

# EY Tax Alert

## **CBDT releases the fifth Advance Pricing Agreement Annual Report for FY 2022-23**

### Executive summary

EY Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

India's apex tax administration, the Central Board of Direct Taxes (CBDT) or the Indian Tax Administration, issued its fifth Annual Report on India's Advance Pricing Agreement (APA) program (the Annual Report or the Report). The Annual Report covers the Financial Year (FY) 2022-23. The Report provides various statistical and qualitative aspects of India's APA program since its inception in 2012, with particular focus on activities during the FY 2022-23, with a view to encouraging discussion and debate among taxpayers, policy makers, media, economists, and similar interests on the strengths and weaknesses of the program.

India launched the APA program in 2012, as a major initiative of the Indian Government towards fostering a non-adversarial tax regime. The APA program allows the Indian Tax Administration to enter into APAs with taxpayers in respect of their international transaction for a maximum period of 5 years with the objective of determining the arm's length price (ALP) or to specify the manner in which the ALP is to be determined. Post notification of the APA program, rollback provisions were introduced in March 2015. The roll back provision allows the taxpayer to rollback the agreement reached in the APA to earlier years, subject to a maximum of 4 years prior to the first year of the APA period. Accordingly, the Indian APA program allows the taxpayer to obtain certainty in matters of transfer pricing for a total period of 9 years.

This Annual Report presents ample numerical data cataloguing the popularity and success of the APA program in India. At the same time, it also indicates the challenges faced and provides an assurance on the commitment of the CBDT to take steps to address these challenges.

This alert captures the key information regarding the Indian APA Program as may be discerned from the Annual Report.

## Status of applications

- ▶ Under the Indian APA program, APAs can be (a) Unilateral (UAPA)- agreement between taxpayer and Indian Tax Administration only, (b) Bilateral/Multilateral (BAPA/MAPA) - agreement between taxpayer, Indian Tax Administration, and tax authorities of one or more countries.
- ▶ Over the last 11 years, 1,659 (1,210 unilateral and 449 bilateral) applications have been filed in India. While the numbers indicate a preference of UAPAs over BAPAs, the share of BAPAs in the total applications filed has been steadily increasing, signifying the need of the taxpayers for bilateral tax certainty and also maturity of India's bilateral program. For example, while BAPAs accounted for 28% and 18% of the total APA applications filed in FY 2012-13 (37 out of 134) and FY 2013-14 (39 out of 214) respectively, the share of BAPAs were 40% in FY 2022-23 (77 out of 193).
- ▶ Out of the filed APAs, a total of 516 (420 UAPA and 96 BAPA) APAs have so far been signed. While the number of agreements being signed saw a decline in FY 2020-21 (with 31 APAs signed in FY 2020-21 as compared to 57 in FY 2019-20 and 52 in FY 2018-19), mainly on account of COVID-19 pandemic, the APA program bounced back in FY 2021-22 with 62 signed APAs and FY 2022-23 with 95 signed APAs. Adaptive measures like virtual discussions and remote signing protocols assisted in this increase in number. It may also be noted that there is an upward trend in the number of bilateral agreements getting concluded and in the complexity of transactions being covered<sup>1</sup>.

## Duration of processing

- ▶ The average duration of processing UAPAs since the beginning of the APA program is approximately 44.2 months. However, it is seen that the average duration for closure of applications in FY 2020-21, FY 2021-22 and FY 2022-23 increased to approximately 54.33 months, 58.23 months and 59.73, respectively.
- ▶ The average time taken to conclude BAPAs during the FY 2022-23 has come down to approximately 62.1 months. This has reduced the average time taken for all BAPAs concluded till 31 March 2023 marginally from 58.91 months (as on 31st March 2022) to approximately 58.77 months.
- ▶ A number of BAPAs are actually resolved much before they are finally signed. However, due to several reasons the formal signing takes longer even after bilateral resolution, which increases the final duration of processing of BAPA.

