

# A Decade of India's APA Program: Why It Still Makes Sense

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In this article, the authors provide an overview of India's advance pricing agreement program, including key benefits to taxpayers and some of the difficulties being addressed by tax authorities.

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In 2001 India enacted transfer pricing legislation codified in the Income Tax Act, 1961. Within a decade of enactment, India came to be recognized as a jurisdiction with an extremely aggressive transfer pricing audit regime. Although initially proposed in 2009,<sup>1</sup> provisions governing the advance pricing agreement program were not enacted until 2012 when the Ministry of Finance introduced the APA program within Finance Act 2012 under the ITA. Given the aggressive positions being adopted and litigated by the Indian Revenue Authority (IRA) the decade of uncertainty regarding the status and fate of the APA program in India caused a lot of concern among large taxpayers. As such, the introduction

of the APA program (which was followed by the introduction of APA rollback regulations in 2015) was celebrated by taxpayers.

### Overview of the Indian APA Program

Under the ITA, a dedicated transfer pricing division was formed to conduct transfer pricing audits. As a result of aggressive audits, tax litigation increased significantly. Consequently, despite the availability of a large pool of skilled workers and low operating costs, India's image as a favored investment destination suffered.

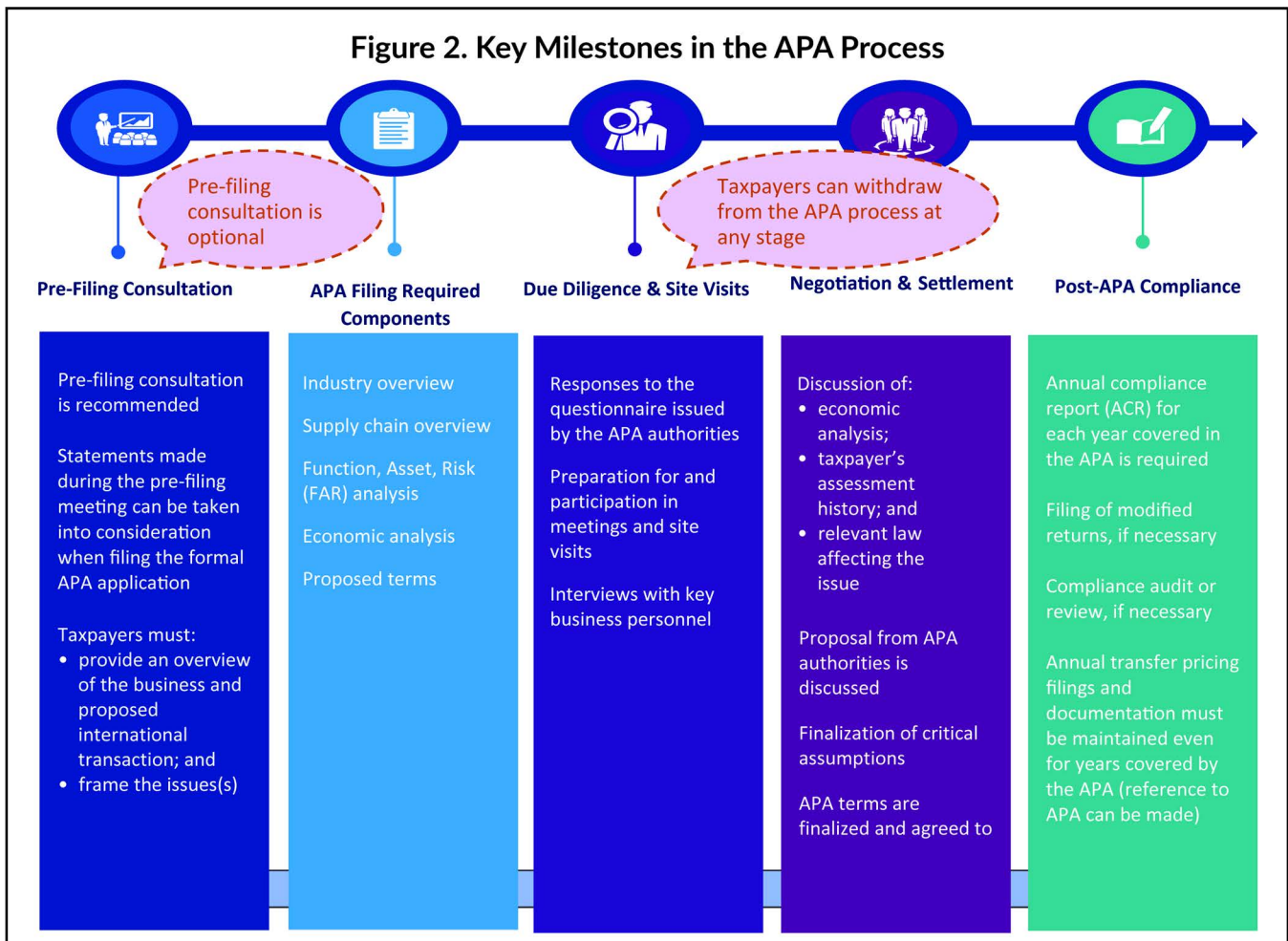
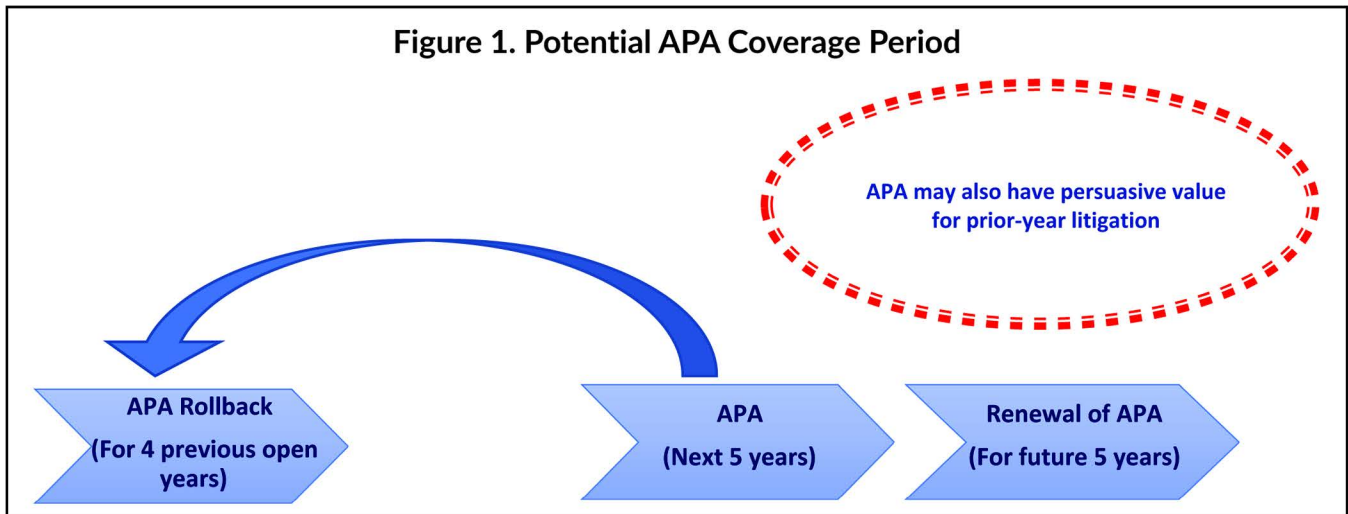
Although taxpayers could seek advance rulings, the rulings were limited to the determination of the taxability of transactions and did not cover the arm's-length determination under the transfer pricing provisions. Moreover, India does not have an administrative (that is, non-litigation) dispute settlement mechanism similar to what is available in other countries, such as the United States and the United Kingdom.

