



# **Advance Pricing Arrangements**

## **Approaches to Legislation**

**(Pilot version for comments)**

**Initial draft - October 2012**

## **Introduction**

This paper, which has been prepared by the OECD Secretariat, discusses the drafting of country legislation on transfer pricing Advanced Pricing Arrangements (APAs). It is targeted towards countries that are developing Advanced Pricing Arrangement rules for the first time, or are seeking to update existing APA rules.

The core of the paper is illustrative APA legislation, which is intended to demonstrate various issues that country APA legislation typically needs to address, and to illustrate possible approaches.

## **Structure**

The paper consists of:

- A brief discussion of policy considerations regarding APAs
- Illustrative APA legislation
- Annex I – explanatory notes to the legislation
- Annex II – summaries of selected country approaches to APAs
- Annex III – a guide to APAs, based on the guidance contained in the OECD's Transfer Pricing Guidelines [Oki's paper]
- Annex IV – a comparative table of selected country approaches to APAs [Celine's Table and EVA's analysis]

## **Drafting Approach**

It should be noted that the approach to country legislation on APAs described below is intended to illustrate a possible approach, or alternative approaches, and is intended to support training and capacity development initiatives. The paper bears no legal status and the views expressed therein do not necessarily represent the views of the OECD member states. For a more comprehensive description of the views of the OECD and its member states in relation to the arm's length principle and transfer pricing, readers are invited to refer to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations which were approved by the Committee on Fiscal Affairs on 27 June 1995 and by the Council of the OECD for publication on 13 July 1995 [C(95)126/FINAL] and were supplemented and updated since (the most recent update of the Transfer Pricing Guidelines was approved by the Council on 22 July 2010, see [www.oecd.org/ctp/tp](http://www.oecd.org/ctp/tp).)

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## POLICY CONSIDERATIONS REGARDING APAs

### *Introduction*

This paper contains a suggested approach to country legislation on Advance Pricing Arrangements (APAs), aimed at assisting countries that are introducing an APA regime for the first time, or are planning to update existing APA legislation.

Countries need to consider very carefully whether they wish to introduce an APA regime and, if they do, the most appropriate time to do so. Not all countries consider that APAs meet their policy objectives or priorities, and some have stated that they do not intend to introduce APAs in the foreseeable future. Nevertheless, many, though not all, OECD countries have introduced APA rules, as have many non-OECD economies. Non-OECD economies that have adopted APAs include:

- China
- Chinese Taipei
- Colombia
- Egypt
- Indonesia
- India
- Kazakhstan
- Malaysia
- Peru
- Romania
- Singapore
- Venezuela

### *Policy considerations*

There are a number of factors that countries will wish to consider in relation to APAs.

#### *a) Taxpayer certainty*

Perhaps the most important role of APAs is to provide certainty to taxpayers on the tax treatment of their cross-border activities. An APA provides comfort to a taxpayer that it will not be subject to a costly audit, with an uncertain outcome, in relation to the relevant transaction(s) that fall within the APA, and over the period of the APA. This is provided, of course, that the conditions of the APA remain fulfilled.

Bilateral or multilateral APAs extend that comfort to the treatment of the relevant transactions (s) in more than one country, and also provide for protection against economic double taxation.

These are important considerations from an **investment climate** perspective.

It is important, however, that APAs are not used to provide preferential or advantageous treatment to individual taxpayers as part of a “tax incentive” strategy. Not only would such an approach undermine

tax yield, it would also disadvantage, and lead to uncertainty of treatment in, the country in which is the counterpart to the relevant transaction(s) is located. APAs should thus adopt and implement internationally accepted standards on transfer pricing.

#### b) *Likely tax yield*

APAs should not be viewed as a means for increasing tax revenue. As mentioned above, APAs are primarily aimed at providing some certainty to taxpayers on the tax treatment of their cross-border activities. From the perspectives of both the taxpayer and the tax authority, an APA is often seen as an alternative to an audit into a company's corporate tax position. If a country has the capacity to carry out effective audits, it is unlikely that devoting resources to APAs will be more effective at raising revenue than employing resource on audits. This is because:

- it is arguable that only compliant taxpayers will apply for an APA,
- an effective audit programme can be targeted at the highest risk taxpayers,
- the threat of effective audit gives all taxpayers an incentive to voluntarily comply with the relevant transfer pricing rules.

#### c) *Resource use*

There are a number of considerations with regards to the most efficient use of tax authority resources. It is important to note that the negotiation of an APA needs to be carried out by knowledgeable transfer pricing specialists in the tax administration. Such resources are likely to be in short supply, and, of course, when employed on an APA, will have reduced availability for other compliance activities, including auditing. Tax administrations thus often face a balance between using scarce resources in a) an APA programme and b) auditing.

