistan without any dispute.

28.7. Procedural issues

The entire superstructure of arbitration under the Arbitration Act is built on the underlying arbitration agreement arrived at between the parties. The law defines an "arbitration agreement" as "a written agreement to submit present or future differences to arbitration, whether an arbitrator is named therein or not".[51] Thus, an agreement in black and white delineating "present or future" differences between the parties and an express consent to submit them to arbitration with an implied willingness to honour the resultant outcome (award) undergirds all arbitration in Pakistan. The Arbitration Act, as interpreted in case law as well as arbitration as practised over time in Pakistan, gives rise to a number of conditions that must be met prior to invoking arbitration by a party to a contract, including that:

– there is a contract that includes an unequivocal and clear-cut arbitration provision;

48. Id.
49. Id..
50. Id.
51. Sec. 2(a) Arbitration Act 1940.

- one of the parties to the contract has commenced proceedings against another party or parties;
- the matter referred to arbitration essentially stems from the legal proceedings;
- the disputant to the proceedings as well as the arbitration has the option to solicit an injunction halting the former, prior to filing the written statement or in any manner becoming a party to the proceedings;
- the petitioner is willing and fully prepared to cooperate with and assist the arbitration through the arbitration process; and
- the court on its own, too, may refer a particular matter to arbitration and also halt the legal proceedings in the meantime.

Under the Arbitration Act, although federal law, the rules of conducting arbitration have been framed by the High Courts to be applicable within their respective jurisdictions.[52] It has been argued that as "the arbitration agreement is essentially recognized as an agreement, albeit a special one, all the generally applicable international principles of contract law are applicable thereto", and therefore, "the person making the arbitration agreement must have the legal capacity to enter into the agreement, and the consideration or object of the agreement must not be illegal etc".[53] There are certain procedural dimensions that are always implied and read into the arbitration agreement *unless a contrary intent is expressly ascribable*, such as that:

- the reference is to a sole arbitrator;
- if the reference is to an even number of arbitrators, the arbitrators must appoint an umpire within 1 month of their appointment;
- the arbitrators must deliver the award within 4 months;
- if the arbitrators have allowed their time to expire without making an award or have delivered to any party to the arbitration agreement or to the umpire a notice in writing stating that they cannot agree, the umpire shall forthwith step in to replace the arbitrators;[54]
- the umpire must declare his or her award within 2 months;
- the disputants must submit all the evidence and do all other things that the arbitrators or the umpire may require;
- the arbitral award is final and binding on the parties to the dispute; and
- the cost of arbitration (including any legal fees) is at the discretion of the arbitrators or the umpire.

The Arbitration Act extends an express preference for a situation wherein the dispute at issue falls within the Act's ambit over the general laws relating

52. Sec. 44 (Power of High Court to Make Rules) Arbitration Act 1940.
53. RIAA Barker Gillette, *supra* n. 21, at p. 6.
54. Id.

to litigation.[55] There is no prescribed maximum length of submitted papers, and English and Urdu are the officially recognized and accepted languages. In general, the Code of Civil Procedure 1908, and the law of evidence[56] apply to all arbitrational proceedings in Pakistan.

28.8. Outlook: The future of arbitration in tax matters

If one were to extrapolate the general perception of arbitration prevailing in Pakistan as regards non-tax litigation into the realm of tax litigation, there is wide acceptance and likelihood of its success. Although the OECD has apparently engaged in a balancing act by presenting arbitration in the MLI as a pro-taxpayer outcome of the BEPS Project, while in reality – when viewed through the prism of the protracted tax disputes resolution scene around the world as well as the economic development divide, there is every possibility of it turning out to be a successful alternative paradigm, too. It is true that there is reluctance in Pakistan as regards committing the state to more international arbitration, but when evaluated in terms of arbitration's supportive role towards an increase in foreign direct investment, and enhancement of Pakistan's national image, the mood could swing in favour of arbitration.

Another significant supporting variable is the relevant tool kit being devised and continually refined internationally and delivered to developing countries in a user-friendly format. These and other related factors would likely render it difficult for any developing country to completely ignore arbitration as the new inevitable reality and continue swimming against the dominant currents. There is no doubt that the implementation of BEPS recommendations is likely to increase tax litigation, and arbitration is most likely to emerge as an answer to the additional workload, but developing countries would need to cover their flanks. Arbitration essentially is less procedural in nature and more objective and fact-based, and is thus likely to encourage and even compel both the tax administration and taxpayers to pull up their socks and be judicious and just in their conduct.

Pakistan recently upgraded its alternative dispute resolution regime, originally introduced in 2001, to offer an additional window for expeditious

55. In this connection, sec. 34 Arbitration Act 1940 provides that "if in a contract there is provision of resolution of dispute between the parties by way of arbitration and parties have agreed to such forum, then such forum is to be resorted to and given preference over filing of suit".
56. PK: Ministry of Law & Justice, The Qanoon-E-Shahadat Order, 1984.

resolution of tax disputes.[57] However, alternative dispute resolution as presently enshrined in law is merely optional in nature, as the tax administration reserves the right to sidestep the recommendations of the alternative dispute resolution committee and proceed to pursue litigation in tax courts, and taxpayers must compulsively follow suit. It is due to this very fundamental flaw in the alternative dispute resolution system that it has so far not proven effective in alleviating taxpayer hardships.

It has now been proposed to make the alternative dispute resolution decision binding for both the tax administration and the taxpayer. Moreover, the revamped alternative dispute resolution regime would go into gear only after both of the litigants have withdrawn their cases pending in court. In order to energize the system, the composition of the alternative dispute resolution committee is also being reconstituted to include a retired judge of a High Court, a representative of the tax administration, and experts from the community of tax professionals. The period in which the alternative dispute resolution must be finalized is also being reduced to 120 days (from 180 days). If a decision is not delivered within the stipulated 75-day period, the alternative dispute resolution committee would stand dissolved, the appeals withdrawn would stand restored and the appellate courts would proceed to decide on the disputes within a 6-month period.

It is obvious that developing countries would feel stressed when walking headlong into arbitration as an overwhelming alternative mechanism of tax dispute resolution; uncontrolled, extensive, and geographically unfixed as it might turn out to be, it resembles a multi-headed monster. The anxiety of developing states majorly stems from their lack of capacity and resources needed to protect their legitimate fiscal interests against mighty taxpayers from powerful states, which, in turn, is anchored in their past 100 years' experience in international taxation centred mainly on the fiction of the permanent establishment and the predatory principle of residence-based taxation. It is plausible that developing countries under the UN Model would feel more safe and secure, as it keeps the state in control of things to a greater degree. Understandably, it is no longer a matter of "if", but rather "when" ad hoc arbitration panels that disjointedly emerged here and there, will evolve into an "international tax court" with permanent international judges or arbitrators and a fixed judicial organization deriving its raison d'être from the collective will of the comity of nations.

57. These amendments to sec. 134A ITO 2001 were announced in the Budget for FY 2018/19, and are, at the time of writing, being debated in the parliament, and when ultimately approved, would be enacted through the Finance Act, 2018.