APA, MAP, Safe Harbour, BAR, DRP, GRI 207 and ESG

All India Chartered Accountants Society

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EY
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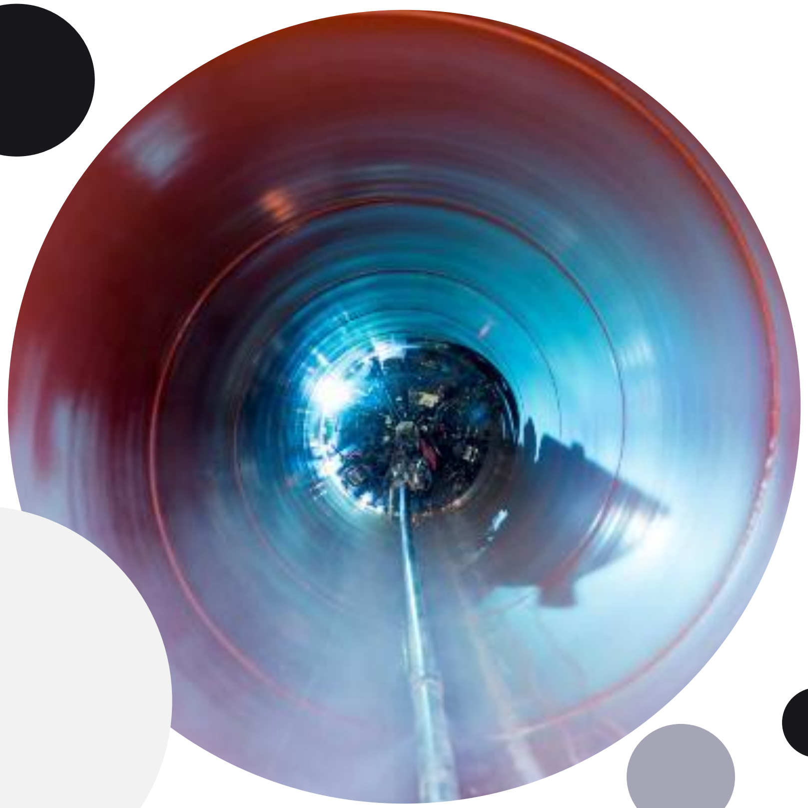
Contents



Advance Pricing Agreement

Background

- Purpose → Launched in 2012 as a dispute resolution mechanism to foster a non–adversarial tax regime
- Types of APA → Unilateral (“UAPA”), Bilateral (“BAPA”) and Multilateral
- Who can apply → Entities who have undertaken an international transaction or are contemplating to undertake can apply
- Coverage → 9 years (5 future years and 4 roll back years).

APA Process

Filing of APA application	Initial questionnaire, site visit, discussion and negotiation	Negotiation with other country (only if Bilateral or Multilateral)	Signing of APA
▸ Filing of pre-filing application (optional and could be anonymous) ▸ Preparation and filing of APA application ▸ Rollback (optional for 4 previous years)	▸ Initial questionnaire(s) issued seeking further details ▸ Site visits/ functional interviews conducted by APA Authorities to understand functional profile ▸ Position paper + face to face meetings	▸ Position paper prepared by APA Authorities ▸ Position paper is negotiated by Indian Competent Authority (“CA”) with foreign CA ▸ On completion of negotiations, the Indian CA formalize a Mutual Agreement (“MA”) document with foreign CA	▸ Acceptance of MA document by Applicant within 30 days ▸ Indian CA and Applicant finalize draft APA → seek CBDT approval ▸ APA signing