While the Indian government did try to overcome these challenges by introducing alternative dispute resolution mechanisms such as the Dispute Resolution Panel,<sup>2</sup> in practice, these programs were not effective. Also, India's lengthy litigation process resulted in a backlog of cases in tax courts and resulted in taxpayers having to remit all or a portion of the proposed tax assessment pending the outcome of the litigation.

The difficulties in expeditiously resolving transfer pricing disputes led to the introduction of the APA provisions by the Central Board of Direct Taxes (CBDT). The introduction of APA

<sup>1</sup>The APA provisions were initially included in the proposed Direct Taxes Code (DTC) in 2009 and again in 2010. However, the DTC was never enacted and the APA provisions were thus collateral damage.

<sup>2</sup>The Dispute Resolution Panel was introduced as part of the Finance Bill 2009 and was formed with the goal of providing a "speedy disposal" of transfer pricing disputes in a matter. Notes on Clauses to the Finance Bill, 2009 [Budget 2009-2010].



legislation was a game changer in addressing the aggressive transfer pricing audit regime in India because these provisions provide a proactive and progressive way to resolve or avoid transfer

pricing disputes. Moreover, the APA authorities have been very assertive in ensuring that the APA provisions are implemented in a fair, pragmatic, and positive manner. (See figures 1 and 2.)

## Growing Pains

The APA program was a major initiative of the Indian government toward fostering a non-adversarial tax regime. In almost a decade of APA program evolution, the government has faced several challenges, such as the growing inventory of pending APA applications, staffing of the APA teams, lack of timeliness in concluding an APA, and understanding and analyzing complex intercompany transactions. Indeed, many of these challenges have been acknowledged by the CBDT in its APA annual report for fiscal 2018-2019.<sup>3</sup>

The CBDT has continuously worked to improve the APA program by undertaking various measures, some of which are listed in Table 1.

**Table 1. Summary of Challenges Faced and Actions Taken**

Challenge	Action Taken
Despite investing substantial time and effort in the APA process, an APA covers only a limited period.	APA rollback provisions were enacted allowing a rollback period of up to four years.
Bilateral APA applications were accepted only in cases in which article 9(2) <sup>a</sup> (or its equivalent) of the relevant treaty was implicated.	Guidance was issued to clarify that bilateral APAs can be accepted even if article 9(2) was not included in the relevant tax treaty. This has increased the scope of bilateral APAs with several tax treaty countries, including Germany, France, Italy, and Belgium.
Lack of adequate resources dedicated by the government to the APA teams; initially, there was only one APA office located in New Delhi.	The APA teams are being expanded. Teams are now also stationed in Mumbai and Bangalore. Resources have also been reallocated from audits and litigation to the APA teams.
APA applications were required to be paper filed at one location in New Delhi.	Because of the pandemic, APA teams have been accepting electronic applications via email.
<sup>a</sup> Article 9(2) of the Indian DTAA with most countries covers transactions between associated enterprises.	

<sup>3</sup> Indian Income Tax Department, "Advanced Pricing Agreement (APA) Programme of India, Annual Report (2018-2019)" (Nov. 2019).

Also, APA provisions were recently expanded for those signed after April 1, 2020, to permit agreement on profits attributable to a permanent establishment in India.

All the steps taken by the Indian government demonstrate that it is aware of the challenges faced by taxpayers and is willing to make changes to the APA program to ensure that it is successful.

## Indian APA Internal Organizational Structure

Two divisions within the CBDT process APA applications. The first is the competent authority of India. Within this division, there are the joint secretary (FT&TR-I) in the MOF and representatives (that is, one director and two undersecretaries). The Indian competent authority processes bilateral and multilateral APAs. (See Figure 3.)

The division that processes unilateral APA filings is led by the principal chief commissioner of income tax. There are four APA teams, each headed by a commissioner of income tax who is in turn supported by additional/joint commissioners of income tax and deputy/assistant commissioners of income tax. The APA commissioners are based in New Delhi, Mumbai, and Bangalore.

## Indian APA Program: Results Achieved

The number of APA applications filed and agreements concluded is indicative of the maturation and growth of the Indian APA program since its founding in July 2012. Taxpayers have managed to obtain certainty on transfer pricing issues for a period of five to nine years (depending upon whether rollback provisions are applicable) with the potential for extending or renewing the APA for an additional five years. Thus, it is possible for taxpayers to obtain certainty for a 14-year period. Figure 4 shows some key statistics of the APA program.

