

APA Programme of India - Progress so far

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During the last decade and a half transfer pricing in India has moved from being merely a compliance work to board room discussions. This is no longer left to tax manager only to frame transfer pricing approach of company but to deal with the controversies as well. Partly, this is due to the fact that most of major economies are toughening their tax laws to discourage profit shifting through intra-group transactions and partly due to the aggressive approach of the transfer pricing authorities in India. The normal litigation process is time taking and resource intensive without any middle path for a compromised solution. Appreciating this, in 2009 Government introduced Safe Harbour regulations proposing threshold for various types of transactions for acceptance by the authorities. However, it was a total failure as the thresholds adopted were too high and unreasonable. In this background, in 2012 the Government introduced Advance Pricing Agreement (APA) programme as an alternative mechanism to resolve disputes. Considering the bitter experience of safe harbour regulations, taxpayers were skeptical about success of the APA programme. They were not sure about the approach of tax officials who are trained more to identify cases of tax evasion and avoidance, rather than entering into negotiated settlement of tax disputes, which is at the core of concluding any APA. Fortunately, the APA set up in tax administration functioned in a most professional manner appreciating the business realities, ensuring a win-win situation for the department as well as taxpayers, resulting in finalization of a large number of APAs in a record time. The Central Board of Direct Taxes (CBDT) has brought out [Third Annual Report](#) on the functioning of Advance Pricing Agreement Programme in India. This brings out the achievements of the programme, issues involved in applications, types of APA applications, time taken in conclusion of agreements and pendency of applications. However, the report does not analyse or comment on the lessons learnt from the concluded APAs and the way forward to reduce litigation. This article analyses some of the statistical details in the report and goes on to mention the areas which the report should have highlighted. Further, this article highlights, at a very high level, the core problem in transfer pricing audit and possible ways to reduce litigation.

Transfer Pricing litigation and its fate - Historical Perspective

In 2012 the Central Board of Direct Taxes brought out a report on Black Money where statistics regarding transfer pricing adjustments during 2004 to 2012 were given. It shows that during Financial Year 2004-05, 23 percent of cases selected for transfer pricing audit suffered adjustment amounting to Rs. 1,220 Crore. In 2005-06 and 2006-07 the percent of cases suffering adjustment remained below 30 percent (22 and 27 percent respectively). In 2007-08 this percentage went up to 39 percent. However, the amount did not go up significantly. From 2008-09 onwards the percentage of cases suffering adjustment kept on going up, reaching 52 percent in 2011-12. The amount of adjustment went up from 6,140 crore in 2008-09 to 44,531 crore in 2011-12. This abnormal increase in amount was due to adjustment on account of share infusion by foreign parents in their Indian subsidiaries.

For policy makers the question to consider is whether the adjustments made by the authorities yielded corresponding revenue to the government?

As per a very high-level study of decision of various Benches of Income Tax Appellate Tribunal reported till November 2019 (5,729 cases) undertaken by the Authors, shows that in majority of cases (62%) the ITAT has decided in favour of taxpayers. Only in 7% of cases the matter has been decided solely in favour of Revenue while in 30% of cases it has been partly in favour of Assessee and partly in favour of revenue. In marginal cases (1%) the issues were remanded back to the AO.

The story is same at the level of High Courts where 76% of the cases were held in favour of taxpayers. Only in 14% of the cases the matter has been decided in favour of Revenue. The Balance 10% of the cases were decided partly in favour of both the litigants.

Thus, the high-pitched transfer pricing additions by tax authorities have not received judicial approval and had not yielded revenue commensurate to the efforts by the officers.

APA has been able to reduce cases of litigation. Initially, the agreement was to apply for future 5 years. However, in 2014 roll back provisions were introduced in the APA programme applying the agreed positions to earlier 4 years as well. Now, a taxpayer is able to have certainty in matters of transfer pricing for a maximum period of 9 years.

