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Germany-India: Transfer Pricing Controversy, Dispute Mitigation & Resolution

Manfred Naumann – Sanjay Kumar – Henning Scheibe – Pramod Joshi

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Speakers



Manfred Naumann

Former Head of Section (TP) in the German Ministry of Finance, Former international representative of the tax administration, Germany

+49 30 25468 5526

manaumann@deloitte.de



Sanjay Kumar

Senior Director, Deloitte India (Former representative of the tax administration, India)

+91 124 679 3601

kumarsanjay@deloitte.com



Henning Scheibe

Partner, Deloitte Germany

+ 49 211 8772 3647

hscheibe@deloitte.de



Pramod Joshi

Partner, Deloitte India

+91 20 6624 4602

pjoshi@deloitte.com

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Introduction

Introduction

The Current Environment

1

Over the years, not only has the bilateral trade increased but German companies have discovered new business and investment opportunities in India and so have the Indian Companies in Germany.

2

In recent times the success story continues as enterprises of both countries extend their business relationship. Thereby, India as one of the fastest growing economies in the world offers various opportunities for German companies. Today, more than 1700 German companies are active in India.

3

Germany is the 7th largest foreign direct investor in India since January 2000. Germany's total foreign direct investment in India from 2000 until 2016 amounted to approx. EUR 9 billion. There are more than 1600 Indo-German collaborations and over 600 Indo-German Joint Ventures in operation.

4

Vice versa, investments of Indian enterprises in Germany have remarkably increased over the last years. Indian entities have invested over EUR 6.5 billion in Germany, especially in sectors of IT, automotive, pharma and biotech. Today, there are more than 200 Indian companies operating in Germany.

5

In the recent years, the intensity of transfer pricing disputes continues to escalate across India and Germany on account of aggressiveness of tax jurisdictions (especially India), a different understanding of transfer pricing and new regulations.

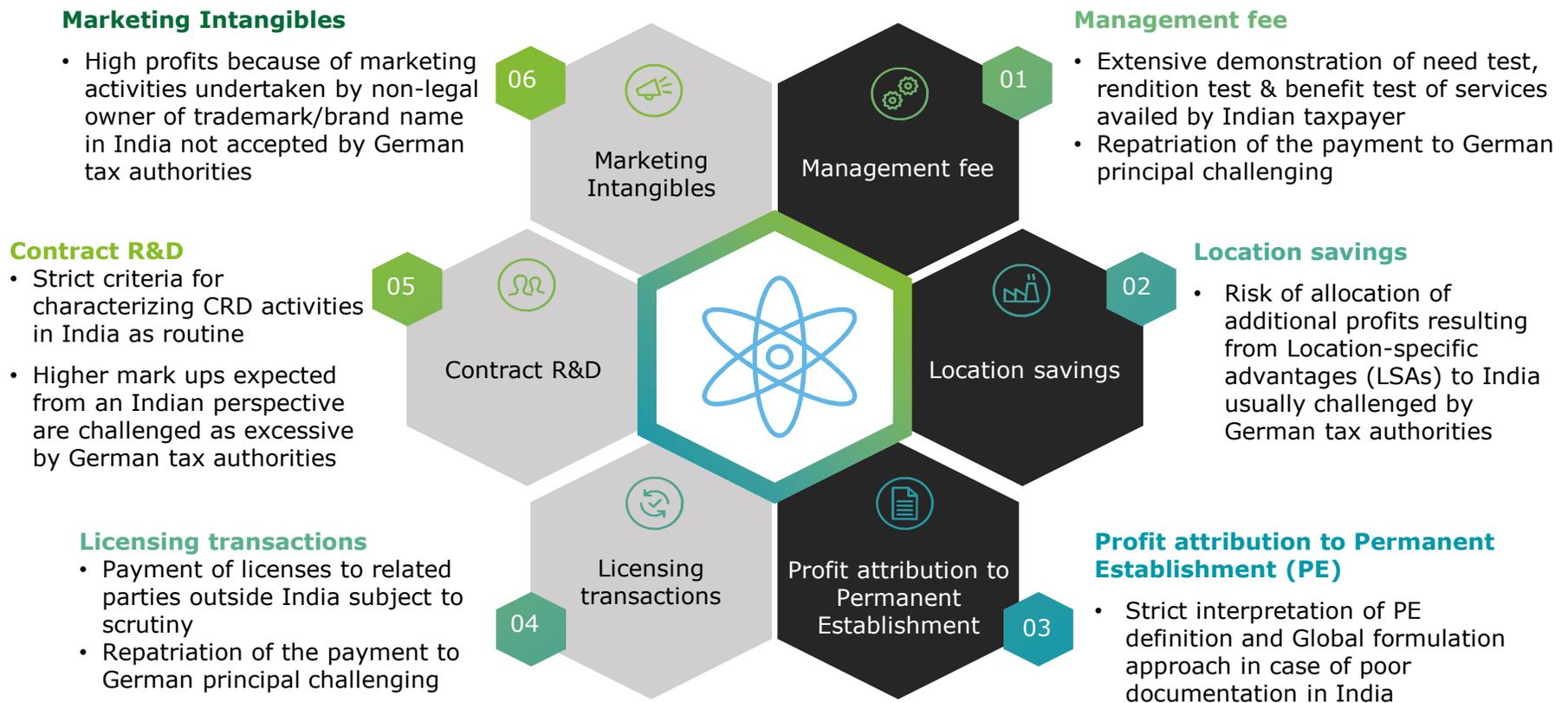
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The disputes have often lead to incidence of double taxation aggrieving tax payers in both countries.