There are a number of aspects to this balance:

- Devoting all specialist resource to an APA programme, at the expense of audit activities, is unlikely to be successful – without the threat of eventual audit of their intra-group transactions taxpayers will have little incentive to seek an APA, or comply with the transfer pricing rules at all. Most tax authorities need to conduct an APA programme in conjunction with an effective audit programme.
- It is likely that an APA can be carried out more efficiently than an audit into the same transaction(s). An APA will normally use contemporaneous data, and the taxpayer will have an incentive to co-operate and provide all relevant data and information.
- However, as mentioned above, is arguable that only compliant taxpayers will apply for an APA, and there is thus a danger that scarce and valuable resource is tied up with compliant taxpayers, at the expense of time spent on auditing high risk cases.
- Even when an APA is in place, the tax administration is not freed from further auditing activities. APAs invariably require a taxpayer to file periodic reports to confirm adherence to the agreement, and that the critical assumptions contained in it remain fulfilled. These reports will

require consideration. Furthermore, transactions outside the scope of the APA may also be the subject of audit activity.

Resources considerations increase the significance of introducing clear criteria for accepting or rejecting APA applications. Provisions such as these are important in order to allow the tax authority some control over the number of APA negotiations it enters into, and to ensure that its scarce specialist resources are engaged only on worthwhile cases that justify the resource cost. Countries may include their criteria for acceptance of an APA request in the APA legislation, or associated guidance. This might include, for example, restricting APAs only to “complex” transactions or those where there is uncertainty over the application of the most appropriate transfer pricing method.

*d) Skills building*

Taxpayers’ incentive to co-operate with the APA process and increased willingness to work with the tax administration often means that involvement in negotiating APAs can help build valuable specialist transfer pricing skills, and build knowledge and intelligence on sectors, industries and/or particular taxpayers.

*e) Capacity to conduct an APA programme*

It is sometimes argued that less experienced tax administrations may lack the knowledge and skills to negotiate fair APAs, especially when faced with large, well-advised multinational enterprises. Similarly, in the case of bilateral and multilateral APAs, there is a perceived risk that less experienced countries may be disadvantaged in negotiations by more experienced countries.

It may be worth bearing in mind:

- The same issues will be in point, of course, in respect of auditing large, well advised taxpayers.
- Risks of entering an unfavourable APAs might be mitigated if initial APAs are entered into for a relatively short period of time (say 3 years), perhaps with an option to extend for a longer period if both parties agree.
- There is no requirement on a tax administration to agree an APA. Tax administrations may decline an APA request, and withdraw from negotiations if an acceptable outcome cannot be reached.

*e) Corruption issues.*

Care needs to be taken to ensure that APA negotiations are subject to similar oversight and balances as audits in order to mitigate risks of corruption.

## ILLUSTRATIVE COUNTRY LEGISLATION FOR ADVANCE PRICING ARRANGMENTS IN RELATION TO TRANSFER PRICING

1. This article applies where an arrangement (“an advance pricing arrangement”) has been made between [tax administration] and a person that:
  - determines a set of criteria for the determination of arm’s length transfer pricing
  - of a specified transaction or specified transactions that fall within the scope of [transfer pricing legislation]
  - over a specified fixed period of time.
2. This article also applies where an arrangement has been made between [tax administration] and a person that determines a set of criteria for the determination of the amount of profit to attributed to a permanent establishment.
3. Where this article applies, and provided that the terms of the arrangement are fully complied with, then:
  - the [transfer pricing legislation] will not apply to any specified transactions over the specified period of time;

OR [as alternative wording]

  - no transfer pricing adjustment will be made under [transfer pricing legislation] to the transaction or transactions that are specified .
4. A taxpayer may request that [tax administration] enters into an arrangement that falls within paragraphs 1 and 2 above. The request shall include:
  - (a) A description of the taxpayer’s activity, of its specified transactions and of the proposed scope and duration of the advance pricing arrangement, and an explanation of why the specified transactions fall within the scope of [transfer pricing legislation];
  - (b) A proposal by the taxpayer for the determination of arm’s length transfer pricing for the transactions to be covered by the advance pricing arrangement, in accordance with arm’s length principle contained in [transfer pricing legislation], describing the comparability factors that are regarded as significant to the specified transactions, the selection of the most appropriate transfer pricing method, and critical assumptions as to future events under which the determination is proposed;
  - (c) An identification of the associated enterprises that are parties to the specified transactions and where those enterprises are resident for tax purposes;

(d) Details of any other country or countries the taxpayer wishes to participate in the arrangement;

(e) Any other information the tax administration may prescribe by regulation.

5. The tax administration will consider the request of the taxpayer and make a decision whether or not to proceed with it.
6. The tax administration may reject the taxpayer's request to enter into an advance pricing arrangement.
7. The [tax administration] may enter into an advance pricing arrangement unilaterally, or in consultation with the competent authority or authorities of the country or countries in which the associated enterprise(s) that are counterparties to the specified transaction(s) are resident.
8. The arrangement may apply to a specified transaction or transactions for periods ending before the arrangement is made.

