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A proactive approach to managing global transfer pricing disputes can enhance both efficiency and effectiveness. Many countries are therefore adopting advance pricing agreements (APA) programs as a way of addressing evolving transfer pricing (TP) issues worldwide – as of January 2012, more than 30 countries allow APAs.

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International disputes and the need for resolutions arise due to the heightened level of TP examination activity. Ernst & Young's Global Transfer Pricing Survey 2010 indicates clearly that many parent company respondents identify TP as the most important tax issue they face. However, inconsistencies in the interpretation and enforcement of TP rules have been inevitable worldwide.

Alternative TP dispute-resolution mechanisms include the following:

- ▶ APAs
- ▶ Relief from competent authority (through the Mutual Agreement Procedure provision of the relevant tax treaty)
- ▶ Litigation.

*Binding arbitration has been initiated as an additional mechanism in some countries.*

#### **APA – trends**

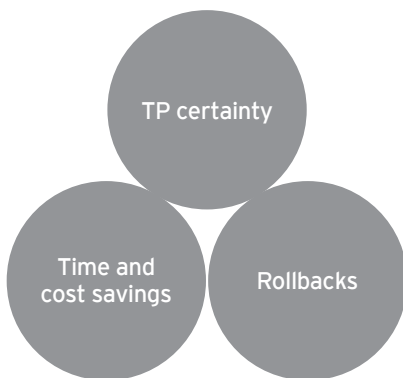
The published statistics of several tax authorities indicate overall record levels of APA applications. According to the Ernst & Young Global Transfer Pricing

Survey 2010, although only 23% of parent respondents use APAs as a controversy-management tool, the level of satisfaction of users with the APA process is high, 90% indicating that they will implement an APA in the future. The 2010 Survey also suggests that litigation of TP disputes continue to be infrequent, with only 11% of overall parent respondents resorting to court proceedings. The only jurisdiction with significant litigation activity is India, where 50% of the respondents rely on litigation for resolution of TP disputes. One obvious reason for this could be the absence of an APA program in India under the current tax law. Realizing the severity of the issue, implementation of the program has been proposed under the impending Direct Tax Code (DTC), and based on public statements made by senior revenue officials and those of the Central Board of Direct Taxes, it appears that introduction of APAs is imminent in the country.

At Ernst & Young, we are committed to strategic global management of TP issues, working with taxpayer personnel to anticipate and address TP disputes at the earliest stage.



## What you derive as benefits from APAs



### ► **TP certainty**

For most taxpayers, certainty regarding their TPs is the single most important benefit gained through the APA process. Bilateral APAs also address the inconsistent and evolving interpretation and enforcement of TP rules in other countries and the risk of double taxation. The potential cost of uncertainty relating to a Transfer Pricing Method (TPM) has risen dramatically in recent years as many countries have significantly intensified their local TP- enforcement

efforts. However, these risks can only be eliminated prospectively by negotiating a bilateral APA.

### ► **Rollbacks**

An APA can provide the opportunity to apply the agreed upon TPM to resolve similar TP issues faced in previous years that have continued to be open for examination or issues relating to controversy in ongoing examinations. However, the tax administration, the taxpayer, and where appropriate, the treaty partner, needs to agree to the application. The primary incentive for some taxpayers seeking an APA is the prospect of a rollback of a TPM developed in an APA to resolve past open tax years (rollback period). Furthermore, a rollback may enable a cost-effective way of resolving an ongoing TP dispute.

### ► **Time and cost savings**

TP examinations are often time-consuming and expensive. The APA process generally takes substantially less time to complete than a TP examination followed by a dispute resolution mechanism, which can easily last for three to four years, and in many cases, longer, due to complex examinations.