Introduction

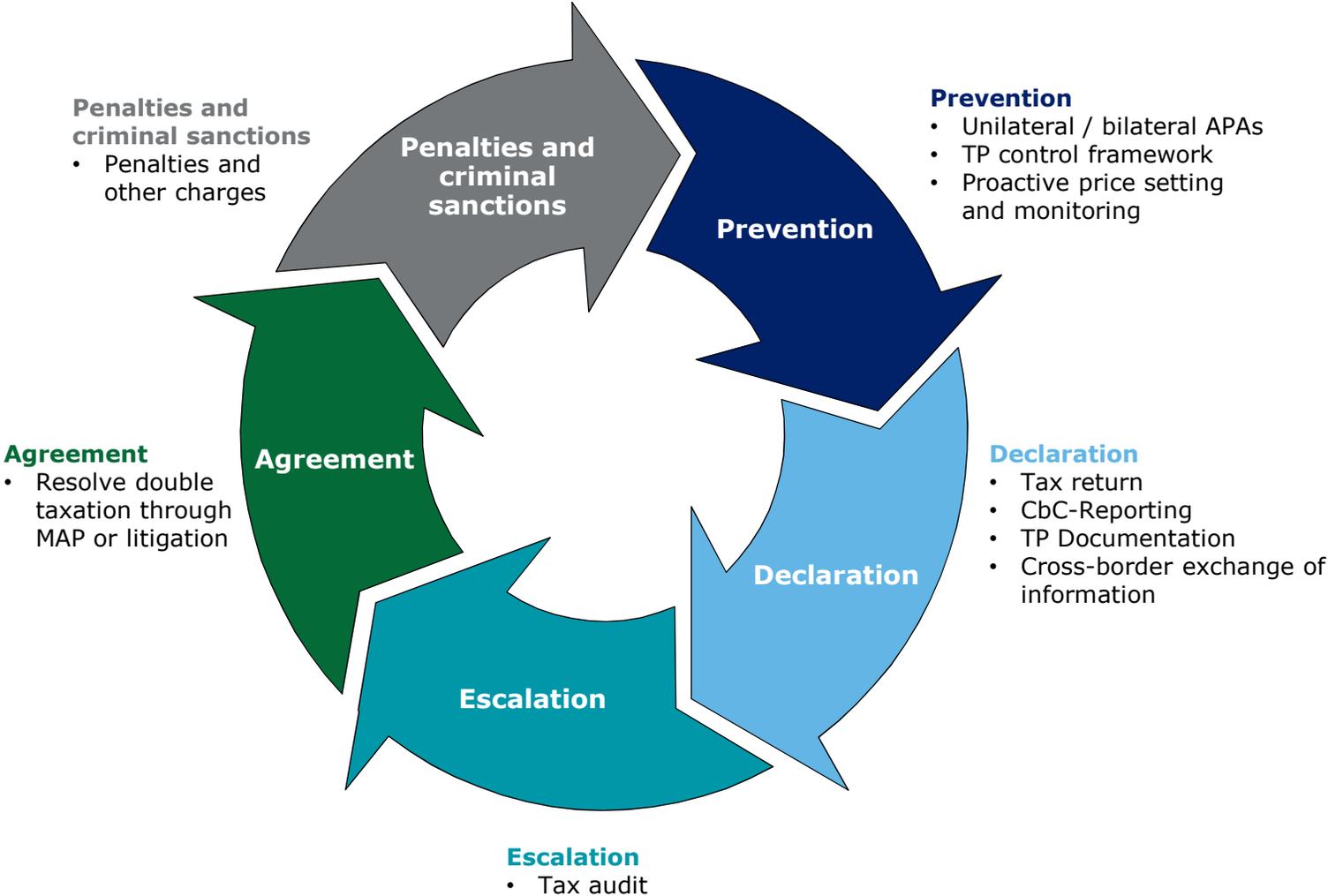
TP Controversy - Hot Topics

Key controversial topics where German and India tax authorities tend to have opposing positions and propose adjustments leading to double taxation:



Introduction

TP Controversy – Life cycle



Introduction

DTAA between Germany and India

Article 25 of Model Tax Convention, in relation to Mutual Agreement Procedure (MAP) was already existing in the Double Taxation Avoidance Agreement (DTAA) between Germany and India.

