



TAX COOPERATION POLICY BRIEF

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A Decade of the Indian Advance Pricing Agreement Programme: Achievements and Challenges

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ABSTRACT

India's Advance Pricing Agreement (APA) programme was introduced in 2012 with the objective of reducing transfer pricing disputes and providing certainty to taxpayers on their international transactions. In the last decade or so, the programme has proven to be a successful dispute mitigation and resolution mechanism. The authors use data and statistics from a recently released report by the Central Board of Direct Taxes (CBDT) in India to highlight the success of the programme, while also acknowledging the challenges ahead, especially as taxpayers' expectations from the programme continue to rise.

KEYWORDS: Advance Pricing Agreements, transfer pricing, tax certainty, dispute prevention, Mutual Agreement Procedure

Le dispositif indien d'accord préalable en matière de prix de transfert (APP) a été introduit en 2012 dans le but de réduire les litiges en matière de prix de transfert et de minimiser les risques pour les contribuables concernant leurs transactions internationales. Depuis une dizaine d'années, le dispositif s'est révélé être un mécanisme efficace d'atténuation et de résolution des différends. S'appuyant sur les données et statistiques tirées d'un rapport récemment publié en Inde par le Central Board of Direct Taxes (CBDT), les auteurs du présent document soulignent la réussite du dispositif, tout en reconnaissant les difficultés à venir liées en particulier aux attentes des contribuables à l'égard de celui-ci, qui ne cessent de croître.

MOTS-CLÉS: Accords préalables en matière de prix de transfert, prix de transfert, certitude fiscale, prévention des litiges, procédure amiable

El programa de los acuerdos previos sobre precios de transferencia (APA) de la India se introdujo en 2012 con el objetivo de reducir los conflictos sobre precios de transferencia y ofrecer seguridad a los contribuyentes en sus transacciones internacionales. En la última década, el programa ha demostrado ser un exitoso mecanismo de mitigación y resolución de disputas. Los autores se basan en datos y estadísticas de un informe publicado recientemente por la Junta Central de Impuestos Directos (CBDT) de la India para demostrar el éxito del programa, sin dejar de reconocer los retos futuros, en particular porque las expectativas de los contribuyentes con respecto al programa siguen aumentando.

PALABRAS CLAVES: Acuerdos previos sobre precios, precios de transferencia, seguridad fiscal, prevención de litigios, procedimiento amistoso

KEY MESSAGES

"Objective of Advanced Pricing Agreements (APA) is to reduce transfer pricing disputes and provide certainty to taxpayers on their international transactions in a non-adversarial setting."

"The policy brief highlights the accomplishments of the Indian APA programme while acknowledging the likely challenges that lay ahead as the programme scales up. It also draws lessons from the decade-long Indian experience for other developing countries exploring the establishment of their own APA programmes."

"In a decade of its existence in India, the APA programme has cumulatively brought about litigation-free certainty for taxpayers, for over 3200 years."

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Introduction

The Central Board of Direct Taxes ('CBDT'), the authority responsible for direct taxes under the Indian Ministry of Finance, has recently released¹ the updated report which contains statistics on its decade-old Advance Pricing Agreement ('APA') programme. The statistics provide an expansive overview of the dispute resolution landscape in India while also providing granular details on the pending and signed APAs, bifurcated into Unilateral and Bilateral APAs ('UAPAs' and 'BAPAs' respectively). UAPAs are agreements between the taxpayer and the government while BAPAs are agreements between three parties, namely two tax administrations and the taxpayer.

The APA is an important policy instrument to provide tax certainty and reduce tax disputes for transactions between related parties, usually referred to as 'associated enterprises' ('AE's). The terms typically included in an APA are the arm's length price of an international transaction between AEs, the transfer pricing methodology that would be used to determine the arm's length price, the duration for which the APA would apply, and the 'critical assumptions' under which the APA shall remain valid. Today, a very large share of international trade is accounted for by related party transactions ('RPT's). For context, the share of RPTs in the total international goods trade in the United States (including both imports and exports) was 42.6% in 2020².