<sup>1</sup>CBDT entered into a record 95 APAs with Indian taxpayers in FY 2022-23, which includes 63 unilateral APAs and 32 bilateral

## Industries

- ▶ The service sector of the Indian economy continues to be the pre-dominant activity in the UAPAs during FY 2022-23. A majority of these, in turn, are captive companies involved in software development of Information Technology (IT) and IT enabled services (ITES), engineering design services, contract research & development (R&D) services, and Knowledge Process Outsourcing (KPO).
- ▶ Further similar to UAPAs, the service sector mainly the IT Industry continues to be predominant in BAPA programs concluded in FY 2022-23.

## Nature of transactions covered

- ▶ The statistics further show as many as 61 types of international transactions are covered in the unilateral APAs and 49 types of international transactions in the BAPAs.
- ▶ Provision of software development services and IT enabled Services feature predominantly in both UAPAs and BAPAs, followed by availing of intragroup services by the Indian applicants.

## Transfer pricing method used

The transaction net margin method has been used in 57% of the unilateral cases and 82% of the bilateral cases. It is also interesting to note that in at least 118 international transactions (95 in UAPA and 23 in BAPA), the other method (residuary method provided in Indian Transfer Pricing Regulations) has been chosen as the most appropriate method. This is an indicator that the APA authorities are taking up resolution of more complex transactions using non-routine TP methods.

## Countries

- ▶ The UAPAs have covered transactions with 130 countries where the affiliates of the Indian applicants are located. Not surprisingly, the USA tops the list and finds its entities in 302 UAPAs followed by China, the UK, Australia, France, Germany, Japan, etc. Many Associated Enterprises are also located in investment and business hubs such as Singapore, Hong Kong, and Ireland.
- ▶ The statistics also show that more than 70% of BAPA applications that are under processing are

APAs. A record of the largest number of single day signings in the history of the program was also created with a total of 21 APAs signed on 24 March 2023

with five countries - the USA, the UK, Japan, Switzerland, and Singapore. Out of the 309 BAPAs under process, 151 relate to USA, 30 to UK, 27 to Japan, 13 to Switzerland and 12 to Singapore. In addition, the BAPA inventory includes applications with most of India's significant trade and investment partners such as Germany (10), France (4), Sweden (9), South Korea (9), the Netherlands (3), Australia (6) and Denmark (4).

- ▶ With 96 BAPAs signed till FY 2022-23, the maximum number of BAPAs signed so far have been with the USA (45) followed by the UK (18) and Japan (10). In addition, 6 BAPAs signed relate to Switzerland, 6 to Denmark, 3 to Australia, Finland, and the Netherlands, 2 to Singapore respectively.
- ▶ In FY 2022-23, out of the 32 Agreements signed with taxpayers, 22 pertained to the USA, 3 to Finland, and 2 each to the UK, Singapore, and Denmark, while 1 pertained to Japan.

## Renewal of BAPA

Majority of the applicants who have signed a BAPA with the CBDT have opted to file a renewal. Out of the 96 BAPAs signed till 31 March 2023, 63 applicants have opted for a renewal of the APA till date.

## Other dispute resolution process

- ▶ Another dispute resolution channel available under India's Double Taxation Avoidance Agreements (DTAAs) is Mutual Agreement Procedure (MAP). It is an alternate dispute resolution process involving two treaty partners, that seeks to remove taxation not in accordance with the DTAA arising from action by one or both treaty partners.
- ▶ It is to be noted that the number of MAP cases closed in 2020 and 2021 are substantially more than the number of new MAP applications invoked. As a result, the total number of MAP in India's inventory is gradually reducing.

## Conclusion

The Indian APA program is a very important part of the Indian Tax Administration's efforts to enhance the ease of doing business in India. The Indian APA Program has matured over the years where complex transfer pricing issues, which were prone to long drawn litigation, are being increasingly resolved through APAs. The resolutions have been to the satisfaction of both taxpayers and the Indian Tax Administration. While taxpayers have managed to get certainty over transfer pricing issues for five or nine years (depending on whether the taxpayer has opted for rollback), the Tax Administration has been able to divert resources away from the audit and litigation processes to more productive work.

While time taken to resolve an APA will inevitably vary according to the facts and complexity of each case, it is well recognized that a fundamental impediment to the greater use of APAs and the general promotion of advance certainty is the time taken to agree an APA. In this context it is heartening to note that the Indian Tax Administration acknowledges the benefits of the APA program and is committed to strengthening the program by providing it adequate resources.

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