
THE ARBITRATION AND CONCILIATION ACT, 1996: A FRAMEWORK FOR RESOLVING INVESTOR-STATE TAX DISPUTES

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ABSTRACT

This paper discusses the applicability of the Arbitration and Conciliation Act, 1996 (ACA) as a possible framework in settling investor-state tax disputes in India, especially in the light of rising investor-state disputes under the Investor-State Dispute Settlement (ISDS) frameworks. As India is becoming a significant destination to foreign investment, taxation related issues, particularly retrospective taxation have brought a lot of challenges to investor confidence and legal certainty.

The Vodafone International Holdings v. Union of India and Cairn Energy plc v. Republic of India high profile cases illustrate the conflict between the sovereign right of a state to tax and the commitments of Bilateral Investment Treaties (BITs), especially with regard to the Fair and Equitable Treatment (FET) standard. The paper suggests that the existing system of ISDS in India is disjointed, in large part because of the inconsistencies among BITs and non-membership in the International Centre of Settlement of Investment Disputes (ICSID). In this respect, ACA can be seen as a feasible domestic tool that can close this gap by providing a structured, neutral, and efficient arbitration mechanism in accordance with international standards, including the UNCITRAL Model Law. The paper puts an emphasis on the concepts of how the ACA can be modified to respond to jurisdictional ambiguities, procedural delays, and enforcement issues in disputes related to taxes.

In addition, it suggests specific reforms, such as establishing specialised tax arbitration panels, adding clear public policy exceptions, and expedited and digital arbitration processes. Based on the comparative practice in other jurisdictions such as Singapore and Canada, the paper highlights the necessity of the capacity building and institutional fortification. Finally, it finds that a revised ACA can find a balance between investor rights and the sovereignty of states and improve the credibility of India as a fair, transparent, and investor-friendly legal regime.

Introduction:-

"Taxes are what we pay for civilized society."

— Oliver Wendell Holmes Jr., former Justice of the U.S. Supreme Court

India, with its burgeoning economy and a vast pool of human and natural resources, continues to attract significant foreign investments. India is the largest economy with the quickest rate of growth in the world, and investors are very interested in its young, talented workforce. The Reserve Bank of India (RBI) reports that the nation's attractiveness as an investment destination was highlighted by **net foreign direct investment (FDI) inflows of \$10.58 billion in FY24** and a **total of \$70.9 billion in gross FDI**¹. Despite this economic success, taxing foreign companies that operate within its boundaries is still a controversial topic, especially when it comes to retrospective taxation like in the Vodafone case. This problem is not specific to India; it occurs all across the world. The arbitral tribunal in **El Paso v. Argentina**², for example, recognized that tax policy is a sovereign affair, giving states the authority to impose taxes inside their borders as they see fit. However, when tax policies that target foreign investors, multinational firms, or their investments clash with the rights guaranteed by international investment law, disputes result.

India's use of retrospective taxes is one of the most notable instances of this problem; it has been at the center of well-known Investor-State Dispute Settlement (ISDS) cases, including the Vodafone and Cairn Energy conflicts³. In these cases, foreign investors contested India's retrospective tax legislation on the grounds that they were in violation of the **Fair and Equitable Treatment (FET)** provision and other protection criteria provided by **Bilateral Investment Treaties (BITs)**. A number of court cases in international arbitration resulted from India's 2012 introduction of a retrospective tax law that attempted to apply taxes to foreign investments made before the law's passage. The international arbitral panel granted Vodafone

¹Indian Brand Equity Foundation, 'Foreign Direct Investment' (IBEF, January 2025) <https://www.ibef.org/economy/foreign-direct-investment> accessed 23 January 2025.

² *El Paso Energy International Company v Argentine Republic*, ICSID Case No ARB/03/15, Decision on Jurisdiction, 27 April 2006, https://icsid.worldbank.org/sites/default/files/parties_publications/C9734/D%20-%20Statement%20of%20Claim%20-%202006.10.%202022/Legal%20Authorities/CL-0081-ENG%20-%20E1%20Paso%20v%20Argentina.pdf accessed 23 January 2025.