If the arrangement relates to a specified transaction undertaken during a period beginning or ending before the arrangement is made, any adjustments are to be made in the manner provided for in the arrangement.

9. During the term of the advance pricing arrangement, the taxpayer will file an annual report which:
  - describes the taxpayer's actual activities for the period of the annual report
  - demonstrates compliance with the terms and conditions of the arrangement
  - and confirms that the critical assumptions have been met.
10. If it is established that:
  - the taxpayer failed to materially comply with any terms or conditions of the arrangement; or
  - there is a material breach of any of the critical assumptions; or
  - there was a change in tax law, or treaty provisions, materially relevant to the arrangement;

the arrangement may be modified or cancelled by [tax authority] from the date of the failure, breach or change referred to above.

11. If it is established that the taxpayer made a misrepresentation, mistake or omission in the information provided to [tax authority] under paragraph 4 above, or paragraph 9 above, or in the course of negotiation of the arrangement, and such misrepresentation, mistake or omission was due to negligence, carelessness or wilful default, the arrangement may be revoked by [tax

authority], and the [transfer pricing legislation ] will apply through the entire term of the arrangement as though it had never been entered into. If the arrangement is not revoked the arrangement may be cancelled or modified (including retrospectively) by [tax authority] taking into account the facts and the circumstances of the case.

12. A person is liable to a penalty of not more than XXXXX if the person makes a misrepresentation, mistake or omission in the information provided —

(a) for or in connection with any application to [tax authority] for them to enter into an advance pricing arrangement, or

(b) otherwise in connection with the preparation of an advance pricing agreement; or

(c) in connection with an annual report described in paragraph 9 above,

and such a misrepresentation, mistake or omission was due to negligence, carelessness or wilful default

13. If it is established that the taxpayer made a misrepresentation, mistake or omission in the information provided to [tax authority] under paragraph 4 above, or paragraph 9 above, or in the course of negotiation of the arrangement, and such misrepresentation, mistake or omission was not due to negligence, carelessness or wilful default, the arrangement may be modified retrospectively, cancelled or modified, by [tax authority] taking into account the facts and the circumstances of the case. [N.B. Divergence from Guidelines in respect of MAP APAs]

14. If:

- an arrangement has been entered into by [tax authority] unilaterally, that is, without consultation with the competent authority of the country in which the counterparty to the specified transaction is resident
- and the terms and conditions of the arrangement give rise to potential taxation which is not in accordance with a treaty with the country in which the counterparty to the specified transaction is resident,
- the provisions contained in the treaty to avoid taxation not in accordance with the treaty shall apply.

15. The tax administration shall ensure the confidentiality of trade secrets and other sensitive information and documentation submitted to it in the course of an advance pricing arrangement proceeding.

## ANNEX I – EXPLANATORY NOTES

### Scope of legislation

Paragraph 1 defines the transactions that fall within the scope of the Advance Pricing Arrangement (“APA”) rules contained in the illustrative legislation. The starting point is that an APA may be made in respect of any transaction or transactions that fall within the scope of the country’s transfer pricing rules. The exact scope will differ between countries. For example, some country transfer pricing rules apply only to cross-border transactions, while others apply additionally to purely domestic transactions. Furthermore, some countries apply exemptions for smaller transactions from their transfer pricing rules. The key point is that an APA would not be available in respect of a transaction that is not within the scope of the country transfer pricing rules.

In addition, Paragraph 2 allows APAs to be made in respect of the amount of profit to be attributed to a permanent establishment. As it is worded, the Paragraph Article does not extend to allow an APA to be made in respect of whether or not a permanent establishment exists, but countries may wish to extend the scope of the Paragraph to allow this.

Some countries restrict the availability of APAs to specified classes of transaction, for example, those above a certain monetary value (see Schedule in Annex IV for country examples).

An actual APA, of course, will apply only to the transaction or transactions specified within the APA. For example, an APA might specify that it applies to “the sale of manufactured components by Company A (resident in Country A) to Company B (resident in Country B), over the period 1<sup>st</sup> January 2012 to 31<sup>st</sup> December 2015”.

Paragraphs 5 and 6 allow the tax authority to decline a taxpayer’s request to enter into an APA. Provisions such as these are important in order to allow the tax authority some control over the number of APA negotiations it enters into, and to ensure that its scarce specialist resources are engaged only on worthwhile cases that justify the resource cost. Countries may include their criteria for acceptance of an APA request in the APA legislation, or associated guidance. This might include, for example, restricting APAs only to “complex” transactions or those where there is uncertainty over the application of the most appropriate transfer pricing method.