Overall, the report paints an optimistic picture of the Indian APA programme. The filing of new APAs, an important indicator of taxpayers' trust in obtaining timely certainty from this programme vis-à-vis other avenues available including the Income Tax Appellate Tribunal ('ITAT'), has bounced back from a low of 74 cases in FY 2021-22 to more than double that figure, with 193 filings in FY 2022-23. Annual signings have also increased to a record-high figure of 95 signings (comprising 63 unilateral APAs and 32 bilateral APAs) in the latest financial year. Over the years, the network of India's bilateral APA partners has also increased, with a total of 96 bilateral APAs now having been concluded, involving agreements

with nine jurisdictions, namely the US, the United Kingdom, Japan, Switzerland, Denmark, Finland, Australia, Netherlands, and Singapore. Of these, the US (45) accounts for close to 50% of the concluded APAs, with the UK (18) and Japan (10) being the other large partners, and the remaining six jurisdictions constituting the balance (25%) of concluded bilateral APAs. However, now that the APA programme has found its stride, it is also important to anticipate challenges that may arise as the programme accelerates.

This policy brief highlights the accomplishments of the Indian APA programme while acknowledging the likely challenges that lay ahead as the programme scales up. It also draws lessons from the decade-long Indian experience for other developing countries exploring the establishment of their own APA programmes.

Key achievements

India's APA programme has matured considerably since its inception in 2012, both in terms of the number of agreements signed, as well as the variety of transactions covered through these agreements. Despite starting relatively late, India signed its 500th APA in the financial year ending 31st March 2023, which compares favourably against statistics of other major economies such as the US and China. India's 500th APA was signed in the 11th year of its APA programme, while the US took 14 years⁴ to reach this milestone. China, which started its APA programme in 2005, has signed only 226 APAs⁵ thus far.

India's performance in the last year is also better than most other large economies, as can be seen from the chart in the next page.

| Financial Year | UAPA Applications | BAPA Applications | Total Applications | Total Signings |
|----------------|-------------------|-------------------|--------------------|----------------|
| 2019-20 | 76 | 50 | 126 | 57 |
| 2020-21 | 100 | 33 | 133 | 31 |
| 2021-22 | 39 | 35 | 74 | 62 |
| 2022-23 | 116 | 77 | 193 | 95 |

Source: CBDT APA Report 2019-20, 2020-21 and 2021-22 and CBDT APA Report 2022-23³

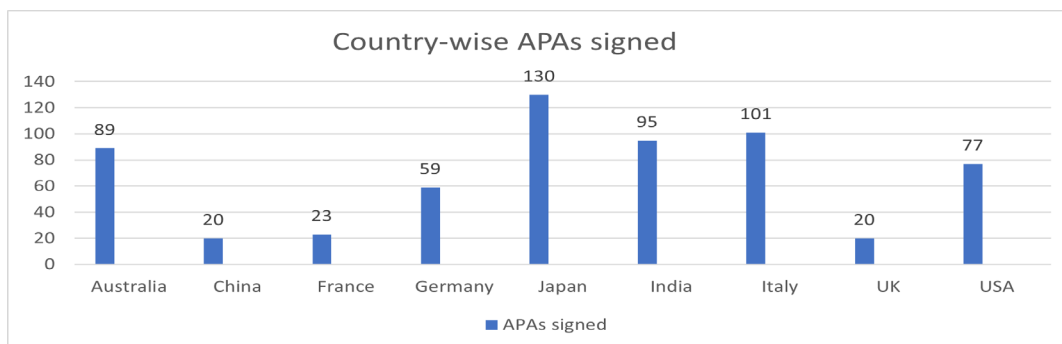
1 CBDT APA Report 2019-20, 2020-21 and 2021-22. Available from <https://incometaxindia.gov.in/Documents/Advance-Pricing-Agreement-APA-Report.pdf>. CBDT APA Report 2022-23. Available from <https://incometaxindia.gov.in/Lists/Latest%20News/Attachments/601/APA-Report-Final-2023.pdf>.

2 US Census Bureau, US Department of Commerce, "US Goods Trade: Imports and Exports by Related Parties, 2020". Available from https://www.census.gov/foreign-trade/Press-Release/related_party/rp20.pdf.

3 See *supra* note 1.

4 US Internal Revenue Service, "Announcement and Report Concerning Advance Pricing Agreements", 31 March 2005. Available from <https://www.irs.gov/pub/irs-apa/a-05-27.pdf>.

5 Annual Report on Advance Pricing Arrangements (2021) - State Administration of Taxation, China. Available from <https://www.chinatax.gov.cn/chinatax/n810214/n810606/c5182942/content.html>.



