

Advance Pricing Agreement – Some Concerns on Implementation



Advance Pricing Agreement is an agreement between the Central Board of Direct Taxes and a taxpayer, in terms of the provisions of the Income-tax Act, 1961 and the Rules/Scheme framed thereunder to determine, in advance, the arm's length price or the manner of its determination or both, in relation to an international transaction to facilitate the application of transfer pricing. The concept, thinking, desire and objectives of APA are undoubtedly most welcome and keep pace with the times. The provisions have been lauded by the industry, professionals and investors at large. However, it appears that in the implementation of these path-breaking provisions and the Scheme framed thereunder, there may be some genuine concerns. The article discusses these concerns. Read on...

Advance Pricing Agreement (APA), as the name suggests, is an agreement between the Central Board of Direct Taxes ("the Board") and a taxpayer, in terms of the provisions of the Income-tax Act, 1961 ("the Act") and the Rules/Scheme framed thereunder to determine, in advance, the arm's length price ("ALP") or the manner of its determination or both, in relation to an international transaction to facilitate the application of transfer pricing.

It is a first such departure from the existing practice of determining ALP post event and in the course of assessment. The provisions, by and large,

do follow the practices adopted internationally. The provisions express the desire of the legislature to adopt a facilitating business-like practice. As explained in the Guidance issued by the Income tax Department on APA (paragraph 4), its advantages, briefly stated, are to (a) provide tax certainty about ALP determination; (b) reduce potential risk of double taxation through bilateral or multilateral APA; (c) reduce compliance costs; and (d) reduce the burden of record-keeping.

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However, it appears that in the implementation of these path-breaking provisions and the Scheme framed thereunder, there may be some genuine concerns.

Dual or Multiple Authorities

In the present scheme, depending on whether the application for APA is for a unilateral, bilateral or a multilateral agreement, the tax payer is required to



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approach various authorities set-up under the present scheme, such as the “APA Team” or the “Competent Authority”, time and again at various stages, such as for pre-filing consultation, application, negotiation, etc. Further, before entering into the APA, a final approval of the Central Government is also required to be obtained. Besides, in case of bilateral or multilateral agreements, a reference may also be made to the authorities of the other country or countries.

Hence, the present procedure for entering into the APA contemplates obtaining approval/clearance from multiple authorities at various stages, which may well make the entire process of entering into an APA cumbersome and long-drawn for the tax payer. Considering that these agreements would play a significant role in finalising the commercial agreement that would be entered into between the parties, such multi-stage approval could be a significant hindrance in making the APA scheme effective and commercially feasible. Further, if one were to consider the present ethos of the Income-tax Department, the foregoing process of entering into an APA may not actually turn out to be a forward-looking reform.

Inadequate Representation by the Applicant

It is not clear or evident from the scheme, whether, when a reference is made to the Central Government for approval, the Applicant would be involved or not. Also, it appears that when there is a bilateral or multilateral agreement, the applicant may not be involved in the negotiations with the other country or countries. These too could be detrimental to the negotiating capacity of the tax-payer at the time of entering into the APA

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Constitution of the APA Team

It may also be noted that the Scheme does not clearly specify the details about the constitution of the APA Team. No details are provided as to the proportion of the tax authorities and the economic experts that would constitute the APA Team. The Scheme only gives a discretionary power to the DGIT(IT) to include such number of experts in economics, statistics, law or any other field as may be nominated by him. Apart from that, it does not provide for involvement of experts in the process. Thus, the authorities involved in the process may or may not have the requisite background, experience and exposure to the commercial world and practices in relation to the process of determining a “price”. Involvement only of administrators in the process may undermine the objectivity of the person engaged in determining the “price”.

Classification having regard to Complexity of Dealings

The APA scheme of Australia classifies the dealings for APA, having regard to the complexity and the classification as: (a) simplified (low value or low risk international related party transactions); (b) standard (not being simplified or complex dealings); and (c) complex (high risk, lack of comparables, significant amount of tax, etc). Accordingly, it prescribes simpler to complex process of entering into APA depending upon the risks and complexity of a particular case.

