

**AN INDIAN PERSPECTIVE ON ADVANCE
PRICING ARRANGEMENTS AND SAFE
HARBOUR RULES**

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ADVANCE PRICING ARRANGEMENTS AND SAFE HARBOUR RULES

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INTRODUCTION

- Transfer pricing is a multi disciplinary subject with an interplay of taxation, economics, law and technical expertise.
- TP audits therefore need detailed disclosures, discussion and verification.
- The involvement of multiple jurisdiction in TP transactions, adds to the complexity.
- Adequate documentation and disclosures to justify ALP are the most effective antidote to TP disputes.

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- Tax payers are generally reluctant to share data and information with the tax authorities.
- TP adjustments and disputes are therefore growing.
- There is a demand for dispute prevention in TP.
- Tax payers desire that there should be simplicity, certainty and lower cost in TP compliance.

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- DRP was introduced as a dispute resolution / prevention measure.
- Safe Harbour (SH) Rules for TP dispute prevention are expected soon.
- The DTC has proposed the introduction of Advance Pricing Arrangements (APA) for simplicity, certainty and cost efficiency in TP.

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TRANSFER PRICING – DISTINCT FEATURES

- Tax payers have enormous expectations of simplicity and certainty from SH Rules and APA.
- TP however has certain distinct features, whose impact cannot be diluted by SH and APA. These are follows :-
 - ❖ Arms Length Pricing (ALP) is the crux of any TP law and its administration. ALP ensures that countries involved in a transaction get proper share of profits in their respective jurisdictions.

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- ❖ TP is a fact intensive application of the ALP principle with proper judgement.
- ❖ A detailed FAR is critical to establishment of ALP.
- ❖ Robust and detailed documentation is needed to justify FAR and ALP.
- ❖ Complexity of transactions demands detailed disclosure, discussion and sharing of data/documents, in the own interests of the assessee.

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- ❖ TP is a complex subject, which needs a multidisciplinary approach.
- ❖ TP compliance is expensive and time consuming.
- ❖ A spirit of mutual agreement and cooperation in TP audits, is better than an adversarial approach.
- ❖ Complexity and uncertainty are inherent to such transactions.

Transfer pricing is thus a taxing issue for the tax payers, as well as the tax authorities.

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DISPUTES IN TRANSFER PRICING

- TP is a complex and detailed process.
- Justification of ALP requires extensive multidisciplinary disclosures and discussions.
- The economic substance of intricate international transactions needs to be explained and substantiated.
- By the very nature of these transactions, there is always room for different interpretations.

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- Differences of opinion are more where FAR/disclosures is deficient.
- It leads to uncertainties in TP.
- Some of the common points of dispute/difference of opinion are stated hereunder :-
 - ❖ Choice of method, tested party and comparables.
 - ❖ Calculation of PLI.

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- ❖ Guarantees for the benefit of AEs.
- ❖ Working capital provided to AEs.
- ❖ Payment of royalty/fees for technical services.
- ❖ Use of intangibles and their valuation.
- ❖ Payments for brands/patents/copyrights.
- ❖ Transactions with AEs in tax havens.

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- ❖ Margins in cost plus methods.
- ❖ Interest on loans to/by AEs.
- ❖ Payments towards management fees/advisory fees.
- ❖ Sharing of costs with AEs.
- ❖ Risk adjustments.
- ❖ Multiple / overlapping payments.

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PRESENT DISPUTE RESOLUTION MECHANISMS

- A large incidence of disputes, hinders the efficiency of regulation.
- The Income Tax Act, 1961, recognises the need to mitigate/resolve disputes.
- The Act has provided for presumptive taxation in certain cases.

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The Act has provided the following authorities to mitigate/resolve disputes.

- Authority for Advance Rulings.
- Dispute Resolution Panel
- Commissioner of Income Tax (Appeals)
- Commissioner of Income Tax

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- Income Tax Appellate Tribunal
- MAP under DTAAAs.

Income tax law and administration are dynamic and ever changing and thus the demand for more effective means of dispute prevention / mitigation.

