

**Advance Pricing Agreement ("APA") &
Mutual Agreement Procedure ("MAP")
India - UK perspective**

April 2019

Agenda

- Introduction
- Overview of APA
- Overview of MAP
- Our BAPA & MAP experience
- Case studies – India-UK specific experiences
- Key considerations
- Abbreviations
- Questions & answers

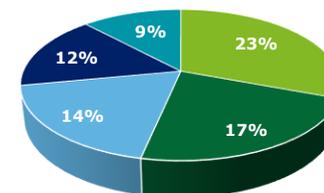
Introduction



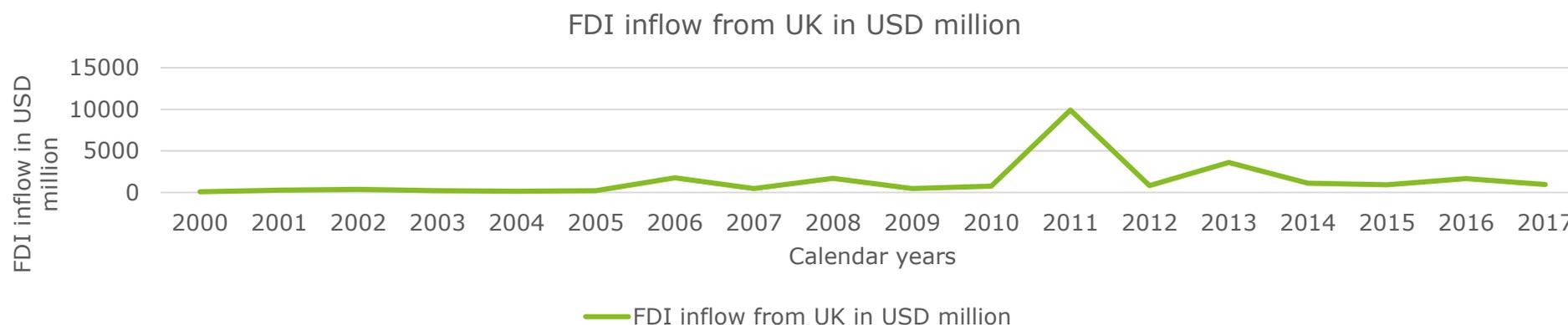
Introduction: UK – a large investor for India

- UK is 4th largest investor in India infusing approx. 6.87% of the total FDI
- In the past two decades, it has contributed a share of USD 25.32 billion out of the total FDI inflows of USD 368.60 billion
- There has been a steady FDI inflow from the UK
- UK MNCs have largely invested in manufacturing sector and services sectors. Manufacturing cover chemicals, drugs & pharmaceuticals, petroleum & natural gas and food processing industries. Service sector largely covers IT & ITeS

Top sectors attracting FDI from UK in the past two decades*



- Chemicals
- Drugs & pharmaceuticals
- Services sector
- Food processing industries
- Petroleum & natural gas



With significant investment of UK based MNCs in India, there are large number of international transactions & numerous TP issues, due to which businesses seek tax certainty under APA & MAP

* https://dipp.gov.in/sites/default/files/FDI_AnnualIssue_2017_Chapter6.1.A.iv_.pdf

Overview of APA



Overview of APA – India

Introduction

APA scheme was introduced from July 1, 2012 – 7 APA filing cycles are now complete

Types of APA

Unilateral, bilateral or multilateral APA can be filed

Pre-filing

An optional pre-filing consultation has been prescribed – such pre-consulting can be on a “no-name” basis



Any new transactions

For new transactions, APA application should be filed before the commencement of such transaction

Renewal of APA

For continuing transactions, APA application is required to be filed before the first day of the financial year which is part of the advance years (i.e. if the APA years are from FY 2019-20 to 2023-24, application needs to be filed on or before March 31, 2019)