Paragraph 6 of the illustrative legislation does not require a tax authority to provide reasons for the rejection of a request for an APA. Some countries do provide taxpayers with reasons for such a rejection, and countries need to consider whether they wish to do so, and, if they do, whether they wish to make it a statutory obligation to do so.

### Effect of the Legislation

Paragraph 3 specifies how transactions that are the subject of an APA will be treated.

Two alternatives are provided. The first removes such transactions from the scope of the country transfer pricing rules for the period of the APA, provided of course that the terms of the APA are met. This provides the taxpayer with some certainty that it will not be subject to transfer pricing audit or adjustment in relation to those transactions. Such a provision will also remove the taxpayer from related obligations that apply to transactions within the scope of the transfer pricing rules. For example, the obligation to maintain transfer pricing documentation.

The alternative wording also provides the taxpayer with some certainty that it will not be subject to transfer pricing audit or adjustment in relation to those transactions. Such a provision does not, however, remove the taxpayer from transfer pricing documentation and similar obligations.

#### Application for an APA

Paragraph 4 describes the information that a taxpayer must provide to the tax authority with an application for an APA.

Some tax authorities also allow (and/or encourage) taxpayers to meet with them informally before a formal application is made. Such a meeting may allow the tax authority to express a view at an early stage on a) whether an APA is legally available in respect of the relevant transactions and b) whether it is willing to enter into APA talks and negotiations in respect of those transactions.

#### Unilateral and multilateral APAs

APAs may be granted unilaterally, bilaterally or multilaterally.

A unilateral APA involves an arrangement between a tax authority and a taxpayer within that authority's jurisdiction. Thus, for example, Taxpayer A in Country A may sell goods to an associated enterprise, Taxpayer B, resident in Country B. If Taxpayer A enters into a unilateral APA with the tax authorities of Country A, that APA will specify a transfer pricing approach that is acceptable to the tax authorities of Country A only. The arrangement will not address in any way the acceptability of the transfer pricing approach to the tax authorities of Country B. Nevertheless, in the course of negotiating the APA, Country A tax authority may seek, or provide, information regarding the relevant transaction, under the exchange of information provisions of any treaty between Country A and Country B.

A bilateral APA seeks to address the transfer pricing of a particular transaction from the perspective of both tax authorities concerned. In the example above, this would normally be achieved through two agreements – one between Taxpayer A and Country A, the other between Taxpayer B and Country B. An essential feature of such an arrangement, however, is that Country A and Country B will discuss and attempt to agree the terms of the two arrangements. Such discussions would be undertaken under the Mutual Agreement Procedure (MAP) of the treaty between the two countries – hence such arrangements are often referred to as “MAP APAs”. Assuming the parties reach an agreement in these discussions, the result will be some certainty that both Country A and Country B accept the transfer pricing approach described in the APAs.

A multilateral APA has the same effect as a bilateral APA, but involves more than 2 countries.

Paragraph 7 makes it clear that the tax authority may enter into bilateral or multilateral APAs, in addition to unilateral APAs. It should be noted, however, that such bilateral and multilateral APAs are normally only possible if treaties, or relevant multilateral agreements, are in place between the countries involved.

#### Applying the arrangement retrospectively

Paragraph 8 allows an APA to cover periods prior to the date the arrangement is made.

An APA will be operative for specified periods as soon as the APA is in force as set out in the arrangement. APAs, however, can take a considerable length of time to negotiate and to reach agreement. This may lead to a situation where some of the years for which the arrangement is sought will have already passed and the taxpayer may have already needed to submit their returns for those years. Countries may also want to be able to “roll-back” the arrangement as an appropriate means of resolving a transfer pricing issue in earlier years although, in bilateral or multilateral cases, the possibility of doing so will depend on the ability or willingness of the tax authority of the other country or countries involved to do so.

Paragraph 8 of the draft legislation enables the arrangement to be applied retrospectively in circumstances such as these. Neither the tax administration nor the taxpayer are obliged to apply the methodology agreed upon as part of the APA to tax years prior to the APA period.

#### Monitoring compliance with the Arrangement

Paragraph 9 requires the taxpayer to submit an annual report to demonstrate that the APA has been applied as envisaged in the agreement. It is important that the tax authority is able to establish that the taxpayer is abiding by the terms and conditions on which the APA is based, throughout its duration. Most countries require the taxpayer to prepare an Annual Report. In many instances, the taxpayer is required to submit the report as part of its annual tax return. The broad intention is that Annual Reports should demonstrate in a concise format that the business has complied with the terms and conditions of the APA. This includes the taxpayer making available the information needed for the tax administration to decide if the critical assumptions or other safeguards in the APA have been met.

Paragraph 10 addresses the situation where the taxpayer fails to comply with any of the terms specified in the APA, or if any of the critical assumptions included in the APA are breached. In such a case, the tax authority may modify or cancel the APA from the date at which the failure occurred.