Source: Authors' compilation

The APA statistics for each country in the chart are based on the most recently available statistics published by these countries, that pertain to 2021-22 for Australia⁶ and the UK⁷, 2021 for China⁸, France, Germany, Italy⁹, and Japan¹⁰, and 2022 for the US¹¹. These countries have been chosen for comparison, because they are among the largest economies in the world with a significant volume of cross-border transactions, and a treaty network¹² similar to India's (which impacts the scope of bilateral APAs, though not necessarily unilateral APAs). India's 96 bilateral tax treaties is in the same range as Japan (78), Italy (103), Germany (94), France (120), and China (102). The UK, with 130 bilateral tax treaties has possibly the largest treaty network in the world, though the US (66) and Australia (45) have significantly fewer treaties than India. These numbers, of course, need to be interpreted with nuance, not just because they do not all pertain to the same time period, but also because each country has designed its APA programme in a way that best serves its interests. For example, some countries like the UK have a stated preference for bilateral APAs over unilateral ones. Bilateral APAs, which involve an agreement between governments of bilateral treaty partners, are more time and resource-intensive, and therefore are fewer in number than unilateral APAs in most countries. Notwithstanding the same, these numbers do reveal that India, despite being a relatively late entrant to the world of APAs, has performed considerably well.

India's APA programme offers certainty to taxpayers for a maximum of nine financial years, with a possible five-year prospective period, and a four-year rollback. At the time of its inception, India's APAs were exclusively "forward-looking", implying that they could only apply to financial years beginning after the date of application by the taxpayer. However, only two years later in 2014, India introduced a legislative provision allowing rollback of an APA for

up to four years. The intent behind this provision, as noted in the Explanatory Memorandum¹³, was to reduce litigation by allowing the agreed transfer pricing methodology to be rolled back to earlier years. Today, the possible nine years of tax certainty through India's APA programme is as high as in most other jurisdictions, with the average length of an APA in the US being 6 years¹⁴, and the UK¹⁵ and Japan also offering covered periods of 3-5 years (with the option of a rollback).

Another important statistic included in CBDT's APA reports is the "ageing analysis" of APAs, which analyses the time taken to sign an APA from the date on which the application was filed by the taxpayer. India's performance on this indicator has been middling, with an average of 44.2 months taken to sign a unilateral APA in India, and 58.7 months to sign a bilateral APA. Admittedly, this is higher than the average time taken in jurisdictions like the US¹⁶ (22.9 months for unilateral and 44.7 months for bilateral APAs in 2022) and Japan¹⁷ (31.6 months on average in 2021), but broadly in the same range as some other major jurisdictions like the UK¹⁸ (58.3 months in 2021-22), Germany (49 months), and Italy (50 months)¹⁹. These numbers would perhaps sound more reassuring from India's perspective, if one considers that APAs in India cover up to nine financial years, which is about the same or higher than in most other jurisdictions.

Some of the other statistics included in CBDT's report also point to the success of the APA programme. One such metric is the number of applications by taxpayers to renew earlier APAs, which reflects an increasing degree of trust in the APA processes as well as outcomes for the taxpayers. Among taxpayers who have signed bilateral APAs involving India and another bilateral treaty partner, 65% have filed applications for a 'renewal APA'. This number would likely increase as more bilateral APAs are concluded, or when the terms of the currently signed APAs end. Though APAs in India, like in many other jurisdictions, are subject to revision and/or cancellation, this can be done only in very restrictive conditions. Some of these conditions include a request by the taxpayer or the other Competent Authority, a change in law that would materially impact the APA, and the breaching of the terms of the APA. The possibility of revising an APA in only specific situations is a strong indicator that the

6 Australian Tax Office, "APA and MAP Statistics 2021-22". Available from https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Advance-pricing-arrangements/?anchor=APA_and_MAC_statistics#KeyAPAsstatisticsforeachincomeyearsof30J.

7 UK HM Revenue & Customs, "Transfer Pricing and Diverted Profits Tax statistics 2021 to 2022". Available from <https://www.gov.uk/government/publications/transfer-pricing-and-diverted-profits-tax-statistics-2021-to-2022/transfer-pricing-and-diverted-profits-tax-statistics-2021-to-2022>.

8 See *supra* note 5.

9 Statistics on APAs and MAPs in the EU (2021) – European Commission. Available from https://taxation-customs.ec.europa.eu/system/files/2023-08/20230816_APA_consolidated_2021%20template.pdf.