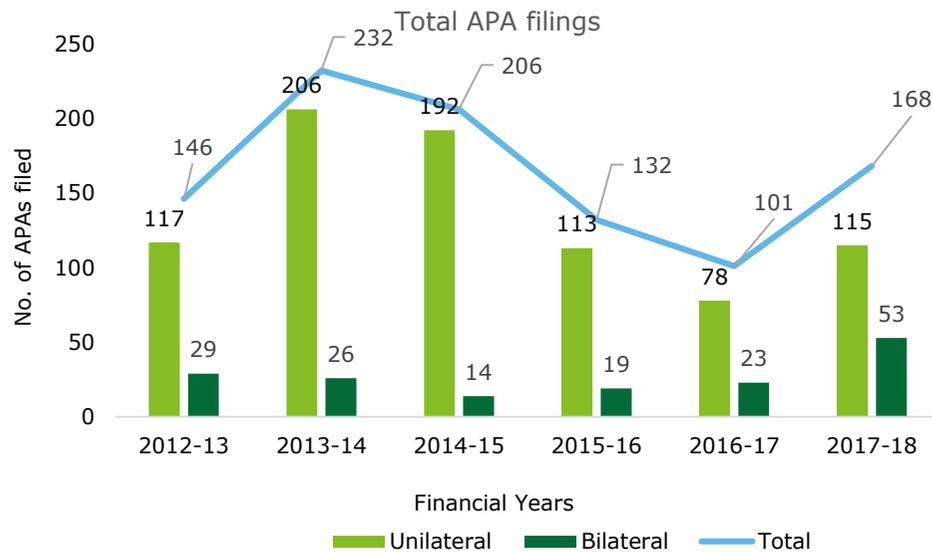
Term of APA

APA is allowed for a maximum period of 5 years (advance years) and the roll back, normally, for a block of 4 years preceding the APA years

Overview of APA – India

Snapshot of applications filed

Total applications filed*



- Total APA applications filed with the CBDT are 1,145 so far
- Close to 85% of the applications filed are unilateral. Of the total bilateral applications, maximum applications are with US, UK and Japan
- Over the period, more than 35* unilateral applications have been converted to bilateral
- Only one bilateral has been converted to unilateral

Bilateral applications filed country-wise*



In last six years, close to 130 UK headquartered companies have applied for APA in India, out of which 45 have applied for bilateral APA which is 30% of the total bilateral applications in India as of March 2018

* Source : Annual Report on the APA programme in India FY 2017-18

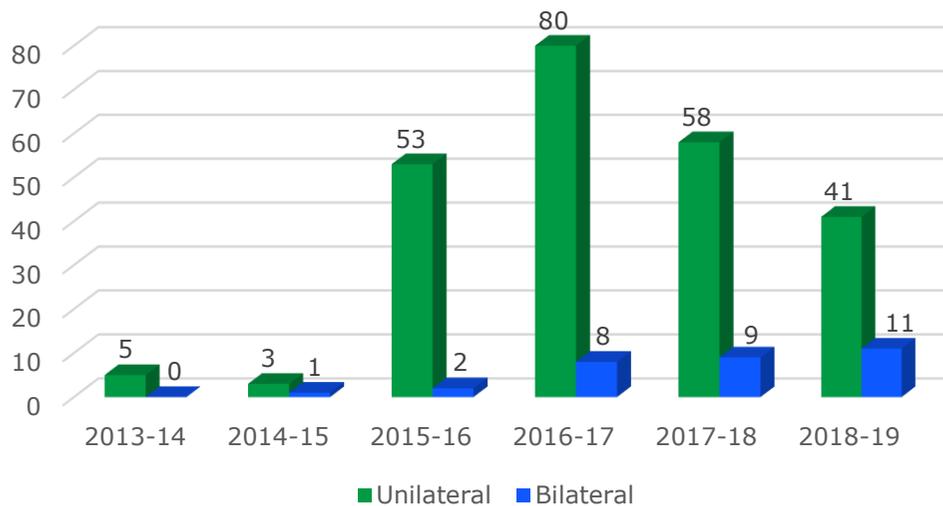
Overview of APA – India

Snapshot of APA conclusions



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

APA conclusion in India



- Significant momentum gained in 3rd year with 55 APAs signed in FY 2015 – 16 and 88 in in the 4th year i.e. in FY 2016-17, 67 APAs in FY 2017-18 and 52 APA in the last FY. The APA program has now crossed the 270 .
- First bilateral APA was signed in December 2014 with Japan in less than 2 years

- India has resolved the highest number of its bilateral APAs with the UK
- Of the total 31 bilateral APA resolutions, close to 32% (i.e. 10) bilateral conclusions are with the UK
- More than 70 UK headquartered companies have attained TP certainty through unilateral APAs in India
- Industries covered in these concluded APAs – manufacturing of auto components, chemicals and IT-ITeS service providers
- International transactions covered in these APAs- brand royalty, intra group service charges, IT services and ITeS, investment advisory services, marketing support services

Source : Annual Report on the APA programme in India FY 2017-18 and press releases issues by the CBDT

Overview of APA – UK

Introduction

Legislation enabling HMRC to enter into APAs was introduced in 1999, and can now be found in TIOPA 2010

Types of APA

Unilateral, bilateral or multilateral APA can be filed

Pre-filing

An pre-filing meeting is required with HMRC due to current practices, such as deploying government resources appropriately and HMRC's "complexity threshold"

Any new transactions

For new transactions, HMRC would usually expect the transaction to be implemented before an APA is sought

Renewal of APA

Greater reluctance to enter into renewals where there is no significant change that would prompt a differing TP methodology.

