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Fast-tracking advance pricing agreements for India's global capability centres
Deloitte Tax Policy Paper 8

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Executive summary

India's export of services led by IT and business services has grown substantially. This has been underpinned by Multinational Enterprise (MNE) groups (primarily from the US) setting up Global Capability Centres (GCCs) in India using the technical and English language skills of India's growing workforce. To maintain India's global competitive edge in the GCC sector, the ease of doing business for these GCCs needs to be

constantly monitored and improved. A common challenge for GCCs is negotiating tax certainty for their transfer pricing transactions with their foreign headquarters and other companies within their MNE group. This paper looks at the transfer pricing challenges faced by GCCs and suggests ways to fast-track Advance Pricing Agreements (APAs) (especially for US-headquartered MNEs) to strengthen tax certainty for GCCs operating in India.



Background

In the financial year (FY) 2023-24, India's export of services at US\$339.62 billion exceeded its export of merchandise goods (excluding petroleum, gems, and jewellery) at US\$320.21 billion.¹ Service exports continue to gain global market share, led by the IT sector. Work from home during the COVID-19 pandemic hastened the adoption of e-commerce, led to higher IT spending globally, and accelerated digital investments by businesses and governments. Multinationals are transforming their business processes to be more agile and adaptive by setting up cloud-based backend technology infrastructure.

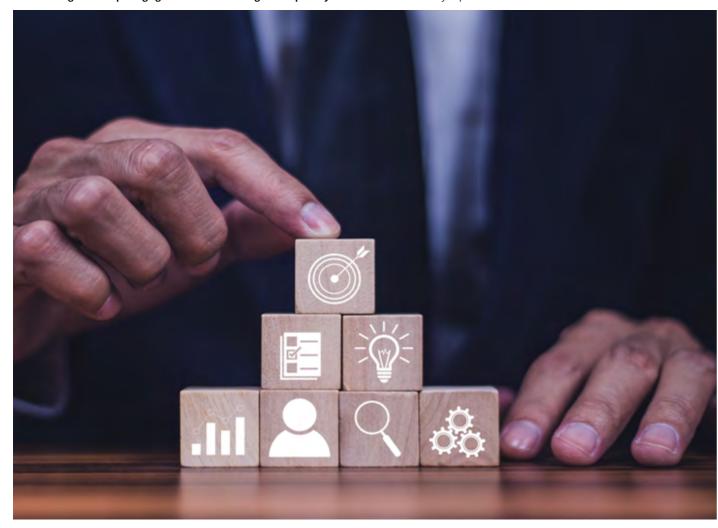
The Reserve Bank of India's quarterly data on the balance of payment and services exports shows that telecommunications, computer, and information services at 49 percent² and other business services at 26 percent accounted for three-fourths of the total services exports from India in the first six months (April-September) of FY 2023-24. The GCC sector, which generates export revenues from India under both of these heads, has led to this substantial growth. GCCs are units set up in India by overseas Multinational Enterprises (MNEs) to provide centralised global technical services, R&D, engineering, and IT support. Many large MNEs have set up GCCs in India, and the number increased from 1,026 in FY15 to 1,580 in FY23. In Q4 2023, 10 new GCCs were established in India and ~60 percent of the GCCs established included the three functional areas: engineering

research and development (ER&D), IT, and business process management. Furthermore, ~65 percent of the GCCs established in India are headquartered in the Americas, predominantly in the US. The GCC market is valued at US\$46.0 billion and is growing at a CAGR of ~11.4 percent.³

India's large, young, technology-savvy workforce with English knowledge skills has been the primary driver for creating a competitive advantage for the country in the GCC sector. Rapid improvements in technology and transport infrastructure have also raised the confidence levels of MNEs in setting up their GCCs in India.

The business environment and ease of doing business in India should be constantly evaluated, monitored, and improved to further enhance and cement its competitive advantage in this sector.

One of the identified improvement areas is in APAs, which the GCCs enter into with tax authorities to ensure a dispute-free, agreed-upon transfer price for their services to their MNE affiliates abroad. This paper looks at steps that the Indian government could take to expedite the negotiation and conclusion of these APAs to give GCCs a tax-litigation-free operating environment to improve India's competitive advantage.



