

HEMANT ARORA & CO. LLP

CHARTERED ACCOUNTANTS

Advance Pricing Agreements

– A presentation by Jeetan Nagpal

ADVANCE PRICING AGREEMENTS

An overview of the APA & its procedures

Introduction

- With an increase in the volume of cross border trade, the volume and complexity of international transactions has also been increasing, giving rise to more and more transfer pricing disputes. Finance Act 2012, with a view to mitigate the TP disputes, introduced the APA provisions.
- Internationally, the APA program is viewed as an effective controversy management tool and therefore, the introduction of APAs in India is surely a welcome step taken by the Indian Government.
- Transactions that are most likely to be secured through an APA would include corporate guarantee fee, service fee mark-ups, contract manufacturing, etc.

Who can be an Applicant?

- An applicant can be any person who has undertaken or is contemplating to undertake an international transaction and he shall be eligible to enter into an APA

Legislative Provisions

- APA is an agreement entered into between the Central Board of Direct Taxes ('CBDT') and the taxpayer, which determines, in advance, the arm's length price ('ALP') or specifies the manner of determination of ALP, or both, in relation to an international transaction.
- The taxpayer can approach the CBDT for determination of the ALP in relation to international transaction that may be entered into by the taxpayer.
- The ALP in an APA shall be determined by using any of the prescribed methods.

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Legislative Provisions

- Once the APA has been entered into with respect to an international transaction, the ALP with respect to that international transaction, for the period specified in the APA, will be determined only in accordance with the APA.
- APA shall have validity for a maximum of consecutive five years and the roll back provisions are also applicable for a period of four previous years, preceding the first previous year covered in the APA. For example - If the taxpayer files an APA application on or before 31 March 2016 covering a period of upto 5 years from financial year (FY) 2016-17 to FY 2020-21 and applies for a roll back, the roll back years can cover the period from FY 2012-13 to FY 2015-16.

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Legislative Provisions

- The APA shall be binding on the taxpayer signing it and the tax authorities. The APA shall not be binding if there is any change in laws or facts having bearing on such APA.
- The CBDT is empowered to declare, with the approval of the Central Government, any APA to be *void-ab-initio*, if it finds that the APA has been obtained by fraud or misrepresentation of facts by the taxpayer.

Types of APAs

- The taxpayers have a choice entering into any of the following APAs
 - Unilateral APA (involves one country)– Agreement entered into between the CBDT and the taxpayer
 - Bilateral APA (involves two countries) – Agreement entered into between the CBDT and the taxpayer subsequent to and based on the agreement between the competent authority in India with the competent authority in other country.

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Types of APAs

- ▣ Multilateral APA (involves more than two countries) – Agreement entered into between the CBDT and the taxpayer, subsequent to and based on the agreement between the competent authority in India with the competent authorities in other countries.

APA Process – Stage I

□ Stage I – Pre-filing Consultation

- Pre-filing consultation enables the applicant and APA team to assess the possibility and likely success of entering into an APA.
- At this stage, it is possible to keep the name of the applicant anonymous.
- Pre-filing application is to be made to the DGIT (International Taxation).
- On receipt of the application, the APA team shall hold consultation with the applicant.
- In case of Bilateral or Multilateral APA, the competent authority in India shall be associated with pre-filing consultation.

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APA Process – Stage I

- The objective of pre-filing consultation is to determine the scope of the agreement, identify transfer pricing issues, determine the suitability of international transaction for the agreement
- Discuss broad terms of the agreement.
- Pre-filing consultation does not bind the CBDT or the taxpayer to enter into the agreement and does not mean that the taxpayer has applied for entering into an agreement.

APA Process – Stage II

□ Stage II – APA Application

- After pre-filing consultation, the taxpayer desirous for applying an APA shall make an application for an APA in Form no. 3CED to the DGIT in the case of Unilateral Agreement or the Competent Authority in the case of Bilateral or Multilateral APA
- For international transaction of a continuing nature - APA application needs to be filed before the first day of the previous year (i.e. by 31st March 2016 for FY 2016-17)
- For any new international transaction – APA application needs to be filed before undertaking such international transaction.

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APA Process – Stage II

- Fee payable at the time of making an APA application is tabulated below:

Amount of international transaction entered into or proposed to be undertaken in respect of which an APA is proposed	Fee (Rs.)
Amount not exceeding Rs. 100 crores	10,00,000
Amount not exceeding Rs. 200 crores	15,00,000
Amount exceeding Rs. 200 crores	20,00,000

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APA Process – Stage II

- Broadly, the information/documents that are required to be furnished in an APA application include:
 - General particulars containing details of international transactions, proposed method, terms and conditions etc.
 - Functional analysis of the taxpayer and all relevant AEs, business strategies, financial statements, marketing and financial studies, copies of relevant inter-company agreements etc.
 - Industry and market analysis, general profile of competitors including market share, industry and general statistics, financial ratios etc.
 - Transfer pricing background, historical information of TP methodologies, policies and practices used by the taxpayer and AE in the past, details of transfer pricing tax audits and appeals etc.
 - TPM Analysis, analysis and explanations needed to establish the appropriateness of the proposed TP method, detailed analysis of TP methods including secondary method, application of the proposed TP method to the covered transactions.

APA Process – Stage III

□ **Stage III - Evaluation and Negotiation stage**

▣ Preliminary Processing of APA application –

- Upon preliminary review of the application, the DGIT shall communicate the deficiency to the applicant within 30 days of the receipt of application.
- The applicant is required to remove the deficiency within 15 days (extendable to 30 days) of the date of service of deficiency.
- If the defect is not removed by the Applicant, the DGIT, after providing an opportunity of hearing to the applicant, may pass an order providing that application shall not be allowed.
- The fee paid by the applicant in such a case shall be refunded.