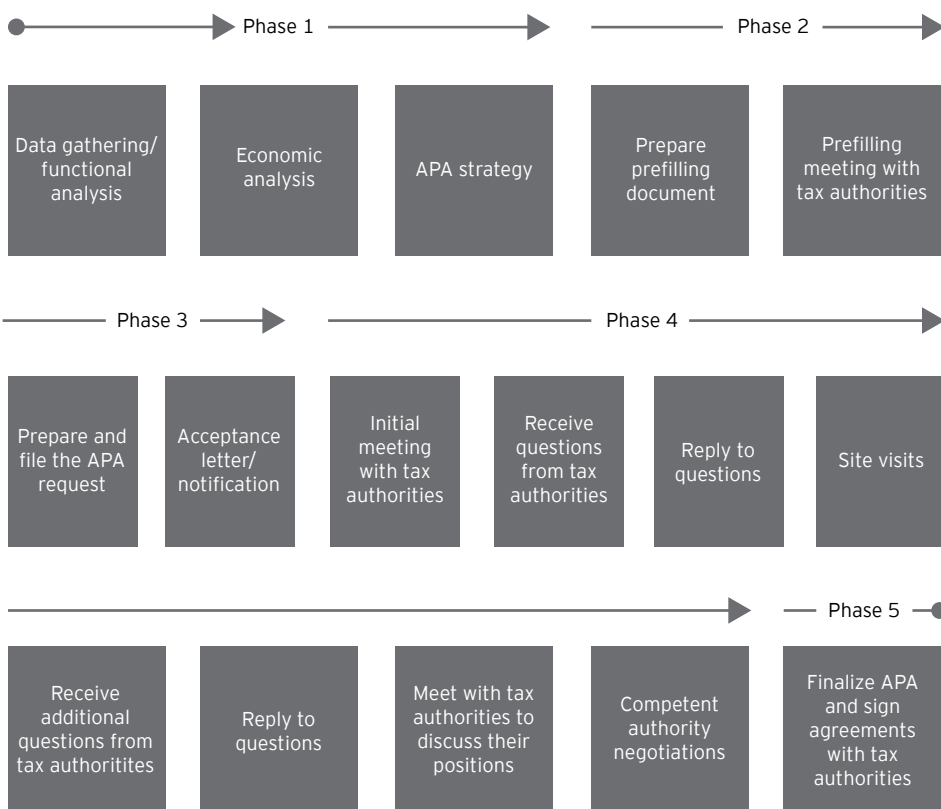
### APA process: bilateral APA timeline

#### APA process for taxpayers

The APA process for taxpayers includes the following phases:

- ▶ APA strategy and TP analysis
- ▶ Pre-filing conference
- ▶ Formal request for APA
- ▶ Evaluation and negotiation
- ▶ Administration and renewal

As the APA process moves forward, interaction is expected to evolve from a general discussion of taxpayers' industries and businesses to more specific transactions, and finally, to drafting and administering agreements





## Best practices in framing an APA mechanism


It is recommended that the best practices proposed by independent bodies such as the Organization for Economic Cooperation and Development (OECD) in its Transfer Pricing Guidelines, as well as the procedures prescribed in other countries, are considered while framing the APA scheme under the Indian tax law. An overview of some possible best practices that may be considered include the following:

- ▶ **Bilateral APA:** Unilateral APAs only partially resolve the problem of cross-border TP issues and can result in economic or juridical double taxation. The experiences of various countries indicates that bilateral APAs are an effective measure to reduce uncertainty for a taxpayer, especially relating to matters involving complex TP and cross-border issues. Bilateral APAs also significantly reduce the possibility of profits either escaping tax altogether or being doubly taxed. Even in cases where unilateral APAs are initiated, the competent authorities of other

interested jurisdictions should be informed about the procedure as early as possible, to determine whether they are willing and able to consider a bilateral arrangement under the MAP. To ensure this, APAs involving the competent authorities of treaty partners should be considered within the scope of the MAP article, even if such arrangements are not expressly mentioned in the article of the relevant tax treaty.

- ▶ **Considerations for facilitating acceptance and discussion of an APA application:** The APA scheme should provide clear guidance on the admission/acceptance criteria for the APA program. It should be ensured that APA applications are encouraged in the case of complex situations in which there are strong business drivers to align management and financial reporting in locations and joint ventures (JVs) within groups, as well as for valuation of unique intangibles, implementation of cost-sharing agreements, cases where traditional TP methods are inappropriate, groups witnessing rapid changes in their business environment, or in some cases, following major restructurings, mergers and acquisitions. The fact that a taxpayer may be undergoing audit or examination





should not prevent it from requesting an APA in respect of its prospective transactions.

