

**Improving the effectiveness and efficiency of Indian Advance Pricing Agreement programme**

**Executive summary**

The Advance Pricing Agreement (APA) programme is an important policy initiative of the Ministry of Finance for resolving long standing transfer pricing (TP) issues, reducing litigation in transfer pricing matters and provide tax certainty to Multinational Enterprises (MNEs) doing business in India.

The progress of APAs in recent years, however, has been slow which has caused a significant backlog of cases, resulting in delay in collection of taxes for the Government and exacerbating uncertainty to taxpayer. By their very nature, TP issues are subject to alternative views and interpretations. Thus, many taxpayers have either opted for, or would like to opt for, an APA to obtain tax certainty. Such a trend has led to increasing number of APA applications every year.

From the Government perspective, there have been challenges in terms of processing these APA applications on time. This can largely be attributed to inadequate resources of APA teams, absence of specialized knowledge, periodic rotation of personnel as well as multi-level approval process for closing every application. In the absence of an effective dispute prevention mechanism like APA, there is also a greater risk that the tax collections may not be possible at a quick pace for the Government. Thus, the efficiency and effectiveness of the APA programme is critical for achieving triple objectives, viz. (a) providing conducive environment for the taxpayers (b) swift collection of taxes and (c) uplifting the economy with more investments into India.

In this regard, certain immediate measures as well as structural, long term reforms have been suggested below to improve the functioning of the APA programme.

Immediate measures	Structural measures
<ul style="list-style-type: none"> <li>• Consider adopting ‘framework’ approach for resolving pending APA cases with low complexity/ risk, e.g., cases involving information technology (IT) / IT enabled services (ITES) transactions</li> <li>• Allocate additional and specialist resources to the APA team</li> <li>• Use online media for preliminary consultations, site visits and negotiations</li> <li>• Create a special window – ‘Accelerated APA’ - for clearing up old cases (similar to Vivad Se Vishwas Scheme)</li> <li>• Fast track APA renewals</li> <li>• Delegate authority for approval of APAs for faster processing</li> </ul>	<ul style="list-style-type: none"> <li>• Rationalise safe harbour rules to make them attractive and thus reduce the load on APAs (which are perceived as the only option for tax certainty)</li> <li>• Issue detailed APA guidance to set the right expectations</li> <li>• Allow opt-ins for “roll forward” options for APA renewals</li> <li>• Endeavor to conclude APA in a timely manner</li> <li>• Bring transparency in the overall APA process</li> <li>• Keep the regular TP assessment in abeyance during the APA process, in line with international practices.</li> </ul>

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### Background

The APA programme of the Central Board of Direct Taxes (CBDT), introduced in 2012, has been very successful in providing certainty on TP matters to taxpayers. The taxpayers have been appreciative of the flexible and solution-oriented approach of the APA authorities while determining tax positions. From merely 146 applications filed in the first year of APA programme, till date more than 1,160 applications have been filed, including both unilateral and bilateral APA applications.

In the initial few years, the number of APAs concluded was quite large. From financial year (FY) 2015-16 to FY 2017-18, a total of 210 APAs were concluded representing about 70% of the total APAs concluded till date. Each APA requires a complex analysis before conclusion and the CBDT must be lauded for creating a global benchmark in providing such certainty to the taxpayers. We understand that as of today, more than 375 APAs have been concluded, which is no small achievement.

In recent years, however, the progress of APAs has slowed down considerably, resulting in a large pendency of cases. Timely completion of APA process is critical to ensure that taxpayers' confidence in this programme is sustained. In fact, one of the commitments in the Taxpayers' Charter unveiled by the CBDT recently emphasizes that the Income Tax Department is committed to provide timely decisions to taxpayers and holds its authorities accountable. Recognizing the seriousness of the problem, the Hon'ble Finance Minister while addressing the National MNCs Conference 2020, organized by the Confederation of Indian Industry (CII) observed, that "APAs were taking too long and should be expedited because it was creating a huge burden on multinationals' books. APAs can be expedited. Otherwise, it defeats the very purpose and non-conclusion within the five years is definitely not acceptable."

### 1. Current pendency of APA cases

As on 20 December 2019, 763 APA applications out of 1,165 applications filed were still under processing<sup>1</sup>. At the average current pace of about 50 agreements being signed every year; it could take up to 16 years to clear the current inventory. Meanwhile, more filings every year will continue to add to the backlog.