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APA Process – Stage III

- ▣ Consultation and discussion
 - After the admission of the application, APA team would conduct the main processing of application by holding meetings with the applicant, calling for additional information/ documents etc., visiting applicant's business premises, making necessary inquiries etc.

APA Process – Stage IV

□ Stage IV – Finalisation of APA

- Post discussions, the DGIT/Competent Authority and the applicant shall prepare a proposed mutually agreed draft agreement enumerating the results of the process and the effect of the agreement.
- The agreement shall be entered into by the CBDT with the applicant after its approval by the Central Government.
- The Applicant needs to communicate acceptance or otherwise to the APA agreed within 30 days.

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APA Process – Stage IV

- Terms of Agreement would generally include:
 - Details of international transactions covered.
 - Agreed TP methodology
 - Determination of Arm's length price
 - Definition of relevant terms
 - Critical assumptions
 - Other conditions, if any
- Till the APA is entered into, the international transactions undertaken by the applicant shall be subject to regular TP audit, but once the APA is entered, the regular audit shall not be undertaken for transactions covered by the APA.

APA Process – Stage V

- **Stage V – Post APA requirement**
 - Annual compliance report in Form 3CEF is required to be furnished by the applicant to the DGIT for each year covered by the agreement.
 - The Annual compliance report, in quadruplicate, is to be filed within 30 days of the due date of filing the income tax return or within 90 days of entering into agreement whichever is later.
 - Annual compliance Audit shall be carried out by the TPO who shall furnish the compliance audit report to the DGIT/Competent Authority, within 6 months from the end of the month in which the annual compliance report is received.

Roll Back Provisions

- The roll back provisions are available in respect of a roll back year.
- A 'roll back year' has been defined to mean any previous year falling within the period of four previous years, preceding the first previous year covered under the APA.
- For example – if the applicant files an APA application on or before 31.03.2016, covering a period of upto 5 years from FY 2016-17 to FY 2020-21 and applies for a roll back, the roll back years can cover the period from FY 2012-13 to FY 2015-16.

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Roll Back Provisions - Conditions

- Conditions for availing roll back:
 - ▣ The international transaction to be same as the international transaction to which the regular APA applies.
 - ▣ The Return of Income and Form 3CEB for the roll back years should have been filed before the due date.
 - ▣ Roll back application should cover all the roll back years, or the years for which relevant international transaction was in existence.

Amendments in Application

- The application can be amended at any stage before the finalisation of the terms of agreement if it does not alter the nature of application as originally filed.
- Withdrawal of APA – an application can be withdrawn before the finalisation of the terms of the agreement. However, no refund of fee is permitted on such withdrawal.
- Revision of APA – an APA can be revised by the Board *suo motu* or on a request of the applicant/DGIT/ Competent Authority in India in the following circumstances:
 - ▣ Any change in critical assumptions
 - ▣ Failure to fulfil conditions on basis of which agreement was entered into
 - ▣ Change in law

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Amendments in Application

- Cancellation of APA – an APA can be cancelled by the Board on the following reasons:
 - ▣ Failure to comply with the terms of the agreement
 - ▣ Failure to file annual compliance report in time
 - ▣ The compliance report filed contains material errors

- Renewal of agreement – the request of renewal of an agreement is required to be made as a new application for the agreement, except the pre-filing.

Advantages of APA

- Certainty – APA brings about certainty with regard to the outcome of the covered international transaction during the APA term and thereby reducing the TP litigation risk
- Reduced documentation burden – the mandatory requirement of maintaining onerous TP documentation by taxpayer each year is alleviated after entering into APA as only an Annual compliance report is required to be furnished.
- Time and cost savings – In India TP audit along with other litigation and dispute resolution process is long drawn and expensive. APA process takes substantially less time and in long run proves cost effective.

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Advantages of APA

- Preferred by tax authorities - In general, tax authorities also prefer APAs as it reduces administration and enforcement costs over the duration of the APAs
- Reduces risk of double taxation
- Mandatory pre-filing gives the taxpayer a chance to discuss key considerations, carry out a comprehensive analysis and take a decision whether to enter into an APA or not.

Conclusion

While the introduction of APAs is a positive move towards bringing in a progressive dispute resolution mechanism, its success in the long run would depend upon ultimately how efficiently and expeditiously it is executed, its practical effectiveness, flexible approach of the tax authorities and technical knowledge of the APA team. Globally, APA program in most countries is a huge success and there is no reason as to why success witnessed in other countries cannot be emulated in India provided the taxpayers ensure that they are adequately prepared before entering into APA negotiations.

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THANK YOU.

HAC Offices

Delhi NCR - 1118-1119, 11th Floor, DLF Galleria, Phase IV, Gurgaon 122002

T + 91 124 257 0888 F + 91 124 257 8088

Mumbai - 410, 4th Floor, AVIOR, Nirmal Glaxy, Opp. Johnson & Johnson, LBS Marg,
Mulund (W) Mumbai 400080

T + 91 22 2561 1982

Dehradun - 1, Tyagi Road, Dehradun 248001

T + 91 135 262 6795 F + 91 135 262 7795

Roorkee – 354B, 30 Civil Lines, Roorkee 247667 India

T + 91 1332 27 3343 F + 91 1332 27 7272