³ Prabhash Ranjan, 'Retroactive Taxation, Investor-State Dispute Settlement, and India: Life Comes a Full Circle' (2022) 50(11) *Intertax* https://www.researchgate.net/publication/363740876_Retroactive_Taxation_Investor-State_Dispute_Settlement_and_India_Life_Comes_a_Full_Circle DOI:10.54648/TAXI2022089 accessed 23 January 2025.

compensation, alleging a breach of the FET norm, even though the Indian Supreme Court ruled in Vodafone's favor. India's employment of retrospective taxation is among the most notable instances of this problem. Likewise, an arbitral decision against India in the Cairn Energy case compelled the government to make a sizable monetary settlement. The growing conflicts between a state's authority to levy taxes and the requirement to shield foreign investments from unjust taxation practices that would deter future investment are reflected in these cases.

Retrospective taxation is a delicate topic since it has an immediate effect on investor trust. Investors face an unpredictable business climate when tax laws are opaque or prone to abrupt changes, such as those enacted retrospectively. Future foreign investments are deterred by this uncertainty since it raises the possibility of legal and financial issues. Due to India's tax laws' ambiguity and uncertainty, foreign investors have sought redress in a number of international arbitrations, which have resulted in substantial cash awards against the Indian government⁴. This persistent conflict highlights the necessity for India to update its tax laws and dispute resolution procedures in order to bring them into compliance with global best practices and give investors clarity and equity.

A vacuum in India's ISDS framework results from its stance in this area, particularly its exclusion from the International Centre for Settlement of Investment issues (ICSID), which complicates the resolution of tax-related issues⁵. Unlike a number of other nations who have signed the ICSID Convention and have a thorough ISDS structure, India is not a party to it. Particularly in cases involving taxes, this omission has raised concerns regarding the enforceability of international arbitral rulings as well as jurisdictional issues. The process of resolving disputes is made more difficult by the absence of a legally binding domestic framework. International examples demonstrate that global investment law acknowledges governments' sovereign rights to impose taxes; but, when tax laws clash with international norms, the delicate balance between safeguarding investor rights and upholding state sovereignty is frequently put to the test.

In order to maintain fair, transparent taxation policies that encourage long-term investment and economic progress, countries must carefully balance upholding their international

⁴ Kluwer Arbitration Blog, 'India ADR Week 2023 Spotlight: Investor-State Disputes' (Kluwer Arbitration Blog, 8 February 2024) <https://arbitrationblog.kluwerarbitration.com/2024/02/08/india-adr-week-2023-spotlight-investor-state-disputes/> accessed 23 January 2025.

⁵ Delhi High Court International Arbitration Centre, *DIAC Journal* (24 April 2021) <https://dhcdiac.nic.in/wp-content/uploads/2021/07/diac-journal-24042021-revised-435696-xmS9P6Pa.pdf> accessed 23 January 2025

commitments with exercising their sovereign taxing powers. The absence of a specialized ISDS framework for tax-related disputes in India's current dispute resolution system makes it difficult to preserve **investor trust** and **preserve national sovereignty**. The difficulty of settling tax issues, which frequently entail complicated legal and financial factors and call for an advanced dispute resolution mechanism, makes the problem worse.

India needs to reevaluate how it handles these disputes in light of the growing number of tax-related ISDS claims and the absence of a defined framework for their settlement. This dynamic necessitates a more thorough analysis of how international investment law and sovereign taxing rights interact, particularly in light of India's changing stance on investor-state conflicts. India should provide more legal clarity and justice to foreign investors, especially in tax-related situations, by putting in place a more **strong and uniform dispute resolution framework**—possibly through modifications to the **Arbitration and Conciliation Act (ACA)**. Maintaining economic growth and solidifying India's position as a top investment destination require a stable legal environment for international investors.

Tax as a major cause of Investor state dispute in India: -

International investment law relies heavily on the **Investor-State Dispute Settlement (ISDS)** process, which allows foreign investors to pursue remedies against host states for treaty violations⁶. The goal of ISDS, which is usually included in **Bilateral Investment Treaties (BITs)**, is to safeguard foreign investments while preventing undue state intervention. India emerged as a major respondent in ISDS cases between 1987 and 2019, and by the end of 2020, it was facing 29 claims. It is noteworthy that nine of these were resolved in relation to a single power plant in 2004. Twenty ISDS claims have been filed against India since 2010, with two victories and six defeats—**four of which concerned tax disputes**—illustrating the continuous conflict between investor rights and state sovereignty⁷.