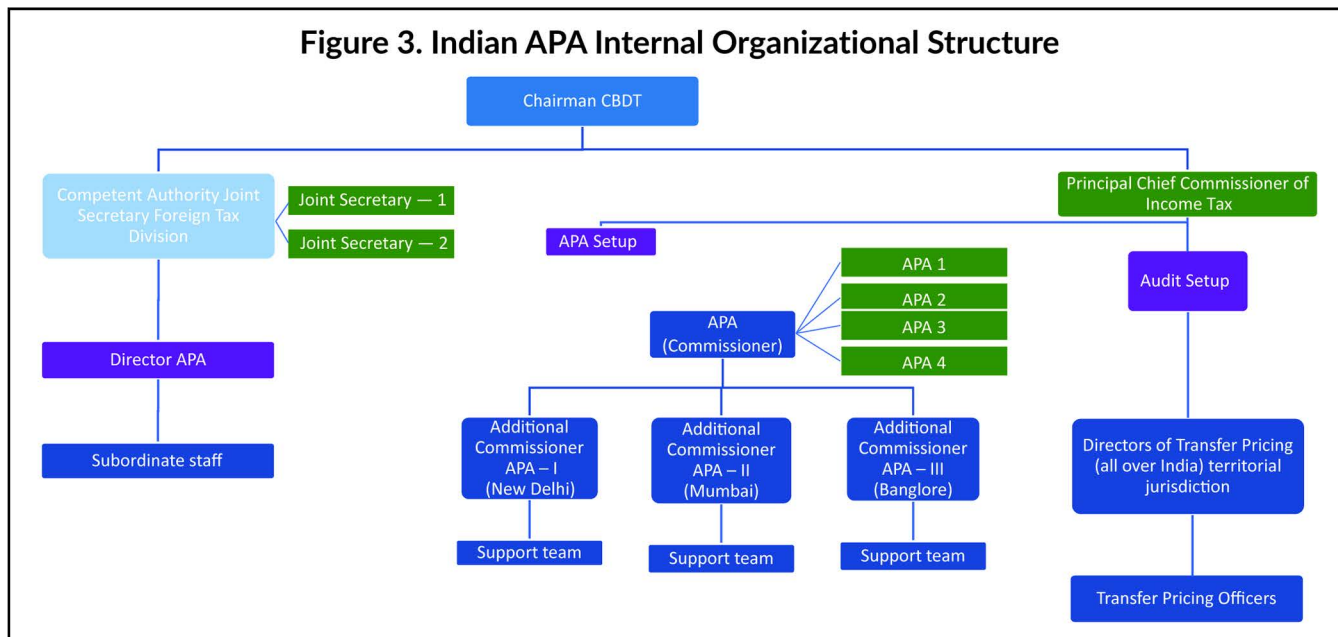
The APA annual report for fiscal 2018-2019 includes several notable points, as shown in Table 2.

## Other Key Highlights

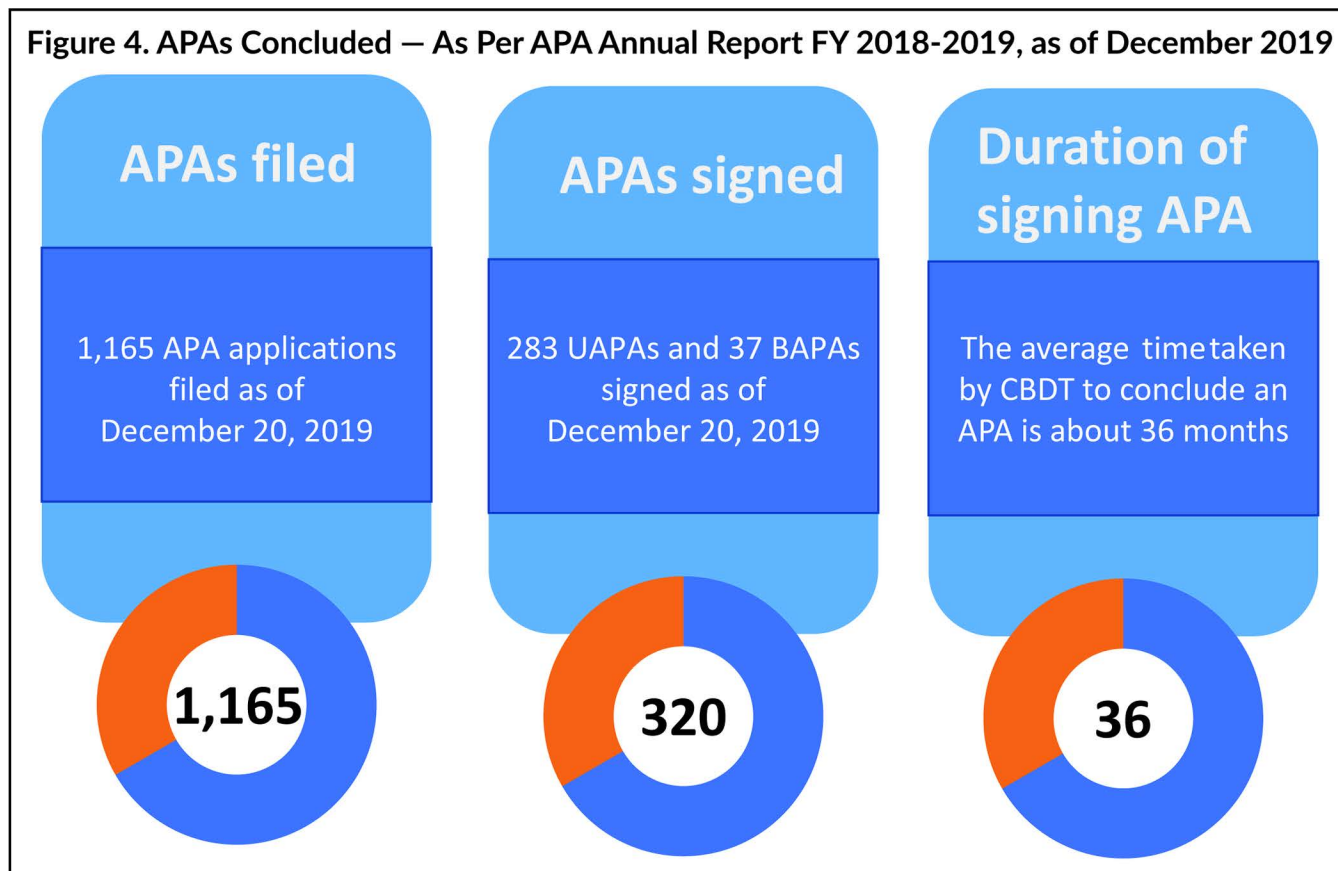
Figure 5 shows a summary of the economic activities performed by the taxpayers in the 41 unilateral APAs concluded in 2018-2019. Figure 6



