

# The Wait is finally Over – Advance Pricing Agreements...



The widely anticipated and eagerly awaited rules for the implementation of the Advance Pricing Agreements ('APAs') were notified by the Indian Revenue Authorities on 31<sup>st</sup> August, 2012. Introduction of provisions relating to APAs with effect from 1<sup>st</sup> July, 2012 in the Income-tax Act, 1961 ('Act') vide the Finance Act 2012 would be like a beacon of hope to many Multinational Corporations as well as Indian taxpayers having intra-group transactions and facing transfer pricing litigations. The prospect of having a certainty with regard to their transfer prices and reduction of future litigation, no doubt would have been a reassuring thought to many finance officers of the companies entangled in transfer pricing litigation. However, the Finance Act 2012 only provided the genesis for APAs into the Indian tax laws without actually providing the rules for its implementation. This article takes you through the provisions and rules for the implementation of APAs.

'The wait is finally over' – No, we are not referring to the latest iPhone 5 launched by Apple. Yes, lifting the curtains on the iPhone 5 this September certainly would have adduced this reaction from the millions of iPhone users and technocrats across the globe. But a similar reaction would not be out of place for the widely anticipated and eagerly awaited rules for the implementation of the Advance Pricing Agreements ('APAs') which were notified by the Indian Revenue Authorities on 31<sup>st</sup> August 2012.

The increased focus and the aggressive posturing of the Revenue authorities on the transfer pricing of international transactions between associated enterprises have resulted in transfer pricing adjustments in case of multitude of taxpayers. This has resulted in rounds of litigations at various levels and an uncertainty for the taxpayers with regard to the transfer price for their intra-group transactions.

(Contributed by the Committee on International Taxation of the ICAI. Comments can be sent to [citax@icai.org](mailto:citax@icai.org))

Given the same, introduction of provisions relating to APAs with effect from 1<sup>st</sup> July 2012 in the Income-tax Act, 1961 ('Act') vide the Finance Act 2012 would be like a beacon of hope to many Multinational Corporations as well as Indian taxpayers having intra-group transactions and facing transfer pricing litigations. The prospect of having a certainty with regard to their transfer prices and reduction of future litigation, no doubt would have been a reassuring thought to many finance officers of the companies entangled in transfer pricing litigation. However, the Finance Act 2012 only provided the genesis for APAs into the Indian tax laws without actually providing the rules for its implementation. The APA rules were finally notified by the Indian Revenue Authorities on 31<sup>st</sup> August 2012.

### 1. What is an APA?

An APA is an arrangement between the taxpayer and the Revenue Authorities in relation to future intra-group transactions with a view to agree upfront on the transfer pricing approach. An APA generally covers an appropriate set of criteria relating to the method, comparables and appropriate adjustments thereto, critical assumptions as to future events etc. to arrive at a transfer price or a pricing methodology for intra-group transactions which would be acceptable for both the taxpayer and the Revenue Authorities.

APAs are generally of two types:

1. Unilateral APA – It is an agreement between the taxpayer and the Revenue Authorities of the country where such taxpayer is assessed to tax
2. Bilateral/Multilateral APA – It is an agreement between the taxpayer and the Revenue Authorities

**The provisions relating to giving effect of the APA in the tax return and completing the assessment are contained under Section 92CD of the Act, which include that taxpayers entering into an APA are mandatorily required to furnish a modified return for the years to which the APA applies within three months from the end of the month in which the APA comes into effect. Modified return will reflect only the modifications relevant to the issues arising under the APA. The Government has now notified the rules, Rule 10F to 10T and Rule 44GA under the Income-tax Rules, 1962 ('Rules') for implementation of these provisions.**

of the country where such taxpayer is assessed to tax and Revenue Authorities of one or more foreign countries where the taxpayer may be having intra-group transactions

### 2. APA in Indian Scenario

Section 92CC and 92CD of the Act contains the provisions relating to APAs. As per the same, any person who has undertaken an international transaction or is contemplating to undertake an international transaction is eligible to enter into an APA. The salient features of the Indian APA provisions are as under:

1. The arm's length transfer price ('ALP') under the APA would be determined using any of the already prescribed method or any other method, with necessary adjustments or variations. Thus, the provisions retain flexibility to determine the ALP using a method which may recognise the commercially rational of the transaction
2. The ALP determined as per the APA mechanism will be considered to be the transfer price of the international transaction subject of such APA
3. The APA is binding both on the taxpayer and Revenue authorities for the international transaction for which the same is entered into as long as there are no changes in the law or facts which formed the basis for the APA
4. The APA would be valid for a period specified in the APA subject to a maximum period of 5 years
5. The APA can be entered into only for future or proposed international transaction or in case of continuing transaction for the previous years occurring after the application is filed and not for the transactions already completed i.e. the APA mechanism do not contain provisions for 'roll back'