Term of APA

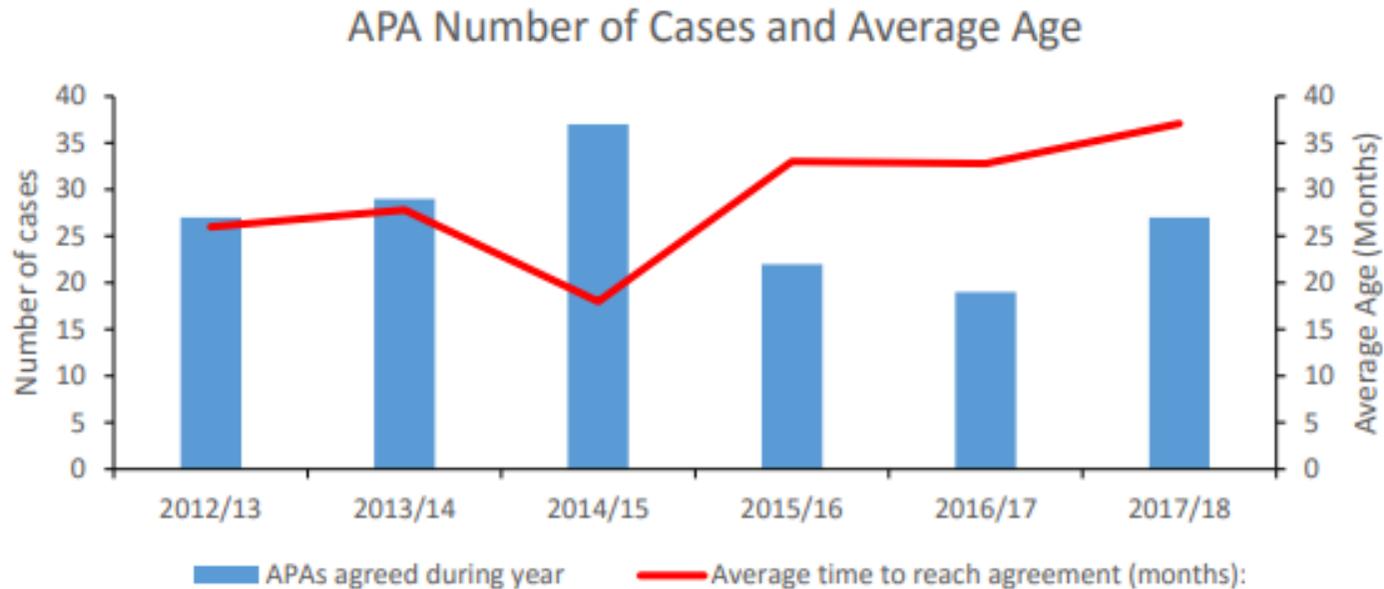
No specified maximum period for an APA, but unlikely to be in excess of 5 years

HMRC willing to consider roll-back on a case-by-case basis



Overview of APA – UK

Snapshot of applications filed, rejected and completed



	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Applications made during year	45	43	66	47	32	16
Applications turned down	0	0	2	3	5	6
APAs agreed during year	27	29	37	22	19	27
Average time to reach agreement (months):	26	27.8	18.00	33.0	32.8	37.1

In last six years, 249 APA applications have been made to HMRC, with 16 applications rejected and 161 agreed. Of the 249 applications lodged over the period, 45 were with India, accounting for c.18% of all applications filed.