#### Consequences of providing inaccurate information

During the course of an APA application, and subsequent discussions and negotiations, the taxpayer will often provide a substantial amount of information to the tax authority concerned. Such information will, of course, be a major determining factor in a) whether the tax authority agrees to enter into an APA, and b) the terms of any APA. It is thus essential that information submitted by the taxpayer is complete and accurate. Paragraphs 11, 12 and 13 deal with the situation where information provided is not accurate.

Paragraph 11 addresses a situation in which the taxpayer has submitted inaccurate information, and done so through negligence, carelessness or willful default. The paragraph allows the tax authority in such situations to revoke the APA. This means that the APA is unwound completely, and the transfer pricing rules then apply as they would in the absence of the APA for all periods covered by the APA, including prior periods. The use of the word “may” in the illustrative wording allows some flexibility, recognizing that revocation may not always be the tax authority’s interest even where negligence, carelessness or willful default is involved. In such cases, the tax authority may choose a different course of action.

Paragraph 12 provides a further sanction against the provision of inaccurate or incomplete information by the taxpayer, due to negligence, carelessness or willful default. This paragraph allows the tax authority to impose a monetary penalty of no more than a specified amount.

Paragraph 13 addresses a situation in which the taxpayer has submitted inaccurate information, but that this is not due to negligence, carelessness or willful default. In such cases, the illustrative legislation allows flexibility of action depending on the facts and the circumstances of the case. Three courses of action are specified:

- The APA may be modified retrospectively. In such cases, the APA remains in operation throughout the intended period (unlike in the case of revocation or cancellation), but the terms are modified from the date the APA came into force.
- The APA may be modified from a specified date. Periods prior to that date, however, are unaffected.
- The APA may be cancelled. This means that, from a specified date, the APA is no longer in force. The terms of the APA do remain in force, however, for the periods prior to the cancellation.

#### Avoidance of double taxation

Paragraph 14 addresses the situation where a unilateral APA gives rise to potential double taxation.

As an example, assume that Taxpayer A in Country A sells goods to an associated enterprise, Taxpayer B, resident in Country B, and that Taxpayer A enters into a unilateral APA with the tax authorities of Country A in respect of the sale of these goods. The APA will specify a transfer pricing approach acceptable to Country A for the duration of the APA. It might specify, for example, that Taxpayer A reports a net profit margin of 4.5% in relation to those sales, for periods 1,2 and 3. Assume also that, subsequently, the tax authorities of Country B examine the transfer pricing between Company A and Company B in the course of an audit of Company B relating to one or more of these periods. As a result of that audit, they may take the view that the transfer pricing agreed in the unilateral APA is not in accordance with the arm’s length principle, and propose an adjustment to the transfer pricing – perhaps to a price that results in a net profit margin of 3.5% to Company A. In this case, there will be potential economic double taxation. As a result, Company A may approach Country A and request that it enters into the “Mutual Agreement Procedure” (MAP) with Country B, in respect of the affected transaction.

Paragraph 14 specifies that, in such a case, and if there is a relevant treaty between Countries A and B, Country A will enter into MAP discussions with Country B, with a view to avoiding double taxation. If necessary, and if the relevant agreement between Countries A and B can be reached, this might require Country A to revisit the terms of the unilateral APA.

Of course, such an issue will not arise in respect of a bilateral or multilateral APA, which will contain terms acceptable to both (or all) countries concerned.

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## ANNEX II – GUIDELINES FOR APAs IN SELECTED COUNTRIES

Regulation on Advance Pricing Agreements (APAs) must be precise and detailed. Together with a reference to APAs in the Corporate Income Tax Legislation, it would be advisable to complement these rules with some sort of administrative guidance (practice statements, circulars) in order to help both taxpayers and Tax Administrations to deal with them.

This annex highlights different aspects in the guidelines issued by 6 selected countries: Australia, Canada, Germany, Japan, UK and the US. For further information, links to full texts are provided.

### 1. AUSTRALIA

#### Regulation:

Practice Statement Law Administration 2011/1

Link to the full text: <http://law.ato.gov.au/atolaw/view.htm?docid=%22psr/ps20111/nat/ato/00001%22>

#### Concept:

An APA is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (for example, method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing of those transactions over a fixed period of time (generally for 3 to 5 years but may be longer). The term of the agreement is discussed during the pre-lodgment meeting and specified in the APA.

An APA may be applied by any Australian taxpayer who has international related party dealings between:

- Related separate legal entities (including PE of separate legal entities).
- Permanent establishment and its head office
- Two permanent establishments of the same entity.

