



India inks Unilateral APA in ITES dealing with severance compensation

Marking a significant development in the Indian Advance Pricing Agreement (APA) space, the Central Board of Direct Taxes (CBDT) entered into a unilateral APA in the Information Technology Enabled Services (ITES) space involving contentious issues dealing with severance compensation for employees.

The ITES industry is one of the most litigated sectors in the Transfer Pricing (TP) arena and has always been under constant pressure from the tax authorities with expectations of high margins, resulting in huge TP adjustments leading to endless litigation. While there have been many APAs in the ITES space in the recent months, this particular APA specifically addresses issues arising from reduction and shutdown of captive activities in India and resulting severance compensation for employees.

Captive service providers at times have to rationalise the size of operations in India or in certain circumstances completely stop Indian captive activities, leading to shutdown costs, employee severance compensation, etc. Mark-up on such severance cost is a much debated issue and the determination of the arm's length treatment of such expenditure may not follow a straight-jacketed approach. It has to be resolved mutually on the basis of a fact based diligent review as was done in this case. The APA authorities adopted a reasonable approach and carried out an in-depth analysis of the taxpayer's facts through various rounds of discussions. The emphasis by the APA authorities was on the Function, Assets and Risk (FAR) analysis undertaken by the taxpayer in the overall supply chain and the authorities were practical and fair in their fact finding approach.

Our comments

The efforts put in by the APA authorities is indicative of the fact that the government is willing to upfront discuss and proactively address contentious issues which is a very positive sign for the industry. This will encourage many others in the industry to consider the APA route to obtain mutually acceptable solutions to their controversial TP disputes and will provide an impetus to the government's agenda of making India an investor friendly destination.



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