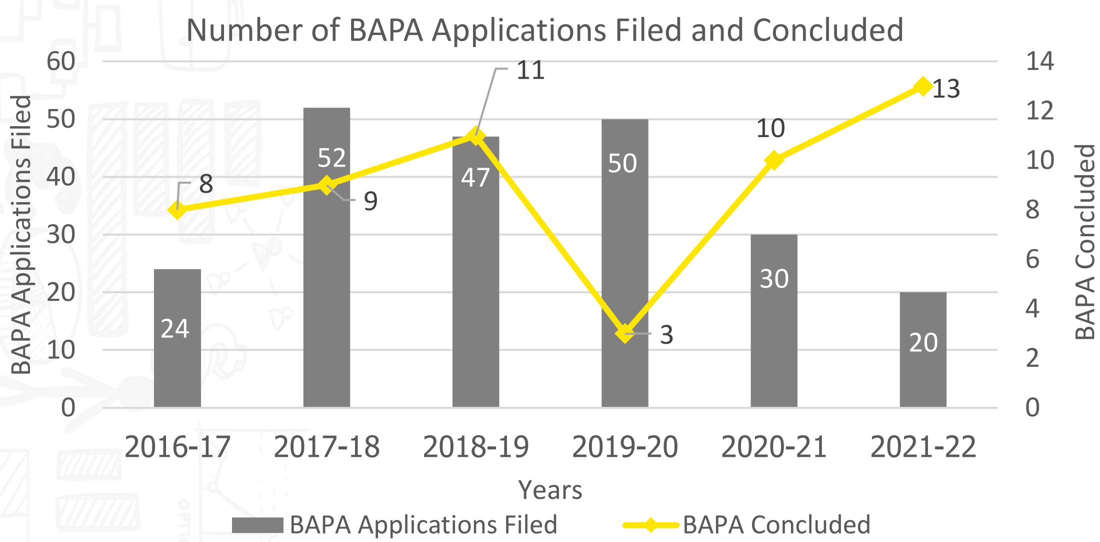
Key APA Statistics

Total APA applications filed as at end of March 2023 – 1450+ [UAPA – 1100+ and BAPA – 350+]

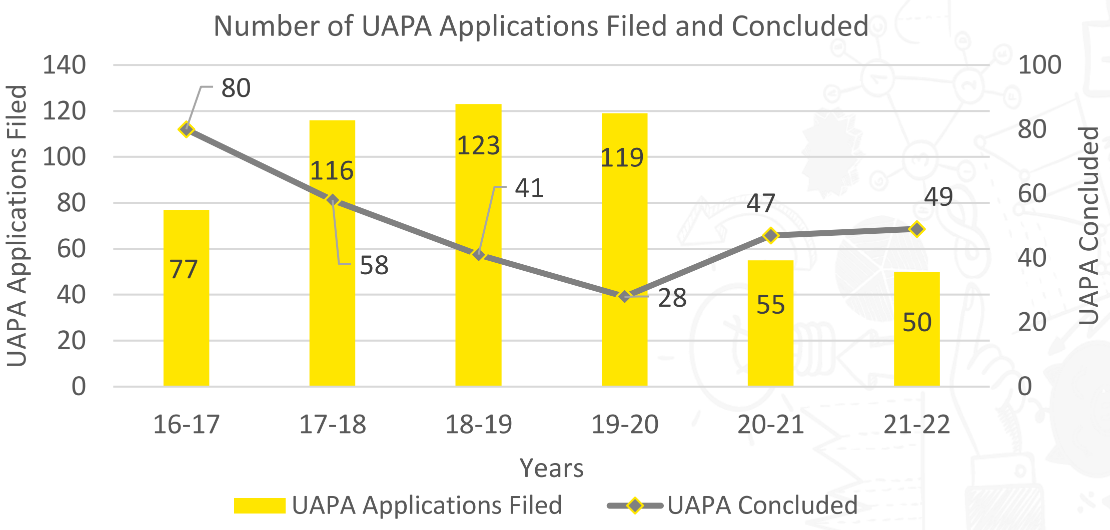
BAPA filing and conclusions..

UAPA filing and conclusions..

- As at the end of March 2023, **85+ BAPA Applications** were concluded
- Average time for conclusion **30 months (approx.)**



- As at the end of March 2023, **450+ UAPA Applications** were concluded
- Average time for conclusion **30 months (approx.)**



Snapshot of some APAs concluded

S. No.	Covered Transaction	Industry/ Functional profile of taxpayer	Nature of APA	Considerations	Time taken to resolve (months)	Results/ Conclusion
1	Payment for intra-group services/ HQ charges	Mobile Telecom Services	UAPA BAPA	Benefit test, examples of receipt of services	18 45	HQ charges allowed with a liberal upper cap
2	Payment of variable royalty	Telecom Equipment	UAPA BAPA	Excess profit split on the basis of relative contribution of the entities involved (Entrepreneurial functions and risks, unique contributions, intangibles, location rent)	36 57	Residual profit split of 60:40 for the first APA. Residual Profit split of 75:25 on renewal
3	Provision of software development services	IT	UAPA BAPA	Value creation, cost base, patents, employee skill set and experience	18 42	Cost plus markup
4	Provision of sourcing services	Retail	UAPA	Return on value of goods sourced from India	18	Cost plus markup
5	Provision of IT enabled services related to claims processing	Healthcare	BAPA	Value creation, cost base, patents, employee skill set and experience	58	Cost plus markup
6	Provision of IT/ IT enabled back office services	Financial Services	BAPA	Analytics, cost base, patents, employee skill set and experience	48	Cost plus markup
7	Royalty for legal ownership of trademark/ tradename	Telecom Services	UAPA	Legal ownership vs Economic ownership, DEMPE	11	Royalty on incremental revenue