Standard business model of a GCC and challenges

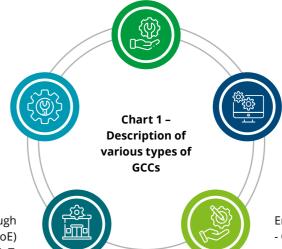
The GCC journey started as small centres set up by MNEs which managed a single function; their competitive advantage was the arbitrage from savings on service-related labour costs. Over the decades, they have now evolved into large, multifunction, globally integrated centres of excellence, using much faster telecommunications and skilled workforce available at scale. GCCs manage backoffice and front-office applications and maintain the telecommunications and cloud backbone of MNEs'

operations. They take care of substantial parts of the procurement, finance, tax, and people functions of the MNE using digital solutions and models. They are increasingly involved in analytics, cybersecurity, and R&D functions, innovating, supporting, and collaborating with other companies in the MNE group. As a result of these multiple activities, a GCC becomes a large, complex business unit with its own finance, procurement, and people-related functions.

Chart 1 describes various types of GCCs set up in India. Many could also offer a mix of these services.

Intra-group services -human resources, information technology, procurement, etc.

R&D services in areas such as bio technology, pharmaceuticals, software, and engineering design



Standard IT/ITeS services software development, call centres, back office support, etc.

Analytical services through Centres of Excellence (CoE) using digital technology, IoT, AI/ML, etc. Engineering design services - CAD/CAM, product design, structural analysis, etc.

Challenges faced by GCCs in India

India has a comparable corporate tax rate (~34.3 percent if tax incentives are claimed/~25 percent if no tax incentives are claimed) to those in upcoming competitive jurisdictions, such as the Philippines (~25 percent) and Malaysia (~24 percent). Hence ease of tax compliance becomes a differentiating factor.

Though India is a hub for the setting up of GCCs by MNEs, companies face the following tax/transfer pricing challenges in the country

The number of tax/transfer pricing audits (assessments) in India is substantially higher compared with other developing markets, such as Malaysia and the Philippines. This is accompanied by the attendant potential risks of tax authorities determining a Permanent Establishment (PE), income attribution, and withholding tax.

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Alternate dispute resolution mechanisms

To address transfer pricing uncertainties and provide a stable working environment for businesses, Indian tax authorities have introduced the following alternate dispute resolution mechanisms to reduce compliance and litigation



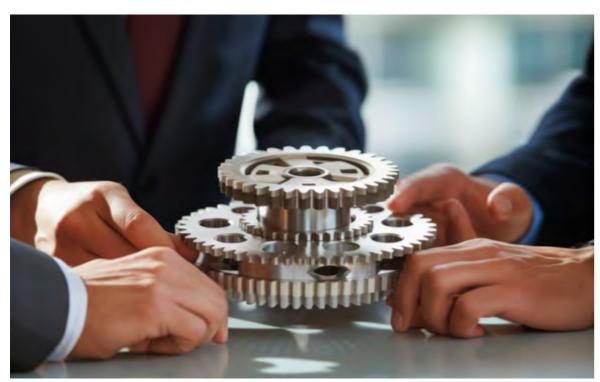
Safe Harbou

SHRs lay down circumstances in which income tax authorities can accept the transfer price declared by the taxpayer for certain specific nature of transactions, such as IT, ITeS, engineering design, R&D, low value-added intra-group services (LVIGS), and corporate guarantee. Where the activities of a business fall within the broad definitions laid down under the SHR and its transactions are below the mandated threshold limits, it can opt for the safe harbour route and file an application with the income tax authorities. However, SHRs are generic and adoptable only by small and medium-sized enterprises (due to threshold limits). In addition, tax certainty achieved via SHR is unilateral, i.e., between the company and Indian tax authorities. It does not provide tax certainty in the foreign tax jurisdiction, unlike in an APA.



Advance Pricing Agreements (APAs)

In line with global best practices, the government introduced an APA programme in 2012 (through the Finance Act, 2012) to provide enhanced tax certainty to MNEs in India. The Indian APA regime now includes three types of APAs: Unilateral APA (UAPA), Bilateral APA (BAPA), and Multilateral APA (MAPA). APA applications cover three business sectors: manufacturing, trading, and services, with most applications from the service sectors, particularly the IT and ITeS sector. While a UAPA offers unilateral tax certainty in India to the taxpayer for the pricing of its related party international transactions, a BAPA/MAPA provides bilateral/multilateral tax relief to the MNE group as a whole both in India and other foreign jurisdictions involved in the group's related party international transactions.



Difference in transfer prices – Compliance versus litigation versus alternate dispute resolution mechanisms

Analysis of India's SHR and APA provisions brings out the challenges in early resolution given the difference in the benchmarking outcomes in (i) the 'local file' prepared and maintained by the MNE

taxpayer, (ii) benchmarking results proposed during transfer pricing assessments by the tax authorities, (iii) safe harbour margins for similar activities, and (iv) outcomes from a UAPA/BAPA.