Statistical data captured in the Annual Report

1. Volume of APAs filed and concluded

In India the taxpayer can enter into either unilateral or bilateral APA. A unilateral APA agreement is between the taxpayer and the CBDT whereas in bilateral APA (BAPA) minimum four parties are involved, viz., Indian taxpayer, foreign taxpayer, CBDT and the concerned foreign tax authority.

Since its introduction till November 2019, more than 1150 applications have been filed, out of which about 82% were unilateral APAs. Out of these 271 Agreements have been entered into (240 unilateral and 31 bilateral). This provided tax certainty for 1779 years to these taxpayers.

Unilateral APAs have been preferred due to various reasons. First, the time and cost involved in a bilateral APA is very high due to involvement of two taxpayers – Assessee and its Associated Enterprise and two tax authorities, namely India and the concerned foreign tax authority. Second, in most of the cases, Indian entities are very small in global network, due to which the parent doesn't not want to get involved. However, with the USA opening bilateral APA with India, this number has increased.

2. Time taken

The average time to conclude 41 unilateral agreements during 2018-19 was 45.22 months. This is better than what most countries have achieved. And for BAPA it took 44.32 months. The average time taken to conclude BAPA was 51.82 months which was on a higher side than the previous years as some long pending APAs were concluded in FY 2018-19. In the similar period USA took 47.8 months and Canada took 44 months to conclude BAPA in their countries.

In the recent years the number of APAs concluded has gone down significantly from 88 in 2016-17 to 67 in 2017-18 and in 52 in 2018-19. Unless the strength of the APA team is increased significantly and the speed of disposal is increased, the programme would collapse as pendency is increasing year after year.

3. Sectors involved

The majority of the APAs were from service sector, followed by manufacturing, trading, trading & services. The majority of the signed APAs were from IT sector followed by Health & Hygiene, Industrial/Commercial Goods, real estate and others.

4. Countries of Parent/AE

The top 6 countries of location of Parent/ AEs were USA, UK, Singapore, Germany, China and Japan.

5. Bilateral APAs

Out of the total 253 BAPA applications filed, 31 applications were signed till FY 2018-19 which gave certainty of 226 years to these tax payers. The maximum BAPA signed involved UK then Japan, followed by USA, The Netherlands, Australia and Switzerland.

Majorly there are 6 categories of transactions concluded in BAPA till the current cycle viz., ITeS, Purchase of Raw Material, Payment of Royalty/License fee, IT, availing of Technical/Professional services and purchase of finished/traded goods.

6. Methods adopted

In APAs filed as well as concluded in maximum number of cases the transfer pricing method adopted is Transactional Net Margin Method. However, in many cases Profit Split Method, Comparable Uncontrolled

Price Method and other method have been adopted.

7. No separate data on fresh and renewal applications

The Report shows an interesting fact regarding applications filed. The number of applications went up from 146 in 2012-13 to 232 in 2013-14 and thereafter decreased in the subsequent three years from 206 to 132 and then to 101 in 2016-17. It increased from 168 in 2017-18 to 170 in 2018-19. This fluctuation can be explained on the basis of the fact that the agreements reached in 2012-13 and thereafter came up for renewal in 2016-17 and in the following years.

Unfortunately, the Report does not give figures for fresh applications and renewal applications separately. This would have given an idea about the current trend of litigation and acceptance of APA.

Conclusion

The report fails to disclose the results achieved in concluded APAs, industry wise and/or international transaction wise. No doubt individual agreements are covered by confidentiality, but information on general basis would go a long way in providing guidance to tax authorities and taxpayers, which would reduce litigation.

It is high time that the government should undertake a comprehensive study of agreements signed in the APA programme, Mutual Agreement Procedure concluded in the recent time and results of various judicial pronouncement for the purpose of providing guidance to tax authorities and taxpayers. A circular or instruction would reduce litigation in making India a better place for investment.