

# Advance Pricing Agreement (APA) – A Step Ahead In Transfer Pricing Regime



The Indian Income-tax Department with its transfer pricing regime has been surrounded by lot of controversies. To mitigate these hardships faced by the taxpayers, the Advance Pricing Agreement (APA) has been introduced. More than 100 taxpayers have shown interest in APA. This article tries to throw light on the Indian APA Scheme, its working, salient features and the process of obtaining an APA.



**CA. Namita Jhaveri**

(The author is a member of the Institute. She can be contacted at [namitajhaveri@gmail.com](mailto:namitajhaveri@gmail.com))

## Introduction

Transfer pricing norms have always been a bone of contention. Recently, MNCs like Shell, Vodafone and Nokia were handed over notices by the Tax Department. There has been a lot of hue and cry from these MNCs supported by their home-country Governments. To combat this, Advanced Pricing Agreement (APA) Scheme was introduced.

An APA, as the name itself connotes, is an agreement between the Central Board of Direct Taxes (CBDT) and any person, which determines, in advance, the arm's length price or specifies the manner of the

**The Ministry of Finance has notified an “Advance Pricing Agreement Scheme” (Rules 10F to 10T of Income-tax Rules, 1962) vide Notification No. 36/2012 dated 30-08-2012.**

determination of arm’s length price (or both) for a set of transaction/s over a fixed period of time in future. In the current tax scenario where our Tax Officers are becoming more aggressive, the APA offers relief by enabling taxpayers to ascertain their potential tax liability in advance and also would help in reducing the potential litigation in the Indian transfer pricing field.

The Ministry of Finance has notified an “Advance Pricing Agreement Scheme” (Rules 10F to 10T of Income-tax Rules, 1962) vide Notification No. 36/2012 dated 30-08-2012. The Finance Act, 2012 had inserted sections 92CC and 92CD in the Income-tax Act, 1961 introducing the provisions of Advance Pricing Agreement (APA). The APA Scheme shall come into effect from the date of its publication in the Official Gazette, i.e. from 30-08-2012.

Once APA has been entered into with respect to an international transaction, the arm’s length price with respect to that international transaction, for the period specified in the APA, will be determined only in accordance with the APA. The maximum terms prescribed for APA is 5 consecutive years, however, no minimum period has been specified.

### Salient Features of APA Scheme

Salient features of the APA scheme which are noteworthy are as follows:

- The arm’s length price shall be determined by any of the methods provided in Section 92C(1), with necessary adjustments and variations.
- There are three types of APA – unilateral, bilateral and multilateral. The applicant has to choose a particular type of APA at the time of making the application. Unilateral APA is an agreement between the Board and the applicant and this process does not involve any agreement with the treaty partner. In bilateral and multilateral APA requests, the applicant is required to make an application with the Competent Authority of India as well as the Competent Authority of the other country. Unilateral APA applications are to be filed with the Director General of Income

Tax (International Taxation), New Delhi whereas bilateral and multilateral APAs applications are to be filed with the Competent Authority of India. In case of bilateral/multilateral APA, the applicant must initiate the procedure for entering into APA with the other country as well and furnish evidence to the Competent Authority of India regarding the same.

Bilateral/multilateral APAs can be accepted by the Indian Competent Authority where:

- (i) A tax treaty exists between India and other country(ies) and the treaty contains an Article on Mutual Agreement Procedure (MAP)
- (ii) In case of international transactions leading to economic double taxation arising out of transfer pricing adjustments, the said tax treaty contains provisions similar to Article 9 Para 2 of OECD model convention on ‘Associated Enterprises’ and
- (iii) There exists a corresponding APA program in the other country.

Hence, one would observe that in case of a unilateral APA a possibility of double taxation may exist, since there is no involvement of Competent Authority of other country and the APA is merely between CBDT and the applicant.

- A team comprising one Commissioner, four Additional Commissioners and four Deputy Commissioners has been constituted by the Board. This team reports to DGIT (International Taxation). The DGIT may include eminent lawyers, economists and statisticians. The team enquires and prepares a draft report in case of bilateral/multilateral applications.
- The broad process of obtaining an APA is as follows:

#### Step I – Pre-filing Consultation

It is mandatory for an Applicant to enter into a pre-filing consultation. In order to undertake the pre-filing consultation, the Applicant needs to file an application with the DGIT in a prescribed Form 3CEC providing the prescribed particulars. The Applicant would undertake a pre-filing

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consultation with the Team. The objective of the pre-filing consultation would include, *inter-alia*, to determine the suitability of international transactions for the APA and to discuss broad terms of the agreement. The APA scheme specifies that undertaking a pre-filing consultation does not bind either the Indian tax administration or the Applicant.