▶ **Governance of the APA mechanism:**

The APA scheme should incorporate clear guidelines on pre-filing meetings, information required and the reasons thereof, and agreed timelines to respond to requests pertaining to information and sharing of information, with a focus on the relevance of the information.

▶ **Pre-filing meetings/Preliminary discussions:**

Pre-filing meetings provide an opportunity to taxpayers to discuss the suitability of an APA and the required documentation and analyses, as well as pertaining to agreement on the APA timetable and discussion of the process for evaluating applications with tax authorities. The scheme should clearly lay down the timeline within which contact with the tax authorities needs to be established before APA submission. The timeline should also factor in any additional time needed in the application process in cases where subsequent pre-filing meetings may be required.

▶ **Lodging of a formal application:** An APA application should include the details of the proposed TP methodology, supported by the relevant information; terms and conditions governing the

application of the TP methodology; a comparability analysis; a discussion on and analysis of critical assumptions and the time period during which it is proposed the APA application should be submitted.

▶ **Analysis/Evaluation of an APA application:**

The scheme should provide for formal communication between the tax office and the taxpayer on the progression of the APA and interim agreement on the issues. The scheme should provide that only a person with sufficient transfer pricing capabilities should lead each APA. This should be determined at the outset. The scheme should also provide for a clear exit criterion. The scope of the APA should be agreed at the outset and a detailed project plan needs to be agreed between the tax authorities and the taxpayer.

▶ **Conclusion of the APA process:** The concluded APA should at the minimum include the following:

- ▶ The transactions, agreements or arrangements covered by the APA
- ▶ The period and tax years covered by it
- ▶ The agreed on TP methodology and the critical assumptions on which it is based. It may also be helpful to set



parameters for an acceptable level of divergence from some assumptions in advance, to provide the required flexibility. The parameters can be set individually for each particular APA and form part of the negotiations between bilateral tax authorities. Only if divergence from the prediction exceeds the parameter should the assumption become "critical" and action considered. Critical assumptions need to be tailored to the individual circumstances of the taxpayer, the specific commercial environment, the methodology and the type of transactions covered. They should not be drawn so tightly that the certainty provided by the agreement is jeopardized, but should encompass as wide a range of variation in underlying facts as parties to the agreement feel comfortable with. It may also be helpful to set parameters for an acceptable level of divergence from some assumptions in advance, to provide the required flexibility.

- ▶ There should be detailed definitions of key terms that form the basis of the methodology (for example, sales, operating profit, operating expenses, etc.).
- ▶ There should be a range of arm's length results and the obligations of the business as a result of the APA.
- ▶ **Corresponding adjustments:** In many situations, there can be inter-company transactions between two

or more taxpayers, where, by virtue of the provisions of domestic tax laws or treaties, all the taxpayers involved in transactions are subject to tax in India. An APA should specifically provide that the arm's length price determined should be binding on the tax authorities with respect to particular transactions as well as to parties involved in those that are taxable in India.

- ▶ **Annual filing requirements:** The scheme should provide for annual filing requirements to ensure that the arm's length price of international transactions entered by taxpayers is in accordance with the APA scheme entered by tax authorities and the taxpayers. The filings can be in the form of a certificate that can be obtained from an Accountant, and which would include details of the nature and value of the transactions, the methodology used to determine the arm's length price, and whether the pricing and income determination is consistent with the APA entered into.
- ▶ **Documentation requirements:** The scheme should provide that taxpayers that have entered an APA need not maintain the documentation prescribed under the Rules. However, it should also provide for the type and nature of documentation, if any, which the taxpayer should maintain during the period for which the APA is effective. This could include documentation, which would be required to substantiate that critical assumptions made on the basis of which the APA has been entered is still valid. The APA scheme should



provide for the same secrecy and privacy safeguards for information generated by the APA process as if this was obtained during an audit process.