Increasing focus on APAs

- Appreciation of facts, business models and complex arrangements by the APA authorities → gaining confidence of the applicants
- Priority to APA renewals instead of following First In First Out (FIFO) approach
- With the improvement in relations between India CA and CA of its treaty partners, (majorly the US), the preference for BAPA has been increasing
- Post COVID progress → APA program regaining momentum in conducting site visits and conclusion of APA
- Increasing intensity of TP audit leading to more filing → both renewals and fresh applications
- Establishment of dedicated APA wing for BAPA → a step towards faster resolution
- Increasing risk of tax audits in other countries → BAPA preferred over UAPA

A comparison!

Benefits of UAPA

- Mitigation of Transfer Pricing ("TP") controversy risk
- Eases data collection and negotiation process
- Reduced consulting and management time cost
- Discussion restricted to India TP and tax positions

Consideration for UAPA

One-sided solution may not be as efficient those achieved through BAPA/ Multilateral APA

Benefits of BAPA

- Dual sided approach - Mitigation of TP controversy risk from the perspective of both countries - Relief from economic double taxation
- Better negotiation
- Reduce taxpayer's disclosure requirements under TP Masterfile → UAPAs are required to be disclosed separately under Masterfile

Considerations for BAPA

Time period of consensus building and finalization is lengthy in few cases

Disclosure of TP/ tax positions to foreign country's CA

Mutual Agreement Procedure

Background

- Process through which tax administrations consult to resolve disputes involving the application of double tax avoidance conventions
- Scope limited to tax treaty and not domestic tax laws
- Double taxation may arise in following circumstances (illustrative):
  - TP adjustment
  - Characterization of income or expense
  - Existence of Permanent Establishment ("PE") in one of the contracting states
  - Attribution of profits to a PE in the other state