10 *Mutual Agreement Procedures Report 2022 - National Tax Agency, Japan*. Available from <https://www.nta.go.jp/english/MAP-Report/2022.pdf>.

11 US Internal Revenue Service, "Announcement and Report Concerning Advance Pricing Agreements", 27 March 2023. Available from <https://www.irs.gov/pub/irs-drop/a-23-10.pdf>.

12 Organisation for Economic Co-operation and Development, *Prevention of Tax Treaty Abuse – IF BEPS Action 6 Fifth Peer Review Report* (Paris, 2023). Available from <https://www.oecd.org/publications/prevention-of-tax-treaty-abuse-fifth-peer-review-report-on-treaty-shopping-9afac47c-en.htm>.

13 See https://incometaxindia.gov.in/communications/circular/circular1_2015.pdf.

14 See *supra* note 11.

15 UK HM Revenue & Customs, "INTM422060 Transfer pricing: methodologies: Advance Pricing Agreements: term of agreement", *International Manual* (2016). Available from <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm422060>.

16 See *supra* note 11.

17 See *supra* note 10.

18 See *supra* note 7.

19 See *supra* note 9.

foundation of the Indian APA programme has been mutual trust and transparency. That one of the conditions for such revision is to cater to situations where the taxpayer may have breached one or more critical assumptions in an APA, but still wants the certainty that an APA provides, successfully imparts a level of flexibility to the programme that benefits the taxpayer as well as the tax authorities.

India's MAP programme

CBDT's report also briefly discusses the Mutual Agreement Procedure ('MAP') programme, the sister programme dealing with dispute resolution in largely the same way as the APA programme deals with dispute prevention. Taken together, the APA and MAP statistics provide a comprehensive overview of the tax certainty landscape in India.

India reports its MAP statistics to the Organisation for Economic Co-operation and Development ('OECD') annually as part of its commitment to the Action 14 Minimum Standard. The latest MAP statistics show a very encouraging downward trend of pending MAP cases, going from a high of 947 cases in 2020 to 697 cases in 2023, meaning that a whopping 250 cases have been closed in three years.

India has consistently closed more MAP cases than were invoked in calendar years 2020, 2021, and 2022, leading to a shrinking inventory year-on-year. However, as of 31st December 2021²⁰ (data for calendar year 2022 is expected to be released by the OECD in November 2023), India still has the fifth highest MAP inventory in the world, trailing only Germany, France, Italy, and Spain.²¹ As per the MAP data available, approximately 80% of the pending cases pertain to attribution/allocation cases, with the rest falling under the 'Other' category. It will be interesting to see if India manages to improve its global ranking when the data for calendar year 2022 is taken into account.

Challenges ahead

Despite the achievements of the APA programme, there are some obvious challenges that would need to be addressed going forward. These challenges have emerged largely from the success of the programme thus far, encouraging applicants – existing and new – to file APA applications (the latest financial year saw 177 APA applications filed). So far, the productivity of the existing workforce in CBDT is higher in comparison to most other jurisdictions, with roughly 3.2²³ APAs being signed for each full-time equivalent ('FTE') employee in the last financial year. For the US²⁴ and the UK²⁵, this number is less than 1, while for Japan²⁶, it is around 2.8. However, it is a fact that India is currently signing fewer APAs than the number of applications received each year, implying that the total pendency of such applications continues to rise. This would have to be addressed through even higher productivity of existing resources (which primarily includes officers equipped in international taxation and transfer pricing matters), or augmentation of resources, or both. In addition, the programme would also be tested on the finer technicalities of transfer pricing, as taxpayers acquire the confidence to seek APAs for more complex international transactions. The APA reports released by CBDT acknowledge the need to strengthen India's APA programme by equipping it with the necessary resources and technical expertise.

Lessons from the experience of India's APA programme for other developing countries

India's experience with APAs has demonstrated unequivocally, the mutually beneficial prospects of a dispute resolution and/or prevention programme for taxpayers and tax administrations. As a discipline, transfer pricing can be complex, given the unavoidable subjectivity often involved in the determination of the arm's length price of an international transaction. However, an APA programme allows tax administrations to understand the larger business, as well as the specific international transaction, in considerable detail. It

| Sl.No. | Calendar Year | Opening Inventory | Invocations during the year | Closures during the year | Closing Inventory |
|--------|---------------|-------------------|-----------------------------|--------------------------|-------------------|
| 1 | 2019 | 866 | 206 | 125 | 947 |
| 2 | 2020 | 947 | 108 | 182 | 873 |
| 3 | 2021 | 873 | 62 | 184 | 751 |
| 4 | 2022 | 740* | 101 | 144 | 697 |

*Opening inventory has been corrected by agreement with the respective treaty partners.

