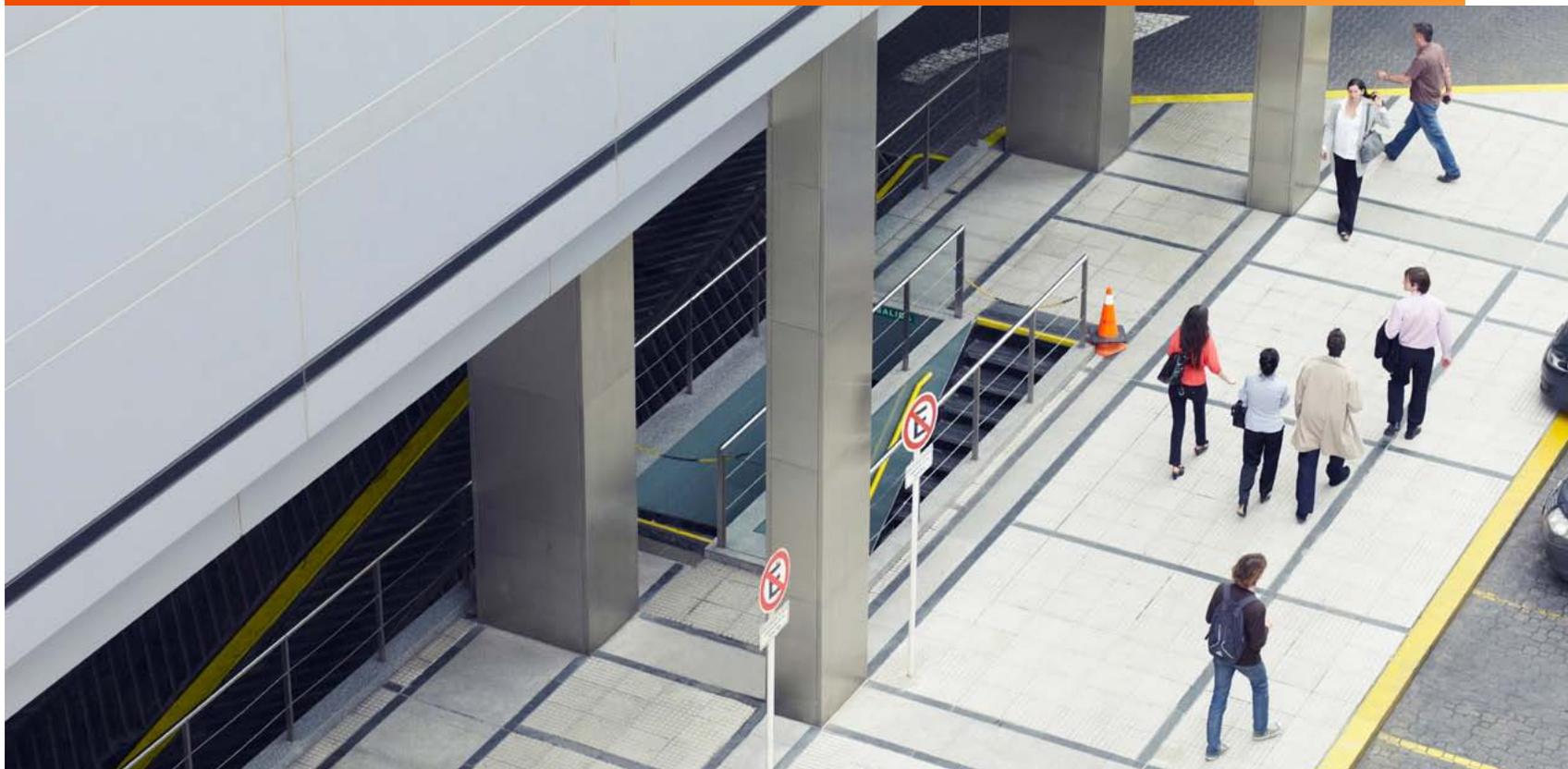


Advance pricing agreements

Frequently asked questions





General

1. What is an advance pricing agreement (APA)?

An APA is an agreement between the taxpayer and the tax authority on the pricing of future intercompany transactions in case of a roll-back, it would also include past years. The taxpayer and tax authority mutually agree on the transfer pricing methodology (TPM) to be applied and its application for a certain period of time for covered transactions (subject to fulfillment of critical assumptions).