**Figure 3. Indian APA Internal Organizational Structure**



**Figure 4. APAs Concluded – As Per APA Annual Report FY 2018-2019, as of December 2019**



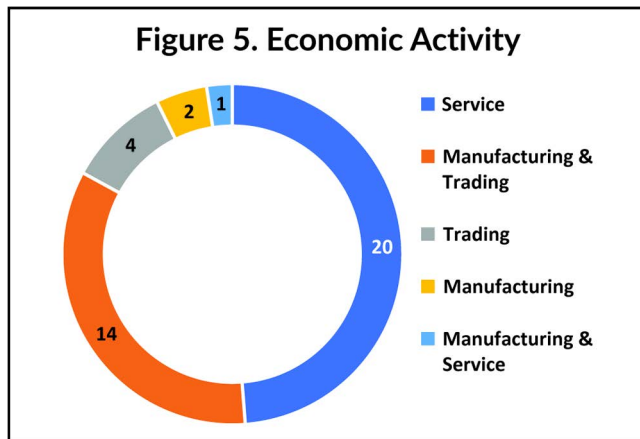
provides a breakdown the industries covered in the unilateral APAs concluded in 2018-2019.

**Experience During the Pandemic**

It is noteworthy that the CBDT has already started signing unilateral APAs using the new remote signing mechanism introduced because of the COVID-19 pandemic. This enables unilateral

**Table 2. Selected Findings From the APA Annual Report**

Significant transactions covered in signed APAs	<ul style="list-style-type: none"> <li>• Payment of royalties, including license fees</li> <li>• Receipt of administrative or technical and other support services</li> <li>• Purchase of semifinished or finished goods</li> <li>• Provision of IT and IT-enabled services</li> <li>• Payment for management services</li> </ul>
Transfer pricing method adopted	In unilateral APAs, the transactional net margin method (one-sided method) <sup>a</sup> and the “other method” are adopted in most cases. The profit-split method is adopted in a large number of bilateral APAs, which evidences the complexity of covered transactions.
Spike in filing of bilateral APAs in recent years	<p>Bilateral filings constitute almost one-third of total applications filed. Reasons for the increase include:</p> <ul style="list-style-type: none"> <li>• willingness to accept bilateral APAs even in the absence of article 9(2) in the relevant double tax avoidance agreement;</li> <li>• bilateral APAs provide complete relief from double taxation; and</li> <li>• successful resolution of many bilateral APAs with several countries, including Japan, the United Kingdom, the United States, Australia, Switzerland, and the Netherlands.</li> </ul>
<sup>a</sup> The transactional net margin method is known as the comparable profits method in the United States.	



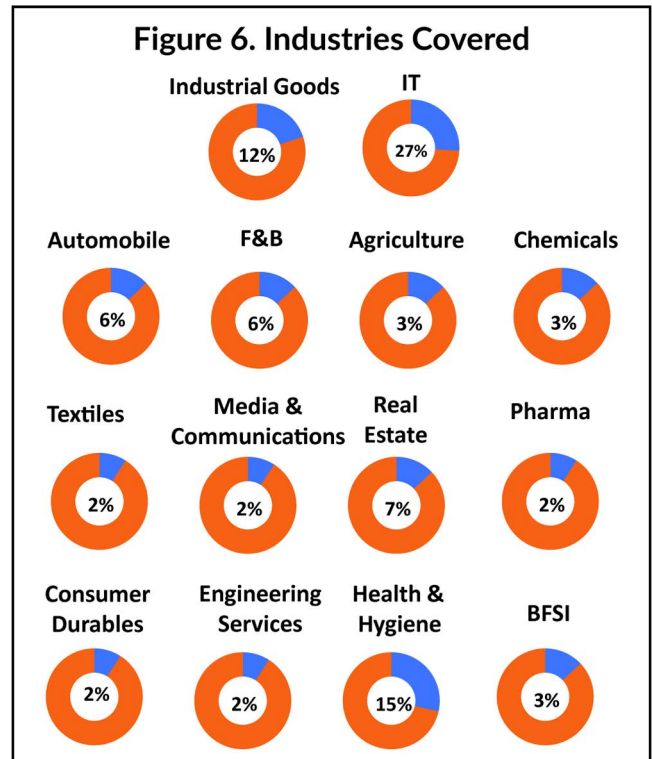
APAs to be finalized despite difficulties presented by the pandemic.

**Comparing APA Programs**

Table 3 compares Indian APA program statistics with those of other major countries based on the latest available annual reports.

The statistics demonstrate that although the Indian APA program is in its infancy compared with most other countries, it has achieved success based on both the number of applications received and the number of APAs concluded. In fact, India concludes both unilateral and bilateral APAs quicker than both the United States and Canada. There is, however, still room for improvement when compared with the United Kingdom and Australia.

For bilateral APAs, India’s top partner countries are the United States, the United



Kingdom, Japan, Switzerland, Australia, and Singapore. Almost 80 percent of bilateral APA applications are with four countries — the United States, the United Kingdom, Japan, and Switzerland.<sup>4</sup> It is interesting to note that the bilateral APA program between India and its

<sup>4</sup>Id.