The provisions relating to giving effect of the APA in the tax return and completing the assessment are contained under Section 92CD of the Act. The same are summarised below:

- a) Taxpayers entering into an APA are mandatorily required to furnish a modified return for the years to which the APA applies within three months from the end of the month in which the APA comes into effect.
- b) Modified return to reflect only the modifications relevant to the issues arising under the APA.
- c) In case of any pending assessment/reassessment proceedings at the time of filing the modified return, the same are to be finalised based on the Modified return and the normal period of limitation for

**A taxpayer which has filed an application for APA is entitled to withdraw the application at any time prior to the finalisation of the APA by filing an application in Form 3CEE. However, in case of a withdrawal of application suo moto by the taxpayer applicant, the fees paid would not be refunded. An application for APA filed by the taxpayer may also be rejected by the APA authority if any defect is noticed in the application Form 3CED or if the application is not in accordance with the understanding reached in pre-filing consultation.**

completion of the proceedings would be extended by one year.

- d) In case the assessment/reassessment proceedings have been completed at the time of filing the modified return, total income would need to be assessed/reassessed based on the modified tax return within one year from the end of the financial year in which the modified return is filed
- e) Any taxpayer aggrieved by the order of the assessment order passed in consonance of the modified return, can file an appeal with the Commissioner of Income-tax (Appeals).

The Government has now notified the rules, Rule 10F to 10T and Rule 44GA under the Income-tax Rules, 1962 ('Rules') for implementation of these provisions.

Rule 10F to 10T specify the procedures for filing APA applications, forms in which the application needs to be filed, information and data to be submitted along with the application, circumstances under which an application may be rejected/withdrawn or discontinued and the compliance procedures post the conclusion of the APA.

Rule 44GA specifies the procedure to be followed in case of a bilateral or multilateral APA.

### 3. Implementation of APA

#### 3.1. Pre-filing consultation

As per the APA rules, every person who wishes to obtain an APA is required to mandatorily undertake a pre-filing consultation before filing a formal application for an APA. An application for pre-filing consultation is required to be made in the specified form (Form 3CEC) to the Director General of Income-tax (International Taxation). The rules provide that the Applicant, if he

desires so, may file the pre-filing consultation on an anonymous basis.

Form 3CEC specified for filing a pre-filing consultation is quite a comprehensive form requiring the applicant taxpayer to furnish such details as details of the taxpayer's business and its business model, group structure, list of associated enterprises with which the transaction is proposed to be entered, functional and risk profile of the taxpayer and its associated enterprise, details of proposed transaction etc.

Based on the details filed, the pre-filing consultation shall broadly cover the following:

- Determine the scope of the agreement;
- Identify the transfer pricing issues;
- Determine the suitability of international transaction for APA;
- Discuss the broad terms of the APA.

The pre-finding consultation does not bind the taxpayer neither the Revenue authority to enter into an APA nor means that the taxpayer has applied for entering into an APA. Thus, based on the pre-filing consultation if taxpayer believes that the said international transaction is not fit for an APA, the taxpayer may not file an APA application and pursue the matter further.

#### 3.2. Filing the APA application

Any person who has completed the pre-filing consultation may then file for an APA in the Form 3CED along with payment of the requisite fees. The filing fees have been linked to the quantum of transaction involved. The schedule of fees specified is specified in the following table:

Amount of international transaction subject to APA	Fees (₹)
Amount not exceeding ₹ 100 crore	10 lakh
Amount exceeding ₹ 100 crore but not exceeding ₹ 200 crore	15 lakh
Amount exceeding ₹ 200 crore	20 lakh

The application for APA is to be filed with the DGIT (International Taxation) in case of a unilateral APA and to the competent authority of India in case of a bilateral or a multilateral agreement.

The application is required to be filed 1) before undertaking the transaction, or 2) in case of transactions of continuing nature which are already in place, before the first day of the financial year for which the application is to be made. For e.g. If an APA is sought

for a proposed transaction, then the application can be filed anytime before entering into the said transaction. Alternatively, if an APA is to be filed for an already ongoing transaction, then an application for assessment year relevant to FY 2013-14 is required to be filed on or before 31<sup>st</sup> March 2013.

Form 3CED too, like the Form 3CEC for pre-filing consultation, requires various details which can be broadly categorised as under:

- a) Details of international transactions proposed to be covered under the APA
- b) Functional analysis of the applicant taxpayer and the relevant entities with regard to the international transaction covering a description of the business strategies (both current and future) relating to R&D, production and marketing, budget statements, projections and business plans for future period covered by the APA, general business and industrial trends
- c) Choice of transfer pricing method
- d) Proposed terms and conditions and critical assumptions for the APA

As can be seen, the details called for in the APA application form are quite comprehensive.

