

Advance Pricing Agreement (APA)

An advance pricing agreement (APA) is an agreement between a taxpayer and a tax authority made ahead of time.

The agreement is based on an appropriate transfer pricing methodology (TPM) for a set number of transactions over a period of time. These transactions are known as “Covered Transactions”

This article will further give details about the Advance Pricing Agreement within the context of the IAS Exam

Overview of Advance Pricing Agreements

Advance pricing agreements are based on an agreed transfer pricing methodology that decides the pricing of future international transactions of the taxpayer.

The raison d'être behind an APA is to provide transparency for a taxpayer regarding tax risks and possible exposure related to such risks. APA is to provide for a more regulated and fair business atmosphere. Such agreements do not serve the purpose of mapping future transactional issues, but in some cases they resolve existing pricing disputes.

Types of Advance Pricing Agreement

There are three types of Advanced Pricing Agreements. They are as follows:

- 1. Unilateral APA:** A unilateral APA involves only the taxpayer company and just the tax authority of the country.
- 2. Bilateral Advance Pricing Agreements:** Bilateral APA's involve a total of four entities: the taxpayer, the tax authority, the associated enterprise and tax authority of the country where the associated enterprise is located.
- 3. Multilateral APA:** This involves agreement about transfer pricing. The entities involved are the taxpayer, the tax authority, two or more associated enterprises and the tax authority of the countries where the enterprises are located.

Benefits of APA

One of the foremost benefits of Advance Pricing Agreements is to help tax authorities in preventing tax evasion. Other benefits of an APA are as follows:

- APAs offer surety when it comes to tax liability of taxpayer's foreign transactions through the application of Arm's Length Pricing technique to decide upon the prices of international transactions.
- When an APA guideline is followed to a great extent, it results in minimizing time and effort that goes into audit tasks. This removes the problem of auditing for a taxpayer who runs business across several countries.
- Extra pressure on resources and reduces the cost of administration through the formulation and applications of APA's.

Advance Pricing Agreement in India

The Advance Pricing Agreement was implemented in 2012 by the Central Board of Direct Taxes to reduce any chances of confusion with regards to the pricing of international transactions through a mutual agreement between the taxpayer and tax authority.

The reason for the introduction of APA's was due to a large number of transfer pricing cases held up in dispute.

Frequently Asked Questions about Advance Pricing Agreement

What is arm's length pricing?

The price at which a willing buyer and a willing unrelated seller would freely agree to transact or a trade between related parties that is conducted as if they were unrelated, so that there is no conflict of interest in the transaction.

What is Transfer Pricing?

Transfer price can be understood as the charges at which one company makes available goods or finance or services to another company that is related to it.