Source: CBDT APA Report 2019-20, 2020-21 and 2021-22 and CBDT APA Report 2022-23²²

20 OECD, Mutual Agreement Procedure Statistics 2021 – India. Available from <https://www.oecd.org/tax/dispute/2021-map-statistics-india.pdf>.

21 "2021 MAP Statistics per jurisdiction". Available from <https://www1.compareyourcountry.org/map-statistics/en/O/all/default>.

22 See *supra* note 1.

23 OECD, Making Dispute Resolution More Effective – MAP Peer Review Report, India (Stage 2) (Paris, 2021). Available from https://read.oecd-ilibrary.org/taxation/making-dispute-resolution-more-effective-map-peer-review-report-india-stage-2_cc6e7579-en#page1.

24 OECD, Making Dispute Resolution More Effective – MAP Peer Review Report, United States (Stage 2) (Paris, 2019). Available from https://read.oecd-ilibrary.org/taxation/making-dispute-resolution-more-effective-map-peer-review-report-united-states-stage-2_305147e9-en.

25 OECD, Making Dispute Resolution More Effective – MAP Peer Review Report, United Kingdom (Stage 2) (Paris, 2019). Available from https://read.oecd-ilibrary.org/taxation/making-dispute-resolution-more-effective-map-peer-review-report-united-kingdom-stage-2_33e2bf3d-en#page1.

26 OECD, Making Dispute Resolution More Effective – MAP Peer Review Report, Japan (Stage 2) (Paris, 2021). Available from https://read.oecd-ilibrary.org/taxation/making-dispute-resolution-more-effective-map-peer-review-report-japan-stage-2_e3d454fd-en.

also allows engagement with the taxpayer in a non-adversarial setting, which allows both sides to work towards a resolution. Having said that, it is important to remember that APAs are no substitute for transfer pricing audits. Given the time and resource intensive nature of APAs, its scale can never match that of a regular transfer pricing audit exercise. However, APAs can serve to complement the audit process by providing taxpayers an avenue outside of the tax appeals process, which offers certainty for an extended period. For instance, in a decade of its existence in India, the APA programme has cumulatively brought about litigation-free certainty for taxpayers, for over 3200 years.

Additionally, it is important to bear in mind that APA programmes across the world, including in India, are primarily aimed at enhancing tax certainty. Revenue mobilization cannot be the primary objective of an APA. Yet, as India's experience has demonstrated, additional revenues (with reference to the tax filing position) can be a positive externality flowing from the programme, especially as it matures.

For a developing country exploring the possibility of initiating an APA programme, it would be useful to start small, and identify certain transactions that could be more amenable to an APA. For this purpose, the feedback from transfer pricing audit teams could be especially useful. If that process proves successful, the APA programme could be scaled up gradually, opening it up to a wider category of taxpayers and transactions, and potentially cover a longer period.

Lastly, the strength of an APA programme lies in the flexibility built into its design. Every APA case is unique, with its own set of fact

patterns and peculiarities, and the APA process allows tax administrations to examine such fact patterns in depth. Any APA, whether unilateral or bilateral, is an outcome of negotiations. From the tax administration's perspective, the APA process ensures consistency and adherence to non-negotiable transfer pricing principles, without necessarily adopting a straitjacketed approach which limits the possibilities of resolution.

Conclusion

If one were to take stock of the APA programme a decade since its inception, there have undeniably been more hits than misses. This is reflected in not just the increasing number of APAs signed, but also in the number of applications received each year, and the expanding network of bilateral APA partner jurisdictions. The success of the programme owes itself to the commitment of all stakeholders to the objectives of enhancing tax certainty for taxpayers and ensuring predictable revenues for the government. As a policy instrument, it has allowed India to successfully reconcile the generally divergent objectives of promoting trade and investment, and mobilizing tax revenues. Going ahead, this programme will be tested against the high standards set in the last decade, which would be harder to live up to as taxpayers' increasing trust in the system would be matched by higher expectations from this programme. However, if the experience of the last decade is anything to go by, there is no doubt that the programme will only scale greater heights in the coming years.

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