#### Types:

An APA might be concluded either unilaterally, bilaterally or multilaterally:

- Unilateral APA. An agreement concluded between the Australian Taxation Office (ATO) and a taxpayer. It applies to the international related party dealings between the Australian taxpayer and a foreign taxpayer.
- Bilateral APA. Agreement between the ATO and a tax treaty partner concerning the transfer pricing of international related party dealings. Each treaty partner confirms the terms of the APA in writing through a letter with their resident taxpayer and agrees to be bound by them.
- Multilateral APA. Agreement between the relevant taxpayers, the ATO and more than one tax treaty partners and binds all its parties.

Depending on the complexity of the dealings:

- Simplified APA. Designed for taxpayers with low value or low risk international related party dealings. It is less time consuming and less costly for taxpayers. Available for unilateral APA.
- Standard APA. Deals with dealings that do not qualify for the simplified or complex type. Available for both unilateral and bilateral APAs
- Complex APA. Deals with complex international related party dealings (complexity for different reasons: dealings are considered to be high risk, lack of comparables, significant amount of tax involved, etc).

#### Process:

The content of each step will depend on the type of APA (simplified, standard or complex)

- 1) Pre-lodgment. The taxpayers provide an APA proposal that will be reviewed by ATO. The proposal will be discussed at the pre-lodgment meeting. The aim of this stage is to identify the scope of the APA and collateral issues.
- 2) Lodgment of formal application.
- 3) Analysis and evaluation.
- 4) Negotiation and agreement. The taxpayer and the ATO will finalize the APA based on the outcomes of the negotiation.

#### Effect:

When the APA comes into effect and the taxpayers comply with its terms, the ATP is prevented from imposing any additional income tax on the covered international related party dealings under the APA.

#### Annual Report:

The taxpayer will be required as part of the APA to prepare an Annual Compliance Report for each year of the APA, containing sufficient information to demonstrate compliance with the terms of the APA. If the taxpayers fail to comply with annual reporting requirements the ATO could consider cancelling the APA where the records did not enable the ATO to confirm readily that the terms of the APA were applied.

## Renewal

A unilateral or bilateral APA may be renewed by the consent of all the parties to it (including the tax treaty partner who is a party to a bilateral APA). A request for renewal of the APA should follow the same procedures that apply to the initial APA request.

## **2. CANADA**

### Regulation:

Information circular on Advanced Pricing Arrangements, March 16<sup>th</sup> 2001

Link to the full text: <http://www.cra-arc.gc.ca/E/pub/tp/ic94-4r/ic94-4r-e.pdf>

### Concept:

An APA is defined as an arrangement between the Minister of National Revenue and a taxpayer. It covers certain transactions and arrangements between the taxpayer and non-resident entities. APAs confirm appropriate transfer pricing methodologies, in advance, and their application to specific cross-border non-arm's length transactions or arrangements for specified periods of time, under specified terms and conditions, for purposes of the Act. The term of an APA is usually 3 to 5 years, but it may depend on the facts and circumstances.

APAs may also be applied to issues similar or related to transfer pricing, such as the proper attribution of income between permanent establishments and other parts of the same entity.

Any taxpayer may apply for APA consideration, regardless of the size of the organization, the type or scope of its operations, or the nature of the transactions and proposed TPMs.

The Canadian Circular includes (in appendix VI) a model of APA.

### Types:

- Unilateral APA. An APA effective for Canadian income tax purposes only.
- Bilateral APA. An APA between the Canadian competent authority and the competent authority of a country with which Canada has an income tax treaty. It includes an agreement, under the mutual agreement procedure article in the relevant tax treaty, covering certain transactions or arrangements between the taxpayer and non-resident entities.

- Multilateral APA. An APA between the Canadian competent authority and the competent authority of two or more countries with which Canada has income tax treaties. It includes an agreement, under the mutual agreement procedure, covering certain transactions between the taxpayer and non-resident entities.

Process:

- 1) Pre-filing meeting. Attended by taxpayer and CCRA officials (Canada Customs and Revenue Agency) in order to explore the suitability of an APA and to informally discuss the APA process and the matters set out in the information circular.
- 2) APA request. CCRA will accept or decline the request. The agency has preference for bilateral and multilateral agreements rather than unilateral ones.
- 3) Review, analysis and evaluation.
- 4) Consideration by the competent authority.

Effect:

An approved APA is regarded as binding on the CCRA and on the taxpayer. If the taxpayers comply with the terms and conditions of an APA, the Tax Administration will consider that the results of applying the agreed transfer pricing methodology have satisfied section 247 of the Act (arm's length principle) for the transactions and periods specified in the APA.

Report:

The taxpayer will need to file APA reports according to the terms of the APA. The report will describe the actual operations for the period and demonstrate the compliance with the conditions of the APA. The Reports will be reviewed by the competent authority.

Renewal:

Requests to renew the APA will follow the same form and procedures in effect at the time the request for renewal is made that apply to initial APA requests.