APA is an effective tool used in several countries with established transfer pricing regimes to avoid potential disputes in a cooperative manner.

2. What are the different types of APAs?

An APA may be unilateral, bilateral or multilateral, as explained below:

- Unilateral: APA entered into between a taxpayer and the tax administration of the country where it is subject to taxation
- Bilateral: APA entered into between the taxpayers, the tax administration of the host country and the foreign tax administration
- Multilateral: APA entered into between the taxpayers, the tax administration of the host country and more than one foreign tax administrations

The Indian APA rules allow for all the three types of APAs.

3. What are the key benefits of an APA?

An APA provides certainty on the pricing and the TPM to be adopted for covered intercompany transactions. Further, a bilateral or multilateral APA also eliminates the risk of potential double taxation arising from controlled transactions. The key advantages of APA can be summarised as:

- Certainty with respect to the outcome of covered transactions during the APA term
- Agreement as to information to be kept for annual report, low annual reporting cost
- Reduction in risk and cost associated with audits and appeals over the APA term
- Imparts flexibility in developing practical approaches for complex transfer pricing issues
- APA renewal provides an excellent leverage of time and efforts expended during negotiating the original APA

The Indian APA rules also provide for all the above benefits that are experienced under APA programmes in other countries. Moreover, the rules exhibit significant amount of flexibility in the process. Besides allowing for withdrawal, revision, amendment, etc., the Indian APA rules also allow the taxpayer to convert a unilateral into bilateral and vice versa in case of need. It also allows a 4 year roll-back under certain conditions.



4. **Who would the APA team comprise of?**

Generally, the APA team (revenue) would comprise of a team leader who is an expert in international tax and transfer pricing who can take help of an economist and other industry experts as necessary. The APA team for bilateral and multilateral APA would also include the competent authority office.

The Indian APA rules provide for the constitution of an APA team (team) which will consist of an income tax authority and experts from economics, statistics, law and other necessary fields. For unilateral APAs, the Director General of Income Tax (International Tax and Transfer Pricing) [DGIT (Intl and TP)] would be responsible, who will be supported by the Commissioner of Income Tax (APA). For bilateral or multilateral APAs, the competent authority of India would be responsible, supported by the Director APA. Further, there are teams reporting to the Commissioner (APA) in three major cities of Delhi, Mumbai and Bangalore to facilitate the process.

Features

5. **Who is eligible to apply for an APA?**

There are no monetary or other conditions prescribed under the Indian APA rules for a taxpayer to be eligible to apply.

However, the APA mechanism is not available for domestic controlled transactions.

Per the Indian APA rules, the APA filing fees are set at relatively high amounts. Also, one of the objectives of pre-filing consultation is stated as 'to determine the suitability of international transaction for the agreement'. Therefore, it appears that while there is no express limitation on eligibility, the government is possibly looking for taxpayers to use the programme for complex and high stake transactions. The past two seasons of APA filing has not shown too many cases of application rejection at pre-filing consultation stage.

6. **What are the transactions that can be covered under an APA? Can I apply for certain specific international transactions instead of all my international transactions?**

Any type of international transaction can be covered under an APA, e.g., transactions involving transfer of tangible and intangible properties, cost sharing, provision and receipt of services, etc.

APAs are also possible for international transactions with permanent establishments.

Further, similar to APA programmes in other countries, the Indian rules allow the taxpayer to selectively apply for an APA only for certain international transactions. In such cases, the taxpayer is required to disclose all other international transactions to the APA team.

It is also pertinent to note that an APA can be applied for both continuing as well as proposed transactions.

7. *Whether an APA is restricted to the determination of methodology only or if a specific price or rate can also be determined in an APA*

Generally, under an APA, the most appropriate TPM is determined upon negotiation and finalisation between the taxpayer and the tax authorities involved. Following agreement on the TPM, the APA may also agree on the transfer price or the outcome of the TPM over the APA term.

The Indian APA rules also provide for agreeing on the TPM alone, as well as the outcome of the TPM and transfer price over the APA term.