Table 1 gives a snapshot of the difference in transfer pricing rates (indicative markups) for each class of international transaction (specific to GCCs).

Table 1 - Snapshot of transfer prices⁴

SI. no	Eligible transactions	Benchmarking analysis (local file) by taxpayer	Transfer pricing audit by tax authorities	Safe harbour rules⁵	APA/BAPA outcomes
1	Provision of software development services (other than R&D services)	12-18%	18-25%	>/= 17% > / = 18%	18-20% (UAPA) and 15-18% (BAPA)
2	Provision of ITeS (other than R&D services)	10-20%			
3	Provision of knowledge- based services/ engineering design services	16-25%	20-30%	18-24%	17-20%
4	Provision of support services	10-18%	13-18%	None	12-15%
5	Provision of contract R&D services relating to software development services	15-20%	25-40%	>24%	20-22%

MNEs in India face uncertainty in determining a transfer price due to these varied benchmarking outcomes.

MNEs setting up operations in India face a challenge in determining their transfer prices, given that different benchmarking outcomes are obtained under different forums in India.

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⁴Based on recently concluded transfer pricing audits, APA outcomes in India and safe harbour rules prevalent in India 5Based on certain thresholds prescribed under the Indian transfer pricing regulations



Importance of unilateral and bilateral APAs for GCCs

Over the past 10 years, more than 1,600 APA applications have been filed in India. In the initial years, the Indian Competent Authorities (CA) have successfully resolved BAPAs with several countries, such as Japan, the UK, the US, Australia, Switzerland, and the Netherlands. Many APA applicants who have witnessed the successful closure of their BAPAs have applied for the renewal of the BAPA for another term. In this period, APA applications were for a variety of business activities, covering services and manufacturing in diverse combinations. The APA applications cover various industries such as food & beverages, health & hygiene, industrial/ commercial goods, IT, and automobiles, with the services sector contributing the maximum number. Overall, the services sector contributes ~30 percent of the total applications signed (both UAPA and BAPA) in India. A diversified basket of international

transactions shows the maturity of the APA programme and the competence of the APA teams in processing applications that include complex transactions. The success of the APA programme hinges on a foundational approach of periodic review and continuous, iterative, quality, and process improvements to delivery and outcomes. Using data to glean valuable learning and using it for improvement of the APA process should be an inbuilt, systematic characteristic of the APA regime.

MNEs operating GCCs in India face transfer pricing issues as their substantive transactions are with their overseas group companies. The major transactions of a GCC are the export/import of services to/from other group companies of the MNE, more commonly termed related party transactions. Accordingly, the prices paid and received in these transactions

between the GCC and its overseas related entities need to be evaluated by the Indian income tax authorities to ensure that these 'transfer prices' adhere to the arm's length principle. This assists in accurately determining the income earned by the GCC and offered for tax in India. The advantage for an MNE that enters a BAPA (compared with a UAPA) for its unit in India is that in a BAPA, the tax authorities of both countries (India and the other country, say the US) are involved. They negotiate the 'transfer price' of the transactions between the Indian

affiliate of the MNE and its headquarters/affiliates (say, located in the US). As a result, the MNE group gets tax certainty about its 'transfer price' in both India and the other jurisdiction (say, the US). In the case of a UAPA, the agreement will only be between the Indian unit and Indian tax authorities, which will provide certainty on taxes to be paid in India, but credit for these taxes in the other country (say, the USA) may still be disputed by the tax authority.

Status of India's BAPA regime

To get overall tax certainty on their transfer pricing transactions, MNEs have been filing for BAPAs (since they were first introduced under the APA regime), while others converted their existing UAPA

applications to BAPA applications. In FY22-23, about 40 percent of the APA applications filed were for BAPAs (**Table 2**).

Table 2 - Summary of APA applications filed⁶

Financial year	UAPA applications	BAPA applications	Total
2012-13	97	37	134
2013-14	175	39	214
2014-15	169	30	199
2015-16	113	24	137
2016-17	80	25	105
2017-18	121	52	173
2018-19	124	47	171
2019-20	76	50	126
2020-21	100	33	133
2021-22	39	35	74
2022-23	116	77	193
Total	1,210	449	1,659

⁶Source: Advance Pricing Agreement (APA) programme of India - Annual Report, August 2023

Table 3 gives the country-wise status of BAPA applications filed, signed, disposed of, and under process from FY 2012-13 to FY 2022-23. As of 31 March 2023, out of the 449 BAPA applications filed, 140 had been signed or disposed of, and 309 were under process, a pendency of ~69 percent. USrelated BAPAs accounted for ~46 percent of BAPA filings and ~49 percent of the pendency.