ARTICLE 25

MUTUAL AGREEMENT PROCEDURE

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Agreement, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of this Agreement.
2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Agreement. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.
3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of this Agreement. They may also consult together for the elimination of double taxation in cases not provided for in this Agreement.
4. The competent authorities of the Contracting States may establish by mutual agreement the mode of application of the provisions of this Agreement regarding the exemption or reduction of taxes.
5. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

However, until end of 2017, India did not accept applications for MAP and Bilateral APA as Article 9(2) of Model Tax Convention on 'Corresponding Adjustment' is absent in the DTAA between Germany and India. Germany could not accept those applications, because India refused to negotiate.

Introduction

DTAA between Germany and India

On 27 November 2017, in a press release India issued a clarification on the acceptance of MAP and bilateral APA applications regardless of the presence or otherwise of Paragraph 2 of Article 9 (or its relevant equivalent Article) in the DTAA's.

Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes

New Delhi, 27th November, 2017.

PRESS RELEASE

Clarification of India's position on the acceptance of MAP and bilateral APA in cases of countries where Article 9(2) of OECD Model Tax Commentary is absent

A number of references have been received from time to time regarding the acceptance of applications pertaining to Transfer Pricing MAP cases and bilateral Advance Pricing Agreements (APAs) where the Associated Enterprise (AE) of the Indian entity is resident of a country with which India has entered into a Double Taxation Avoidance Agreement (DTAA) but the Agreement does not contain Paragraph 2 of Article 9 (or its relevant equivalent Article) relating to 'Corresponding Adjustment'.

The matter has been examined by the Central Board of Direct Taxes (CBDT) and it has been decided to accept Transfer Pricing MAP and bilateral APA applications regardless of the presence or otherwise of Paragraph 2 of Article 9 (or its relevant equivalent Article) in the DTAA's.

(Surabhi Ahluwalia)
Commissioner of Income Tax
(Media & Technical Policy)
Official Spokesperson, CBDT.

Introduction

DTAA between Germany and India

India's acceptance of Bilateral competent authority proceedings even without Article 9(2) is a major step forward to amicably arrive at a resolution and ensures economic non double taxation.

Based on discussions with the Federal Tax Office in Germany (the German competent authority), Germany is now also willing to accept bilateral proceedings with India, absence of Article 9(2) notwithstanding.

Germany has always taken the position (following the OECD) that – notwithstanding the absence of Article 9 (2) - bilateral proceedings between India and Germany are possible. But the German CA has not been successful in this respect.

This change in India is a great opportunity for the enterprises of both jurisdictions currently suffering double taxation. There is the opportunity for clearing the past tax issues and/or to obtain certainty in the tax treatment in future years.

Furthermore, since both India and Germany are part of G20 and highly committed to OECD BEPS Action Plan, there is hope for taxpayers regarding alignment of TP practices in both countries going forward, if compatible principles govern this issue.