Retrospective taxation, in particular, has been at the heart of cases like Vodafone and Cairn Energy. Despite the Supreme Court's decision in Vodafone's favor, the company's issues under the India-UK and India-Netherlands BITs emerged following India's 2012 retrospective tax

⁶ European Parliamentary Research Service, *The Reform of Investment Dispute Settlement: From the Current BITs System to an ICS?* (European Parliament, February 2015) https://www.europarl.europa.eu/RegData/etudes/BRIE/2015/545736/EPRS_BRI%282015%29545736_EN.pdf accessed 23 January 2025

⁷ Supra 3

law. Citing a violation of the Fair and Equitable Treatment (FET) criterion, the arbitral tribunal decided against India in 2020 and awarded Vodafone INR 850 million in legal fees⁸.

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The Role of ACA in Resolving Tax Disputes in Investor-State Dispute Settlement (ISDS)

International arbitration has increasingly become the preferred mechanism for resolving Investor-State Dispute Settlement (ISDS) conflicts, particularly those involving taxation issues. Arbitration allows investors and states to settle disputes outside of national courts, offering a neutral and internationally recognized forum. This approach is exemplified in high-profile cases such as **India-UK BIT (Vodafone II)**⁹, **India-Netherlands BIT (Vodafone I)**¹⁰, **Vedanta v. India**¹¹, and **Cairn Energy v. India**¹², where tribunals ruled against India's retrospective taxation measures, finding that they violated investor rights under relevant treaties. These cases highlight the complex intersection between a host state's sovereign right to tax and the protection of foreign investors' rights under international investment agreements.

Despite the increasing reliance on arbitration, India's legal framework for resolving tax-related ISDS disputes remains inconsistent and fragmented. India has not ratified the **ICSID Convention**, which complicates alignment with global arbitration standards. Consequently, disputes related to taxation and investment are governed by **Free Trade Agreements (FTAs)**

⁸ Nishith Desai Associates, *Vodafone Holdings B.V. versus Republic of India* (Nishith Desai Associates, [October 2020]) https://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research_Papers/Vodafone-Holdings-B.V.-versus-Republic-of-India.pdf accessed 23 January 2025

⁹ Jindal Global University, '*Union of India v Vodafone Group PLC United Kingdom & Anr*' (Mapping ADR, [17 April 2024]) <https://jgu.edu.in/mappingADR/union-of-india-v-vodafone-group-plc-united-kingdom-anr/> accessed 23 January 2025

¹⁰ Nishith Desai Associates, '*Vodafone Investment Treaty Arbitration Award – Part I*' (Dispute Resolution Hotline, 5 October 2020) <https://www.nishithdesai.com/generateHTML/4329/4> accessed 23 January 2025

¹¹ *Republic of India v Vedanta Resources Plc [2025]* SGCA (Singapore Court of Appeal) <https://www.judiciary.gov.sg/judgments/case-briefs-by-smu/republic-of-india-v-vedanta-resources-plc#:~:text=Before%20the%20CA%2C%20India%20and,be%20an%20abuse%20of%20process> accessed 23 January 2025

¹² Kluwer Arbitration Blog, '*The Cairn Energy v India Saga: A Case of Retrospective Tax and Sovereign Resistance Against Investor-State Awards*' (Kluwer Arbitration Blog, 2 July 2021) <https://arbitrationblog.kluwerarbitration.com/2021/07/02/the-cairn-energy-v-india-saga-a-case-of-retrospective-tax-and-sovereign-resistance-against-investor-state-awards/> accessed 23 January 2025.

and **Bilateral Investment Treaties (BITs)**, which vary in their provisions, especially regarding tax disputes. This variation creates confusion and inconsistent outcomes in arbitration, leading to jurisdictional issues, especially concerning the enforcement of arbitration awards or conflicts between investment agreements and commercial contracts¹³.

India's approach, as reflected in the **BIT Model 2015**, grants arbitration powers but includes several limitations to protect the state's sovereignty¹⁴. These limitations restrict arbitral tribunals from revisiting legal issues that domestic courts have conclusively resolved or from assessing decisions made by the state's judicial authorities. Additionally, the tribunal's jurisdiction is limited regarding issues of national security, foreign exchange regulations, or financial measures. The tribunal must also respect domestic **confidentiality and privilege rules, safeguarding sensitive state documents**. These safeguards reflect India's commitment to balancing investor protection with the preservation of its sovereign rights.