8. *What are critical assumptions?*

Critical assumptions refer to a set of taxpayer related facts and macro economic criteria (such as industry, business, economic conditions, etc.), the continued existence of which are material to support the concluded position under an APA. A material change in any of the critical assumptions may result in the revision of the APA, or even termination in extreme circumstances.

Critical assumptions form an integral part of the Indian APA programme as well. However, the rules do provide for sufficient flexibility to amend and revise an APA following a change in critical assumptions.

9. *For how long would an APA remain valid? Is renewal possible after expiry of the APA term?*

The Indian APA rules provide for an APA term up to five years in addition it can also cover upto four preceeding years in case of a roll-back.

Unilateral, bilateral or multilateral APAs may be renewed with the consent of all the parties to it, including the tax treaty partner who is a party to a bilateral or multilateral APA. A request for renewal of the APA would follow the same procedures that apply to an initial APA request.

It is essential for taxpayers to seek renewal early enough to allow the renewal to be negotiated and put in place prior to the expiration of the earlier APA. If the facts and circumstances are largely similar, a renewal can be completed in a relatively shorter timeframe.

10. *Whether there can be a roll back of the concluded APA to cover past open years which are not yet audited?*

Usually, APAs cover prospective years, and if they provide reasonably agreed basis for resolving open issues, the agreed TPM / outcome can also be applied to resolve prior year issues.

The Indian APA rules have been recently modified to introduce roll back upto four years prior to the APA period. The detailed rules are yet to be announced.

Process

11. *What is the APA process in India and how does it differ from other established APA programmes in the world?*

In line with APA programmes in other countries around the world, the Indian APA rules prescribe a process that breaks into the following four phases:

Pre-filing consultation

The process for APA starts with the pre-filing application (Form No3CEC) and a consultation meeting. The meeting is held with the objective of determining the scope of the agreement, understanding the transfer pricing issues involved and examining the suitability of international transactions for an APA.

The taxpayer also has an option of applying for a pre-filing consultation on an anonymous basis. This process is non-binding on the taxpayers and the revenue authorities.

Formal APA application

After the pre-filing meeting, if the taxpayer is desirous of applying for an APA, an application is to be made in the prescribed form (Form No3CED) containing specified information. The APA application filing fee is also payable at this stage.

Negotiation

Once the application is accepted, the APA team will hold meetings with the applicant and undertake necessary inquiries relating to the case. Post the discussion and inquiries, the APA team will prepare a draft report which shall be provided to the competent authority (for bilateral and multilateral APA), or DGIT (Intl and TP) (for unilateral APA).

During this phase, the APA team may schedule site visit primarily to verify and validate the functional analysis.

Finalisation

This phase involves the exchange of comments on the draft APA, finalisation of the APA, and giving effect to the initial years covered under the APA term that have already elapsed.

12. *What is the statutory fee for filing an APA application?*

The APA filing fee, i.e. fee to be paid while filing the formal APA application depends upon the amount of the proposed covered transactions over the proposed APA term, as below:

- 1 million INR for international transactions up to 1 billion INR
- 1.5 million INR for international transactions up to 2 billion INR
- 2 million INR for international transactions greater than 2 billion INR

However, there is no fee prescribed for the pre-filing consultation process.

13. What is the key information required for filing or negotiating an APA? Can I submit the required information documents later during the analysis and negotiation process?

In addition to the information required at the pre-filing consultation stage, documents containing the following information, among others, are required to be filed along with the APA submission:

- Details of proposed covered transactions
- Disclosure of other controlled transactions
- Transfer pricing background
- Financial statements, for past years and forecasts or financial projections
- Industry analysis (description of the taxpayer's core activities in the relevant industry)
- Business structure (description of the main business arrangements within the group of companies to which the taxpayer belongs)
- Detailed functional analysis (analysis of the functions performed by the taxpayer in relation to the controlled transactions, assets used to perform these functions and related business and commercial risks)
- Relevant economic analysis including impact of the proposed TPM

As can be seen, the prescribed form (Form No 3 CED) provides for detailed information to be filed with the APA application. While one may observe that several of these documents and information are generally available as part of the transfer pricing documentation maintained by the taxpayer, APA requires a deeper dive in to the facts, and the financial data.