### **3. GERMANY**

Regulation:

Information Circular on bi or multilateral mutual agreement procedures under double taxation agreements for reaching APA aimed at granting binding advance approval of transfer prices agreed between international associated enterprise (issued by the Federal Ministry of Finance of Germany in October 5<sup>th</sup> 2006)

Link: to the full text: <http://www.oecd.org/tax/transferpricing/47655669.pdf>

Concept:

An APA is an agreement between one or more taxpayers and one or more tax administrations. It lays down (before controlled transactions between associated enterprises in different countries are carried out) a transfer pricing method in accordance with the arm's length principle, for fixing transfer prices for given business transactions over a given period. Further criteria for determining transfer prices can be agreed (e.g. identification of comparables, calculations for suitably effecting adjustments, critical assumptions with regard to future incidents, etc.).

Types:

Unilateral, bilateral and multilateral

Process:

- 1) Preliminary talks (pre-filing). Discussion between the taxpayer and the Federal Central Tax Office about the procedure to follow the content of the APA request and the documents to include.
- 2) Request. The scope of application in terms of both content and period has to be defined in the request. The other country with which an advance agreement is to be reached has to be named. The applicant may restrict its APA request to certain exactly specified types of transactions or to transactions with certain exactly specified associated enterprises, or to transactions with associated enterprises in given countries. The applicant must justify why the proposed transfer pricing method complies with the arm's length principle
- 3) Rejection/Acceptance

Effect:

Tax authorities are bound by the APA, provided the underlying facts of the APA have been implemented and the critical assumptions have been satisfied. The taxpayer is under no obligation by reason of the APA to implement underlying facts used as a basis for the APA. If it fails to so, then the APA become obsolete and lose all legal effect. If the taxpayers implement the facts, then it is also bound by the agreement. If it charges prices other than those agreed in the APA, then the tax authorities may base

taxation on the provisions of the APA, then the tax authorities may base taxation on the provisions of the APA, notwithstanding any diverse amounts charged.

Report:

The taxpayer must draw up and submit an annual report showing that the matter underlying the agreement has been realized in the fiscal year concerned, and in particular that the critical assumptions have been satisfied.

Renewal:

An APA may, with the country's permission, be extended beyond the period of application, if a request to this effect is duly filed and it is credibly proved that the underlying facts in future will match the underlying facts on which the APA has been based.

#### **4. JAPAN**

Regulation:

Commissioner's Directive on the Operation of Transfer Pricing (Administrative guidelines) issued by National Tax Agency of Japan, on June 1<sup>st</sup> 2-11 (last amendment June 25<sup>th</sup> 2007). Chapter 5: Advance Pricing Arrangements.

Link to the full text: [http://www.nta.go.jp/foreign\\_language/07.pdf](http://www.nta.go.jp/foreign_language/07.pdf)

Concept:

The confirmation made by a District Director of a Tax Office or a Regional Commissioner of a Regional Taxation Bureau with regard to the methodologies of calculation of arm's length price and the specific details thereof (hereinafter referred to as TPM) deemed to be the most reasonable to be adopted by a corporation.

The term is, in principle, from 3 to 5 taxable years.

Types:

Unilateral, bilateral.

Process:

- 1) Pre-filing consultation. The RTB division shall accede to requests from corporations for a pre-filing consultation. These consultations are intended to help make APA procedures more convenient for corporations and to expedite APA procedures.
- 2) Request to be filed along with the prescribed documents.
- 3) Review of the request by the examination group of the Tax Office.
- 4) Acceptance/Rejection.

Effect:

Tax returns complying with the content of the APA for the confirmed taxable years shall be treated by the District Director as having been conducted at the arm's length price.

Report:

Taxpayers shall be requested to submit reports with the prescribed information, justifying that they filed tax returns complying with the contents of the APA. The RTB division shall evaluate the report submitted and determine whether the corporation complies with the content of the APA.

Renewal:

When a corporation files a request for renewal of its APA, the request shall be processed in accordance with the conditions envisaged by the Circular for the request.

## **5. UNITED KINGDOM**

Regulation:

Statement of Practice 2/10 on Advanced Pricing Agreements (this SP updates an earlier Statement on APAs published in 1999). Guidance about how HMRC interprets and applies the APA legislation

Link to the full text: <http://www.hmrc.gov.uk/agents/sop.pdf> (Page 319)

Concept:

Written agreement between a business and the Commissioners of HMRC which determines a method for resolving transfer pricing issues in advance of a return being made. When the terms of the agreement are complied with, it provides assurance to the business that the treatment of those transfer pricing issues will be accepted by HMRC for the period covered by the agreement. Typically the term is from 3 to 5 years.

An APA can be used to resolve questions relating to the following broad situations giving rise to transfer pricing issues:

- Transfer prices between separate business enterprises where questions may arise as to the determination of the arm's length principle.
- Attribution of income or profit between parts of a business enterprise which operates in more than one country where questions may arise as to the taxable income to be recognized in any such part.