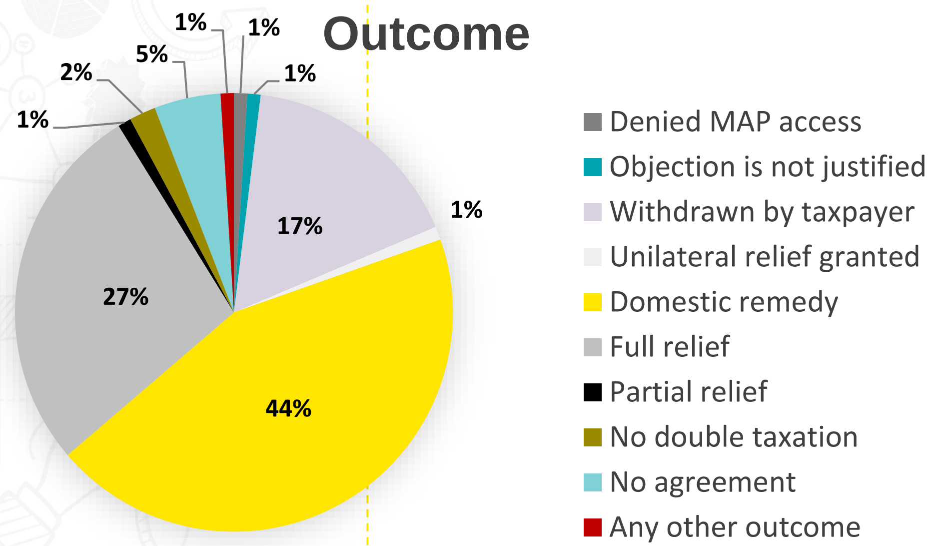
MAP Process

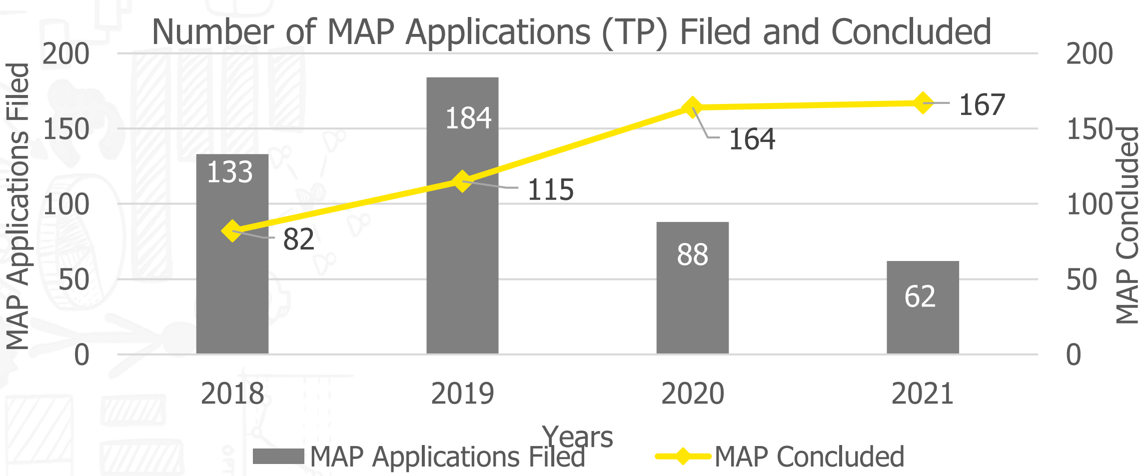
MAP procedure in India					
If a MAP is filed by counter party in foreign jurisdiction → Foreign jurisdiction will intimate India CA	India CA to call for relevant information from taxpayer and tax department	India CA convey acceptance/ rejection along with preliminary view	Both CAs shall exchange views through position papers	If MAP is successfully resolved, both CAs shall formalize mutual agreement	Communication of MAP to taxpayer for acceptance/ rejection

- *If MAP is filed by taxpayer in India (Form 34F), some of the processes may be reversed.*
- *If both CAs unable to resolve MAP, they would close MAP as unresolved.*

Transfer Pricing Cases

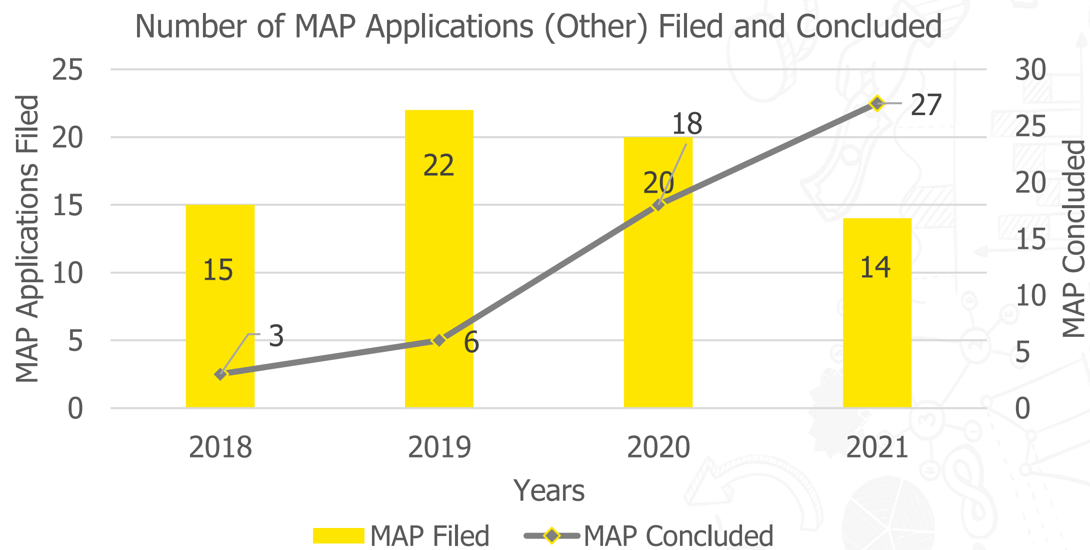
- As at the end of 2021, **167 MAP Applications** were concluded;
- Average time for conclusion **39.28 months**;





Other Cases

- As at the end of 2021, **27 MAP Applications** were concluded
- Average time for conclusion **31.88 months**;



Snapshot of some MAPs concluded

S. No.	Covered Transaction	Industry/ Functional profile of taxpayer	Time taken to resolve (months)	Results/ Conclusion
1	Payment for intra-group services/ HQ charges	Professional Firm & services	81	Taxable income of the Indian branch agreed at fixed percentage of gross India revenues and non-taxability of income from intra-group services in the hands of recipient (US based) entities
2	Provision of software development services/ IT enabled services	IT/ ITeS	56	Cost plus markup
3	Provision of business support services	Sogo Shosha	50	Cost plus mark-up on value added cost
4	Trading and Manufacturing of AC Drives and Trading of Robotics	AC Drives & Robotics	7	Partial relief granted with respect to demand raised for the years involved in respect of the additions made to the income
5	Advertisement, Marketing and Promotion (AMP)	Telecommunication	-	Full relief by India CA
6	Royalty for trademark/ tradename	Manufacture and Sale of Electrical goods	27	Agreed royalty rate