The rules at present provide for upfront filing of the above documents. Further, the applicant may, if considered necessary, provide additional documents and information for consideration of the APA team, or the competent authority in India, or his or her representative.

It is observed that the APA team has been considerate in allowing sufficient time to provide some of these information following filing of the formal application.

14. As part of the APA process, will the authorities visit my office for investigation or verification of facts?

A well drafted and thorough APA application helps significantly reduce the questions from the tax administrations as well as the overall time in execution. Upon filing of the formal APA application, the tax administration will review it in detail.

Once the APA team starts reviewing the formal APA application, there will be rounds of questions raised by the APA team to obtain clarification and additional information as may be needed. In addition to the rounds of questions, the APA team normally visits the applicant's business premises. It may be helpful to organise site visits, especially in cases involving complex manufacturing operations, heavy use of fixed assets, intangible assets, etc. This is a common practice observed in other countries.

The site visits provide the APA team with a firsthand feel of the actual operations underlying the covered transactions and make it easier for them to better understand and appreciate the business realities. The taxpayer can suggest the relevant people to be interviewed to provide the APA team with better understanding of its business.

15. Can I revise my application once it has been filed?

The taxpayer may request in writing for an amendment to an application at any stage, before the finalisation of the terms of the agreement. In this regard, the applicant needs to also provide the circumstances requiring the changes and submit supporting documentation with a proposed course of action as early as possible.

The DGIT (Intl and TP) (for unilateral APAs) or the competent authority in India (for bilateral or multilateral APAs) may allow the amendment to the application, if such an amendment does not have the effect of altering the nature of the application as originally filed. Further, an amendment to the application may require an additional fee to be paid.

16. How much time does it take to negotiate and conclude an APA (unilateral and bilateral)?

In most cases unilateral APA takes one to two years to finalise, and a bilateral APA takes two to three years. None of the countries have a specific timeline to finalize an APA, though they are guided by tentative target timelines.

The Indian APA rules also do not specify any timeline to complete the entire process.

It will depend on a number of factors such as - (i) complexity of the transactions to be covered; (ii) availability or relative workload of the examiners and officers; (iii) whether it is a unilateral or bilateral APA; and (iv) the time taken by the treaty partners to review the bilateral and multilateral APA requests.

India has gone through two rounds of APA filings with 378 applications filed so far, i.e., 146 by March 31, 2013 (first APA year FY 2013-14) and 232 by March 31, 2014 (first APA year FY 2014-15).

As of today, out of the 146 applications filed by March 31, 2013, five APAs have been signed by March 31, 2014 covering a range of international transactions.

Many other cases are in advanced stage of negotiation.

17. Is it possible to withdraw an APA application filed with the APA Authorities? Can I get the refund of application fees?

The taxpayer may withdraw itself from the APA process at any time before final agreement is reached.

If the taxpayer opts to withdraw from the APA process, the APA filing fees would not be refunded.

18. How would the compliances be done (e.g., Return of Income, Form 3CEB etc.) in the interim period when the APA is under negotiation?

Per the Indian regulations, the annual transfer pricing compliances and income tax return filing should be carried out by the taxpayer in the regular manner until the APA is concluded.

Once an agreement is reached, the taxpayer would be required to file revised return (for the covered years that has elapsed) within 3 months from the end of the month in which the agreement is entered into. Further, in case the assessment of the year under APA is completed or is pending, the same has to be completed giving regard to the APA.

19. What are the annual compliance obligations of the taxpayer once an APA is agreed with the revenue authorities?

The taxpayer will be required, as part of the APA, to prepare an annual compliance report ('ACR'), for each year of the APA, containing sufficient information to detail the actual results for the year, and to demonstrate compliance with the terms of the APA.

The ACR need to be furnished within thirty days of the due date of filing the income tax return for that year, or within 90 days of entering into an agreement, whichever is later.

The details of the ACR are provided in form 3CEF. It contains information on the actual results for the year to demonstrate compliance with the terms of the APA, and the necessary information and computation to ascertain the outcome of the application of the TPM for the covered transactions. As required in many countries, the taxpayer is required to declare whether there are any changes in the business model, functional and risk profile, critical assumptions and organizational structure.

