

# ***TR 94/D32 - Income tax: transfer pricing: application for advance pricing agreements - bilateral and unilateral advance pricing agreement procedures***

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## Draft Taxation Ruling

# Income tax: transfer pricing: application for advance pricing agreements - bilateral and unilateral advance pricing agreement procedures

### other Rulings on this topic

TR 92/11; TR 94/14

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*Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.*

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## What this Ruling is about

1. This Ruling provides guidelines to taxpayers seeking an Advance Pricing Agreement (APA). An APA represents an agreement between the taxpayer and a tax authority that establishes the transfer pricing methodology (TPM) to be used in any future apportionment or allocation of income, deductions, credits or allowances so as to ensure arm's length transfer prices or results are achieved for income tax purposes.
2. For the purposes of this Ruling, the term TPM is not restricted to any one specific methodology. An APA may adopt one specific methodology, several methodologies (e.g., for different types of transactions), a mixture of commonly used methodologies, or some other methodology or methodologies. In this regard see paragraphs 343 to 367 of Taxation Ruling TR 94/14.
3. The determination of an arm's length TPM is a difficult and complex area of income tax law for both the taxpayer and the tax administrator. The APA process attempts to address the concerns regarding the uncertainties surrounding transactions, agreements or arrangements between related parties and the potential for double taxation by allowing taxpayers and tax authorities to address and resolve international transfer pricing issues on a prospective basis.
4. As an administrative service to taxpayers, the Australian Taxation Office (ATO) has put into place the APA program because it

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provides taxpayers with significant benefits and convenience in complying with the arm's length standard. The APA process provides taxpayers who have related party transactions, agreements or arrangements with non-residents the opportunity to obtain an agreed inter company TPM which reflects arm's length principles.

5. An APA will specify on a prospective basis which TPM should be used to determine the earnings of the taxpayer to be taxed in relation to a particular transaction(s), agreement(s) or arrangement(s).

6. Generally APAs relate to the establishment of a TPM which will result in an arm's length price or result taking into consideration the normal fluctuations of the market place. However, there may be circumstances where it is more appropriate for the APA to fix a particular price, after having agreed on a TPM. Similarly, there may be circumstances where an APA may agree on a particular transaction or business activity which is not in relation to a TPM (refer to paragraphs 53 and 54).

7. An APA provides greater certainty for both the taxpayer and revenue authorities concerned and minimises the likelihood of a dispute in the event that the taxpayer is subsequently subject to audit. An APA reduces the costs and time involved relative to a transfer pricing audit.

8. Because an APA provides certainty on an appropriate TPM, it minimises the possibility of double taxation in the future and reduces the taxpayer's ongoing compliance costs. The taxpayer is also better placed to predict costs and expenses, including tax liabilities.

## Ruling

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### Scope of APA

9. A taxpayer may obtain an APA regarding the application of a TPM applicable to its related party transactions, agreements or arrangements with its foreign affiliates. The APA will apply to such transactions, agreements or arrangements as are relevant for the purposes of Division 13 of the *Income Tax Assessment Act 1936* (ITAA) and the *Income Tax (International Agreements) Act 1953* (IT(IA)A), which gives the force of law to the double tax agreements between Australia and its tax treaty partners (see paragraphs 45 to 54).

10. Because of the unique nature of each individual case, the information requirements, processing and finalisation of each case will depend on the individual facts and circumstances of the case (see paragraphs 53, 54, 87, 92, 141 and 148).

**Applying for an APA**

11. Any taxpayer with international transactions, agreements or arrangements or interests may apply for an APA. The ATO will consider applications pertaining to both tax treaty and non-tax treaty partner countries but subject to the limitation that a bilateral APA would only be possible in the former case (see paragraphs 39 to 44, 82 and 83).

12. The capacity for the ATO to accept and deal with all APA applications will be governed by a number of factors and it may be necessary in some cases for applications to be rejected (see paragraphs 82 and 192 to 194).