Advantages and disadvantages

Advantages

- More scope for negotiation than domestic law remedies
- Decisions of CAs if accepted by the taxpayer would override decisions of domestic authorities
- Stay of tax demand in certain cases with the presence of MOU between countries
- Can be pursued along with conventional domestic remedies
- Possibility of obtaining correlative adjustment in other contracting state in case settlement is accepted by the applicant

Disadvantages

- Repetitive proceedings for each subsequent year
- Stay of demand presently only in case of few countries (like US, UK)
- Time consuming procedure (Only US and UK have agreed for time duration of 2 years for completion)
- Black box procedure (Often limited/ no participation of taxpayer in negotiation process)
- No relief in respect of interest and penalty (to be taken up under domestic litigation)
- Relied upon by tax authorities in subsequent years to the detriment of the taxpayer even when no MAP has been filed

India MAP Approach

Key observations

- India has not accepted arbitration where CAs are not able to arrive at a conclusion within specified timeline
- India relaxed provisions regarding availability of Article 9(2) in Double Tax Avoidance Agreement (DTAA) for accepting TP cases under MAP which led to an increase in MAP cases
- India made certain amendments in Rule 44G to address recommendations of Peer Review Report 2017 and align MAP provisions with minimum standard laid down by BEPS Action 14
- India CA not resolving cases through MAP in case order is passed by Income Tax Appellate Tribunal ("ITAT") unless applicant can prove patent mistake.
- There should be a demand payable. In cases of reduction of loss, India CA tends to reject application

Safe Harbour

Background

- Defined in the Indian Income tax law as circumstances in which the tax authority shall accept the transfer price declared by the taxpayer.
- Provides circumstances in which eligible taxpayers may elect to follow a simple set of prescribed TP rules in connection with clearly and carefully defined transactions.
- CBDT introduced Safe Harbour Rules in 2013 and were applicable for five years starting FY 2012-13. Was not welcomed by the taxpayer due to perceived high margins and ambiguity.
- CBDT issued amended TP Safe Harbour Rules 2017, applicable for three years beginning FY 2016-17.
- Prices established would be automatically accepted by the tax administrations if application is found eligible.
- Assessment simplicity → Safe Harbour scrutiny completed within a span of approximately 6 months

Considerations

- Can be generally opted for service transactions where Indian entity does not perform significant functions or assumes significant risks
- If a taxpayer were to satisfy all conditions for "insignificant risk" – may be construed as a PE
- No clarity on treatment of closely linked transactions
- Taxpayer not eligible to invoke MAP if opted for Safe Harbour
- Safe Harbour margins are on a higher side because of which only few taxpayers apply

Comparison of APA, MAP, Safe Harbour and Domestic Litigation

Comparative Analysis

Criteria	MAP	APA	Safe Harbour	Domestic Appeal
Time frame	► Generally 2-3 years	► Generally 2-3 years	► Audit scrutiny for safe harbour compliance like to conclude in approximately 6 months	► 8-10 years to reach finality
Eligibility	► Request for MAP can be made only when there is double taxation or taxation inconsistent with treaty ► Application admitted at CA's discretion	► Any international transaction undertaken/ proposed to be undertaken	► Only "eligible assessee" undertaking "eligible international" transaction	► No such eligibility
Certainty	► Greater chance of reaching certainty, decision of CA binding on Revenue	► 5 years binding agreement with the Indian government (& foreign tax administration, wherever applicable) and option of 4 years roll back	► Certainty only when the tax authorities accept filing as valid	► Both parties have right to appeal. Certainty only achieved after decision of courts.
Frequency	► Repetitive proceedings for each subsequent year ► Resolution under MAP is valid only for the issues raised for that particular year	► One time exercise can get a 5 years agreement along with a 4 years roll back and it can be renewed with comparatively less effort	► Yearly compliance timelines to be adhered. Risk of taxpayer/ transaction being reviewed for eligibility year on year	► Annual audits and necessity to pursue litigation every year
Transactions	► Request for MAP can be made only in relation to issues where adverse inference is drawn	► Open for all types of international transactions – complex/ routine transactions ► Flexibility to cover "closely linked transactions" as well	► Restricted only to notified international transactions ► General TP provisions apply to other transactions ► No clarity on treatment of closely linked transactions	► Open for all types of international transactions – complex/ routine transactions