Dispute Prevention/Resolution

Dispute Prevention/Resolution Options for the taxpayers

Option 01 >

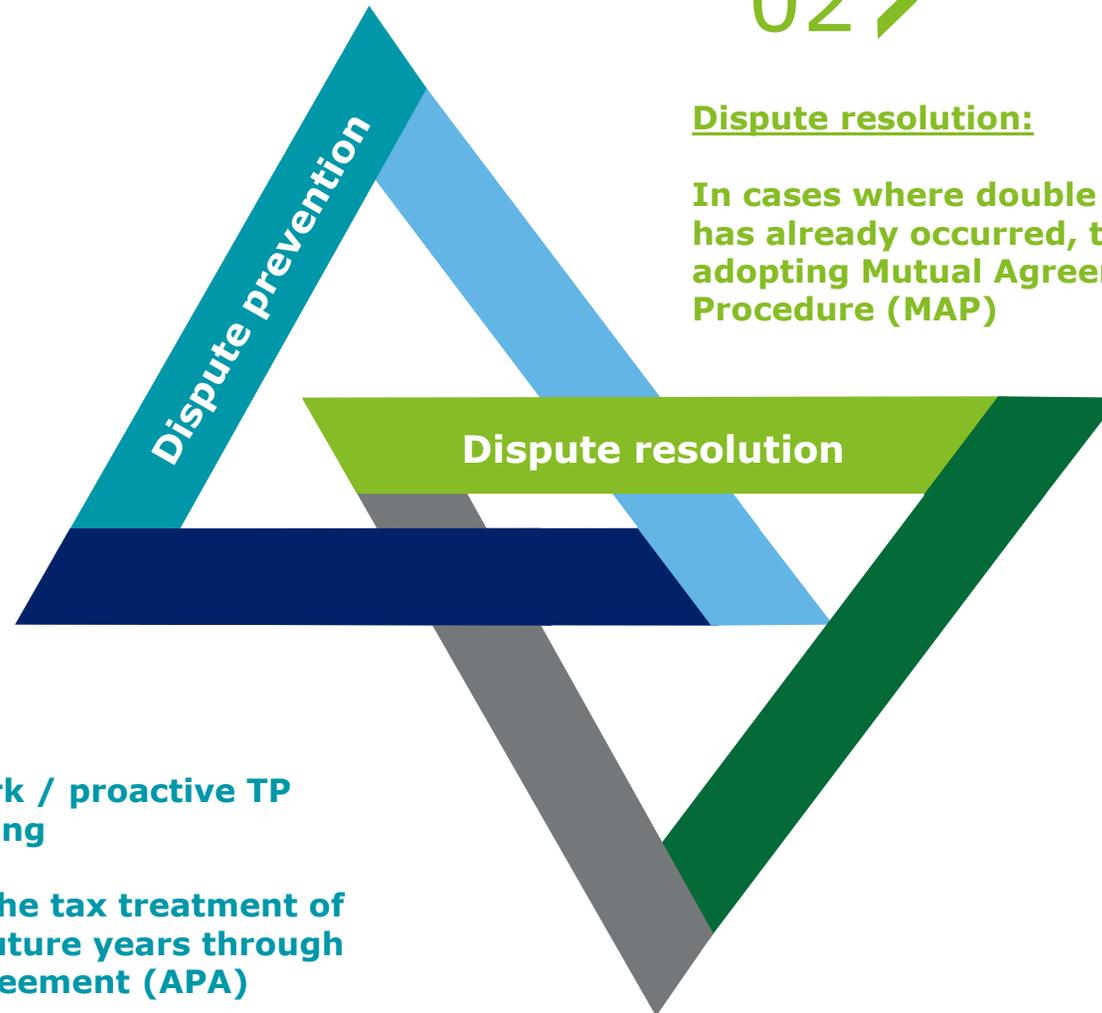
Dispute prevention:

- TP control framework / proactive TP setting and monitoring
- Obtain certainty in the tax treatment of transfer prices for future years through Advance Pricing Agreement (APA)

Option 02 >

Dispute resolution:

In cases where double taxation has already occurred, tax relief adopting Mutual Agreement Procedure (MAP)



Dispute Prevention

Dispute Prevention

Option 1: Advance Pricing Agreement

- APA is a mutual understanding between a taxpayer and one or more national tax authorities that establishes the transfer pricing method to be used for future transactions covered by the APA.
- APA provides tax certainty with regard to the determination of arm's length pricing of the international transactions, if the transactions are performed according to the APA.
- Types of APA:

Unilateral APA

Involves the following parties:

- Taxpayer
- Local tax authority
- Not possible in all countries for transfer pricing issues (e.g. normally not in Germany)

Bilateral APA

Involves the following parties:

- Taxpayer
- Foreign associated enterprise of taxpayer
- Local tax authority
- Foreign tax authority