#### **Step II – Filing of an Application**

The application for APA is to be made in the prescribed form 3CED along with requisite documents and prescribed fees. The application form is an exhaustive form seeking details such as corporate background of applicant as well as associate enterprises, transaction flows of the multinational enterprise (volumes, directions and amounts) that may have an impact on the pricing of the covered transactions, accounting and costing systems, detailed functional analysis, business strategy, relevant financial, marketing and operating information, etc.

Before filing the application the applicant is required to pay fees by means of electronic transfer directly to the Government account. The prescribed fee structure is as follows:

<b>Amount of international transaction entered into or proposed to be undertaken in respect of which an agreement is proposed during the proposed period of agreement.</b>	<b>Fees in INR</b>
Amount not exceeding ₹ 100 crore	10 lakh
Amount between ₹ 100 crore and ₹ 200 crore	15 lakh
Amount exceeding ₹ 200 crore	20 lakh

Time limit for filing of application: In case of existing/continuous transaction the application is to be made before the first day of the previous year relevant to the assessment year for which the application is made. In all other cases the time limit is before entering into the international transaction.

The applicant may however withdraw the

application in Form 3CEE any time before finalisation of terms of APA. The fees shall however not be refunded.

#### **Step III – Preliminary process of Application**

Once the application has been filed, if a defect is noticed in the application (including if a relevant document is not attached) or if the application is not in line with the understanding reached in pre-filing consultation, either the DGIT or the Indian Competent Authority (as the case maybe) will serve a deficiency letter on the Applicant asking the Applicant to rectify the defect or to modify the application. The deficiency letter, if any, is to be served on the applicant within one month from the date of filing of the application. The Applicant will be given 15 days to rectify the defect/modify the application or such extended time as may be requested, which will in any case not exceed 30 days from the date of service of the deficiency letter.

#### **Step IV – Processing of the Application**

In this stage, the Team or the Indian Competent Authority will ask the applicant to furnish information, additional documents and even visit the site/premises of the applicant. In case of a bilateral or multilateral APA process, the Indian Competent Authority (CA) would enter into discussions with the CA of the relevant foreign country of which the Associate Enterprise ('AE') of the Applicant is a resident—the APA scheme requires that the foreign AE of the Applicant initiate an APA with the CA of the country in which the foreign AE is a resident. Based on these discussions/negotiations, the two CAs would formalise a Mutual Agreement Procedure ('MAP') arrangement and which would be intimated to the Applicant by the Indian CA. In case no agreement is reached between the Indian CA and the foreign CA, the Indian CA would intimate the Applicant of this development. At this stage, the Applicant would have the option of either proceeding with the APA without the benefit of the MAP process (i.e. convert it into a unilateral APA) or withdraw the application.

Depending on the type of APA the DGIT or Indian

**Unilateral APA is an agreement between the Board and the applicant and this process does not involve any agreement with the treaty partner.**

CA and the applicant would then mutually prepare a proposed draft of the agreement. This agreement will be executed by the CBDT with the Applicant after it receives the approval of the Central Government.

#### **Step V – Compliances after obtaining APA**

An annual compliance report has to be filed to the DGIT for each year covered in the APA, in Form No. 3CEF, within 30 days of the due date of filing the income-tax return for that year, or within 90 days of entering into the APA, whichever is later by the taxpayer.

The Transfer Pricing Officer shall carry out a compliance audit for each year covered in the agreement. Time limit for completion of the same is 6 months from the end of the month in which the annual compliance report is filed. Regular audit need not be undertaken for transactions covered by the APA.

The Act permits the taxpayer to file a modified tax return over a period of three months from the end of the month in which APA has been obtained so as to give effect to the terms of APA.

- The APA scheme provides that the APA would specify the international transactions covered, the agreed transfer pricing methodology, the determination of the arm's length price, if any, critical assumptions, etc.

'Critical assumptions' has been defined in Rule 10F(f). It means the factors and assumptions that are so critical and significant that neither the Applicant nor the tax administration would continue to be bound by the APA if any of the factors or assumptions change. What the 'critical assumptions' are has not been defined within the APA scheme. The APA scheme requires that the Applicant, in its APA application, would list out the critical assumptions that the Applicant has considered in proposing the APA. The scheme also provides that if the critical assumptions change, the APA can be revised or cancelled. The onus is cast on the taxpayer to intimate the DGIT, in case there is a change in critical assumptions.