### 2. Reasons for the slow-down of APA process

Following are some of the key reasons for the slowdown in APAs:

- I. In the recent years, the number of APA applications have increased significantly due to factors such as absence of options for controversy and dispute prevention is driving MNCs to APA option.
- II. In addition to the above, wherever the MNCs have desired tax certainty with mitigation of double taxation risks, the taxpayers have looked at filing bilateral APA applications. In the recent years, the number of bilateral APA applications has increased significantly due to factors such as:
  - (a) Relaxation in Article 9(2) of tax treaties (which provides for co-relative relief) in order to invoke bilateral APAs. This has opened more doors for bilateral APAs.

<sup>1</sup> Annual Report 2019-20, Ministry of Finance

- (b) Opening of bilateral APAs by the United States of America (US) in 2016 and conversions from unilateral to bilateral APAs.
- III. APA renewal process has, so far, been essentially a “repetition” of the original APA process, requiring submission of documents from scratch, site-visits and filing detailed responses rather than leveraging the work done in the original APA. This is bringing down the efficiency of the programme and causing the delay as well.
- IV. Multiple levels of approvals within the APA programme slow down the decision-making framework. There is also a long-time gap between processing of APA file and conducting site visits.
- V. Despite such increased workload, the number of APA officials in CBDT have not increased commensurately to deal with the rising inventory. Further, frequent transfers/team changes are adversely impacting the turnaround time for some closures.
- VI. Also, with transfers/ new deputations, difficulty is also faced in terms of lack of experience/ training for the newly inducted team members in the APA teams.

### **3. The need to improve speed of the APA programme**

The slow-down in the overall APA process has had an adverse impact on India’s ability to minimize disputes and collect taxes on time, which in turn impacts tax certainty. The efficiency and effectiveness of the APA programme is important for achieving triple objectives for the Government, viz. (a) providing conducive environment for the taxpayers (b) swift collection of taxes and (c) uplifting the economy with more investments into India.

### **4. Suggestions for enhancing the efficacy of APA programme in India**

As discussed above, given the existing backlog of cases as well as influx of new applications, a twin-fold approach to resolve the APA cases is recommended viz. (1) immediate measures (2) structural measures.

#### **4.1 Immediate measures**

##### **I. Consider adopting “framework” approach for resolving pending APA cases with low complexity/ risk**

Many taxpayers with simple fact patterns/low complexity have opted for APA to have certainty, as this is easily accessible. This has resulted in huge influx of APA applications primarily involving low complexity cases/ fact patterns.

Given the maturity curve in the Indian APA programme, it should be possible to segregate the pending APA cases into high, medium and low complexity/ risk buckets having regard to the nature and complexity of cases. Typically, cases involving intellectual property transfer, high end research & development activities, licensing, marketing intangibles, financial transactions, profit attribution to permanent establishment may be considered as “high complexity/risk” category; whereas cases such as typical routine distribution/ contract manufacturing types of activities can be put into “medium complexity/risk”. The balance can be considered as “low complexity/risk” cases e.g. routine back office IT/ ITES centers, business support services etc.

There could be some additional checks and balances as referred to in Section 6.2.(I) while categorizing the cases into least complex and most complex.

A large portion of the long pending applications pertains to information technology IT/ ITES followed by other sectors. Therefore, given the extensive experience of the Indian APA teams in dealing with such IT/ITES cases, efforts should be made to conclude such standard rather low complexity/risk cases as part of a “framework” (agreeing on a specific rate/margin). Such an approach would clear large part of the pending cases. For the balance cases involving high and medium complexity cases, appropriate attention can be given by the respective teams. This would also reduce the workload to greater extent and brings in quality and efficiency in terms of closing some complex matters.

## **II. Allocate additional and specialist resources to the APA team**

The Indian APA programme has seen some of the best people in administrative as well as operational roles. However, with the promotions and retirements, unfortunately some of these senior officers had to move out of the APA regime. Given the current backlog of cases, the Government can support the APA programme by bringing back some of these experienced officials, on special duty, to help in resolving all pending APA cases. This can be done in specific window (say for 6 months or so). Further, the services of such senior and experienced officials can be availed for resolving “high” and “medium” complexity cases so that appropriate attention is given to resolve the pending backlog on priority basis. Further, support can be requested from third party industry experts to quicken up the process.

With faceless assessment in place, the Indian APA team can also get some support from the Technical Unit specializing in TP matters to support resolution of existing backlog of APA cases specifically involving “low complexity/risk” or “framework” cases. This can be done in specific window (say for 6 months or so). The support from Technical Unit would also be helpful in faster revenue collections from standard APA cases.