**Table 3. Key Statistics From Selected Jurisdictions**

Particulars	India	United States	United Kingdom	China	Australia	Canada
Period of statistics	FY 2013-2019	FY 1991-2017	FY 2012-2017	FY 2005-2016	FY 2012-2016	FY 2012-2016
APA program in place	FY 2012-2013 (7 years)	1991 (27 years)	1999 (19 years)	1990 (28 years)	1991 (27 years)	1990 (28 years)
APAs filed	1,155	2,346	265	—	332	161
Unilateral APAs	944	570	—	—	191	—
Bilateral APAs	211	1,364	—	—	135	—
Multilateral APAs	—	11	—	—	—	—
No data available	—	401	—	—	6	—
APAs signed	271	1,713	166	139	197	161
Unilateral APAs	240	590	—	84	94	—
Bilateral APAs	31	1,108	—	55	103	—
Multilateral APAs	—	15	—	—	—	—
Average time to close unilateral APA (months)	32.5	40.4 <sup>a</sup>	26	Majority < 1 year	13.06	40.3
Average time to close bilateral APA (months)	44.32	46.9	—	50% < 1 year	19.87	49
Number of years covered in APA	5 years	5 years	5 years	5 years	5 years	5 years
Rollback available	Yes — 4 consecutive previous years	Yes — no specific number of years	Yes — no specific number of years	Yes — max 10 previous years	Yes — no specific number of years	Yes — no specific number of years

<sup>a</sup>The United States had an average timeline of 35.4 months for unilateral APAs and 47.8 months for bilateral APAs in 2018. Indian Central Board of Direct Taxes, “Advance Pricing Agreement (APA) Programme, Annual Report (2018-2019)” (Nov. 2019).

largest trade and treaty partner — the United States — only began in early 2016. Since launching its bilateral APA program with India, the United States tops the list of countries with which bilateral APA applications have been filed, followed by the United Kingdom and Japan.

### Ongoing Challenges

Although the APA program has assisted the Indian government in portraying a positive image on the tax enforcement front, there are challenges that need to be overcome to make the APA program an even bigger success. Some of these challenges are discussed below.

### Ongoing Compliance

The law does not provide an exemption from preparation of the annual transfer pricing documentation and the filing of Form 3CEB even in cases in which an APA has been signed. Although some APAs provide an exemption from maintaining annual documentation, taxpayers must still file Form 3CEB. Consequently, taxpayers incur additional costs and expend effort even though an agreement has already been reached.

### Team Strength and APA Offices

The number of individuals responsible for handling APA applications is disproportionately

low when considering the year-over-year increase in APA filings and the number of unresolved cases. This is especially true given that all APA applications require an in-depth study of the facts and often involve complex transactions.

Exacerbating the issues is the fact that APA officers are periodically transferred to different divisions resulting in a lack of continuity for both the government and the taxpayer. To that end, expanding the size of APA teams and ensuring that consistent teams are in place would go a long way in helping India reduce the time needed to conclude an APA and putting its timeline on equal footing with other tax jurisdictions.

Although the APA program originally included provisions for the inclusion of experts in the field of economics, statistics, and law, those experts have yet to be added to the APA teams.

Also, APA Commissionerates are stationed in only three cities — New Delhi, Mumbai, and Bangalore. Expansion into other cities would alleviate logistical burdens for many taxpayers.

### Revisiting Positions in Renewal Applications

Renewal applications are filed by taxpayers when the APA term has ended. While some renewal applications are completed in a short period of time when compared with the original APA application, this is not true for all. In many renewal cases, the APA authorities revisit the function, asset, and risk analysis when the facts remain materially unchanged from the original APA. In some cases, the APA authorities insist on a higher markup or profitability for the Indian entities even when the facts have not changed. This leads to a lack of certainty for applicants contemplating an APA renewal even when the facts are unchanged.

### Less Negotiation Power in Unilateral APA

When entering a unilateral APA, the Indian tax authorities make the most of their negotiating power and generally insist on a higher markup for the same transaction than they would in the bilateral APA. Thus, taxpayers who enter a unilateral, instead of a bilateral, APA often end up in a worse position.

### APA Relief to Reduce Markup Cannot Be Granted

APA authorities interpret the transfer pricing legislation as prohibiting them from negotiating

an outcome that results in a reduction of income below what was originally reported by the taxpayer. Therefore, taxpayers are not able to achieve an outcome in an APA that is more favorable than their existing positions.

### Standardization of Similar Transactions

Although there are some cases in which a taxpayer's specific facts are considered, it is often the case that the APA authorities are guided by predetermined terms and arm's-length ranges irrespective of the taxpayer's specific facts, especially if the matter involves IT or IT-enabled services transactions.

### Taxpayer Information Firewall Needed

There is no provision within the ITA that safeguards taxpayer information and prevents the misuse of confidential information the taxpayer shares with the tax authorities during the APA proceedings. Hence, there is a possibility that the information disclosed could be used against the taxpayer in subsequent proceedings if the APA negotiations fail. The lack of a safeguard preventing the misuse of information can have a chilling impact on discussions between the tax authorities and taxpayers.

