

APA implementation in India and China under the spotlight

Sobhan Kar of Deloitte India and Aaron Wang and Michael Sun of Deloitte China evaluate the use of advance pricing agreements in their jurisdictions, and consider how both countries' programmes are likely to evolve.

Tax certainty has occupied pole position in all tax discussions across the globe over the past few years. The OECD has also designated a 'Tax Certainty Day' since 2019. This importance attached to tax certainty is a very welcome initiative, as uncertainty abounds.

Cross-border tax disputes – particularly transfer pricing disputes – have consistently risen over the past three decades despite attempts by international agencies and tax authorities to provide alternative measures to achieve dispute resolution and, more importantly, dispute prevention. The proposed changes under the OECD two-pillar approach are expected to bring in greater certainty but much will depend on the implementation guidance that remains pending.

Among the alternatives to resolve or prevent transfer pricing disputes, the advance pricing agreement or arrangement (APA) is one of the most robust and effective. Many countries have APA programmes and have successfully used them to provide certainty to taxpayers. Over the past decade, more and more countries have introduced their own APA programmes.

The G20 and OECD countries, under BEPS Action 14, have played an important role in the expansion of APA programmes by announcing them as a key element of an improved mutual agreement procedure (MAP) regime under bilateral tax treaties.

Countries are peer reviewed on a number of MAP-related issues, including a few questions about their bilateral APA programmes. It has become imperative to also have some form of detailed peer review of the APA regimes of different countries. This would nudge countries to bring about changes in their APA rules and practices that would make the APA regimes more effective.

India's APA regime

India introduced an APA programme in 2012 and it received a tremendous response. This was no surprise, because India was already an aggressive transfer pricing jurisdiction and there were a large number of audits and resultant adjustments to the transfer prices declared by taxpayers.

In the first three years, more than 500 APA applications were filed. As the APA programme in India completes 10 years, this number has reached close to 1,500 applications. Of course, these are not 1,500 different taxpayers, because many applicants who went into the APA programme in the initial years have also filed for renewal of their agreements.

About 425 APAs have been entered into by the Central Board of Direct Taxes (CBDT) and the applicants. Approximately 200 applications have been disposed of due to a variety of reasons, such as withdrawal of applications, no agreement being reached, and corporate restructurings. Thus, a huge inventory of about 900 APA applications remains.

India allows for unilateral, bilateral, and multilateral APAs. A vast majority of Indian APAs are unilateral and the rest are bilateral. Only a couple of multilateral applications have been accepted by India so far.

There are many reasons for having more unilateral applications.

In the initial years of India's APA programme, the USA – India's largest trading partner – was not willing to negotiate bilateral APAs with India due to some legacy problems. This forced many multinational entities (MNEs) to apply for unilateral APAs in India to at least gain tax certainty on the Indian side.

Another reason was the perception among taxpayers that bilateral negotiations would take a lot of time. This perception emerged from the fact that MAP resolutions achieved by the Indian competent authority were few and far between.

It is notable that once India and the USA agreed upon a framework in 2015 to resolve common transfer pricing disputes in MAPs in a fast-track, formulaic manner, the USA opened the bilateral APA corridor.

In its APA program, India allows for a prospective agreement for a maximum period of five years. It also allows for a rollback of the agreement to a maximum of four prior years. Initially, there was no rollback provision, before it was introduced in 2014. In respect of unilateral APAs, no downward adjustment is allowed in the rollback years. However, in practice, no downward adjustments are allowed at all, even for the prospective years.

Assessing India's APA programme

If we evaluate the positives and negatives of the Indian APA programme, we find that after ten years it stands on an even keel.

The factors going for the APA programme are many. It has found imaginative solutions in respect of complex transactions that would have been unlikely or more difficult to obtain under normal transfer pricing audits. The APA teams have been very proactive and open in engaging with taxpayers to find answers to difficult questions. There is no mandatory pre-filing required before taxpayers can make an APA application. It happens only at the option of taxpayers and, albeit non-binding, can also be done on an anonymous basis. APA applications can be amended quite easily, which includes converting a unilateral application to a bilateral one or vice versa.

The biggest drawback of the Indian APA programme is the scarce human resources allocated to it. APAs are fact intensive and need a lot of data analysis. These processes are time consuming. With a large number of applications filed over 10 years, the APA teams are saddled with too much work. Only 16 officers in four APA teams have the responsibility for processing hundreds of applications. Thus, the pace of processing applications has steadily fallen.

While the COVID-19 pandemic has played a significant role in impacting the pace of disposals in the past two years, a shortage of human resources has been the real bane.

The other problematic area has been the lack of transparency on the part of the APA teams.

When the APA programme started, there was a single APA team and its approach was very open and transparent. That has changed over the past few years. In the initial years, the economic analysis was done jointly with the applicants and a set of comparable companies were finalised in consultation with the latter. Thus, the taxpayer had a fair idea of the proposals being sent to the CBDT for approval.

Today, the APA administration operates in isolation, giving an impression that it is shrouded in secrecy. And once the CBDT approves a negotiating range, which is based entirely on the APA teams' unilateral analysis, the applicants are asked to negotiate with the APA team. There are other procedural rigidities that need to be addressed by the CBDT, bearing in mind the basic collaborative philosophy of the APA programme as introduced by the CBDT.

The Indian APA programme has been fairly successful and could have been even better but for the shortcomings mentioned above. It is expected that the CBDT will take the requisite steps to breathe fresh life into the programme. For starters, it should provide more human resources, amend the APA rules, and issue a standard operating procedure (SOP) for APA teams and taxpayers to adhere to.

