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Indian APA Program Takes Off

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The Indian tax authorities on March 31 signed the first five advance pricing agreements (APAs) in the program's history.

Transfer pricing presents many tax, legal and operational challenges for both taxpayers and tax authorities. To many taxpayers, the uncertainty resulting from the possibility of transfer pricing adjustments – including the potential commitment of management time to successfully defend a transfer pricing examination – goes beyond acceptable business risk.

After India introduced transfer pricing regulations in 2001, the tax authorities' approach in the initial years was fairly reasonable. However, in more recent years the Indian tax authorities have become very aggressive, resulting in a surge of transfer pricing audits, both in terms of the percentage of cases that incur transfer pricing adjustments as well as the quantum of those adjustments.

Appreciating that scenario, the government introduced an APA mechanism in the Finance Act 2012. By March 31, 2013, 146 applications had been received – a substantial number for a first-year APA program. The APA team followed a proactive and intensive methodology to verify the facts in the applications. The negotiation process was carried out in a collaborative manner, with the goal of determining equitable and fair arm's length prices. The process has now culminated in the signing of five agreements on 31 March. This is a great achievement by any standard, given that there are very few instances in which APAs have been concluded in the first year of a program.

The success of India's APA program is driven jointly by the authorities and by taxpayers. Authorities must appreciate the realities facing businesses, and based on that try to reach an equitable solution. On the other hand, taxpayers should be transparent and proactive in sharing information and documents with the tax authorities.

An important lesson from the APA process thus far is that taxpayers must be mindful of a wide range of issues that may come up for discussion during the course of the APA negotiations. Some key issues, for example, relate to site visits conducted by the APA team, interaction with senior employees to understand the functional profile of the taxpayer, the role played by overseas associated enterprises in the transaction under examination, and the level of detail of the information maintained by taxpayers to demonstrate their functional profile. There should be clarity and completeness on these issues to ensure the successful conclusion of an APA.

The success of the APA program will send the right signal to foreign businesses interested in India that the risk of a transfer pricing adjustment may be mitigated through this newly introduced collaborative tool, and may help bridge the current trust deficit between taxpayers and the tax authorities.

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