Comparative Analysis

Criteria	MAP	APA	Safe Harbour	Domestic Appeal
Double tax mitigation	▸ Possibility of avoiding double tax impact through correlative relief	▸ Double taxation can be avoided in case of BAPAs ▸ Option of converting UAPA to BAPA, subject to conditions	▸ No access to MAP to avoid risk of double taxation if safe harbour is accepted by tax authorities in India but challenged in other country	▸ Double tax exposure if appeal is against taxpayer; uncertainty on correlative relief ▸ Double tax mitigation certainty could be achieved on order passed by Supreme Court in India
Compliance requirements	▸ Annual TP documentation & Form 3CEB compliance to be met for each FY ▸ Rule 44G - Aggrieved resident to apply to CA in prescribed Form No. 34F	▸ Reduced compliance cost relative to complying with annual documentation & Form 3CEB. ▸ Only an annual compliance report in the prescribed form is to be furnished	▸ Annual TP documentation & Form 3CEB compliance to be met for each FY ▸ Relatively simplified/ time bound audit process for eligible transactions	▸ Annual TP documentation & Form 3CEB compliance mandatory for each FY ▸ Various forms to be filed at several tiers of appellate authorities
Taxpayer Involvement	▸ At the discretion of CA	▸ Full involvement	▸ Full involvement	▸ Significant involvement as every level of audit and appeal
Approach	▸ More scope for negotiation/ compromise	▸ Very flexible	▸ Legalistic approach, no negotiations	▸ Legalistic approach, no negotiations

Board of Advance Ruling

Background

- The Finance Act 2021 had made amendments to cease the Authority for Advance Rulings and prescribed for a new forum for advance rulings under the Income-tax i.e., Board for Advance Rulings.
- Application can be filed before BAR only if the case:
  - is not pending before income-tax authority/ appellate forum
  - does not involve determination of fair market value of any property
  - does not relate to transaction/ issue designed for avoidance of tax