Table 3– Country-wise status of BAPA applications⁷

Country	Applications filed (including UAPAs converted to BAPAs)	Agreements signed	Applications disposed of due to other reasons	Applications under processing
	Α	В	c	D=A-B-C
US	205	45	9	151
UK	71	18	23	30
Japan	39	10	2	27
Switzerland	20	6	1	13
Singapore	16	2	2	12
Finland	15	3	1	11
Germany	10	0	0	10
Sweden	9	0	0	9
South Korea	9	0	0	9
Australia	9	3	0	6
Canada	6	0	0	6
Ireland	6	0	1	5
Denmark	10	6	0	4
France	5	0	1	4
Netherlands	10	3	4	3
Luxembourg	2	0	0	2
Italy	2	0	0	2
New Zealand	1	0	0	1
China	1	0	0	1
Czech Republic	1	0	0	1
Belgium	1	0	0	1
Indonesia	1	0	0	1
Total	449	96	44	309

Table 4 gives a description of the nature of the major transfer pricing transactions, that is, those transactions that were covered in 10 or more

resolutions out of a total of 179 different categories of transactions covered under the APA regime.

Table 4 - Description of the nature of major transfer pricing transactions⁸

Nature of transaction	Number of transactions
Reimbursement/Recovery of expenses	36
Provision of ITeS	19
Trade receivables and payables	16
Provision of software development services	13
Other closely linked transactions	11
Purchase of fixed assets	11
All other categories of transactions (each covered in less than 10 resolutions)	73
Total	179

The highest number of categories covered (reimbursement/recovery of expenses, provision of ITeS, and software development services) under APAs typically relate to transactions undertaken by GCCs with their MNE counterparts/headquarters abroad.

Table 5 shows the time taken to resolve BAPAs that were signed by the end of FY 2022-23. About 46 percent (44 out of 96) of those signed agreements took an average of 3-5 years to resolve. Per the government's annual report on APAs, while a

number of BAPAs are actually resolved earlier, due to reasons such as the MNE wishing to conclude both the unilateral and bilateral legs of its application together, the formal signing takes longer. This increases the duration of processing BAPAs.

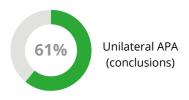
Table 5 - BAPAs signed until 31 March 20239

Duration of processing	Agreements signed until 31 March 2023 (FY 2022-23)
1 within 12 months	1
13-24 Months	3
25-36 months	11
37-48 months	22
49-60 months	22
61-72 months	13
73-84 months	14
85-96 months	6
97-108 months	3
108-120 months	1
Total	96

Table 6 provides an overview of the APAs concluded in the services sector (involving transactions specific

to GCCs such as software development services and ITeS) up until March 2023.

Table 6 - APA conclusions in the services sector¹⁰





Service sector

Certainty

Certainty on the transfer pricing method to be applied to its cross-border transactions, reducing the risk of double taxation and providing a stable environment for business operations. This can help companies make informed decisions about setting up a GCC in India.



Efficiency

BAPAs can reduce the time and resources needed for dispute resolution, as well as the time and resources required for compliance with transfer pricing regulations. This can help companies set up a GCC in India more quickly and efficiently.



Competitiveness

BAPAs can enhance the competitiveness of India's GCCs by providing certainty and reducing the time and resources needed to resolve disputes and comply with transfer pricing regulations. This would help India's GCCs in ease of doing business and maintain India's competitive advantage.



BAPAs can attract more investment for setting up GCCs in India by providing certainty and reducing the time and resources required for dispute resolution and compliance with transfer pricing regulations.



Opportunity for fast-tracking APAs for the GCC sector

Recommended timelines for resolving BAPAs

The BAPA Manual on best practices issued by the Organisation for Economic Cooperation and Development (OECD) recommends (assuming timely responses by the applicant and accounting for specific circumstances of an application) a period of 30 months for completing a new BAPA case (from the receipt of a complete BAPA application by the competent authorities of both countries). This could be further reduced to 24 months once the respective countries have taken sufficient efforts to streamline and optimise their BAPA processes and resources.¹¹ Both governments can rely on concluded BAPAs to fast-track new applications.