**APA defined**

13. An APA is an agreement between the taxpayer, the ATO and, where appropriate, a foreign tax authority regarding the income tax treatment of international transactions, agreements or arrangements between related parties or associates. An APA establishes what TPM should be used to determine arm's length prices or results for future transactions, agreements or arrangements covered by the agreement and specifies the TPM to be used for determining the income and/or expenditure of the taxpayer for income tax purposes in relation to a particular transaction(s), agreement(s) or arrangement(s) (see paragraphs 39 to 42 and 45 to 54).

14. A proposed TPM has to be in accordance with the arm's length principles reflected in the provisions of Division 13 of the ITAA and the relevant provisions of Australia's double tax agreements (see paragraphs 163 to 165).

**Applying APA to prior years**

15. Neither the ATO nor the taxpayer is compelled to apply the TPM, agreed as part of the APA, to prior year returns. Arrival at an appropriate TPM for the prior years would depend on the particular facts and circumstances surrounding those years (see paragraphs 84 to 91 and 222 to 223).

**Withdrawing from APA process**

16. A taxpayer may discontinue or withdraw from the APA process at any time (see paragraphs 131 and 132).

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## **Bilateral APAs**

17. An APA should, wherever possible, be concluded bilaterally through the Mutual Agreement Procedure Article under the relevant tax treaty or treaties. The mutual agreement procedure would involve exchanges between the appointed "Competent Authorities" under the relevant tax treaty or treaties, which in the case of Australia is the Commissioner of Taxation or his authorised representative (see paragraphs 38 to 44).

## **Unilateral APAs**

18. A unilateral APA, not involving a foreign tax authority or involving a non-tax treaty country, will normally be in the form of a Private Binding Ruling (see paragraphs 208 to 215).

## **Information requirements**

19. Under the APA program, a taxpayer is required to present to the ATO the TPM that it believes to be the most appropriate to its particular facts and circumstances. The taxpayer will also be required to submit documentation supporting the appropriateness of its proposals, which would include, for example, data relating to the industry, markets and countries to be covered by the agreement (see paragraphs 141 to 152).

20. The extent of information necessary to determine an appropriate TPM will depend on the facts and circumstances of each individual case. However, the taxpayer should ensure that sufficient information and supporting evidence is supplied to enable the ATO to make a reasoned decision regarding the taxpayer's proposal (see paragraphs 141 to 152).

21. For bilateral APAs, the ATO requires that the same information should be made available to all tax authorities which are to be a party to the APA (see paragraphs 75, 109 to 111, 154 and 155).

22. The taxpayer and affiliates must offer full cooperation and be open about pricing policy. They should demonstrate a willingness and ability to supply detailed information about their products and performance in Australia and overseas (see paragraph 75).

23. The TPM proposed should be one that clearly reflects an arm's length result, is supported by available and reliable data, requires few adjustments and can be easily administered by both the taxpayer and the ATO (see paragraphs 74 and 163 to 165).

**Prelodgment meeting**

24. To initiate the process, a taxpayer should firstly seek a prelodgment meeting to discuss the requirements of the APA.

A request for a prelodgment meeting should be made in writing to the Australian Competent Authority (see paragraphs 77 to 80).

25. The request for a prelodgment meeting should preferably include a draft outline of the taxpayer's case (see paragraphs 99 to 101).

26. The prelodgment meeting with the ATO would be on a without prejudice basis and should be used to discuss the suitability of an APA, the taxpayer's proposed TPM and the information requirements. At the prelodgment meeting, taxpayers can obtain more information regarding the APA process, assess the documentary requirements and ascertain the extent of information required to enable a proper determination of the their request prior to lodging a formal application (see paragraphs 92 to 98).

**Formal application**

27. The formal application should be complete with the proposed TPM and be in accordance with the information requirements contained in this Ruling, subject to any agreements reached at the prelodgment meeting (see paragraphs 139 and 140).