## **III. Use online media for preliminary consultations, site visits and negotiations**

It is relevant to note that the coronavirus pandemic has changed the working style across industry sectors and government organizations. Under the pandemic constraints, there has been greater dependence on the virtual working modes. The new working ways have brought tax administrations around the world closer. In fact, the US Internal Revenue Services has noted that such virtual environment has actually helped in more closure of APA cases due to greater collaboration<sup>2</sup>. CBDT too should consider adopting virtual ways to connect with taxpayers and tax authorities for certain APA stages in order to enable speedy resolutions. This includes increased use of technology for site visits and for other negotiations as well.

In most of the standard cases such as IT/ITES, a site visit can be completed quickly and through online media (e.g. video conferencing, conference calls). The CBDT can consider permitting “lite versions” of the site visits - to be conducted either through conference calls, management representation at APA office or electronically through video conferencing. This would optimize costs and provide flexibility to the APA teams and taxpayers in terms of availability of personnel. Thereafter if required, the APA team can decide as to whether a full-fledged physical site visit is required or not. Further, in cases involving specific transactions (such as financial transaction), option to conclude APAs without site visit should also be included.

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<sup>2</sup> Andrew Velarde, Virtual Environment a Boon to IRS Mutual Agreement Work, Tax Notes Today (12 February 2021).

#### **IV. “Accelerated APA” - special window for clearing up old cases**

Similar to the Vivad Se Vishwas Scheme, the Government can also introduce a limited period window i.e. “Accelerated APA” to clear all backlog of APAs wherever the site visits are concluded or where limited fact finding is needed. For this purpose, as mentioned above, depending on the complexity and risk, additional teams (with people who have extensive experience as well as use of Technical Unit) can be allotted to resolve the pending cases. This approach could very well be appreciated by the investor and taxpayer community.

#### **V. Fast track APA renewals**

APA renewals could be expedited in cases where facts have remained unchanged from the original APAs. In such cases, site visits could be exempted to achieve faster closure. Countries such as US and Denmark have also introduced measures for fast tracking of APA renewals cases. Given such international best practices on APA renewal, similar process is recommended in India so as to bring quick closure to APA renewal cases.

#### **VI. Delegation of authority for approval of APAs**

As highlighted earlier, there is a long-time gap between processing of APA file and conducting site visits. This is primarily because there are multiple levels of approvals within the APA programme. To reduce the time lag, it is suggested that depending on the complexity level, the authority for approval can be delegated. High complexity cases may be approved by CBDT members whereas the approvals for medium risk can be delegated to the Joint Secretary – FT&TR Division and low risk cases can be approved by Chief Commissioner of Income Tax (APA). Such delegated approval ladder would quicken the process of resolving APA cases.

Even the TP orders are currently passed in a similar way as suggested above. Depending on the risk factors, Joint Commissioner can approve some orders for medium to low risk cases whereas Commissioners would only look at the approval of high-risk cases. Reference can also be made to mutual agreement procedure (MAP) resolutions where officials at Commissioner rank would have the power to negotiate and agree on range of margins which are broadly well within the blanket approval given by CBDT.

### **4.2 Structural measures**

#### **I. Bring necessary changes to safe harbour rules to reduce the load on APAs (which are perceived as the only option for tax certainty)**

The safe harbour rules may be rationalized (based on trends in concluded APAs) to make them more attractive for taxpayers, so that the burden on APAs can be reduced. The safe harbour rules must cover additional sectors/ transactions to ensure maximum coverage. The intention should be to reduce the risk of double taxation by ensuring that the rate isn't beyond arm's length range and reduce the substantial compliance costs.

**The key benefit of this suggestion is that the eligible taxpayers would also start looking at simple and easy to follow certainty routes, thereby reducing the load on APAs.**

## **II. Issue detailed APA guidance to set the right expectations**

It would be useful to inform both tax authorities and taxpayers as to what would be acceptable filing positions, expected documents/ information for effective negotiation, minimum expectations of the Government from such APAs (sector-wise) and possible resolution. This would reduce the uncertainty and subjectivity (to some extent) specifically on the APA process and brings in much required consistency and uniformity across all APA Commissionerate. This would also provide a basis for much speedier APA resolutions. In order to enhance the clarity, possibility of publishing actual APA outcomes in some complex matters on an anonymous basis, may also be considered just to show-case how both tax authorities and taxpayer worked together to resolve the matter.