However, the Indian APA Scheme does not make any such classification. Having regard to the number of transactions in the service sector and, in particular, in the nature of "business process outsourcing", some such classification and, in particular, "simplified" version would be of great value, covering "small" transactions or enterprises.

Timeline

The provisions of the Scheme do not provide for any timeline whatsoever for conclusion of APA. In fact, the law contemplates and provides for giving effect to an APA, if entered into after the process of assessment is completed!

Lack of time limits coupled with the requirement of dealing with multiple authorities could possibly contribute to the delays. The delays may affect the applicants, commercially and otherwise, in the following circumstances or manner:

- the applicant may have to plan his affairs keeping in mind the commercial agreement for the price and possible price under APA;

- it will have to continue to comply with the provisions of the Chapter including determination of ALP, maintenance of documents, audit, assessment process etc; and
- for compliance with other laws, especially those that depend on the price charged or paid by the applicant, like, payment of customs duty, remittances etc. Indeed, it is not clear from the provisions or the scheme whether the price determined as per APA can be used by other government authorities for determining compliances under other laws (to illustrate, payment of customs duty or effect or impact on the remittances made based on the commercial price). To put it differently, the law does not provide any immunity or insulation in respect of application or applicability of APA otherwise than for the purposes of the Act.

In the absence of any immunity provided under the present provisions of APA, these concerns of the taxpayers get further enhanced particularly because of the fact that the price determination under the APA is not a time-bound process and therefore, the applications may remain pending for several months or even a few years. In such cases, when a price is subsequently agreed under an APA and there is no immunity provided to the taxpayer under the present law, the taxpayers may face notices by the Customs, Excise, etc regarding violation of the respective laws on account of a subsequent price determination.

This concern may also be addressed by the Government by providing for a time limit for entering into an ALP as well as by providing for immunity to the tax payer under any law on account of any implication arising from a subsequent price determination on account of entering into an APA with the Board.

Confidentiality and Sharing of Information

While dealing with the matter of confidentiality in the Guidance, in reply to FAQ 24, it is stated: *“Internationally, most countries allow sharing of APA information with on field audit officers. The confidentiality provisions of the Income tax Act also allows such sharing within the income tax department”.*

When an applicant submits the information, in the course of consideration of the agreement, it is for the purposes of reaching the agreement with the

Board and having regard to the "tax" objectives or advantages considered and set out in the Guidance issued by Department. To put it differently, the information furnished or the details shared may be having regard to achievement of the "tax objectives" and not necessarily the commercial objective (in the case of a willing buyer and willing seller). In other words, the tax objectives may substantially influence the process.

Now, “Arm’s length price” (ALP) is the price applicable in a transaction between uncontrolled enterprises. In other words, ALP is a price that an unrelated willing buyer is willing to pay to an unrelated willing seller. Whereas the APA mechanism deals with determination of “Arm’s length price”; the entire mechanism is based on negotiations between the taxpayer and the APA team of the Tax Department to arrive at a mutually agreeable price which would provide the applicant taxpayer certainty of tax determination, lower the exposure of tax demands and consequent litigation as also reduce the compliance costs and burden. Thus, the price determined under the APA Scheme in most cases would not be an ALP but an agreed negotiated price.

This dichotomy raises a very important concern for the taxpayer that if the information furnished by the taxpayer for the purposes of APA is shared, such information, as such, may not be relevant for determination of ALP in terms of the transfer pricing provisions of Chapter X of the Act. ALP determination needs to be based on commercial facts and commercial considerations, not influenced by any other factor. Accordingly, such information may prejudice the determination of ALP as per the transfer pricing provisions. Besides, even after furnishing of all the information, the application made may be rejected by the Tax Department. In such a case, it would be unfair for the Tax Department to use the information furnished by the applicant in determination of the transfer price, though such information was not agreed upon by the Tax Department for accepting the APA application by the applicant.

The Tax department needs to address these and other relevant issues for a successful implementation of the APA scheme and the provisions. At the least, the Tax department and/or the applicant may agree to make such provisions, in the agreement, which may wholly or partly address the above issues. ■