28. Generally, the formal APA application should incorporate the taxpayer's proposed TPM along with the terms and conditions which will govern the application of the TPM, and the suggested time period for which the TPM would apply. Data showing that the proposed TPM produces arm's length results between the taxpayer and specific foreign related entities for specific related party transactions, agreements or arrangements should also be provided (see paragraphs 141 to 152).

29. The ATO does not prescribe any set format or method of presentation. However, in preparing their case, each taxpayer is required to clearly indicate in their submission the TPM employed and the reasons for adopting that TPM (see paragraphs 139 and 140).

**Critical assumptions**

30. The APA will define in advance changes in circumstances that are so significant that neither party would continue to be bound by the APA. These changes in circumstances are known as critical assumptions (see paragraphs 166 to 170).

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31. If there is a change in critical assumptions underlying the APA that renders the APA unfair or unworkable, the taxpayer, ATO and, where appropriate, the foreign tax authority should enter into discussions to revise the APA or alternatively cancel the APA if agreement on a revised TPM cannot be reached. Similarly, an APA may be revised or cancelled if there is a significant change in the tax law or relevant tax treaty provisions (see paragraphs 224 to 230).

## **Annual reports**

32. The taxpayer must prepare an annual report, for each year of the APA, containing sufficient information to detail the actual results for the year and to demonstrate compliance with the terms and conditions of the APA. The annual report is separate to any requirement the taxpayer has regarding the lodgment of an annual income tax return (see paragraphs 201 to 205).

## **Term of APA**

33. The APA will have prospective application only, generally for taxable years beginning after the date of execution of the APA and will be of limited, specified duration - usually 3 to 5 years with an option to extend the APA after that period (see paragraphs 222 to 223 and 234 to 239).

34. The taxpayer can be assured that the ATO will not make any adjustments, under Division 13 of the ITAA or the relevant provisions of the double tax agreements, to the TPM used by the taxpayer provided there is compliance with the terms and conditions of an APA (see paragraphs 208 to 220).

35. This Ruling is not meant to be exhaustive, but is intended to provide an overview of the APA process and to highlight the key provisions and requirements of the program. Those taxpayers who may consider that an APA would be beneficial should obtain more detailed information through a without prejudice prelodgment meeting with the ATO (refer to paragraphs 92 to 98).

## **Date of effect**

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36. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

## **Explanations**

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37. The expression "related parties" refers to enterprises not dealing at arm's length with each other. The expression "related party transactions, agreements or arrangements" refers to transactions, agreements or arrangements between related parties.

### **Bilateral (Multilateral) and Unilateral APAs**

38. All references in this Ruling to an APA are, unless otherwise stated, references to both a unilateral and a bilateral APA.

39. For the purposes of this Ruling, a bilateral APA is an agreement, arrangement or determination between the taxpayer, the ATO and one or more tax treaty partner countries relating to the treatment for income tax purposes of a taxpayer's transactions, agreements or arrangements between those tax jurisdictions. A bilateral APA may involve separate agreements, arrangements or determinations between the taxpayer and each revenue authority plus a further agreement, arrangement or determination between the ATO and each of the revenue authorities. A bilateral APA would be executed under the Mutual Agreement Procedure Article of the relevant double tax agreement or agreements between Australia and the foreign country or countries.

40. In essence, a bilateral APA may be defined as being a binding agreement, arrangement or determination between a taxpayer, the ATO and one or more foreign tax treaty partner countries, on the transfer pricing methodology acceptable to each tax authority in respect of the taxpayer's transactions, agreements or arrangements between those tax jurisdictions.

41. An APA would normally be undertaken at the request of a taxpayer, although there may be occasions where the ATO may recommend an APA to a taxpayer.

