India signs two bilateral APAs with the U.K. for management charges and brand royalty

Marking a significant development in the Advance Pricing Agreement (APA) space, India recently signed its first two bilateral APAs with the U.K. on transactions of management charges and brand royalty, avoiding seven years of potential litigation for two companies of a U.K. based group engaged in manufacturing of automotive and industrial components.

The Indian APA programme was introduced in 2012 to bring about certainty and uniformity in transfer pricing matters of multinational companies and reduce litigation. The programme allows unilateral as well as bilateral APAs to be entered into by the taxpayers. Unilateral APAs are agreed between Indian taxpayers and the Central Board of Direct Taxes (CBDT), without the involvement of the tax authorities of the country where the associated enterprise is based. Bilateral APAs include agreements between the tax authorities of the two countries.

In the last three years, an overwhelming number (over 500)\(^1\) of APA applications have been filed demonstrating good faith and positive expectations of the taxpayer companies from the programme. Resolution of these APAs has steadily caught pace over the last several months with 39 APAs\(^2\) signed by the CBDT until 22 January 2016. With the conclusion of two bilateral APAs with the U.K., the total tally of signed APAs has increased to 41 (38 unilateral and three bilateral).

These are first such bilateral resolutions involving the controversial issues of management charges and brand royalty. The two taxpayer companies recently also concluded their Mutual Agreement Procedure (MAP) proceedings with the U.K. on the same set of transactions. With the APA outcome now in place, 12 years of existing/potential litigation for each of the two companies has been resolved.

Management charges or group cost allocations and royalty payments for intangibles such as brand are one of the most litigious issues in the area of transfer pricing, which involves greater subjectivity since the considerable emphasis is placed on the benefits derived from the services or intangibles in addition to the pricing. The Indian and the U.K. Competent Authorities as well as the APA Office provided a very pragmatic and rational resolution of the controversial issues, notwithstanding the fact that not much guidance was available internationally on the resolution of similar issues through the APA route.

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\(^1\) 386 applications were filed till 24 December 2014 as per the CBDT Annual Report and further over 150 applications have been filed till 31 March 2015

Our comments

This is a positive development for the taxpayer community and is reflective of the Government of India’s commitment to make bilateral dialogues with other countries, an effective means of resolving existing and potential disputes in the field of transfer pricing. The conclusion of these APAs is expected to foster positive sentiments among foreign investors in India and encourage them to opt for the bilateral APA route in order to obtain a certainty on their transfer prices.