Filing trends show that cumulatively, BAPA applications now account for ~30 percent of APA applications and that the number of BAPA applications is also increasing steadily (from 37 applications in 2013 to 77 applications in 2023; refer Table 2). This indicates that MNEs increasingly seek to achieve overall cross-border tax certainty by accessing BAPAs under India's APA regime. In addition, about 50 percent of BAPA applications filed, signed, and pending are related to MNEs headquartered in the US (refer Table 3). A substantial proportion of the transactions covered under these BAPAs (reimbursement/recovery of expenses,

¹¹Best Practice 5, Bilateral Advance Pricing Arrangement Manual, OECD Forum on Tax Administration https://www.oecd-ilibrary.org/taxation/bilateral-advance-pricing-arrangement-manual_4aa570e1-en

¹⁰Advance Pricing Agreement (APA) programme of India - Annual Report, August 2023

provision of ITeS, and software development services) reflect transactions undertaken by GCCs with their MNE group entities abroad (refer Table 4).

While many GCCs commence operations by undertaking a limited set of functions, they quickly scale up the value chain to provide niche services to their parent organisations. These business models entail tax and transfer pricing challenges for MNEs. Based on the best practice recommended timelines,

Indian tax authorities could engage with their US counterparts to resolve the GCC sector BAPAs in 24 months. To achieve this ambitious timeline, a focused implementation under the BAPA regime needs to be prioritised. This will give a fillip to the ease of doing business for MNEs operating GCCs in India

Conducting BAPA processes by leveraging virtual access

BAPAs could be fast tracked by using IT to enable virtual site visits and interviews of personnel of GCCs. As these are service entities, a detailed onsite examination of a manufacturing process is not involved. This would also be of administrative

convenience for both tax authorities and taxpayers in terms of coordinating travel and in-person meetings. Similarly, virtual meetings between the Competent Authorities (CAs) from the US and India would reduce the logistics of travel and save time in negotiations.

Formulating a BAPA framework agreement with a Mutual Agreement Procedure (MAP) framework

The recent successful resolution of transfer pricing-related double taxation issues by the CAs of India and US through a common 'framework agreement' under MAP of the India-USA tax treaty is a pointer to expediting similar resolutions under the BAPA programme. A framework agreement was formulated between the CAs of India and the US under the MAP provisions of the India-US Double Taxation Avoidance Convention (DTAC) in January 2015 to expedite a backlog of transfer pricing disputes relating to the US-headquartered Indian subsidiaries in the IT and ITeS sector. The countries

set out several financial parameters and the costplus margins that could be applied to each case. As a result, many MAP applications in the IT and ITeS segments have been resolved, significantly reducing the inventory of pending MAP cases.

A similar approach could also be devised for pending UAPAs and BAPAs for IT/ITeS applications under the APA regime, even though in APAs the arms' length price would be determined based on the Functions, Assets, and Risk (FAR) analysis of the particular taxpayer. As many pending UAPAs and BAPAs would

be IT/ITeS cases, a similar mechanism can help expedite negotiations and conclusions between the CAs, thereby reducing the pendency of cases.

In a BAPA, the CAs enter a negotiation process based on which the briefing/position paper is prepared by the field team. However, analysing the outcome data for a similar set of APA applicants (for example, in the IT and ITeS sector; refer Table 1), it is evident that they cluster around a modal arm's length price, so despite detailed FAR analysis and site visits, the outcomes are quite close to an 'ideal' arm's length price. Recognising this, the process and outcomes of these completed APAs can be utilised to reduce the large inventory of similar APA cases. Otherwise, APA teams often invest a large part of their time asking and scrutinising varied information that may or may not be relevant for the case. The tax authorities in both countries can consider devising a framework of various quantitative and qualitative parameters and the range of arm's length prices between which the

negotiation can be done by the APA authorities with the taxpayers.