China's APA regime

China has experienced remarkable challenges since 2020, as it started to combat the COVID-19 pandemic amid a slowdown of the economy and increased geopolitical difficulties. Although not directly correlated, many observers



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Before joining Deloitte, Sobhan served the Indian Revenue Service for more than 21 years. He was instrumental in setting up the APA programme in India during 2012–14. He was part of the Indian Competent Authority team as director (APA) – CBDT and negotiated various bilateral APA applications and transfer pricing MAP cases with the competent authorities of North American and European countries. Sobhan also finalised numerous unilateral APA applications. He was the Indian delegate for Working Party 6, the Bureau of Working Party 6 of the OECD, and the FTA MAP Forum of the OECD from 2014 to 2020.

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Aaron has served clients across a wide range of industries and has been active in controversy resolutions such as TP assessments, and national tax audits, and has helped multinational companies to secure certainty on their complex TP issues. As a project leader, he has concluded bilateral advance pricing agreements (APAs), bilateral APA renewals, and mutual agreement procedures for many of his clients.

Aaron started his professional career in Shanghai and has worked in Beijing, Singapore, and Suzhou at different stages of his career, before returning to Shanghai in 2014. This experience greatly expanded his professional exposure and network.

have noticed a development of the focus and approach in the response of China’s State Taxation Administration (STA), and the development of China’s APA programme played a very important role.

As the STA puts in the cover note of its 2020 annual APA report, published in September 2021, “The outbreak of the pandemic and the resurgence of unilateralism has made the need for cross-border tax certainty even more urgent for the taxpayers”.

In response, and in parallel with its efforts on the bilateral APA (BAPA) programme, the STA placed a focus on the unilateral APA (UAPA) and, for the first time, delegated the signing authority to provincial- and local-level tax authorities by introducing a simplified UAPA procedure in 2021 that quickly rolled out to the whole nation by gazetting a formal tax circular since then. In 2020, 15 UAPA cases were concluded successfully, an increase from 2019. It is expected that the number of UAPA cases should continue to rise in the coming years.

Several years ago, the central STA in Beijing started to restructure its transfer pricing resources. On one hand, the STA has been keener than ever to be one of the leading tax jurisdictions to participate in the G20 and OECD BEPS discussions as a developing superpower, and on the other hand, to address the resource limitations with the changing landscape of tax compliance and internal revenue. The STA has held (virtual) meetings with OECD working parties to exchange ideas on various aspects of taxation challenges, among which, APA and MAP programmes were naturally one of the areas where China wishes to show its development.

At home, the STA is actively responding to President Xi’s ‘dual circulation’ strategy; i.e., domestic and international dual circulation and that combination – the pursuit of both economic self-reliance and of greater economic leverage when dealing with foreign countries. The STA devised its pragmatic solution on APA programmes: promoting a simpler UAPA at local level in conjunction with more

dedicated resources on BAPAs at central level, and meanwhile keeping the two channels closely connected.

Inbound Chinese MNCs have seen a lower threshold, a higher chance, and less concern to use APAs to prevent transfer pricing controversy. The STA has clearly prescribed in its simplified UAPA circular that any information available to a local tax authority during the UAPA process, regardless of the conclusion of the application, will not be viewed or perceived as anything indicative of transfer pricing risks of taxpayers, nor directly used in a future transfer pricing audit by any tax authority.

The simplified UAPA programme is more than procedures. Instead, the simplified programme ties back closely to China's central efforts to secure foreign capital and investment, and export trade, by providing greater tax certainty to, and enhancing confidence in, foreign investors. In other words, the programme is tasked to succeed. A couple of pilot cases were concluded straight after the simplified programme was launched in 2021, sending out a clear message to those taxpayers of interest (and concern).

Looking ahead in China

Given the push down of signing authority of simplified UAPAs to local level, it would not be a surprise to see local tax administrations acting proactively and entering APA conversations more frequently. At the same time, local tax administrations could also be more mindful of local resource structures, which vary between regions in China and tiers of tax administrations, simply to avoid too much backlog.

This is all because of the (i) within 90 days requirement, as prescribed in the simplified UAPA rule, for a local competent tax administration to conclude review and inform a taxpayer of its decision as to whether a simplified UAPA application is accepted, and (ii) the within six months requirement thereafter to complete the negotiation process for an accepted application. Such time-bound requirements on tax administrations are not prescribed in normal APA procedure rules.

There may be more to expect from the above development. An example is the wider collaboration that has been observed between the tax and customs authorities on the pricing of importation of goods. For that, Shenzhen (Southern China) has been the first mover to issue and implement a formal collaborative administration mechanism between the two authorities, starting in May 2022.

By virtue of synchronising the existing APA programme (tax administration) and advance ruling programme (customs administration), the collaborative mechanism aims to create a



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Michael had a nearly 14-month international secondment with Deloitte in the UK, during which he worked closely with the UK TP practice and other European offices within the Deloitte network, with a focus on TP economics. Michael's major clients cover public and private MNCs in the consumer, pharmaceutical, and financial services industries.

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transparent window between the two authorities to agree in advance a taxpayer's import pricing and profit level. Taxpayers could accordingly apply and sign up for the two programmes, over which a consistent result may be aimed for.

Looking forward, we hope to see China acting more on its commitment to the OECD's BEPS actions, and regarding the ever-closer impacts of the two pillars and associated global tax revamp, and coming up with more ideas to increase the effective use of APAs. It is envisaged that the next three years could be a golden era of APAs in China.