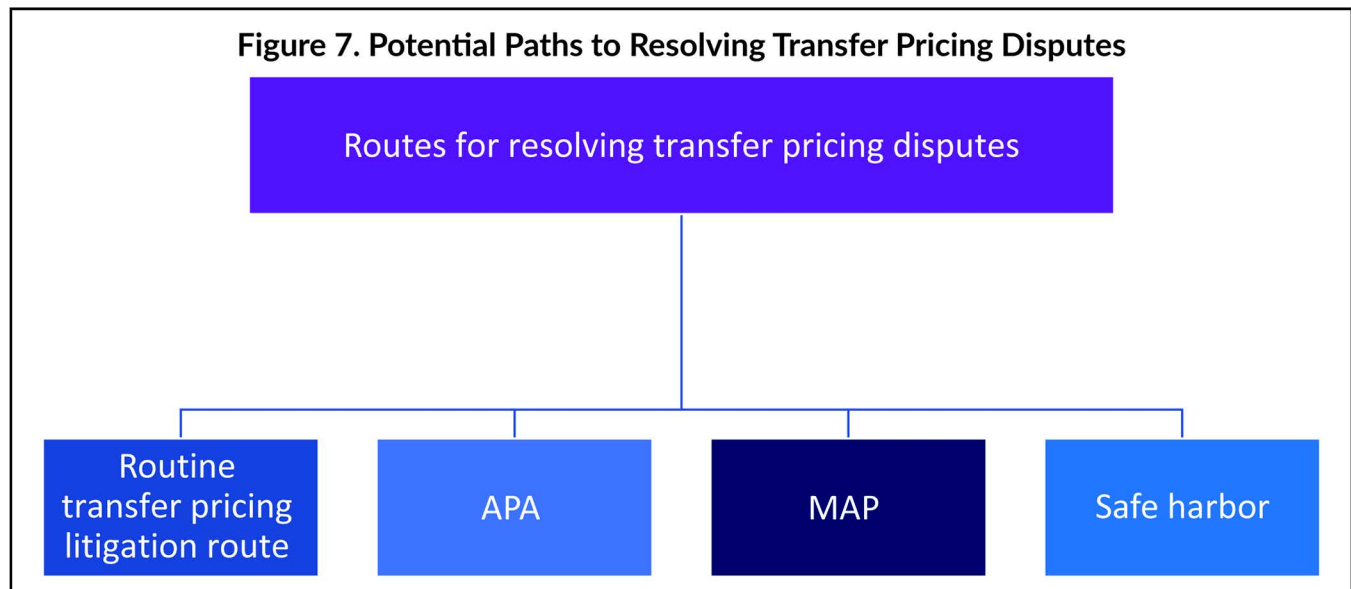
### Detailed Post-APA Audits

Upon conclusion of an APA, taxpayers are required to undertake annual compliance measures, which are then audited by tax authorities. These audits are intended to ensure that taxpayers have complied with the critical assumptions and other conditions agreed to in the APA. In some post-APA audits, tax officers have attempted to expand the scope of their examination beyond their jurisdictional powers (that is, compliance with the APA provisions). However, the Indian government has recently announced its intention to have post-APA audits conducted by a separate set of officers to alleviate this issue and ensure a smoother post-APA audit for the taxpayer.

### Available Alternatives to APA: A Comparison

There are alternatives to an APA that taxpayers can take advantage of to resolve a transfer pricing dispute. These are shown in Figure 7.





### Routine Transfer Pricing Litigation

This option relates to a routine transfer pricing assessment conducted by tax officers. In this case, a taxpayer has two potential paths:

- appeal to the Commission of Income Tax (Appeals); or
- apply to the Dispute Resolution Panel.

After the order or direction is passed by the commission or Dispute Resolution Panel (that is, a decision has been made), a taxpayer may still challenge the adjustment by appealing to the Income Tax Appellate Tribunal and then, if necessary, to the High Court and the Supreme Court. Figure 8 depicts the process.

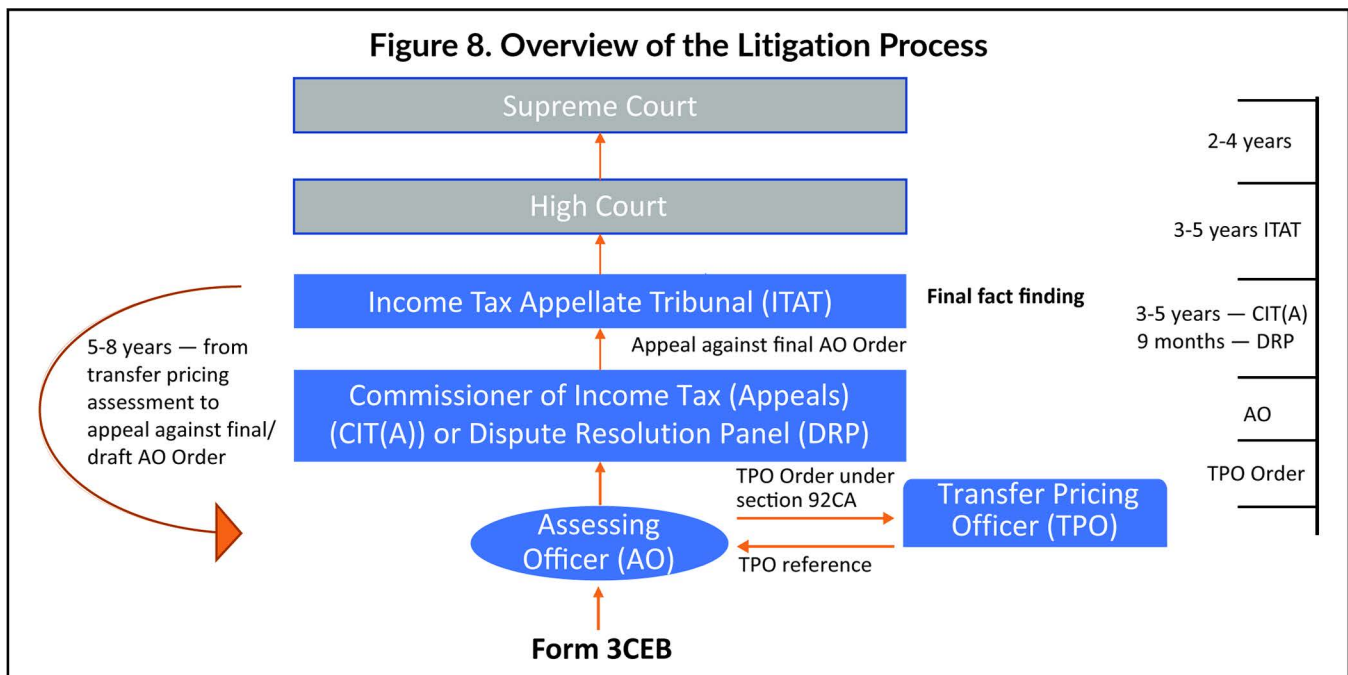
The primary issue with this route is that it generally takes eight to 12 years for a dispute to be resolved. Most of the transfer pricing litigation gets slowed in the appellate channels, which causes the taxpayer to incur costs (including payment of the tax due pending a final decision) and expend significant resources. Another challenge is that the markup suggested is at times substantially higher than that suggested in the safe harbor provisions (discussed *infra*), which already provide a government-favorable markup range. Compounding the issue is that the interest that accrues on confirmed adjustments is 12 percent. The aggressive stance in domestic audits has remained unchanged, and recent audit cycles have shown the tendency of tax authorities to make large assessments. For instance, a recently

concluded audit cycle proposed a median markup of approximately 26 percent for IT companies and approximately 24 percent for IT-enabled services companies.