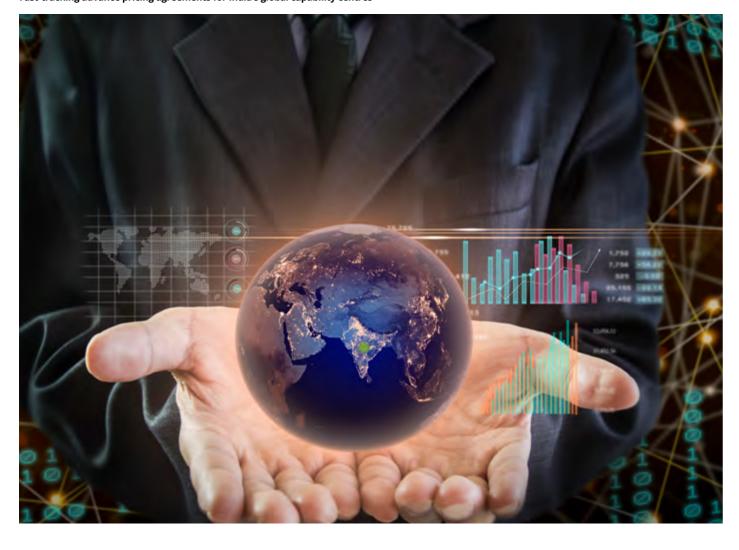
In the US, the APA programme works with the Office of the US Competent Authority (USCA) to resolve transfer pricing cases under the mutual agreement procedures of its bilateral tax treaties, under a common Advance Pricing and Mutual Agreement (APMA) programme. Since 2020, the Treaty Assistance and Interpretation Team (TAIT) has also been housed with APMA to resolve competent authority issues arising under other articles of US tax treaties. In India, a similar synergy exists between the BAPA negotiation and MAP programmes as they are housed under the same division.

Therefore, a fast-tracking mechanism for APAs for India-based GCCs between the CAs of the US and India is an achievable goal considering the resounding success of the framework agreement in resolving transfer pricing disputes under MAP.

Qualified Maquiladora Approach Agreement (QMA) between the US and Mexico

Another successful template for this would be the QMA, which is the result of an agreement between the US and Mexico in the 1960s to make investments in the manufacturing sector in Mexico more attractive. The QMA allows a US taxpayer to avoid double taxation on the contract manufacturing and assembly functions performed by its maquiladora (a factory in Mexico run by a foreign company and exporting its products to that company's country of origin). This is achieved through the

maquiladora entering into a unilateral advance pricing agreement with the large taxpayer division of Mexico's tax authority under terms negotiated in advance between the competent authorities of the two countries. The countries have crafted a series of agreements to refine and improve this process, including a framework agreement to avoid double taxation, which resulted in the creation of a QMA in 2016 and was renewed in 2020.¹²





Using the above templates, a similar comprehensive, flexible, and broad framework would reduce redundancy and increase the pace of UAPA and BAPA resolutions for GCCs in India set up by USheadquartered MNEs. This would, in turn, pave

the way for faster APA resolutions with other jurisdictions. Overall, it would encourage more investments by MNEs into India by facilitating seamless business operations and,- avoiding double taxation for their GCCs.



About the Tax Policy Group

Tax policy is evolving rapidly in India and globally. Globalisation and digitisation have brought unprecedented changes, and governments have cooperated internationally on new tax rules and a thrust for transparency in tax matters. Deloitte has contributed to global and domestic initiatives. It engages with international and country tax organisations and authorities and responds to their requests for submissions. It continues to keep clients informed of these changes and develops technology tools to assist them analyse the impact and comply with them.

The Tax Policy Group brings together the knowledge and experience of Deloitte tax professionals and subject matter experts around the country in the critical area of Indian tax policy. Its mission is to enhance dialogue among tax professionals, industry leaders, academia, and government.



Tax incentives for savingsAdjusting for changes in work-life



Indian advance pricing agreement programmeEvaluation and way forward



Authority for advance rulings in indirect taxes A critical analysis



Minimum alternate tax on companies Challenges and way forward



Advance rulings in IndiaDelivering greater tax certainty



Reducing income tax disputes in India
A way forward



Tax deduction and collection at source Easing compliances in India

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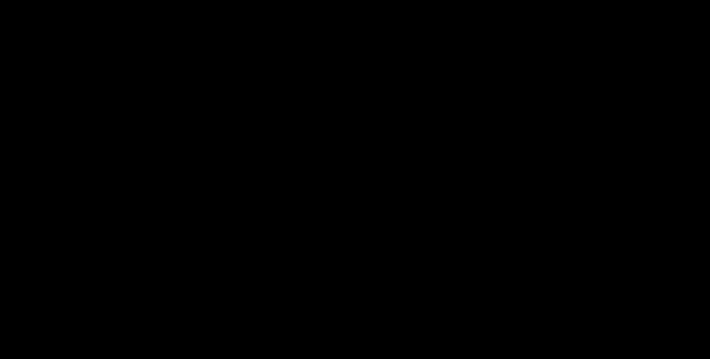
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