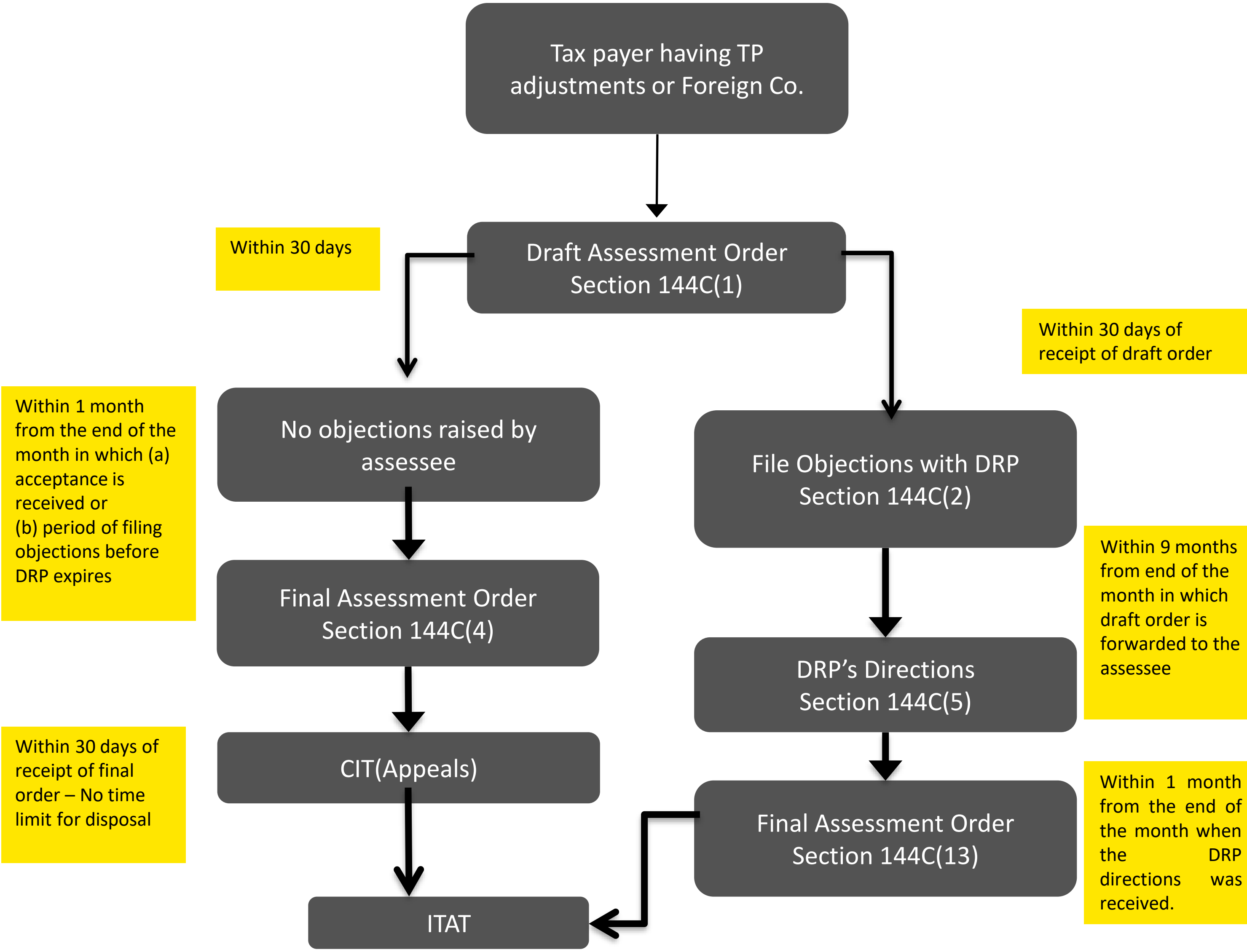
Considerations

- Upfront crystallization of the tax implications of proposed transactions
  - Uncertainty associated with tax litigation put to rest
  - Brings certainty to transactions undertaken
- Non-binding → appeal against order of BAR may be made before the High Court (Finance Act 2021)
- Significantly faster dispute resolution process as compared to the normal litigation process
  - Advance ruling takes 6-8 months, as compared to 1-2 years involved even at the second-level appellate tribunal level
- BAR is better suited to sort out complex international tax issues, which may not be appreciated by lower-level authorities

Dispute Resolution Panel

Dispute Resolution Panel

- Since 2009
- Collegium of 3 CITs
- Purpose is to provide speedy dispute resolution
- Orders of DRP passed on or after 1.6.2016 not appealable by the tax department
- No tax demand till disposal of appeal
- Department could file cross objections if appeal filed by taxpayer (Finance Act 2023)



Global Reporting Initiative (GRI) Standard 207

Environment, Social and Governance ("ESG")

- 2004 report from United Nations, *Who Cares Wins*, first mentioned ESG issues. Report rapidly gained international attention and was welcome by various stakeholders.
- After nearly 2 decades, various governments have updated laws to emphasise ESG.
- From a business perspective, ESG reporting is important to demonstrate how corporate purpose is brought to life and supports creating long-term value. It can also strengthen corporate reputations and trust with stakeholders. Increased regulations and consistency related to ESG disclosures is strongly supported by users and preparers.

Environmental

Issues focused on climate risks, carbon emissions, energy efficiency, use of natural resources, pollution and biodiversity

1

Social

Issues focused on human capital, labour regulations, diversity, Diversity Equity and Inclusion, safety, human rights and community involvement

2

Governance

Issues focused on board diversity, corruption and bribery, business ethics, compensation policies and general risk tolerance

3

- ESG today is broadly thought of as a reporting framework. Companies rely on sustainability reporting standards to determine how and what they report.
- One of the most commonly used reporting framework is GRI.

Global Reporting Initiative

Background

- GRI is Netherlands headquartered Non-Governmental Organization ("NGO") founded by US-based non-profit organisations in 1997 after calls for corporate transparency following Exxon Valdez oil spill
- Sole responsibility for setting GRI standards lies with Global Sustainability Standards Board (GSSB)

Aims and Context

- GRI exists to help organizations be transparent, take responsibility for their impacts and help create a sustainable future

Reporting Standards

- The GRI Standards are organized into three series:
  - GRI Universal Standards *(requirements/ disclosure/ guidance each organization must comply with e.g., GRI 1, 2 and 3)*
  - GRI Sector Standards *(Standards that apply to specific sectors, e.g., GRI 11, 12, 13 etc.)*
  - GRI Topic Standards *(Impact of particular topics, e.g., GRI 207, 403, 305 etc.)*
- Companies report on issues that are material to them. Typically materiality is determined based on what ESG issue is considered financially material in a given industry.
- Over 10,000 companies use aspects of the GRI Standards

GRI-207 (applicable from 1 January 2021)

Approach to tax (disclosure 207-1)

- Tax strategy, governance body that approves the strategy and periodicity
- Approach to regulatory compliance and link to the business and sustainable development strategies

Tax governance, control and risk management (disclosure 207-2)

- Tax governance and control framework
- Mechanisms to report concerns about unethical or unlawful behavior with respect to tax
- Assurance process for tax disclosures

Stakeholder engagement and management of concerns related to tax (disclosure 207-3)

- Approach to engagement with tax authorities
- Approach to public policy advocacy on tax
- Processes for collecting and considering views of stakeholders

Country-by-country reporting ("CbCR") (disclosure 207-4)