**In bilateral and multilateral APA request, the applicant is required to make an application with the Competent Authority of India as well as the Competent Authority of the other country.**

**In case of existing /continuous transaction the application is to be made before the first day of the previous year relevant to the assessment year for which the application is made. In all other cases the time limit is before entering into the international transaction.**

- An APA can be revised by the CBDT as per the various conditions set out in the APA scheme, including, on account of change in critical assumptions, change in law or a request from competent authority of another country in case of bilateral/multilateral agreements. Either the tax administration or the taxpayer can request for a change in the terms of the APA. A revision to the APA proposed by the CBDT will not be implemented without the consent of the taxpayer—if the taxpayer does not agree to a revision in the APA, the APA can be terminated. The CBDT has the right to reject a revision to the APA which may have been requested by the taxpayer—however, in this case, the APA would not be terminated.
- An APA can be cancelled by the CBDT for reasons detailed in the APA scheme, including failure to file the annual compliance report or the annual compliance report containing material errors or if the APA is obtained on account of misrepresentation of facts. The taxpayer would be given an opportunity to be heard in case an APA is to be cancelled by the CBDT.
- An APA can be renewed. The request for renewal of an APA has to be made as a new application, using the same procedure as outlined for in the APA rules except for pre-filing consultation.
- The Board has been empowered to declare with the approval of Central Government any agreement void *ab initio* if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts and thereafter all the provisions of the Act shall apply to the person as if such APA has never been entered into. For the purpose of computing any period of limitation the period beginning from the date of such APA and ending on the date declaring the agreement void *ab initio* shall be excluded.

#### **Benefits of Indian APA Scheme**

- o It will provide tax certainty with regard to determination of arm's length price of the

international transaction with respect to which the APA has been entered into

- o Minimise the risk of potential double taxation through bilateral or multilateral APAs
- o Reduce compliance cost by eliminating the risk of transfer pricing audit and resolving long drawn and time-consuming litigation and other dispute resolution process
- o Lowers the burden of record-keeping as the taxpayer knows in advance the required documentation to be maintained to substantiate the agreed terms and conditions of the agreement
- o An APA can be filed for transactions which are in litigation before Tax Authorities/ITAT.

#### Key considerations not considered in the Indian APA Scheme

- o No time limit has been set for completing the entire process of APA. Hence the taxpayer is not certain when and what the outcome would be.
- o The Scheme is silent as regards the confidentiality of documents, data, information and projections submitted during the APA process to be used for initiating/concluding other tax proceedings.
- o Unlike many countries the Indian APA Scheme is silent on rollback provisions, thereby dampening the opportunity to resolve some of the past disputes.
- o The Scheme does not throw more light on the manner in which the pre-filing consultation will be carried out.

#### FAQs on APA

Certain FAQs on APA resolved by the Income-tax Department recently are as below:

- Q. If a taxpayer has more than one international transaction but desires to have an APA for only one



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of the transactions; can APA authority insist for all transactions to be covered?

- A. There cannot be any compulsion that the taxpayer should enter into APA in respect of all international transactions undertaken by him. However, if one international transaction is intrinsically linked with another international transaction in a manner that one cannot be benchmarked independently, the tax administration can inform the applicant that both international transactions need to be covered in the application.

- Q. Is it possible to convert unilateral APA to bilateral/multilateral APA?

- A. Yes, but before finalisation of the terms of agreement.

- Q. During the APA negotiation process, which may take 2-3 years, is it necessary to follow regular provisions of the Income-tax Act?

- A. Yes, regular provisions of the Income-tax Act are to be followed till APA is concluded and modified return is filed accordingly.

- Q. Will retrospective amendments in law have a bearing on the concluded APAs?

- A. Only that retrospective law which governs the APA can have an impact on APA already concluded.

- Q. What would be impact of concluded or ongoing MAPs/domestic litigation on APA?

- A. The past history of the case will be looked into and discussed during APA negotiations. However, it is not mandatory that the same stand as taken in the past shall decide the APA process.

- Q. The filing fee is based on value of international transaction. A situation may arise where the actual value at the end of the period is more or less than what was envisaged at the time of filing of application. What would be the impact of this change?

- A. The mere fact that the value of international transaction happens to be more than what was projected earlier would not have any effect on the quantum of fee which has already been paid.

#### References:

- The Indian Income-tax Act
- CBDT Guidance Note on APA Agreement with FAQs
- Related articles of Economic Times, ITAT Online.org, Taxmann etc. ■