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Advance Pricing Agreement rules notified

The Advance Pricing Agreement (APA) is an arrangement between the taxpayer and the tax authority covering the future transactions, with a view to solve the potential transfer pricing disputes in a cooperative manner. APA provisions were introduced in India with effect from 1 July, 2012 by the Finance Minister in the Union Budget 2012. The Central Board of Direct Taxes (CBDT), by notification in the official gazette, has introduced the detailed rules providing the procedures and necessary forms for application/administration of the APAs.

The rules provide for constitution of an APA team (team) which shall consist of income tax authority and experts from economics, statistics, law and other necessary fields. APAs can be applied for existing as well proposed transactions.

In line with the expectation, the rules have provided for both the unilateral as well as the bilateral/multilateral APAs. This is a welcome step since a unilateral APA may not be able to assure relief from double taxation to the Multinational Enterprises (MNEs). The Government has shown an inclination towards bilateral APAs by questioning the tax payer on reasons for filing a unilateral APA application in cases where double taxation avoidance agreement (tax treaty) exists. However, in case the bilateral APA negotiated between competent authorities is not acceptable to the taxpayer, the taxpayer may at its option continue with process of entering into a unilateral APA without benefit of mutual agreement process.

A comparison of the key features of Indian APA rules with global best practices along with our observations is provided below:

Feature	Global Best Practice	India	Observation
Pre-filing meeting	✓	✓	The pre-filing consultation meeting would play a vital role in the entire process. This would be an appropriate forum for the taxpayers to test the waters; expectations from both sides can be clearly spelled out. By permitting anonymous pre-filing meetings without any charge, the Government has also comforted the tax payers; this would act as an enabler for the taxpayers to get on board, despite any scepticism from past experiences on transfer pricing audit.
Flexibility – amendment /withdrawal /revision	✓	✓	The APA rules have provided significant flexibility in the overall process by allowing the tax payer to amend the APA application, provide further information/documents for consideration of APA team and allowing for revision of APA in case of change in critical assumptions/ law under which the agreement is covered, etc. The taxpayer is also permitted to withdraw the APA application at any time before finalisation and therefore, the taxpayer is not under an obligation to complete the APA process or accept the outcome. Furthermore, the APA rules also provide flexibility in terms of agreeing upon a transfer pricing methodology or arm's length price. Accordingly, the taxpayer should have an option of agreeing to a transfer pricing methodology instead of a single point arm's length price in case of complex transactions.
Team composition – experts in economics, statistics, law, etc.	✓	✓	The rules provide for constitution of APA team consisting of experts in economics, statistics, law, etc. The Government, through its intention to form such team, has clearly exhibited its dedication and seriousness towards the APA programme.
Documentation simplification	✓	✓	The Annual Compliance Report (ACR) would reduce the compliance burden of the taxpayers.
Roll-back	✓	✗	Though not expressly provided in the rules, per practical experiences in other countries, the resolution reached in unilateral/bilateral APAs should be helpful for resolving open years.

Feature	Global Best Practice	India	Observation
Timeline	×	×	<p>The rules do not prescribe any indicative timeline for concluding the APAs.</p> <p>Taking clue from certain timelines provided for in the rules (e.g. serving deficiency letter, removal of the deficiency or modification of the application, etc.), the Government has shown its inclination towards early processing of the APA applications.</p>

Transfer pricing has been a significant source of tax controversy in India and the lack of clarity in matters relating to transfer pricing has pushed back several large investment proposals of foreign MNEs in India. However, after reviewing the detailed rules notified by the Government, one can reckon that the Government has demonstrated its sincere commitment towards implementing a successful APA programme. While clarification on certain aspects would be required, the Government has provided constructive rules primarily in line with the mature jurisdictions which would surely encourage the MNEs to opt for the APA process.

The salient features of the procedure laid down for APA are described below:

Pre-filing consultation

The process for APA would start with pre-filing consultation meeting. The taxpayer can request for a pre-filing consultation meeting which shall be 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 the APA. The taxpayer also has an option of applying for a pre-filing consultation on an anonymous basis. The pre-filing consultation shall neither bind the Board nor the taxpayer to initiate or enter into an APA.

Application for APA

After the pre-filing meeting, if the taxpayer is desirous of applying for the APA, an application would be required to be made in specified form. For continuing transactions, the APA can be applied for period starting from 1 April, 2013 and for proposed transactions, the APA can be applied at any time before undertaking the actual transaction.

Apart from the basic details, the taxpayer would be required to provide the international transactions to be covered, type of the APA applied for, reason for not applying for bilateral/multilateral APA, proposed transfer pricing methodology, detailed functional analysis, standalone and consolidated financial statements for prior five years, etc.

Procedurally, the application for unilateral APAs would be made to Director General of Income-tax (International Taxation) (DGIT) and for bilateral and multilateral APAs to the Competent Authority in India.

The application would be required to be filed alongwith the requisite fee. The fee for an APA is linked to the value of transaction undertaken or proposed to be undertaken.

Amount of international transaction	Fee
Amount not exceeding INR 1000 Million (Approx USD 20 Million)	INR 1 Million (Approx USD 20,000)
Amount exceeding INR 1000 Million (Approx USD 20 Million) but not exceeding INR 2000 Million (Approx USD 40 Million)	INR 1.5 Million (Approx USD 30,000)
Amount exceeding INR 2000 Million (Approx USD 40 Million)	INR 2 Million (Approx USD 40,000)

Withdrawal of APA application

The taxpayer has an option to withdraw the application anytime before the finalisation of the terms and conditions of the agreement. However, the filing fee shall not be refunded in case of withdrawal.

Defective application

If there is any defect in the application, the taxpayer shall be served a deficiency letter within one month from the date of receipt of application. The taxpayer shall be provided a time of fifteen days from date of service of letter to make good the deficiency. A defective application, if not corrected within fifteen days (extendable to thirty days) would be rejected, in which case the filing fee shall be refunded to the taxpayer.

Procedure

Once the application is accepted, the APA team shall hold meetings with the applicant and undertake necessary inquiries for the case. Post discussion and inquiries, the APA team shall prepare a draft report which shall be provided to the competent authority or to the DGIT, as the case may be. Based on the same, the DGIT/competent authority shall prepare a draft agreement, which post the approval of the Central Government shall be entered between the Board and the applicant. The agreement shall mainly include the international transactions covered, the agreed methodology, determination of arm's length price and the critical assumptions for the agreement.

Compliances post APA

The taxpayer shall be required to file an Annual Compliance Report (ACR) to the DGIT within 30 days of filing the return of income or 90 days of entering into APA, whichever is later. In the ACR, apart from the basic details, the taxpayer shall provide information such as details of change in business model, change in functional or risk profile, change in critical assumptions *vis-a-vis* those agreed in the APA. The transfer pricing officer (TPO) shall conduct the compliance audit based on the details provided in ACR to ensure that the terms as agreed in the APA have been met by the taxpayer. The TPO shall furnish its' report within six months from the end of the month in which the ACR was submitted, to the DGIT/competent authority.

Cancellation of APA

The Board may cancel the APA, in case the taxpayer fails to furnish the ACR, there are material errors in the ACR, the TPO finds that there is a failure on the part of the taxpayer to comply with the terms and conditions of the APA or on account of fraud or misrepresentation of facts by the taxpayer.

Revisions and renewal of APA

The APA may be revised in case there is a change in the critical assumptions, law under which the agreement is covered or in case of a request from the competent authority in other country in case of bilateral or multilateral APA. After completion of the APA term, the taxpayer also has an option to apply for renewal of the APA using the same procedure as provided for original application.

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