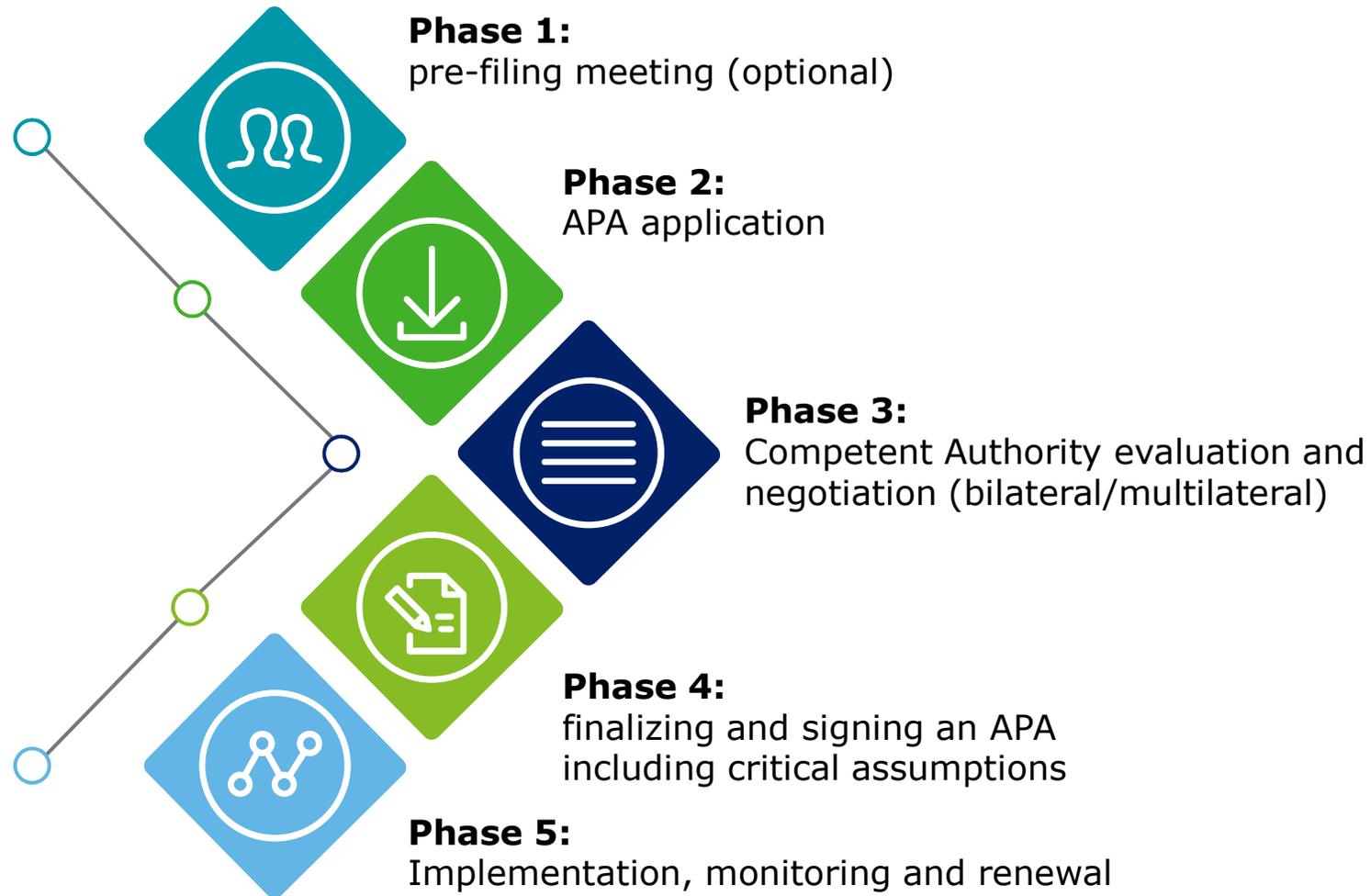
Multilateral APA

Involves the following parties:

- Taxpayer
- Two or more foreign associated enterprises of the taxpayer in different countries
- Local tax authorities in the respective countries
- Foreign tax authorities of respective foreign associated enterprises

Dispute Prevention

APA - Procedural framework



Dispute Prevention

APA Overview – Germany and India

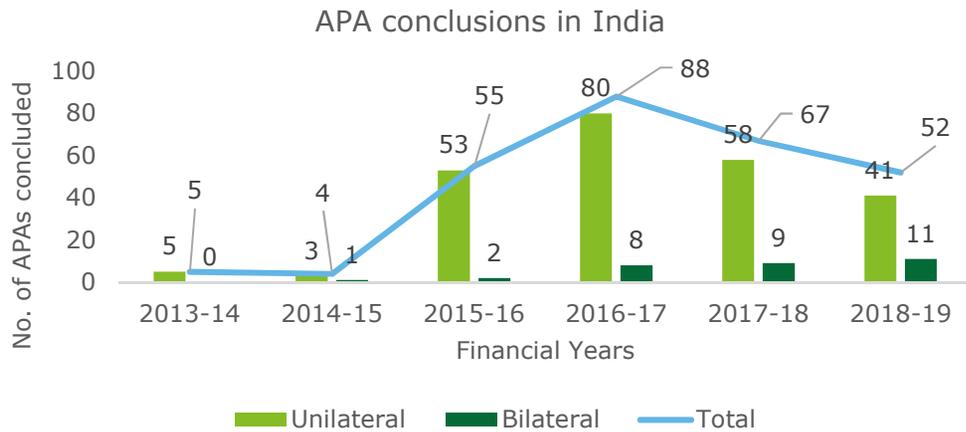
Both Germany and India offer highly committed APA programs. Germany already has a well established and functioning APA set up and in India the APA program was introduced in 2012