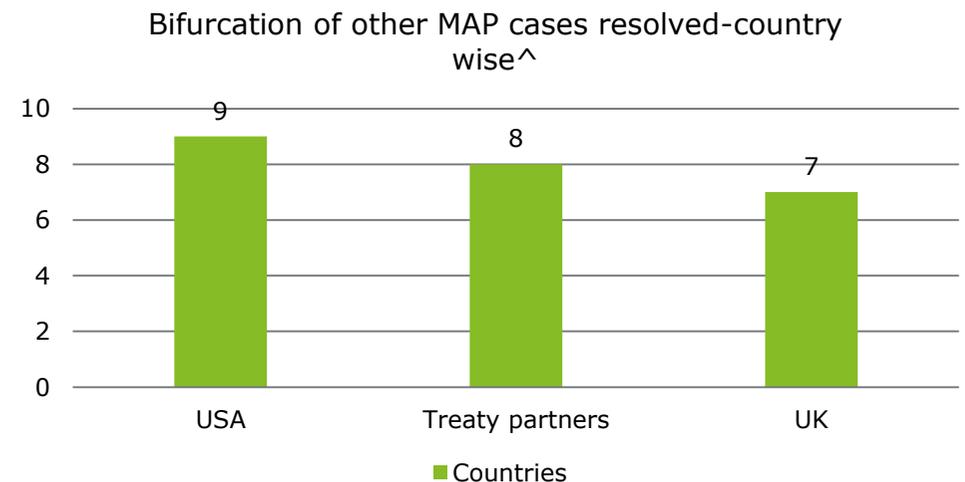
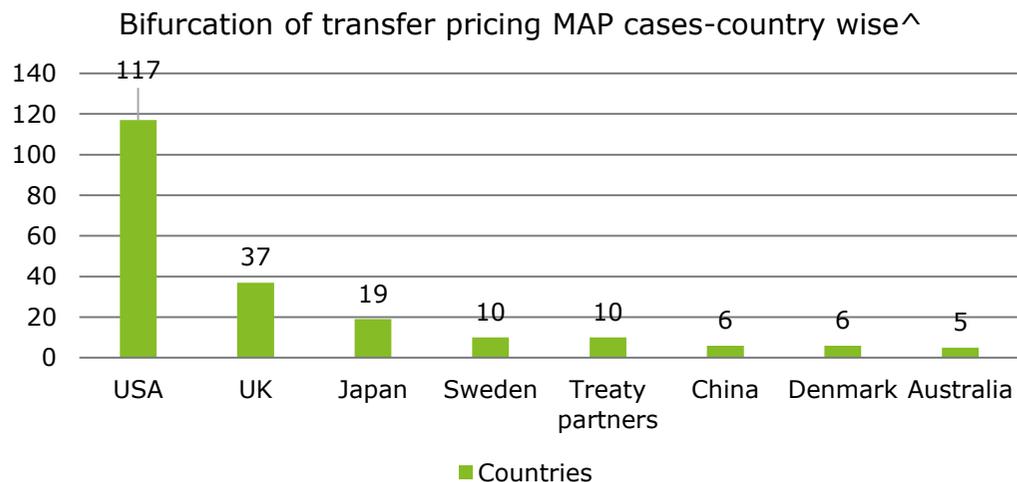
Source : HMRC Transfer Pricing and Diverted Profits Tax Statistics for 2017-18

Overview of MAP



Overview of MAP – India and UK

- From April 01, 2014 to December 31, 2017, India has successfully resolved over 500 tax disputes* with USA, UK, Japan, China, Netherlands etc. under MAP.
- Transactions resolved under MAP include provision of IT services and ITeS (BPO and KPO), payment of royalty, payment of management fees, cost contribution arrangements, engineering design services, contract R&D services etc.
- As of 01 January 2017, the UK had a start inventory of 319 (209 TP) MAP cases, had started 344 (110 TP) cases and settled 206 (67 TP) cases.
- Of the 67 TP cases settled, 4 were relieved unilaterally, 2 were resolved using domestic remedies, 46 resulted in 100% of the double taxation being resolved, 2 with partial resolution and 4 with another outcome. 2 cases were denied and 4 were settled with no agreement. 3 were withdrawn by the taxpayer.
- The average time taken by HMRC to resolve cases in 2017 was 38.6 months.



*Source : *Annual Report published by the Ministry of Finance FY 2017-18 up to December 31, 2017

[^] OECD - India's MAP statistics up to December 31, 2017 (MAP cases started before January 1, 2016 and closed in 2017 are not included)

Our BAPA & MAP experience



Our experience of BAPA/MAP

BAPA

- **Filing timelines** – Both the countries have different due dates for filings. So, filing to be planned appropriately for consistent period.
- **Acceptance of BAPA applications** – UK accepts applications after detailed scrutiny. Limited acceptance of UAPA applications.
- **Joint site visits** - In some cases, HMRC participated in site visits in India. Similarly, Indian CA also participated in site visits in UK.
- **Negotiations** – CAs regularly communicate through mail exchanges and final negotiations are concluded during the bi-annual meetings.
- **Timeline for bilateral resolutions** - Generally conclusion takes approx. 30-36 months for the conclusion of BAPA.
- **Conversion possible** - India allows conversion of BAPA to UAPA and vice versa. HMRC expects applications to be made on a bilateral basis.
- **Combination of unilateral and bilateral applications**
– India allows single application for BAPA as well as UAPA. HMRC expects APA applications to be on a bilateral basis only, other than in certain circumstances.