- ▶ **Monitoring the APA process:** The APA mechanism should provide for revision or cancellation and roll-back of an APA. The circumstances and conditions under which an APA can be revised or cancelled should be provided for. For example, it should be provided that in cases where a situation arises that causes a material difference to the business and economic conditions essential for continuation of the APA, the taxpayer can file a request for APA revision. Similarly, it can be provided that an APA will be cancelled in the event a taxpayer has not submitted a request for revision, even when a material difference in the critical assumptions required to continue with the APA has arisen. An APA should be cancelled if any of the facts on which the APA request is based is revealed to be false or it contains a material error. The APA mechanism should also provide for circumstances when a request for an APA for a covered period (to apply to certain prior years) should also be incorporated.
- ▶ **Knowledge transfer:** An environment for facilitating knowledge-sharing needs to be created. This could include a central online repository of APA experience and utilization of existing highly skilled TP specialists to train and coach other personnel. Furthermore, adequate succession planning for TP

officers should be put in place so that taxpayers are not adversely affected by any change caused due to retirement or transfer of specialist officers appointed for the entry of taxpayers into APAs.

- ▶ **Miscellaneous:** Clear guidelines should be established for a review mechanism that can be used if APA negotiations reach a standstill. Furthermore, significant investment needs to be made on training and education of tax officers for successful implementation of APA.

To be successful, an APA program needs to provide a collaborative and cooperative atmosphere that is intended to find a mutually satisfactory solution. It is not easy to create such an atmosphere in the contentious world of TP. A tax administration must be able to give taxpayers enough confidence to come forward with their pricing issues and challenges, which often involve extremely sensitive tax issues that can produce a strong natural tendency on their part not to make an affirmative presentation to a taxing authority. A tax administration must also work with taxpayers to find mutually satisfactory solutions and bring together pertinent operational groups within the tax administration to address issues. The success of APA programs in many countries offers a significant opportunity for the Indian tax administration to resolve international TP issues, mutually, in a proactive manner, and thereby, reduce rising costs as well as the time and administrative issues entailed in continued litigation.

# How Ernst & Young can help you

Transfer pricing and tax controversy play an increasingly critical role in global businesses. All major tax administrations are expected to intensify TP enforcement. This has resulted in an unprecedented rise in controversy as multiple jurisdictions vie for the same taxable income. To help businesses tackle these challenges, Ernst & Young has assembled a strong global network of prominent TP professionals, many of whom have previously held senior positions relating to TP issues with tax authorities. In today's environment, it is essential to take a proactive approach to address controversy by building productive relationships with tax administrators.

Ernst & Young's experienced team of TP professionals can provide the insight you need to make informed and practical decisions. They can also assist you with an economic analysis and represent you in negotiations with the tax authorities. Our TP professionals develop a global strategy to help them identify and weigh the options for dealing with local country TP conditions and terms in the areas of:

- ▶ APAs
- ▶ Competent authority relief
- ▶ Audit defense and litigation support

## Our value proposition

Ernst & Young has a global network of seasoned TP professionals who can help you to enhance your ability to work more effectively with tax administrators around the world'

- ▶ We have wide experience in providing a holistic suite of services – from assisting in the development of a preliminary APA strategy to final negotiations with government authorities.
- ▶ Advice from experienced APA professionals makes a substantial difference at all stages of the APA process. Our teams can help you negotiate and employ APAs to resolve your TP disputes, where possible, to enable greater tax treatment certainty, improved timelines and cost savings through a TP examination and freedom from penalty exposure.

In the world of APAs, experience matters:

- ▶ Ernst & Young has helped multinational enterprises obtain over 400 APAs in the US and a large number of APAs around the world.
- ▶ Ernst & Young LLP currently represents taxpayers in 30% of pending APAs at the Internal Revenue Service in the US.
- ▶ In the Americas, 35 Ernst & Young professionals were formerly senior government officials with the responsibility of dealing with TP controversy.