Moreover, the Indian assessment regime is moving toward a faceless regime (e-proceedings). Although the faceless audit regime does not cover cross-border transfer pricing (it does include domestic transfer pricing cases), the government is expected to enact legislation expanding the faceless audit regime to cover all transfer pricing matters. Faceless audits are conducted almost exclusively through written submissions by taxpayers to the revenue authority and thus taxpayers have little to no opportunity to explain the nuances of their position. Moreover, deadlines to provide information are somewhat inflexible and are generally shorter than deadlines in the “traditional” audit sense. As such, taxpayers have less time to gather and assemble the relevant data and present it in a manner that is easy for the revenue authority to review. Consequently, taxpayer challenges are expected to be exacerbated under this regime.

### Safe Harbor Provisions

Safe harbor provisions were introduced in the Finance (No. 2) Act, 2009, to provide certainty, administrative simplicity, and reduce litigation. The revised safe harbor provisions, which were effective from April 1, 2017, reduce the margins for various transactions including IT and IT-



enabled services, knowledge process outsourcing, contract research and development, and intragroup loans. CBDT also introduced safe harbors for low value-added services. Though no formal guidance has been issued, it was recently announced that the safe harbor provisions would be extended to cover profits attributed to a PE.

Although a good idea in theory, the revised safe harbor margins are often higher than what is generally agreed to in an APA. Also, taxpayers are ineligible to use the safe harbor provisions if the value of the transaction exceeds a specified amount. Moreover, even if a taxpayer takes advantage of the safe harbor provisions, preparation of yearly transfer pricing documentation is still required. As a result, the safe harbor provisions have proved to be of limited use in resolving transfer pricing disputes.

### Mutual Agreement Procedure

A mutual agreement procedure can be pursued in addition to, or instead of, domestic procedures. Once a MAP is initiated, the tax demand is generally stayed (depending on the protocol with the countries) until the dispute is ultimately resolved. Thus, if a taxpayer is engaged in a MAP, it does not have to remit the tax due while the MAP is pending. MAPs provide finality to the assessment and thus, if the decision of the competent authority is in the taxpayer's favor, all

proceedings under the ITA for that issue are overruled. Recent guidance published by the CBDT underscores India's commitment to resolving MAP cases within 24 months.<sup>5</sup> However, revenue authorities are not required to reach a resolution in a MAP.

Further, although these requests are often granted, MAP provisions do not require the competent authorities to provide taxpayers with an opportunity to present their cases either in-person or via written submission. The taxpayer may therefore lose a bit of "control" when initiating a MAP. There have also been instances in which taxpayers are assessed penalties when a MAP resolution has been reached between the competent authorities and the taxpayer agrees to the resolution. This could deter taxpayers from entering into a MAP. Also, a taxpayer's case could be delayed if the competent authorities of the countries involved in the MAP disagree on a similar issue in a MAP for an unrelated taxpayer. In other words, a taxpayer's case may be delayed, or the result could be influenced, because a similarly situated taxpayer presented the same issue.

<sup>5</sup> CBDT, MAP Guidance/2020, F.No. 500/09/2016-APA-I (Aug. 7, 2020).

**Table 4. Comparative Analysis**

Particulars	APA	Safe Harbor Provisions	MAP
Coverage for past years	Yes	No	Yes
Coverage for future years	Yes	Yes	No
Maximum period of coverage	14 years (4 rollback years + 5 years covered + 5 years under renewal)	5 years	Only past years, subject to tax treaty between India and respective country
Transaction value threshold	No	Yes	No
Unilateral settlement	Yes	Yes	No
Opportunity to participate in the proceedings	Yes	Yes	Not guaranteed

**Conclusion**

While each of the above-discussed dispute resolution mechanisms have their pros and cons, based on our experience, the protections afforded by an APA typically make it the favored approach.

Some of the benefits of the APA program are shown in Figure 9.

Thus, while the APA program has its share of challenges, when considering the potential alternative approaches, the advantages an APA offers far outweigh its shortcomings. Taxpayers, especially those with complex transactions or stable and predictable business models, should therefore consider entering into an APA to achieve certainty for a number of years.

**The Path Forward**

Overall, the Indian APA program has been a success in its early years. Although the introduction of APA provisions in India generally lagged behind other revenue authorities, the Indian APA authorities have done well to meet the global benchmarks in terms of achieving APA closures. Taxpayers that have signed an APA have experienced the practical approach of the APA team in recognizing business realities.

In 2017 KPMG India conducted a survey on the experience of taxpayers and tax authorities, and the responses received have been summarized in Figure 10.