Key fact	Germany	India
Where to apply for an APA	Federal Central Tax Office (BZSt, Bundeszentralamt für Steuern); always informing the local tax office	Unilateral APA: Principal Chief Commissioner of Income Tax Bilateral and Multilateral: Competent Authority Joint Secretary Foreign Tax Division
Types of APA	Bilateral and multilateral (as an exception unilateral confirmation)	Unilateral, bilateral and multilateral
Pre-filing meeting	Yes, usually one, but not necessary	Optional
Possibility of roll back	Yes, essentially as MAP in legal terms, if otherwise no change is possible	Yes, 4 years preceding the APA years
Possibility of roll forward	Yes, in substance a new APA, duration depends	Renewal possible for next 5 years after the term of APA
Filing fee	EUR 20,000 (renewal fee EUR 15,000)	The fees for filing an APA application are based on the aggregate transaction value proposed to be covered in the APA (ranges from INR 10 lacs to INR 20 lacs)
Term of agreement	3 to 5 years, may be renewed for another period of 5 years	Maximum period of 5 years for one term. May be renewed for another 5 years
Average time to negotiate	24-36 months	24-36 months

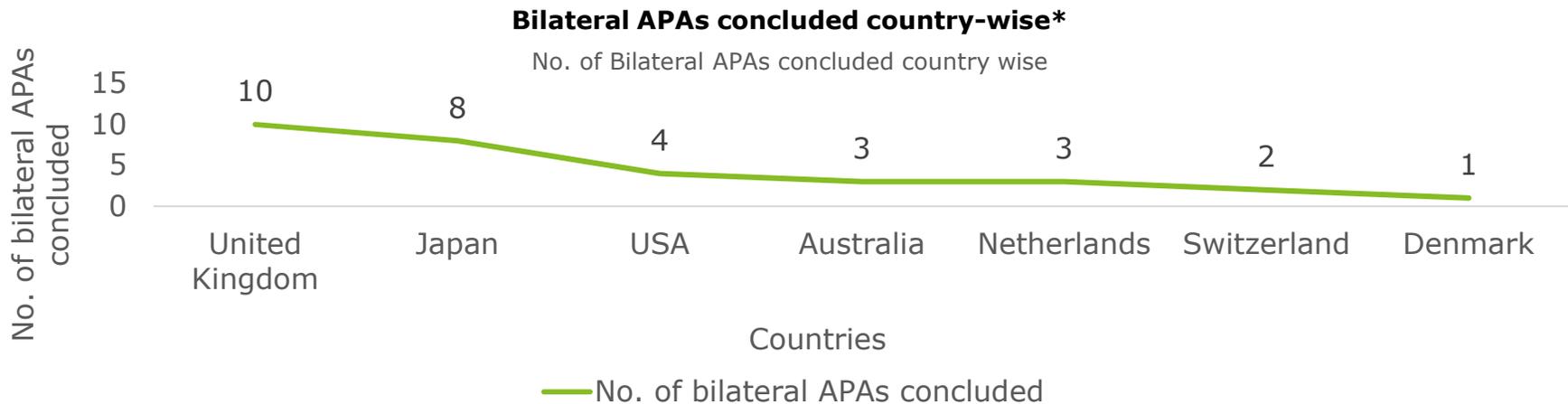
Dispute Prevention

APA Status - India

 Total 271 – 240 Unilateral and 31 Bilateral APA concluded so far



- Close to 1100 applications filed in six APA cycles.
- Maximum bilateral APA applications are with US, UK and Japan.
- 35 unilateral applications have been converted to bilateral
- India has opened up for bilateral negotiations with major treaty partners- France, Germany, Finland, Belgium etc. after relaxation of Article 9(2)