42. Where the APA process does not involve or require agreement with the foreign tax authority or involves a non-tax treaty country, the subsequent agreement, arrangement or determination is referred to as a unilateral APA. Unilateral APA cases include those where the taxpayer requests that the foreign tax treaty partner(s) (or tax authority(s)) are not involved or where the foreign tax treaty partner(s) (or tax authority(s)) do not wish to be involved. A unilateral APA may therefore be defined as an agreement, arrangement or determination between a taxpayer and the ATO in respect of the treatment for income tax purposes of the taxpayer's cross international borders transactions, agreements or arrangements.



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43. A unilateral APA may be executed at the request of a taxpayer who does not want the involvement of the foreign tax authority. However, the taxpayer must show good and sufficient reasons for not wanting the foreign tax authority involved.

44. There may be occasions when a taxpayer is uncertain as to whether a unilateral or bilateral APA should be undertaken because the taxpayer is not aware of the foreign tax authority's thinking on the issue. In such cases, the ATO will, on behalf of the taxpayer, make representations to the foreign tax authority to determine if it is receptive to a bilateral APA process.

## **Purpose and scope of APAs**

45. The ATO recognises the significant benefits to taxpayers of APAs, particularly in assisting them to voluntarily comply with their taxation obligations by providing them with specific guidelines on how transfer pricing methodologies (TPMs) are to be determined and applied. The primary purpose of an APA is to confirm an appropriate TPM for future transactions, agreements or arrangements, and determine how the TPM is to be applied for specific international transactions between related parties. However, as previously mentioned, an APA may, in certain circumstances, be used to fix a particular price or agree on a particular transaction, agreements or arrangements or business activity which is not in relation to a TPM.

46. The ATO does not propose to provide an APA process for taxpayers with only domestic transactions. Nor is it intended that the APA process be used for determining the TPM for transactions, agreements or arrangements relating to past years (ie, an APA does not have retrospective application and only applies to future years). Even so, the ATO can envisage situations where an APA could provide a basis for resolving issues raised in prior year audits, as well as in years not under audit.

## **Transactions, agreements or arrangements covered by APA**

47. The APA would specify which TPM should be used to determine the income and/or expenditure of the taxpayer for income tax purposes in relation to particular types of dealings, transactions, agreements or arrangements. The APA would also determine in which country the relevant income should be taxed or how much should be taxed in each or the process by which it will be worked out.

48. An APA applies only to future specified related party cross border transactions, agreements or arrangements involving a taxpayer and its foreign affiliates for a specified period of time.

49. The APA will apply to such transactions, agreements or arrangements as are relevant for the purposes of Division 13 of the ITAA, the relevant provisions of Australia's double tax agreements and, in addition, other provisions in the ITAA dealing with international transactions, agreements or arrangements.

50. An APA may cover many different types of related party transactions, agreements or arrangements including transfers of tangible or intangible property, services, cost sharing and global trading.

51. The ATO prefers that an APA cover all of the taxpayer's transfer pricing practices and will give weighting to such cases when prioritising which APA requests it will entertain (refer also to paragraphs 192 to 194).

52. The ATO will consider APA applications which are limited to specific groups of related party transactions, agreements or arrangements or specific affiliates. However, in such cases the taxpayer must firstly convince the ATO that the effort required in examining specific issues/transactions is warranted. The ATO considers that transfer pricing issues are often inter-related and the examination of methodologies requires a holistic review of the business. Taxpayers seeking an APA can usually be expected to do so because they require holistic solutions. A specific issue or limited transaction APA would therefore not, in the main, be appropriate.

53. The predominant purpose of the APA process is to provide certainty on the TPM to be used. However, the process may also be used to obtain certainty regarding the income tax treatment of other dealings or business arrangements of the taxpayer. The ATO intends to have a flexible approach in what can or needs to be covered in an APA. The scope of an APA may therefore go further than just transfer pricing issues. For example, the APA process could be applied to profit allocation or income attribution issues arising in the context of global securities and commodity trading operations. Such issues as branch allocations of head office expenses or the attribution of branch income may also be the subject of an APA.