### 3.3. *Withdrawal/rejection of the application*

A taxpayer which has filed an application for APA is entitled to withdraw the application at any time prior to the finalisation of the APA by filing an application in Form 3CEE. However, in case of a withdrawal of application *sou moto* by the taxpayer applicant, the fees paid would not be refunded.

An application for APA filed by the taxpayer may also be rejected by the APA authority if any defect is noticed in the application Form 3CED or if the application is not in accordance with the understanding reached in pre-filing consultation.

In case any deficiency is noticed by the APA authority – DGIT (International taxation) in case of unilateral APA or the Competent Authority in case of Bilateral or Multilateral APA, the APA authority shall first serve a deficiency letter on the applicant within one month from the date of receipt of the application. The applicant shall remove the deficiency or modify the application within 15 days of receipt of the deficiency letter or within a maximum extended period of another 15 days. In case the defect is still not rectified, the application may be rejected after giving an opportunity of being heard to the applicant. In case the application

is rejected, the fees paid by the applicant would be refunded.

### 3.4. *Processing of application*

If the application filed by the Applicant is found to be complete in all aspects, the APA authority may allow the application to be taken up for processing in consultation and discussion with the applicant in accordance with the provisions of Rule 10L.

Broadly the APA application will be processed as under:

- a) Hold meetings with the applicant;
- b) Call for additional document or information or material from the applicant;
- c) Visit the business premises of the applicant; or
- d) Make such inquiries as it deems fit in the circumstances of the case.

On completion of the above process, the APA authority i.e. the DGIT (International Taxation) or the Competent Authority along with the applicant shall prepare a proposed mutually agreed draft APA containing the results of the process carried out for determining the arm's length price under the APA. The APA shall be entered into by the APA authority only after seeking the approval from the Central Government.

An application for APA may be amended by the applicant any time before the finalisation of the terms by the APA authority. Such an amendment may only be permitted if the amendment does not have effect of altering the nature of the original application. Further, such amendment would only be allowed if it is accompanied by an additional fee, if any.

### 3.5. *Procedure for dealing with Bilateral or Multilateral APA applications*

Rule 44GA of the Rules deal with the provisions relating to an application filed for bilateral or a multilateral APA. A bilateral or a multilateral APA application, like the unilateral application, too has to be filed in the normal Form 3CED.

A bilateral or a multilateral APA application shall not be processed unless the associated enterprise situated outside India has initiated the process of APA with the Competent Authority in the corresponding country.

The Competent Authority in India shall enter into a negotiation with the Competent Authority of the corresponding country and try to reach a set of terms which are acceptable to both the parties. In case the

Competent Authorities agree to a set of terms for the APA, the Competent Authority in India shall formalise a mutual agreement procedure arrangement with the corresponding Competent Authority and intimate the same to the applicant. In case there is a failure to reach an agreement, the applicant would be notified likewise.

It needs to be noted that the Applicant would not be entitled to be the part of the discussion between the Competent Authorities.

On being intimated about the APA agreed by the Competent Authorities, the applicant is required to communicate its acceptance or otherwise of the same within 30 days. In case the APA is not acceptable to the applicant, the applicant may choose to enter into a Unilateral APA or withdraw the application.

### 3.6. A typical APA – terms covered

An APA may among other things include –

- a) The international transactions covered by the agreement
- b) The agreed transfer pricing methodology, if any
- c) Determination of the arm's length price, if any
- d) Definition of any relevant terms to be used in items 'b' and 'c' above
- e) Critical assumptions
- f) The conditions, if any, other than provided in the Act or these rules

An APA shall not be binding on the Revenue Authorities or the taxpayer if there is a change in any of critical assumptions or breach of any conditions of the APA. An APA may be revised or cancelled, if there is a change in any of the critical assumptions or a breach of the conditions.

### 3.7. Compliances post APA – Annual Compliance report

After obtaining an APA, the taxpayer applicant is required to furnish an annual compliance report in the prescribed Form 3CEF with the APA authority for each year covered in the APA.

The annual compliance report is required to be filed in quadruplicate within 30 days of the due date of filing of the income-tax return for that year or within 90 days of entering into the APA, whichever is later.

### 3.8. APA compliance audit

The Transfer Pricing Officer ('TPO') holding jurisdiction over the taxpayer would carry out a compliance audit of the APA for each of the year

covered under the APA. For the purpose of carrying-out the compliance audit, the TPO may require the taxpayer to –

- a) Substantiate compliance with the terms of the APA, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;
- b) Submit any information, or document to establish that the terms of the APA have been complied with.

