MNCs approach tax dept, seek revision of agreements due to Covid-19

Business Standard | Last Updated at September 7, 2020 06:08 IST

The Covid-19-led economic disruption may lead to reopening of several specific tax agreements that multinational companies (MNCs) have with Indian tax authorities.

These companies are reaching out to the direct tax board to seek clarity on revising the advance pricing agreements (APAs) with critical assumptions and preset margins having become irrelevant on account of factors like relocation of persons, supply-chain disruption, abnormal expenses, change in asset deployment, risk assumed, etc.

Tax authorities are of the view that while all agreements may not be affected since APAs are long-term in nature, the government will consider if companies have documented the specific changes.

The industry has asked the income-tax (I-T) department to issue a directive on the modification of APAs due to the Covid-19 pandemic, taking into account stress and the economic situation. Most companies, barring those in software, information technology (IT) or consumer non-durables space, have been affected and been forced to alter supply chains and business models.

Mukesh Bhutani, managing partner at BMR Legal, said with most sectors impacted except IT, there have been instances where APA authorities have been approached for revision and a case-by-case approach is being applied.

“A guidance shall certainly assist. The situations are revision of agreed APAs and a new approach to deal with ongoing APAs, with regard to the impact on margins for the current fiscal year,” said Bhutani.

He added that besides reviewing the agreed APAs, the government will have to review downwards safe harbour limits, and exercise discretion on transfer pricing audits supported by strict administrative guidance.

“The absence of active tax administration and orientation of field officers to deal with post-Covid situations of transfer pricing audits is the biggest challenge,” added Bhutani.

Rahul Garg, partner, PwC India, said companies in the non-IT space, such as travel or hospitality, are among the ones thinking of moving to the APA authorities for a revision in agreements.

APA is basically an ahead-of-time understanding between a taxpayer and the tax authority on an appropriate transfer-pricing methodology. APAs provide certainty to the company operating in India for a maximum of nine years (prospective five years and four roll-back years) and avoid conflicts over sharing of taxes between India and the other countries, and reduce transfer-pricing disputes.

Sunil Gupta, head-direct taxation, Reliance Industries, pointed out at a recent industry discussion that in cases where there is relocation of assets of change in functions and risks, taxpayers would like revision in APAs.

"There are cases where we will need to apply for revision in APAs, where long-term plans are not achievable. It requires a directive and a liberal guidance from tax authorities and that the Covid situation should be considered sympathetically," said Gupta at an international tax webinar organised by the Associated Chambers of Commerce and Industry of India.

A senior tax official said that a revision may be possible in accordance with the law. "The APAs are long-term agreements and are normally expected to be honoured by both parties. But, in Covid-type situations, there is a provision under which taxpayers can go and ask for a change. If changes in assumptions are within the parameters of the law, I don't see why they won't be revised."

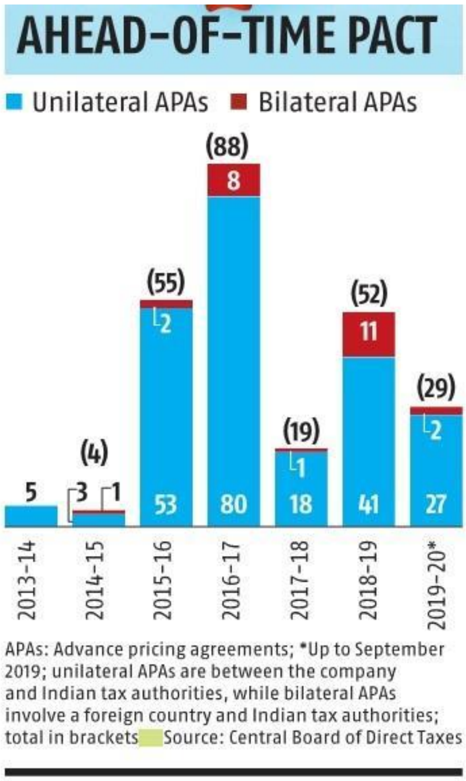
APAs could be a unilateral agreement between the company and Indian tax authorities or a bilateral agreement involving a foreign country.

According to I-T rules, an agreement may be revised if there is a change in critical assumptions or failure to meet a condition, subject to which the agreement has been entered into.

However, the official added that that documentation will be key in such scenarios. "We will look for documents, so a company must have relevant documents in place. If a company has changes taking place, such as assets getting redeployed, etc and there is documentation in place, the government will consider," said the official. A formal guidance on revision may be issued.

However, companies are seeking clarity over whether digital documentation will be accepted by the tax authorities as evidence of beneficial and value-added services. This is because of the fact that people are providing virtual advice and information due to travel restrictions and lockdowns. So, emails, documents or similar paper trails, which serve as documentation, can be archived to form the basis for making important decisions, pointed out tax experts.

Divakar Vijayasarathy, founder and managing partner, DVS Advisors LLP, said that documentation may be tough in the current volatile environment. "In many cases, we are seeing multiple changes to business models virtually on a month-on-month basis, making the case for documentation complex and fluid. Many agreements are waiting to fructify on the way forward before revising for a meaningful outcome and application."



Nitin Narang, partner-transfer pricing , Nangia Andersen LLP, said that robust business rationale and documentation will need to be submitted to build a case for the revision of APA.

“Given the change in economic conditions, there is no doubt that the business models and supply chains will be modified, considering the options that are realistically available for the outright purpose to keep business afloat. Thus, the Central Board of Direct Taxes (CBDT) should be willing to look into the factors of the taxpayers and allow a revision if the situation so demands,” added Narang.

Garg of PwC India pointed out that as long as companies can document basic assumptions related to sales and purchases well, getting a revision may not be a problem. “However, when one goes for negotiation, what specific documents may be needed have to be seen. It is after all an interactive process,” said Garg.

According to the rules, the revised agreement is expected to have the period for which original terms of APAs will be applied and the date from which the revised terms of the APA will apply. “It can be interpreted that if the taxpayer or CBDT wishes to revise only part of the number of years under APA, that should be possible to be effected in the revision of the APA process,” added Narang.

Amit Maheshwari, partner, AKM Global, said that foreign related parties may like to renegotiate margins with Indian entities, but may face resistance from tax authorities.

“We don’t expect many MNCs coming forward to renegotiate APAs, as this is a temporary blip and they face resistance from tax authorities. Moreover, the changing characterisation of Indian entities from low-risk to high-risk service providers could be a double-edged sword, as it may result in higher margins in future years,” said Maheshwari.

A tax official gave an example of how not all APAs may be affected, as the facts won't change over a long-term period. He said at least 10 APAs are awaiting approval since February. Since the Covid-19 lockdown delayed the process, the APA commissioners got in touch with taxpayers in May and June if they wanted revisions. "But, not a single taxpayer asked for any change in APAs and signed them," said the official.

Some argue that companies in the final leg of APAs — with a year or two left — may look at abandoning them and go with the 'arm's length principle of taxation'.

He added that in cases where there is change in supply chain or the flow of transaction for which APA was obtained, the existing APA might cease to be relevant owing to change in