MAP

- **Bilateral tax treaty** – Article 27 of the India-UK DTAA authorizes both countries to enter into bilateral negotiations.
- **Limitation period for application filing** – India- UK treaty does not provide any period of limitation to apply for MAP. The deadline for applying for MAP is determined by UK domestic legislation. This will change under the MLI, once this is ratified by India.
- **Relief from tax demand** - MAP application with the UK allows the benefit of deferment of tax demand (as per the MoU for suspension of enforcement of collection of taxes). Large number of UK MNCs have applied to HMRC to resolve double taxation through MAP due to tax and TP adjustments in India.
- **Negotiations** – Effective negotiations between the two countries started after 2015. MAP requests from India were welcomed by HMRC way before 2015 as well.
- **Timeline for resolutions** – Generally 24 to 36 months; having given that the CAs have reached a settlement on similar cases for other companies, the time frame may be shorter.

Case studies – India-UK specific experiences



Case study 1 – Intra Group Services (IGS)

Key issues/challenges

- IGS challenged – looked by the Indian revenue at as means to repatriate money
- Considered as a shareholder activity or duplicative or non-beneficial services
- Usually disallow the entire/part of the IGS
- Documentation to be maintained by the taxpayer each year

Approach and outcome

- APA authorities evaluate the following:
 - Need, benefit and rendition test
 - Computation methodology – basis for allocation
 - Consistency with group policy
- APA resolution for IGS is generally achieved as a percentage of sales. UAPAs are concluded with an upper cap of 2-3% on sales and BAPAs are concluded with an upper cap of 4-5% on sales
- Global cross charge report, agreements, back-up invoices are some of the documents that are required to be maintained as part of post APA compliance process
- In case of lower profits, the IGS cost would be reduced automatically to maintain the minimum profit levels

Case study 2 – Payment of royalty

Key issues/challenges

- Yearly benefits derived from license of IPs being challenged
- Reason for multiple payments for intangibles – royalty and technical fees for services being charged separately
- Royalty is generally not allowed in case of loss scenario

Approach and Outcome

- APA authorities evaluate the following:
 - Need and benefit through factory/site visit, detailed discussion with key personnel and supporting documentation of benefit test
 - Comparison of royalty rates paid by Indian entity vis-à-vis other Group entities
- Royalty agreed:
 - As a fixed percentage; or
 - On residual profit split method; or
 - Fixed percentage with residual split in case of abnormal profits
- Royalty payments allowed in loss years with commercial justification that losses attributable to external factors such as underutilization of capacity, etc.
- Increase in royalty rates allowed with increase in profitability with an upper cap

Case study 3 – Provision of IT-ITeS (captive service providers)

Key issues/challenges

- Primary challenge around comparable selection, mark-up percentage on the cost base and components of such cost base
- Indian Revenue alleges that taxpayers in India are performing significant value added functions warranting high mark-ups
- Indian Revenue has been using the educational background/skill set/compensation/experience etc. of the Indian employees for alleging higher mark-ups
- Involvement of taxpayers in performance of DEMPE functions requiring PSM approach

Approach and Outcome

- APA authorities evaluate the following:
 - Understand the overall value chain of the business and role and responsibilities of the Indian entity
 - Conducting functional interviews of key stakeholders through site/office visits
 - Discussion on the components of the cost base of the Indian entity
- Captive service providers are generally allowed cost plus mark-ups – mark-up percentages depends on the complexity of functions
- APA provides disciplined system for invoicing and collection, such as:
 - Periodicity of invoice
 - Weighted average credit period
 - Interest for excess credit period

Case study 4 – Provision of investment advisory services

Key issues/challenges

- Audit issue primarily relates to compensation to the Indian advisors/sub-advisors
- Functions performed by Indian advisors/sub-advisors are generally compared to merchant/investment banking activities
- Significantly high mark-ups have been proposed to make transfer pricing adjustment
- Educational qualifications/skill set/compensation etc. considered to allege higher mark-ups during audit