However, the **BIT Model 2015** is not mandatory, and its provisions are meant to guide future agreements. The lack of consistency across BITs creates jurisdictional uncertainty and complicates the dispute resolution process¹⁵. A unified framework for resolving ISDS disputes would be beneficial. The **Arbitration and Conciliation Act, 1996 (ACA)** can play a crucial role in this regard. Already governing commercial disputes, the ACA can be adapted to handle investment disputes, including those involving complex tax matters.

The ACA provides a structured framework for arbitration in both domestic and international commercial disputes. Investment disputes typically involve substantial claims for damages or compensation, often arising from violations of contractual obligations. Arbitration is a valuable tool for resolving such disputes, offering a fast, private process free from delays and public exposure associated with court proceedings. Furthermore, arbitration allows parties to select experts in the relevant field, ensuring the dispute is handled by individuals with the necessary technical expertise.

¹³ *Analysis of 2015 Draft Model Indian Bilateral Investment Treaty* (Government of India, August 2022) <https://cdnbbsr.s3waas.gov.in/s3ca0daec69b5adc880fb464895726dbdf/uploads/2022/08/2022081624.pdf> accessed 23 January 2025.

¹⁴ Kluwer Arbitration Blog, '*Unveiled: Indian Model BIT*' (Kluwer Arbitration Blog, 18 January 2016) <https://arbitrationblog.kluwerarbitration.com/2016/01/18/unveiled-indian-model-bit/> accessed 23 January 2025

¹⁵ Kluwer Arbitration Blog, '*Investor-State Arbitration Meets Mediation: Putting Mediation and Conciliation Back into ISDS – The Asian Experience*' (Kluwer Arbitration Blog, 2 October 2020) <https://arbitrationblog.kluwerarbitration.com/2020/10/02/investor-state-arbitration-meets-mediation-putting-mediation-and-conciliation-back-into-isds-the-asian-experience/> accessed 23 January 2025

Arbitration clauses are commonly included in BITs, reflecting the parties' mutual willingness to resolve disputes through arbitration. The ACA offers a clear structure for arbitration, applicable to both domestic and international disputes. It is particularly useful in situations where international bodies like **ICSID** are unavailable, as India is not a party to the ICSID Convention. The ACA provides an alternative for resolving disputes between foreign investors and the state, ensuring arbitration follows a clear set of rules and procedures, making the dispute resolution process more efficient.

The ACA can be highly beneficial in resolving tax-related ISDS disputes. While it does not directly govern treaty-based issues under mechanisms like ICSID, it can be used in cases where investment contracts include arbitration provisions. The ACA ensures that disputes are resolved impartially, efficiently, and in line with internationally recognized **principles of justice**¹⁶. This contributes to maintaining investor confidence, especially in complex tax disputes arising from actions taken by the host state.

The ACA aligns with procedural norms of several BITs, particularly those based on the **UNCITRAL Model Law**. It supports the enforcement of foreign arbitral awards under **Part II**, in accordance with the **New York Convention** or **Geneva Conventions**. Additionally, **Part III** of the ACA offers a conciliation process, an alternative dispute resolution mechanism that fosters cooperative settlements and reduces the need for prolonged arbitration.

By ensuring that disputes are resolved transparently and efficiently, the ACA can become an integral part of the ISDS framework, improving India's attractiveness as an investment destination. The ACA eliminates uncertainties that often discourage foreign investors, providing a more predictable and structured arbitration process. It can reduce jurisdictional overlaps between domestic laws and international treaties, offering a clearer legal environment for both states and investors. In tax disputes, the ACA could create specialized panels of experts to ensure complex tax matters are resolved fairly and accurately, safeguarding both state and investor interests.

The ACA's emphasis on procedural efficiency, including the use of digital tools and expedited arbitration procedures, allows for quicker dispute resolution, reducing the operational and

¹⁶ OECD, *Improving the System of Investor-State Dispute Settlement* (OECD, February 2006) https://www.oecd.org/content/dam/oecd/en/publications/reports/2006/02/improving-the-system-of-investor-state-dispute-settlement_g17a1771/631230863687.pdf accessed 23 January 2025

financial burden on investors. This approach positions India as a fair and investor-friendly jurisdiction, balancing investor protection with the preservation of state sovereignty¹⁷. By incorporating provisions for managing tax-related disputes, the ACA demonstrates India's commitment to creating a stable, transparent, and investor-friendly environment.