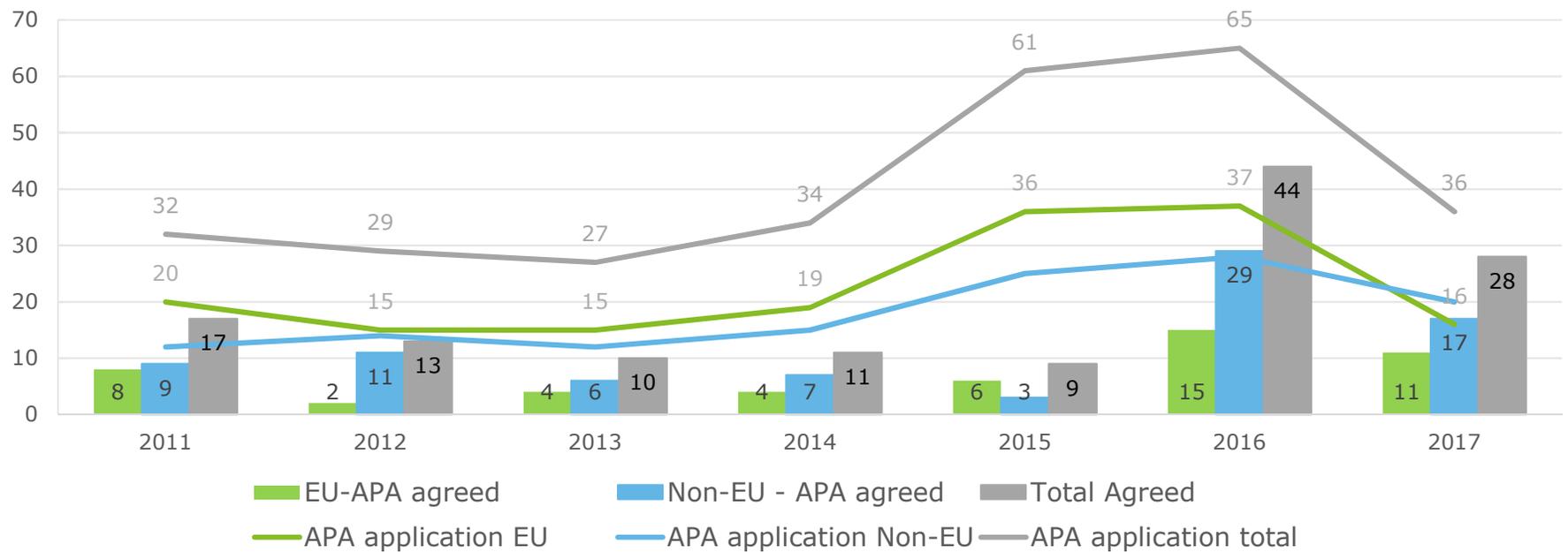


Source: *Annual APA Performance Report FY 2017-18 and press releases published by CBDT
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Dispute Prevention

APA status – Germany

2011 - 2017



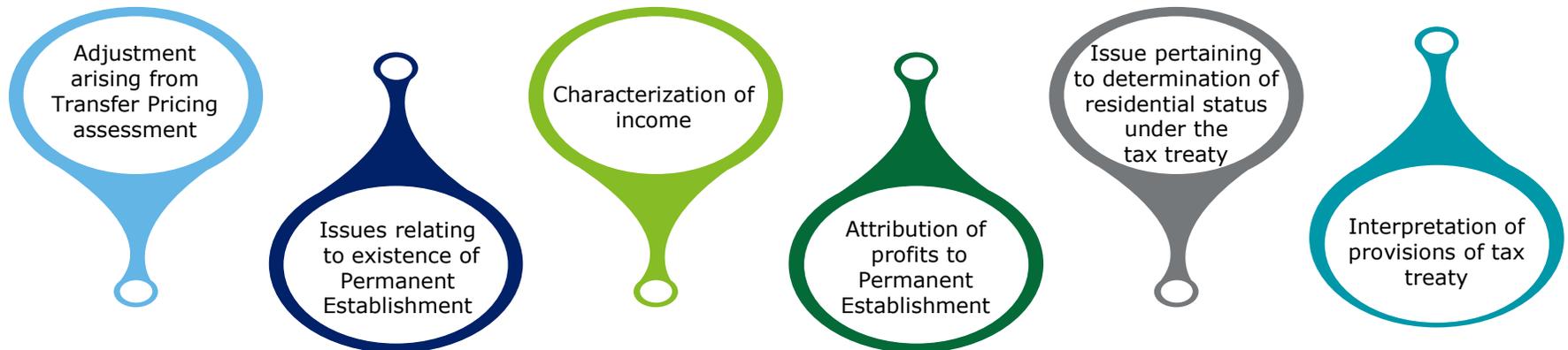
Source : Statistics on APAs issued by EU Joint Transfer Pricing Forum