54. Whether the APA process is used in this way will be determined by the ATO after examining the particular facts and issues in question and, in particular, after considering their relevance or connection with the transfer pricing issue that is the subject of the APA.

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## APA benefits and risks

55. The success of the APA process is based around an environment which encourages cooperation between the taxpayer, the ATO and, where appropriate, the foreign tax authorities, in reaching common agreement on an appropriate TPM. The APA process provides a cost effective and speedy alternative for determining the most appropriate TPM to be applied.

56. The ATO is hopeful that the APA process will provide an opportunity to discuss complex tax issues in a less confrontational atmosphere than in a transfer pricing audit. This should stimulate a free flow of information among all parties involved and facilitate the achievement of a legally correct and practicably workable solution. The non adversarial environment should also result in a more objective review and discussion of the data and information supplied.

57. The APA process places a taxpayer in a better position to present its case and obtain a favourable resolution because:

- (a) the APA process is conducted in a cooperative and non adversarial environment;
- (b) APAs are prospective and therefore there are no existing tax issues in dispute; and
- (c) the ATO (and other tax authorities) wish to comprehensively deal with the matter based on appropriate and workable principles.

58. APAs substantially lessen the cost and time to all parties that is usually incurred in the case of a transfer pricing audit because the APA process normally requires the taxpayer to propose the TPM and support this with appropriate documentation. The parties are more likely to reach an amicable agreement since there is no tax payable figure in question and no possibility of penalties because the APA involves a future transaction(s), agreement(s) or arrangement(s) yet to be undertaken or executed.

59. By contrast, a transfer pricing audit requires the ATO to obtain information from the taxpayer regarding past transactions, agreements or arrangements. The ATO then uses the information to determine a TPM for the transaction(s). The process often leads to protracted arguments and possible litigation between the taxpayer and the ATO because the issues relate to actions which have already been executed and there is an amount of tax payable (and possibly penalties) in question.

**The benefits of an APA**

60. Other benefits of the APA process are that it:

- (a) may provide solutions to situations where there is no realistic alternative way of both avoiding double tax and of ensuring that all profits are correctly attributed and taxed;
- (b) provides certainty on an appropriate TPM for the taxpayer and therefore enhances the predictability of tax treatment of international transactions;
- (c) substantially reduces or eliminates the possibility of double taxation in the future;
- (d) prevents costly and time consuming examinations of major transfer pricing issues which may arise as a result of a future transfer pricing audit;
- (e) avoids protracted and expensive litigation without reducing the legal status of the agreed TPM because it is undertaken in a cooperative environment; and
- (f) places the taxpayer in a better position to predict costs and expenses, including tax liabilities.

61. A bilateral APA has the added benefit that it reduces the taxpayer's record keeping burden as the taxpayer will know in advance what records to keep to substantiate the agreed TPM. Generally, taxpayers will not be required to keep documentation potentially relevant to other methodologies. The taxpayer's record keeping requirements can therefore be better streamlined and may, in some cases, simply involve keeping records showing that a specific outcome has been reached.

62. Because the APA process is undertaken in a cooperative manner, it is designed to be completed within 12 months of the formal application. This is a distinct advantage over the time and costs involved for a transfer pricing audit which generally runs well over the 12 month period. This time saving results, in a large part, from the fact that Competent Authorities are dealing with current data as opposed to prior year data which is often difficult and time consuming to gather.

**The risks of an APA**

63. While there are some factors which might cause concern to taxpayers contemplating undertaking an APA, the ATO believes that the benefits of an APA can significantly outweigh any associated costs or concerns. Taxpayers may have concerns about:

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## ***High costs of complying with APA requirements***

64. A taxpayer must voluntarily subject itself to ATO scrutiny by providing detailed industry and taxpayer specific information and by submitting annual reports demonstrating compliance with the APA for each taxable year covered by the APA.