**The key benefit of this suggestion is that this would set the expectations from the taxpayers for speedy APA resolutions.**

## **III. Opt-ins for “roll forward” for APA renewals**

One of the key hindrances of the APA renewal programme is the time taken to conclude the renewal, even though the facts and circumstances are the same. APA renewal process essentially repeats the entire original APA process, requiring submission of documents from scratch, site-visits and filing detailed responses rather than leveraging the work done in the original APA.

It is suggested that in year 5 of the APA term, an option should be given to the taxpayers to opt in for “roll forward” the ongoing APA upon establishing the fact that there would be no change in the facts, functional profile and other circumstances of the APA. Taxpayers can provide a management representation by way of a meeting with APA teams or by way of a written confirmation. Having such an option in the year 5 greatly saves the time in rolling forward the APA benefits. In this regard, it is also useful to look at some of the country practices in relation to “roll forward” options such as Germany and China who provide for simpler forms for such extension requests.

**The key benefit of this suggestion is that this relieves a lot of burden on the APA officials; thereby enabling them to focus on key APA cases which have more revenue potential.**

## **IV. Endeavor to conclude APA in a timely manner**

As discussed above, there is no stipulated time for closure of APA cases under the law. This leads to delays (whether intentional or unintentional) both at the end of taxpayers and APA teams. A firm commitment on time for closure will make both taxpayers as well as APA team accountable for speedy resolution. In cases where taxpayers are non-responsive, the CBDT could direct the APA application to be closed after providing an opportunity of being heard within a reasonable time (say 6 months) and clear the pending inventory. Further, efforts should include quick timelines for issue of questionnaires, site visit map, expected timeline for negotiation and closure, thereby reflecting the strong commitment to close APAs in a time bound manner.

**The key benefit of this suggestion is that it expedites the closure; thereby leading to faster collection of revenues for the Government. It also brings in more efficiency in the overall process.**

#### **V. Bring transparency in the overall APA process**

One of the concerns is the lack of transparency in providing the taxpayers the basis of negotiations as well as movement of APA cases within APA teams and the CBDT. In the absence of adequate information from APA teams, taxpayers are unable to have conversations with their foreign counterparts in a meaningful manner. They are also unaware about the status of the application. With greater digitalization, we recommend that the process be made online wherein all the status of each application can be seen on the dashboard of respective taxpayers' profile on the Income Tax e-Filing Portal with clear information on the below elements:

- ▶ Status of pending application, where it is pending including the official's details (who is reviewing the file) as well as reason for such pendency and time left to resolve the APA case.
- ▶ Basis for arriving at a particular rate/ margin
- ▶ E-filing will allow expeditious handling and maintenance of voluminous documents/records.

**This will be helpful in bringing in transparency in the overall process and help in forecasting a reasonable time for closures.**

#### **VI. Keeping the regular TP assessment in abeyance during the APA process**

Currently, the time limit for concluding assessments does not consider keeping TP assessment under abeyance or extending the time limit until the signing of APA for the APA covered years including roll back. Further, the Income-tax Act, 1961 does not provide for suspension in collection of tax until signing of APA. This results in administrative inconvenience for the taxpayers to simultaneously go through the rigorous assessment proceedings despite having opted for APA regime. Given the inordinate delay in APAs, the Government can consider extending the time limit for completing TP assessments for APA applicants/ APA covered international transactions by a couple of years on putting the assessment on hold for the period when the APA is pending. Such interim period could be excluded for purposes of the statutory assessment timelines. Similar practices or rules for keeping the assessments in abeyance or deferral of assessments are followed in countries such as the US, Australia, Germany and Hong Kong, as part of their bilateral APA or MAP programme. Also, if the APA does not get concluded within the prescribed time as mentioned above, possibility of having a "blocked assessment" for the APA covered years can also be recommended in order to bring in efficiency for the CBDT.

**The key benefit of this suggestion is that it would bring in "ease of doing business" for the taxpayers and encourage them to opt for APA route.**

#### **5. Conclusion**

APAs have contributed to the Government's commitment to a non-adversarial tax regime and faster revenue collections. We believe timely conclusion of APAs will continue to help achieve the programme's objective of:

- a) providing certainty,
- b) collecting fair amount of taxes on timely basis,
- c) promoting non-adversarial tax regime, and
- d) boosting the country's attractiveness to foreign investors
- e) improving India's ease of doing business quotient

The suggestions above may be considered, and necessary steps may be taken to strengthen the APA programme.

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