- Names of the entities and activities; employees; revenues: third parties and intra-group; Profit before tax; tangible assets, Income tax paid; Income tax accrued
- Reasons for the difference between Effective Tax Rate and statutory rate

Environmental Social Governance – Tax

What is the ask from Tax

A clear and transparent tax policy or strategy available in the public domain that addresses tax issues

- Commitment not to transfer value created to low tax jurisdictions without business rationale
- Commitment to pay tax where revenue/value is generated
- Commitment not to use tax schemes based upon form without commercial substance.
- The company's approach to TP
- Company’s approach on use of secrecy jurisdictions or so-called "tax havens":
- Control Framework/ Policies with clearly defined roles and responsibilities for taxation that address issues such as responsible taxation, transparency, TP, etc., going beyond minimum legal tax disclosure requirements

How can be achieved

Currently, there is no single standard reporting regime for ESG tax. Disclosure is generally purpose-driven and may be done in various ways:

- Integrated reporting, e.g., as part of the annual report or sustainability report
- Separate tax transparency/tax contribution report
- Statements/publications on the organization’s website
- With or without third-party assurance

Available reporting framework/guidance (illustrative):

- Global Reporting Initiative (GRI) 207: Tax (refer slide 24) – most commonly followed
- Local jurisdictional ESG principles
- Organisation for Economic Co-operation and Development (“OECD”) CbCR requirements

What to report

Qualitative information

- Tax strategy/policy
  - Accountability and governance
  - Commitment to responsible tax practice and attitude to tax planning
- Tax governance, control and risk management
  - Internal controls to manage tax operations and tax uncertainties
  - Transparency policy

Quantitative information

- Tax contribution and tax collection “on behalf” (depending on sector/industry)
- CbCR information
  - Leverage from CbCR under OECD BEPS Action 13
  - Limited to corporate income tax

Roadmap to develop and implement ESG Tax

1 Review of tax process and controls

- Review current state tax structure, operation model and day-to-day tax process & activities
- Perform gap/fit analysis with group tax policy and identify and implement governance framework
- Review tax internal controls framework and procedures to strengthen execution of group tax policy in day to day operation

2 DATA & SYSTEMS

- Identify key disclosure messages of the tax contribution report and define scope of data to be collected
- Design standard data collection templates to communicate data requirements to local teams, explore opportunities to automate in-house data collection process
- Instil process to cleanse, consolidate, format and present the data collected (e.g. via visualisation)

3 ESG Reporting and Assurance

- ESG Reporting as an organisation: Focuses on providing transparency of tax-related risk of the group to shareholders and other stakeholders
- ESG Reporting as an investor: Focuses on positive impact to society and long-term value creation via incorporating tax as a metric to responsible investment
- Voluntary external assurance on public ESG Reporting

4 Ownership and monitoring

- Communicate with all relevant internal stakeholders on group tax policy, governance framework and downstream implementation procedures of ESG Tax
- Internal trainings on ESG tax to create awareness

Tax Transparency Report - Key considerations

1. Consistency of information disclosed with other sources e.g. tax return filings, published financial statements etc

2. Alignment of tax strategy with corporate governance and Corporate Social Responsibility ("CSR") disclosures in annual reports and elsewhere

3. Enhancing value in adding contextual information to company's tax strategy and total tax and non-tax contribution

4. Ensuring right interpretation of the information by (a) interested stakeholders, (b) revenue and government bodies (c) community at large

5. Enhancing reputational image of the Company through transparent disclosures and explaining key decisions

6. Identifying set of principles and 'minimum standards' to guide disclosure of tax information

7. Any issues to be dealt with before publishing information about your tax affairs?

8. Whether your systems accurately capture and extract the data to be disclosed?

ESG and Transfer Pricing Issues

Supply Chain & Business Restructuring

- Decentralization of manufacturing functions to reduce emission from transportation
- ESG-driven aggregation of manufacturing steps if the suppliers are non-compliant
- Centralized ESG risk management for the supply chain
- Centralized carbon-efficient management of logistics or fleet management in order to rely on an expert team reducing the global emission footprint of the group
- Centralised management of suppliers to ensure compliance with Group's ESG policies
- Major new product costs and/or savings (e.g., energy costs, realization savings because of lower energy consumption) → which entity should bear costs or enjoy benefit of savings
- Which entity should bear ESG related risks (if material)
- Development of new products and processes (e.g., improving facility and fleet functionality)

Other Impacts

- Impact on new or existing brand value
- Creation or enhancement of intellectual property assets
- Profit sharing changes that reflect new environmental costs, new products or new processes
- ESG reporting and branding costs: whether these costs may be passed to group members

Thank You