Taxing authorities frequently consult with our professionals on how to establish new APA programs.



## What clients say about us

*"The support provided by Ernst & Young has been excellent, particularly, when handling SEC related issues, making themselves available for calls at short notice and generally helping the company in handling various technical issues. Support has exceeded our expectations."*

*- Vice President, Finance of a global IT company*

*"I believe their efforts and focus helped us a lot, as we were able to secure almost a clean order for a Pune entity and reduce adjustments substantially for Delhi entities. "*

*- Tax head of a MNC.*

*"Their approach is transparent and is highly reliable."*

*- Finance head of a multi-national automobile company*



# Our leaders

## **Vijay Iyer**

Tax Partner and National Leader  
Transfer Pricing Group  
Ernst & Young  
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**Vijay** has been rated as one of the world's leading transfer pricing advisors for India by the Legal Media Group's Guide to the world's leading tax advisers.

Vijay leads the Transfer Pricing practice of Ernst & Young India. With an experience spanning nearly two decades, he has been advising clients on domestic and international tax matters. Over the past 11 years, he has focused on transfer pricing as his area of specialization and has serviced a large number of multinationals operating in India. He is actively involved in Transfer Pricing Litigation, both as an arguing counsel and as an advisor assisting clients in devising their litigation strategies.

## **Monique van Herksen**

EMEIA Tax & Transfer Pricing  
Controversy Leader

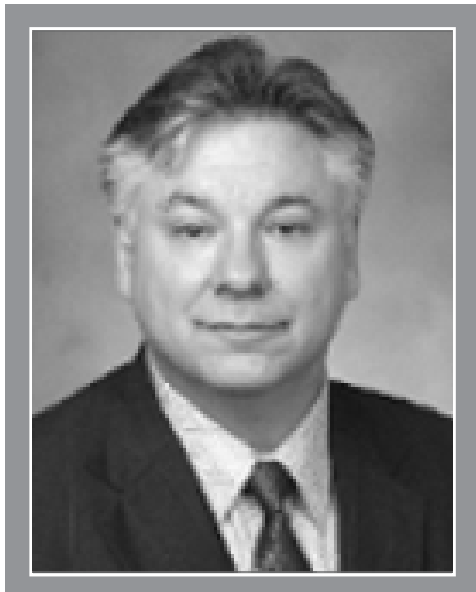


**Monique** is Ernst & Young's Global Head of Transfer Pricing Controversy and EMEIA Head of Tax Controversy, specializing in cross-border dispute resolution including Mutual Agreement Procedures and Arbitration. She counsels and assists with controversy in all of its potential phases: prevention, diagnosis, litigation/related negotiation, and the (necessary) aftercare.

She regularly teaches to government officials including through the EU Fiscalis Programme that serves to provide internal training to the tax authorities of EU Member States. She regularly presents papers and issues in her field of expertise to governmental organisations such as the OECD, EU and UN and to private interest groups such as the TEI, ATI, IFA, the IBFD, the Dutch Association of Tax Lawyers and the Dutch Organisation of Tax Advisers (NOB). Monique is a member of the ABA, the Dutch Association of Tax Lawyers, the NOB and IFA. She serves as a member of the IBFD's transfer pricing advisory board, is a business member of the EU Joint Transfer Pricing Forum and serves on the Practice Council of NYU. She is registered with the Netherlands Arbitration Institute. She furthermore serves the United Nations' Transfer Pricing-Practical Issues Subcommittee that deals with transfer pricing in Developing Countries.

## **Bob Ackerman**

Americas Director of Transfer Pricing  
Global Accounts and Controversy



**Bob** has extensive experience in the development and implementation of tax strategies relating to migration of intangibles and execution of licensing and cost-sharing arrangements. His experience also includes a significant emphasis on resolution of international transfer pricing controversies at audit and competent authorities. Bob has 35 years' experience in handling international tax and transfer pricing issues with Ernst & Young LLP and the Internal Revenue Service (IRS). He was the first director of the Advance Pricing Agreement Program at the IRS.



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#### About Ernst & Young

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