

## Ministry steps in to reduce transfer pricing disputes

After the hue and cry by corporate India over huge transfer pricing orders slapped by the tax department running into thousands of crores, the government has stepped in with a key reform. The finance ministry has directed the Central Board of Direct Taxes (CBDT) to put in place a framework for an Advance Pricing Agreement (APA) mechanism, two officials familiar with the development said.

“The government has given clearances to constitute the APA panel. The CBDT will now constitute a panel and put up draft rules,” said one of them. The ministry has also given its nod to appoint “an APA head”. The board is working to get the mechanism running by April 1, 2012, the official added.

Transfer pricing refers to adjustment of charges made between related parties for goods, services or use of property. It is a recent phenomenon and an emerging area of taxation, globally brought into existence by the emergence of multinationals, which has led to billions of dollars moving across countries within a single company.

<b>APA ADVANTAGES</b>
<b>FOR COMPANIES</b>
* Resolution of uncertainty on a prospective basis
* Prevention of double taxation
* Avoidance of penalties and litigation costs
* Lower compliance costs
* Development of a cooperative relationship with the tax authorities
<b>FOR GOVERNMENT</b>
* Increase in foreign direct investment as a result of more certainty around transfer pricing matters
* Reduced administration and enforcement costs
* Removal of disputes, litigation time and costs
* Experience helps with future improvements in regulations

At present, the taxman has a 43-month window after a tax year is over to come up with adjustments on transfer pricing. For example, this October, the tax department raised adjustments amounting to thousands of crores for transactions completed in financial year 2007-08. This creates a huge uncertainty for multinational corporations, often skewing their budgets and hitting investment plans, consultants say.

A lack of clarity and retrospective adjustments also result in double taxation in many cases. Companies find it difficult get refunds in such cases.

In this context, the government move is a welcome relief as it will help bring some kind of certainty for companies on their tax liabilities on account of transfer pricing, said consultants.

The finance minister had talked about the APA in past Budget speeches. Provisions related to APA were also included in the Draft Direct Taxes Bill of 2010. But, this is the first concrete step the government has taken towards operationalising the mechanism and could come into force independent of the implementation of the Direct Taxes Code, officials said.

An APA is a binding contract between the revenue department and a taxpayer by which the department agrees not to seek a transfer pricing adjustment for a transaction if the taxpayer files the tax return for a year consistent with the agreed transfer pricing method.

The mechanism is designed to resolve actual or potential transfer pricing disputes in a cooperative manner, as an alternative to getting into lengthy legal disputes. The direct taxes Bill had proposed a maximum validity of five years for such agreements.

Experts say the government should put in place the so-called safe harbour rules for the APA to function well. Rajan Vora, partner, tax & regulatory services, Ernst & Young said, "Safe harbour provisions, wherein the department clearly comes up with benchmarks on different transactions, should be operationalised. Individual companies can then apply for pricing agreements based on these provisions."

APAs may be unilateral (involving the tax authority of one country) or bilateral and multilateral, involving the tax authorities of two or more countries.

APAs are popular in many countries across the globe, including Australia, the US and Japan, and are used widely by companies in dispute resolution. A global survey by consulting firm Ernst & Young found the satisfaction level with APAs as a controversy management tool was very high and 90 per cent of users were likely to use it again.

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