65. Nevertheless, the ATO considers that the APA process significantly reduces the burdens on taxpayers, while enhancing compliance in a cooperative manner. The process represents a big improvement in terms of time and expense over the traditional transfer pricing audit because it focuses all parties' efforts on the one set of facts in a non adversarial environment. It therefore does not require the same need for documentation and information and taxpayer's money and resources are not wasted pursuing documents which in the end may have little relevance.

66. If, however, there is no APA in existence and the taxpayer is subject to a transfer pricing audit, the taxpayer will need to show that the TPM used was appropriate. This may require that the taxpayer spend a considerable amount of time providing historical information, developing methodologies (where one is not already in place) and negotiating with the ATO and possibly a foreign tax authority. This process can become quite cumbersome and expensive both in resources and cost for both the taxpayer and the ATO.

## ***Leaking of trade secrets and commercially sensitive information***

67. An APA may require the disclosure of trade secrets, which may raise concerns about the confidentiality of sensitive information and documentation submitted to the ATO.

68. Taxpayers are reassured that the ATO and other tax authorities are subject to strict secrecy and disclosure provisions (refer also to paragraphs 240 to 243).

## ***The process is not cost effective for small businesses***

69. Small business taxpayers may see the initial APA procedure as being expensive, time consuming and not cost effective for them.

70. The ATO recognises that taxpayers operating on a small scale may view the APA process as being uneconomical. The ATO does not wish to discourage such taxpayers from entering into an APA. Small business taxpayers should note that the level of information required for an APA varies from case to case and therefore the level of information required from a large multinational enterprise would not necessarily be required for a smaller enterprise.

71. To accommodate small businesses contemplating an APA, the ATO will take a flexible approach and will attempt to streamline the process. Small businesses should use the without prejudice prelodgment meeting process to discuss the APA requirements and voice any concerns regarding the cost and practicality of entering into an APA. The prelodgment meeting may be used by taxpayers to determine the "feasibility" of entering into the APA process.

***An APA does not prevent audit activity***

72. An APA does not prevent the ATO from undertaking audit activity in the future, although any audit on related party transactions, agreements or arrangements that are the subject of the APA would only check compliance with the APA (refer to paragraphs 216 to 221).

73. In the event that agreement on an appropriate TPM cannot, for whatever reasons, be reached or the taxpayer withdraws from the APA process, the taxpayer is not insulated from subsequent use by the ATO of the factual information disclosed during the APA process.

74. However, taxpayers are assured the ATO will not use the APA process simply to gather information about them for audit purposes.

**Applying for an APA**

75. The ATO requires that:

- (a) the same information should be made available to all tax authorities which are to be a party to the APA;
- (b) it retains the right to refuse to consider a particular request;
- (c) the taxpayer's affiliate also enter into the APA process, although this may not always be appropriate in the case of a unilateral APA;
- (d) the taxpayer and affiliates offer full cooperation and be open about pricing policy with a willingness and ability to supply detailed information about their transactions, agreements or arrangements and performance in Australia and overseas;
- (e) any agreed price(s) or methodology(s) should be in accordance with the arm's length principles reflected in Division 13 of the ITAA and the relevant provisions of Australia's double tax agreements;
- (f) the price(s) or methodology(s) proposed should be a reasonable one that clearly reflects an arm's length result, be supported by available and reliable data, requires few

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adjustments and can be easily and efficiently administered by the taxpayer(s) and tax authorities; and

- (g) where a unilateral APA is proposed by the taxpayer, the taxpayer must fully explain their reasons for not wanting the foreign tax authority involved.

76. The ATO encourages Australian taxpayers to have foreign related parties involved in an APA draw up a comparable APA request, using the same TPM, for the tax authorities in their respective countries.

## How to apply

77. To initiate the process, a taxpayer should firstly seek a without prejudice prelodgment meeting to discuss the requirements of the APA (see paragraphs 92 to 98 below). A request for a prelodgment meeting should be made in writing to the Australian Competent Authority.

78. The request for a prelodgment meeting should preferably include a draft outline of the taxpayer's case (see paragraphs 99 and 101 below).