Finally, sovereignty concerns over taxation capability—often raised in ISDS mechanisms—can be addressed through the ACA as the governing framework for arbitration. By ensuring arbitration follows domestic legal norms, the ACA strikes a balance between state and investor interests¹⁸. This approach helps mitigate concerns about excessive foreign influence in the arbitration process, making it more acceptable to the host state while enhancing investor confidence in the long-term stability of India's investment climate.

Recommendation

Challenges for Investor-State Dispute Settlement (ISDS) include balancing investor rights and sovereignty, procedural delays, and jurisdictional ambiguity, especially in tax-related disputes. These problems can be lessened by amending the Arbitration and Conciliation Act (ACA).

- **Ambiguity in Jurisdiction: -**

As demonstrated by cases such as *Vodafone v. India*, disputes frequently arise regarding the overlap between treaty duties and domestic laws. By clarifying the jurisdictional scope of treaty-based arbitration by an amendment to the ACA, Singapore's arbitration regulations can help minimize disagreements¹⁹.

- **Procedure Delays: -**

Procedural complications delay ISDS lawsuits, as *Cairn Energy v. India*. Similar to ICSID reforms, ISDS can be streamlined by implementing digital platforms and

¹⁷ UNCTAD, *Investor-State Disputes: Prevention and Alternatives to Arbitration* (UNCTAD, 2010) https://unctad.org/system/files/official-document/diacia200911_en.pdf accessed 23 January 2025

¹⁸ BFD, *Sovereignty and Tax Treaty Dispute Settlement* (IBFD, December 2024) https://www.ibfd.org/sites/default/files/2024-12/20_007_sovereignty_and_tax_treaty_dispute_settlement_final_web.pdf accessed 23 January 2025

¹⁹ Dr. Matthew Secomb, Aditya Singh, and Philip Tan, '*Determining Arbitrability of Disputes in Singapore: The "Composite" Approach*' (White & Case, 22 February 2023) <https://www.whitecase.com/insight-alert/determining-arbitrability-disputes-singapore-composite-approach> accessed 23 January 2025

stringent deadlines through the ACA's accelerated arbitration provisions.

- **Balancing Investor Rights and Sovereignty: -**

Tax issues can call into question state sovereignty, as is the case with India's retrospective taxation laws. Motivated by Canada's comprehensive public policy framework²⁰, the ACA can incorporate explicit public policy exceptions to safeguard state interests while upholding treaty obligations.

- **Specialized Tax Dispute Resolution Procedures: -**

ISDS claims pertaining to taxes necessitate knowledge not found in conventional arbitration frameworks. To guarantee equitable and uniform decisions, the ACA can set up specialized tax arbitration panels with industry-specific specialists, based on the OECD's BEPS framework.

- **Capacity Building: -**

When it comes to managing ISDS lawsuits, India lacks sufficient experience. Institutional capacity can be increased by funding training programs for judicial and arbitration practitioners, as Singapore and the UK have done.

ACA improvements can balance state and investor interests and increase ISDS efficiency by tackling jurisdictional, procedural, and sector-specific issues, resulting in a strong and equitable arbitration system.

Conclusion: -

In conclusion, the Arbitration and Conciliation Act (ACA), 1996 provides a strong framework for resolving the intricate issues raised by India's Investor-State Dispute Settlement (ISDS). By utilizing the ACA's organized arbitration framework, procedural efficiency, and adherence to international standards, tax-related disputes—a frequent cause of conflict—can be successfully reduced. The ACA can increase investor confidence while preserving India's regulatory

²⁰ Martin Papillon, 'Comparing Policy Feedback Effects in Federal Systems: The Case of Provincial Indigenous Consultation Policies in Canada' (2024) *Journal of Comparative Policy Analysis: Research and Practice* 686 <https://www.tandfonline.com/doi/full/10.1080/13876988.2024.2386363> accessed 23 January 2025

independence by including provisions that strike a balance between investor rights and state sovereignty, jurisdictional clarity, and specialized tax dispute procedures. Furthermore, by implementing procedural changes and capacity-building programs that draw inspiration from global best practices, India can improve its ability to settle ISDS matters fairly and effectively. Adopting ACA improvements in ISDS will ultimately strengthen India's standing as a trustworthy investment destination and show its dedication to investor create fair and transparent investment environment.