The TPO is required to complete the compliance audit and furnish the report to the APA authorities within six months from the end of the month in which the annual compliance report is received by the TPO.

### 3.9. Revision of APA

An APA can be revised or cancelled under any of the following circumstances:

- a) There is a change in the critical assumptions or there is a breach of the conditions subject to which the APA has finalised;
- b) There is a change in the law that modifies any matter covered by the agreement but it is not of a nature which renders the APA non-binding; or
- c) There is a request from the Competent Authority of the corresponding country for revision of the APA in case of a bilateral or a multilateral agreement

An APA may be revised by the APA authority either *suo moto* or on a request by the taxpayer. However, where the APA is sought to be revised by the APA authority *suo moto*, no revision shall be made unless an opportunity of being heard is given to the applicant. In case the applicant is not agreeable to the revision, the APA may be cancelled.

In case the APA authority is not agreeable to the revision proposed by the applicant, the authority shall reject such proposed revision by passing a speaking order.

### 3.10. Cancellation of APA

An APA may be cancelled by the Revenue Authorities in the following situations:

- a) Compliance audit report contains finding of a breach of the terms of the APA by the taxpayer;
- b) The taxpayer has failed to file the annual compliance report within time;
- c) The annual compliance report furnished by the taxpayer contains material errors;

- d) Where the revision proposed to the APA by the Revenue Authorities are not agreeable to the taxpayer and hence, the APA is cancelled; or
- e) Where the APA has been obtained on account of a fraud or misrepresentation of facts.

No order for cancellation of the APA shall be passed without giving an opportunity of being heard to the taxpayer. Further, the order for cancellation of APA shall be a speaking order and should contain reasons for non-acceptance of the taxpayer's submission.

The order for cancellation of the APA is also required to specify the effective date for cancellation of the APA.

### 3.11. Renewal of APA

For renewing the APA, the same procedure as specified for a new APA application needs to be followed except the pre-filing consultation procedure.

### 4. Benefits & Risks Associated with APA

Following are likely to be the benefits of APA –

- a) Likely to provide a certainty of the transfer prices of international transaction.
- b) Would help in avoiding transfer pricing litigation in respect of the transactions covered by the APA. A Bilateral or a Multilateral APA may be even more effective in mitigating transfer pricing litigation as it binds authorities of both the countries.
- c) The APA would be agreed by senior Revenue Authorities like the DGIT (International Taxation) or the Competent Authorities of the countries and approved by the Central Government.



**Rule 44GA of the Rules deal with the provisions relating to an application filed for bilateral or a multilateral APA. A bilateral or a multilateral APA application, like the unilateral application, too has to be filed in the normal Form 3CED. A bilateral or a multilateral APA application shall not be processed unless the associated enterprise situated outside India has initiated the process of APA with the Competent Authority in the corresponding country.**

- d) APAs likely to provide solutions to complex and difficult or unique transactions.
- e) As the authorities have agreed on the transfer price upfront, the risk of double taxation is eliminated or mitigated.

However, it necessarily does not mean it is likely to a smooth sailing. Following could be the risks or the pitfalls of an APA:

- a) The APA is likely to be a time-consuming exercise, especially in the case of a Bilateral or a Multilateral APA as the Competent Authorities of the corresponding countries are also involved.
- b) An APA may not provide certainty in case of a Unilateral APA or if the APA involves unreliable prediction on market conditions without adequate critical assumptions.
- c) Taxpayers may be required to divulge more information in an APA application than is normally required for a transfer pricing assessment.
- d) Considering the nature of the information divulged as well as the fact that the information collected would be shared with the respective transfer pricing authority holding jurisdiction over the taxpayer, the said details could be used against the taxpayer in course of the transfer pricing proceedings.
- e) The fairly lengthy procedure for obtaining the APA may create a strain on the resources of both, the taxpayer as well as the tax authorities in terms of time and costs.

### 5. Way forward

Across the world, APA regulations have been successfully implemented and have helped to reduce the transfer pricing litigation to a great extent and have provided the taxpayers a certainty with regard to their transfer pricing methodology. Given the said experience, introduction of APA regulations in India augurs well for the taxpayers facing transfer pricing adjustments and provide them with an alternate dispute resolution panel, albeit one which helps in avoiding the dispute. However, the fairly high application fees (up to ₹20 lakh in some cases) and the past experience of taxpayers with the Dispute Resolution Panel may act as a deterrent for the taxpayers. Given the same, one needs to wait and watch whether the APA achieves its objective.

Initial reports suggest that iPhone 5 has certainly lived up to the hype and expectations of the iPhone lovers. It needs to be seen whether the Indian APA regulations was worth the wait. ■