## Where to apply

79. The International Tax Division in the National Office of the ATO has primary responsibility for the APA program. All APA expressions of interest and formal applications should be directed to:

The Competent Authority  
International Tax Division  
Australian Taxation Office  
PO Box 900  
CIVIC SQUARE ACT 2608  
Telephone: (06) 216 1111

80. The Competent Authority will arrange for the establishment of an APA Review Team from a Branch Office which is considered the most appropriate to handle the APA request. The APA Review Team will review the request and arrange and attend the prelodgment meeting. At the prelodgment meeting taxpayers can obtain more information regarding both the APA process and documentary requirements prior to lodging a formal application.

**Processing fees**

81. The ATO does not charge a fee for processing an APA request or for any prelodgment meetings.

**Who can apply**

82. Any taxpayer with international transactions, agreements or arrangements or interests or contemplating investment in Australia may apply for an APA. The ATO will consider applications pertaining to both tax treaty and non-tax treaty countries as well as applications that involve tax havens. The fact that a taxpayer may be under audit by the ATO does not prevent the taxpayer from applying for an APA (refer to paragraphs 84 to 91). It should be noted, however, that the ATO has a discretion whether or not to accept and deal with an APA application and that it may be necessary in some cases for applications to be rejected (see paragraphs 192 to 194).

83. Small business taxpayers with international transactions, agreements or arrangements or interests should not be discouraged from entering the APA process. The without prejudice prelodgment meeting process should be used by them to evaluate the feasibility of entering into an APA.

**Applying for an APA during the course of an audit**

84. A taxpayer may apply for an APA during the course of an ATO audit. However, the APA can only be for future years. The fact that a taxpayer has applied for an APA should not result in the audit activities in relation to the prior years being put on hold. It is not necessary that the audit activities cease while an APA is being considered as an APA cannot have retrospective application. Taxpayers should therefore not expect the audit to cease.

85. It is important to note that the audit and APA are separate processes. They will be resolved separately. They may have different teams working on them, although the information will be shared between the Audit Team and APA Review Team.

86. Where an audit is in progress and a taxpayer requests an APA, the audit of the relevant issues may be held in abeyance if it is agreed by all parties that the APA will assist with the completion of the audit. Although an APA can only apply to future years, where the facts and circumstances surrounding the APA and the audit years are sufficiently similar, the APA information, analysis and resulting TPM may be relevant in determining the audit issues.



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87. The decision to continue with, hold in abeyance or cease the audit or part thereof will be made by the Audit Case Manager who will consider the facts and circumstances surrounding the particular case. This decision should also be based on the advice and recommendations of the APA Review Team. There are a range of possibilities about how the two processes should be handled administratively and the options are case specific. ATO experience is limited but factors which may need to be considered are:

- the cooperation and assistance offered by the taxpayer to finalise both the APA and audit;
- the stage of the audit (ie, how far down the track has it gone and how close it is to finalisation);
- the issues in question both in the audit and the APA request;
- the similarities or otherwise between the facts and circumstances surrounding the years under audit and the APA request;
- the relevance of information and documentation submitted as part of the APA application to the prior years;
- whether there is likely to be any significant differences between the results of the audit and the APA and the reason for such differences;
- whether it is possible to finalise part of the audit, leaving the issues which are related to the APA in abeyance; and
- whether conclusion of the APA will assist in concluding the audit.

88. Throughout the process, the onus is on the taxpayer to show good faith and facilitate the completion of the APA and the audit. The taxpayer must also demonstrate that it will be to the ATO's advantage to hold the audit in abeyance. The taxpayer should also produce an outline of the APA showing time lines that will be met.

89. It may be suitable in some cases to defer some part of the audit for a short period pending completion of the APA but finalisation of that part of the audit could recommence, with written notice to the taxpayer, at any time at the discretion of the ATO. Alternatively, the ATO may suggest the taxpayer defer the lodgment of the APA application until the ATO is ready to state its position on an issue so that the taxpayer's APA application can fully and completely respond to the ATO's concerns.