Thin capitalization issues will be dealt via a separate Advance Thin Capitalization Agreement (ATCA).

Types:

- Unilateral. Binding agreement between a UK business and HMRC. This agreement confirms the tax treatment in the UK but it does not determine how the issues are to be resolved in any other country involved.
- Bilateral. Agreement between HMRC and the Administration of other country in accordance with the Mutual Agreement Procedure article on their tax treaty. This type of APA aims to eliminate the risk of double taxation and therefore is the one recommended by HMRC.
- Multilateral. There is no discrete mechanism for reaching multilateral agreements so, in reality, multilateral APAs are strictly multiple and complementary bilateral APAs. This type is appropriate for business operating in several countries

Process:

- 1) Informal talk. HMRC strongly recommend that an enterprise interested in submitting a request contacts it first to informally discuss its plans before presenting a formal application (what is called an Expression of Interest).
- 2) Formal request. By any UK business, any non-resident trading in the UK through a PE and any UK resident trading through a PE outside the UK. This formal request should follow the content envisaged by the Statement of practice.
- 3) Review. HMRC will consider the request on the basis of its facts and features. If there are not complex transfer pricing issues (no matter if the size of the transaction or the enterprise), HMRC would not accept the request.
- 4) Acceptance/Rejection.

Effect:

The APA provides assurance to the business that the treatment of those transfer pricing issues will be accepted by HMRC for the period covered by the agreement. On the business' side, it commits itself to demonstrate adherence to the agreed method for dealing with the transfer pricing issues during the term of the APA in the form of an annual report.

Report:

An annual report will generally accompany the business' tax return. The requirements of each report will be set out in the APA. The broad intention is that annual reports should demonstrate in a concise format whether the business has complied with the terms and conditions of the APA.

Renewal:

The business may request renewal of an APA. The renewal application should expressly consider any changes or anticipated changes in facts and circumstances since the existing agreement was reached. HMRC will conduct a review of the renewal application.

## **6. UNITED STATES**

Regulation:

Internal Revenue Proc. 2006-9 issued by Internal Revenue Service, released on December 19<sup>th</sup> 2005

Link to the full text: <http://www.irs.gov/pub/irs-drop/rp-06-9.pdf>

Concept:

Voluntary process whereby the IRS and taxpayers may resolve transfer pricing issues under 482 of the Internal Revenue Code. An APA is an agreement between a taxpayer and the Service in which the parties set forth, in advance of controlled transactions, the best transfer pricing method (TPM) within the meaning of 482 of the Code and the regulations. The agreement specifies the covered controlled

transactions, TPM, term, operational and compliance provisions, appropriate adjustment, critical assumptions, annual reporting responsibilities, etc.

The taxpayer must propose a term for the APA appropriate to the industry, products and transactions involved. Although the APA term is determined on a case-by-case basis, a request for an APA should propose an APA term of at least 5 years unless the taxpayer states a compelling reason for a shorter term.

#### Types:

- Unilateral. It involves only an agreement between the taxpayer and the IRS. But, in order to ensure that no potential for double taxation results from an APA, an APA should be concluded on a bilateral or multilateral basis between the competent authorities through the mutual agreement procedure of the relevant income tax treaty.
- Bilateral/Multilateral. It involves a request for an APA between the taxpayer and the IRS, accompanied by a request for a mutual agreement between relevant competent authorities. The “APA Program” prepares a recommended negotiating position for the US competent authority as a basis for discussions with the foreign competent authority.

#### Process:

- 1) Pre-filing conference. A taxpayer may request it with the APA Program in order to discuss informally the suitability of an APA. Among the areas of discussion are the covered transactions, the potentially applicable TPMs, etc.
- 2) Request. The Internal Revenue Procedure specifies the items to be included in the request.
- 3) Review by IRS.
- 4) Acceptance/Rejection.

#### Effect:

An APA is a binding agreement between the taxpayer and the IRS. If the taxpayer complies with the terms and conditions of the APA, the IRS will not contest the application of the TPM to the subject matter of the APA except as provided in this revenue procedure. The taxpayers remain otherwise subject to US income tax laws and applicable income tax conventions. An APA will have no legal effect except with respect to the taxpayer, taxable years and transactions to which the APA specifically relates.

#### Report:

Taxpayers must file an annual report for each taxable year covered by the APA. The taxpayer must file a timely and complete annual report describing its actual operations for the year and demonstrating compliance with the APA's terms and conditions.

Renewal:

A taxpayer may request renewal of an APA using the procedures for initial APA requests. To expedite the preparation and evaluation of an APA request, however, taxpayers are encouraged to request a pre-filing conference to discuss with the APA Program. The APA Program will endeavor to expedite the processing of a renewal APA.

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