The issue of profit attribution to a PE has resulted in a lot of litigation, and courts have

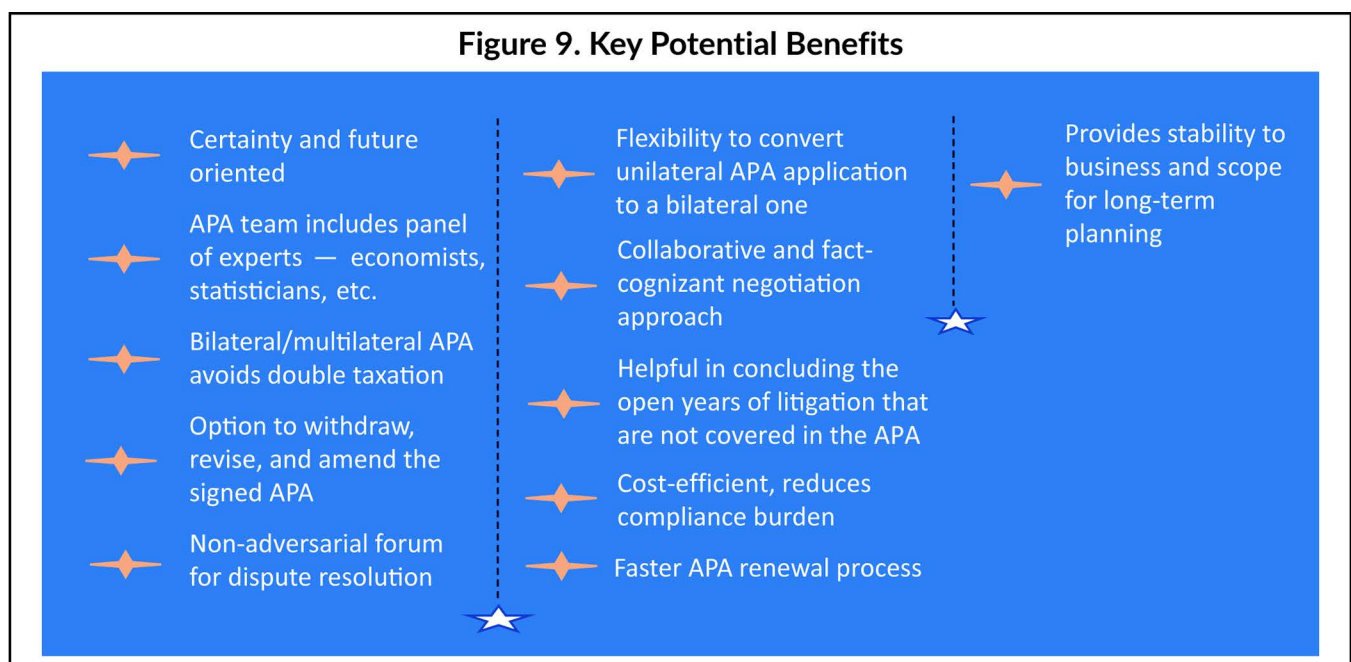
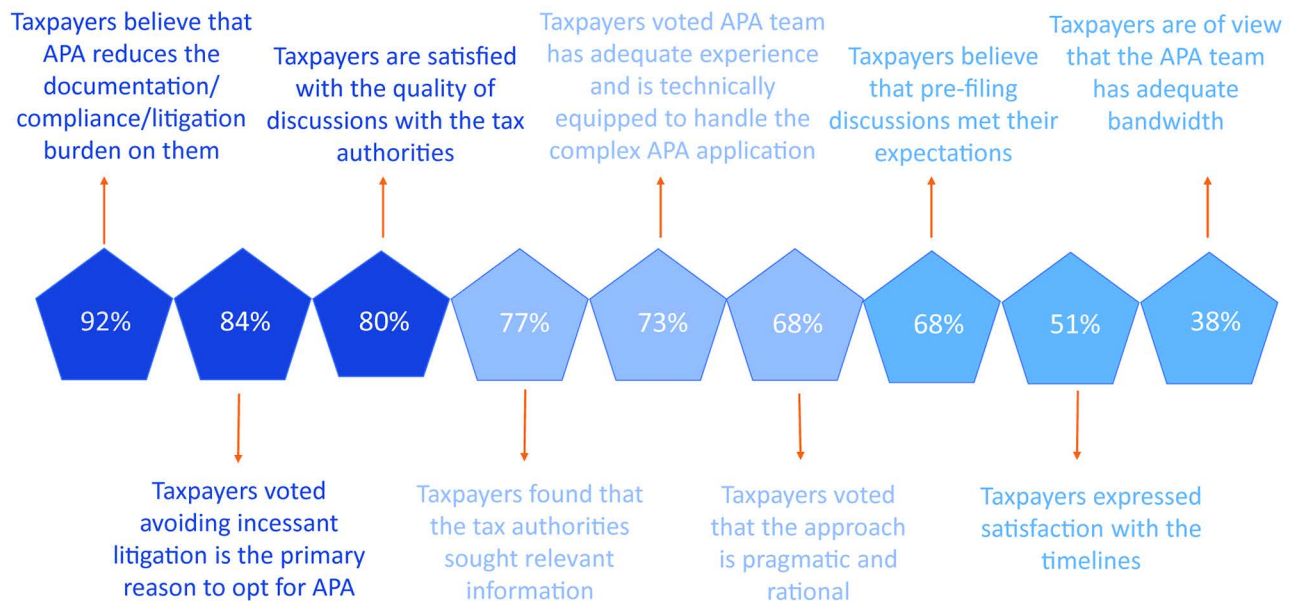


Figure 10. Summary of Findings



Source: KPMG, "Advance Pricing Agreement Survey Report 2017" (May 2017).

reached different conclusions. Accordingly, the action of the Indian government in extending the APA program to cover issues relating to profits attributed to PEs will go a long way in resolving disputes and avoiding litigation.

While there is still room for improvement, the Indian government has time and again demonstrated its commitment to improving the APA program and providing it with appropriate resources. Virtual site visits, virtual meetings with competent authorities, APA agreements signed digitally because of COVID-19 pandemic constraints, and other recent measures, like the extension of the APA program to cover issues relating to profit attribution to a PE, are concrete examples of the Indian government's commitment. The government is also determined to reduce the time it takes to conclude unilateral

APAs, and the experience gained in handling complex transactions over the past decade is expected to aid this objective. Consequently, the APA program continues to remain at the forefront of the various tax dispute resolution mechanisms.<sup>6</sup> ■

<sup>6</sup>The information in this article is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the authors only and does not necessarily represent the views or professional advice of KPMG LLP.

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