Approach and Outcome

- APA authorities evaluate the following:
 - Understands the entire investment process activity flow with specific focus on the areas/key functions undertaken by the taxpayer
 - Conduct interview of the taxpayer's deal/investment team to corroborate the functions, assets and risk analysis
 - Discussion on the components of the cost base of the Indian entity
- Cost plus mark-up considered as the most appropriate approach to benchmark the Indian advisors/sub-advisors
- More recent trends shows that the APA authorities are enquiring about inclusion of ESOPs etc. in the cost base of the Indian advisors/sub-advisors

Case study 5 – Manufacturing activities

Key issues/challenges

- Challenges in comparable selection by the Indian Revenue – companies with high mark-ups are sometime cherry picked
- Aggregation approach involving multiple transactions at times is challenged to propose transfer pricing adjustment
- Re-characterization of FAR in a few cases – contract manufacturer being compared with a full fledged manufacturer etc.
- Benefit of economic adjustments denied (risk, working capital adjustment etc.)

Approach and Outcome

- APA authorities evaluate the following:
 - Understanding the value chain, resulting business model and key business drivers of the taxpayer
 - Conducting functional interviews of key stakeholders through site/office/factory visits
 - Discussion on appropriateness of aggregation approach for closely linked transactions
- Aggregation approach considered acceptable by the APA authorities along with transaction by transaction corroborative analysis
- In a few cases, transaction specific benchmarking considered as primary approach by the APA authorities – overseas tested party can be acceptable
- Flexibility in allowing capacity utilization adjustments as well as other economic adjustments

Key considerations



Key considerations



BAPA outcomes

- BAPA negotiations allows better outcomes for taxpayers than UAPA



Overriding nature of BAPAs

- BAPAs may override the domestic rule over treaty and relax some of the conditions
- Allows lowering the taxable income for earlier years which is not allowed as per Indian tax laws



Cash repatriation

- This condition is required in almost all the APAs. Expectation of Indian revenue is that the taxpayer has to bring money into India



Secondary adjustment

- With the introduction secondary adjustment rules in India, cash repatriation condition has become mandatory from FY 2016-17 and is no more negotiable for any TP adjustment relating to FY 2016-17 and onwards



Credit period

- Conditions relating to maintenance of weighted average credit period and interest for excess credit period is generally negotiated and agreed in the APAs

Abbreviations

Abbreviation	Description	Abbreviation	Description
TP	Transfer Pricing	BPO	Business Process Outsourcing
AE	Associated Enterprise(s)	KPO	Knowledge Process Outsourcing
FY	Financial Year	R&D	Research and Development
UK	United Kingdom	OECD	Organization for Economic Co-operation and Development
USA	United States of America	CA	Competent Authorities
USD	United States Dollar	HMRC	Her Majesty's Revenue and Customs
FDI	Foreign Direct Investment	BAPA	Bilateral Advance Pricing Agreement
MNC	Multinational Corporation	UAPA	Unilateral Advance Pricing Agreement
IT	Information Technology	DTAA	Double Taxation Avoidance Agreement
ITeS	Information Technology Enabled Services	MoU	Memorandum of understanding
IP	Intellectual Property	ESOP	Employee Stock Ownership Plan

Questions & answers





Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

This material has been prepared by Deloitte Touche Tohmatsu India LLP (“DTTILLP”), a member of Deloitte Touche Tohmatsu Limited, on a specific request from you and contains proprietary and confidential information. This material may contain information sourced from publicly available information or other third party sources. DTTILLP does not independently verify any such sources and is not responsible for any loss whatsoever caused due to reliance placed on information sourced from such sources. The information contained in this material is intended solely for you. Any disclosure, copying or further distribution of this material or its contents is strictly prohibited.

Nothing in this material creates any contractual relationship between DTTILLP and you. Any mutually binding legal obligations or rights may only be created between you and DTTILLP upon execution of a legally binding contract. By using this material and any information contained in it, the user accepts this entire notice and terms of use.

©2019 Deloitte Touche Tohmatsu India LLP. Member of Deloitte Touche Tohmatsu Limited

Deloitte Touche Tohmatsu India Private Limited (U74140MH199 5PTC093339), a private company limited by shares, was converted into Deloitte Touche Tohmatsu India LLP, a limited liability partnership (LLP Identification No. AAE-8458), with effect from October 1, 2015.