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NEED FOR SAFE HARBOUR RULES / ADVANCE PRICING AGREEMENTS –

- It is necessary to protect our tax base, but tax payers should not be put to avoidable hardship.
- Dispute prevention, without emaciating the force of regulation, is better than expensive and uncertain litigation.
- The set up of DRP has been the first step in this direction.
- Tax payers yet perceive DRP to be more a dispute resolution mechanism, than a prevention one.

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- There is a demand to prevent disputes in TP, for the sake of simplicity, certainty and compliance cost reduction.
- SH and APA are emerging as the most effective ways to reduce litigation in TP.
- Safe Harbour is not a new concept in India. The Act has several provisions of presumptive taxation.
- APA as proposed by DTC will significantly strengthen dispute prevention in TP.

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A BRIEF OVERVIEW OF SH RULES AND APA

- The Memorandum explaining the provisions of the Finance Bill 2009, stated that there has been considerable dispute, as a large number of transactions are being subjected to adjustment. It is therefore proposed to empower the CBDT, to formulate safe harbour rules i.e. to provide the circumstances in which the tax authorities will accept the TP declared by the assessee.

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- SH is a comfort mechanism meant to give compliance relief, administrative simplicity and certainty for tax payers and tax administrators.
- The concept of SH is that the results declared by a tax-payer who fulfills certain prescribed conditions are accepted without scrutiny.
- SH means that the results of the taxpayer who fulfills the required conditions are accepted and are exempt from detailed scrutiny.

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- APA is an arrangement between the tax authority and the tax payer that determines in advance of intra group transactions, an appropriate TP mechanism, for a fixed period of time.
- APA can be successful only if tax authorities are open and willing to reach an amicable solution and the assesseees are willing to share the necessary information with the tax authorities, under covenants of confidentiality.
- SH is general and APA is tax payer specific. They need to keep pace with market dynamics to be realistic and acceptable.

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SAFE HARBOUR RULES – PRESENT STATUS

- The Act has authorised CBDT to frame safe harbour rules.
- A committee has been set up by the CBDT to formulate rules for safe harbour provisions, that would enable IT authorities to accept TP without scrutiny.
- The Committee is chaired by the DG-International Taxation and consists of income tax officers and representatives from the ICAI and the trade/industry.

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- The objective of the committee is to set conditions under the SH Rules to facilitate the acceptance of TP and set acceptable margins as benchmarks for industries.
- The SH rules are at an advanced stage of consideration.
- Administrative procedures and conditions for involving the benefits of SH rules will be the subject of guidance by CBDT in future.
- The SH Rules are soon expected to be in place.

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THE DTC PROPOSALS / APA

- The DTC includes APA in the domain of transfer pricing regulations.
- APA has been defined by the code to mean an agreement between the taxpayer and the tax authorities for the upfront determination of ALP in relation to an international transaction.
- The DTC provides that the CBDT shall frame the APA scheme.

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- APA should get better cooperation due to joint negotiation and consultation.
- APA is an advance ruling, to have a prospective application, beginning after the date of execution for a limited period, subject that the facts and conditions on which the ruling was passed have not undergone any change.

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- The issues to be considered while framing of APA schemes would include :-
 - ❖ Confidentiality of data.
 - ❖ Acceptable range of factors.
 - ❖ Introduction of bilateral/multilateral APAs.
 - ❖ Duration of validity.
 - ❖ APA for SMEs.
 - ❖ Working relationships with other jurisdictions.
 - ❖ Possibility of retrospective applicability.

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- The combined / uniform objective of APA and SH is to :-
 - ❖ Provide compliance relief through simplicity.
 - ❖ Certainty of acceptance of TP.
 - ❖ Do away with TP audit.
 - ❖ Administrative simplicity.
 - ❖ Prevention of disputes.
 - ❖ Certainty of tax liability under international transaction.

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EMERGING ISSUES IN SH AND APA

- Global experience of SH and APA, though country specific, has been mixed.
- There is no universally applicable formula for all industries and transactions.
- Tax authorities need to protect their share of revenue in international transactions and cannot completely do away with TP audit.

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- The Rules of SH are awaited. A number of practical issues will however emerge upon application of SH Rules.
- Success of SH/APA is contingent on sharing of data by the taxpayer.
- In an everchanging /dynamic economy SH/APA will need an inbuilt flexibility to remain relevant even in changed conditions.



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Thank You Very Much