Information to be included in ACR also forms part of APA agreement and as such reflect the result of discussions and negotiation with APA team.

Following the filing of the ACR, the jurisdictional TPO would carry out a compliance audit for each of the years under the APA term. The TPO would provide a report to the DGIT (Intl and TP) (for unilateral APAs) or the competent authority in India (for bilateral and multilateral APAs).

It is important to note that the APA can be cancelled for not filing the ACR in time and also for furnishing the same with material errors.

Key considerations

20. In case litigation is pending before tax authorities and ITAT, will my application be accepted?

There is no restriction for filing an APA in respect of transactions which are in litigation before tax authorities and ITAT. Accordingly, even if litigation in relation to the covered transactions is pending before tax authorities and ITAT, an APA application could be accepted.

That said, the prescribed form for applying for pre-filing meeting does require the taxpayer to provide information in relation to history of transfer pricing audits, assessments and present status of appeals.

21. Can the documents submitted during the APA process be shared with tax authorities for initiating and concluding other tax proceedings?

While negotiating APAs the taxpayers may have to submit sensitive information such as future business projections, marketing strategy, audited financials of associated enterprises, etc. It is important to consider the issue of sharing information filed by the taxpayer during an APA process, by the APA team with the on-field audit officers.

In this regard, most developed jurisdictions have rules governing sharing of such information, in the sense that either the sharing of such information is not allowed or only facts can be shared, without holding the taxpayer against any analysis submitted during the APA process.

At this point, the Indian APA rules are silent on this matter. It is believed that since most taxpayers to whom transfer pricing requirements apply, are subjected to regular audits, similar information would be accessible by the on-field audit officers as well during the audit process.

That said, some clarification in this regard is required from the government in order to dispel the apprehensions of the taxpayers.

22. Whether confidentiality of information filed during the APA process will be maintained? Will the revenue department publish details of the APA cases in the public domain?

It is highly expected that in order to ensure the success of an APA programme the APA authorities maintain strict confidentiality of taxpayer's data. During the pre-filing stage and subsequently in the APA application, a lot of critical and confidential data are discussed and shared with the APA authorities. In most cases classified information not only for Indian entities but also information pertaining to overseas associated entities may be provided with respect to the margins earned, basis of pricing, etc. Such information should be used only for negotiation purpose and arriving at the agreed TPM.

Since, APA is a client specific private agreement between that taxpayer and the governments of two or more states, the details of the agreement should not be ideally published in the public domain. This is unlike an advance ruling which is published in the public domain. Also, the Indian income-tax act provides for maintaining confidentiality of the information, which should be respected in this process.

Although not on case specific basis, the APA authorities of many countries publish annual reports on APA statistics which can provide guidance to taxpayers. However, the identity of the taxpayers involved is not revealed in such annual reports. It may be helpful for the taxpayers in the coming years, if the Indian APA office publishes such statistics after the programme is well established.

23. *If there is a significant change in law or facts, would the APA still be valid. Can I apply for an amendment to the APA or do I have to file a fresh application once again?*

In the event of a change in law or facts it is most likely that the ‘critical assumptions’ would be impacted. These critical assumptions, as discussed earlier, are the bedrock on which the APA would stand. It is advisable to apply for a revision of the APA, which is permissible under the Indian APA rules. The APA authorities may agree on revision of the APA if there has been a material change in circumstances of the case instead of cancelling the APA and asking for a fresh application.

However, if the change in law is such that it renders the APA non-binding, a revision may not be possible.

Prep for APA: Basics

24. *How best I can prepare myself for an APA?*

It takes a significant amount of time to prepare the strategy, roadmap, alternative options available, etc which is very important for being prepared to take on the discussions with the APA team.

The following parameters are important in order to “*get the house in order*”

- Preparation of a robust transfer pricing policy
- Aligning transfer pricing policy with commercial substance
- Having intercompany agreements aligned to business substance and transfer pricing policy
- Adherence to transfer pricing policy with strong back up documentation
- Deciding on the information and documentation to be shared
- Availability of financial projections
- Having alternative plan of actions in case APA does not work

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