Dispute Resolution

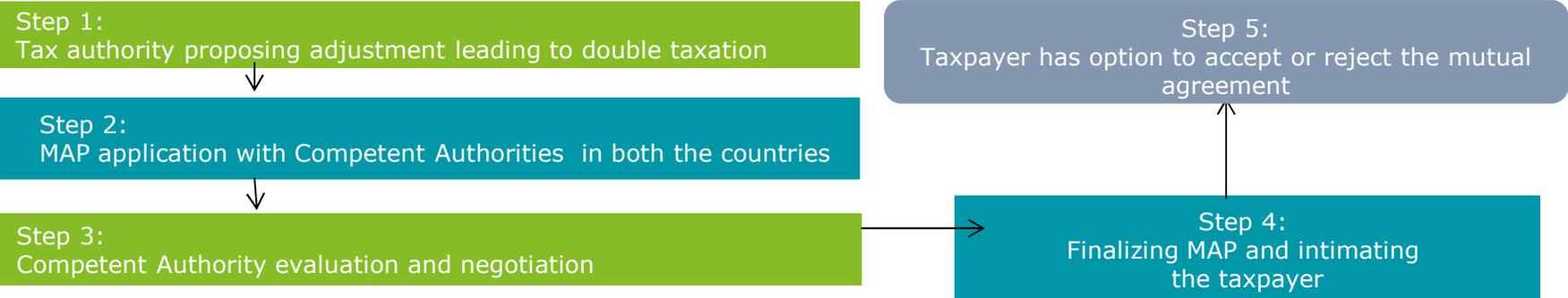
Dispute Resolution

Option 2: Mutual Agreement Procedure

- MAP is a mechanism for the resolution of international tax disputes incorporated in the double tax avoidance agreement (DTAA) of many countries.
- It entails resolution of disputes through the intervention of the Competent Authorities of each country who evolve a mutually acceptable solution.
- Relief under MAP is in addition to the dispute resolution mechanisms available under domestic tax laws
- Scope is limited to only issues pertaining to tax treaties and does not extend to domestic tax laws. It may resolve issues including:



MAP process



Dispute Prevention

MAP Overview – Germany and India

Overview of MAP programs in both Germany and India:

Key fact	Germany	India
Where to apply for an MAP	Federal Central Tax Office (BZSt, Bundeszentralamt für Steuern); always informing the local tax office	Competent Authority (CA) Joint Secretary Foreign Tax Division
Taxpayer involvement	<ul style="list-style-type: none"> • Taxpayer required on need basis for information gathering and explanations. • Meetings may be scheduled with CAs on request. However, the taxpayers are not part of the bilateral negotiations between CAs. 	<ul style="list-style-type: none"> • Taxpayer required on need basis for information gathering and explanations. • Meetings may be scheduled with CAs on request. However, the taxpayers are not part of the bilateral negotiations between CAs.
Binding nature	<ul style="list-style-type: none"> • Binding on tax authorities • Taxpayer has option to accept or reject the mutual agreement and may proceed with litigation 	<ul style="list-style-type: none"> • Binding on tax authorities • Taxpayer need not accept if detrimental, can continue with domestic tax law appeal
Filing fee	No filing fee	No filing fee
Average time frame	Generally 2-3 years	Generally 2-3 years

Dispute Resolution

Germany & India - MAP application status for 2017

The table below represents the MAP applications in 2017:

Particulars	Germany No. of cases	India No. of cases
Opening inventory on 01/01/2017	521	620
Number of cases initiated in 2017	177	121
Number of cases completed in 2017	156	95
Ending inventory on 31/12/2017	542	646

Source : <https://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics-2017-per-jurisdiction-transfer-pricing.htm>

* Please note that these statistics primarily reflect MAPs with other countries, as of 2017.

Practical Insights

Bilateral negotiations between India and Germany

Relaxation of Article 9(2) norms by India has opened the doors for bilateral negotiation between India and Germany under MAP and bilateral or multilateral APA.

Germany has always been open for entering into bilateral negotiations with India. Thus, it would entertain these bilateral negotiation requests now with Indian government accepting such requests.

Some German companies have converted their existing Unilateral APAs into bilateral APAs to exploit the new opportunity and obtain tax certainty without any double taxation exposure.

3-4 fresh Bilateral APA applications have also been filed by some German headquartered companies to achieve tax certainty in both the countries.

5-6 MAP negotiation requests are made with the competent authorities of the two countries to resolve past litigations.

Due to initial years, the quantum of bilateral negotiation requests are low but it has been increasing year-on-year at fast pace

Dispute Resolution

Practical Insights and key take aways

Eligible years for MAP

What are the eligible years for MAP entertained by both the countries?

Timing effect on rollback

Whether roll back applications are accepted for period starting prior to issue of Press release by India (November 2017)? What is the deadline for application of MAP?

Conversion of APA

Whether Unilateral APA applied/covering periods prior to issue of Press release by India (November 2017) are eligible for conversion to Bilateral APA?

Alleviation of double taxation

Statute of limitations: What are the effects on years for which tax return is already filed or tax audit has already been concluded?

Issue on available resources

Whether Competent Authorities in both the countries have the possibility to deal with these cases?

Q&A



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