90. At any time where an audit or part thereof has been held in abeyance and the ATO has reason to believe that the APA is not proceeding in the best interests of finalising the audit, the ATO may,

with written notice to the taxpayer, recommence the audit. If any double tax implications arise as a result of the audit, the Mutual Agreement Procedures of the relevant double tax agreement or agreements, should be used to resolve the matter.

91. Where it is agreed to hold the audit or part thereof in abeyance pending the outcome of the APA, any adjustments made to the assessments of the audit years using a TPM or other information from the APA will not constitute a voluntary disclosure. Once audit activities have commenced and the ATO has made contact with the taxpayer or their representatives normal penalty provisions apply to any adjustments made to those assessments under review.

### **Prelodgment meetings**

92. Cases which are suitable for an APA will require varying levels of detail and information as part of the APA submission. Prior to reaching a decision concerning lodgment of a formal APA application, the APA process provides the taxpayer with an opportunity to discuss the process, information requirements and explore the opportunities for the completion of a successful APA with the ATO by means of a prelodgment meeting.

93. The prelodgment meetings should be used to clarify up front what a taxpayer expects from the APA process and what it is they are trying to achieve, together with what is expected of them. It also gives the taxpayer an opportunity to consider what relevant information it could supply and how best to present its case.

94. The prelodgment meeting should also be used to:

- discuss the extent of documentation and analyses required;
- determine the need for independent expert advice;
- discuss the taxpayer's proposals regarding the TPM;
- clarify whether the taxpayer's foreign affiliate has already approached its respective tax authority;
- agree on the proposed lodgment date for the formal APA application;
- agree on a likely timetable to submit documentation, complete the APA, etc;
- identify any issues which relate to policy matters or matters of principle; and
- discuss the process for evaluating the APA request.

95. The taxpayer should be aware as to whether its foreign affiliate is prepared to submit all information required under the foreign

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country's APA procedures and whether its affiliate is presently under examination by the foreign tax authority. The taxpayer should also be aware as to the standing of its affiliate with the foreign tax authority (eg, whether relations are strained due to audit or litigation).

96. ATO Branch Office staff (usually the APA Review Team) will normally attend the prelodgment meetings. There may not be sufficient time to select the APA Review Team prior to the first prelodgment meeting, therefore further meetings may be required once the APA Review Team is established.

97. The APA process is to be undertaken in a cooperative manner and therefore the ATO encourages regular meetings to discuss and review the proposals. There may, for instance, be occasions when more than one meeting is required to determine the suitability for an APA, the TPM or determine the extent of information to be lodged by the taxpayer.

98. The prelodgment meeting and all other discussions leading up to the formal application will be on a without prejudice basis.

## **Draft outline of case**

99. The taxpayer should normally provide a draft outline of its case at the time of lodging its expression of interest/request for a prelodgment meeting. The draft outline would be used as the basis for discussions at the prelodgment meeting. This is to ensure that both the ATO and the taxpayer are not at cross purposes before the taxpayer goes to the expense of formally complying with the APA information requirements.

100. The draft outline should include information explaining how the taxpayer intends to approach the overall transfer pricing issue(s).

It should provide:

- an overall understanding of what is involved;
- an indication of the prospective dollar amounts involved;
- the scope of the issues to be covered by the APA (e.g., what is to be included and excluded);
- how the taxpayer proposes to demonstrate that its proposal is in accordance with the arm's length dealings principle;
- a thorough description of the facts (but not legal argument); and
- highlight any potential conflicts or differences in interpretation.

101. If a draft outline of the taxpayer's case has not been provided by the taxpayer, the ATO may request a draft outline prior to the prelodgment meeting and/or the formal lodgment of the APA application.

### **The APA process**

102. Following the prelodgment meeting, and where an APA is considered appropriate, the taxpayer will be required to lodge a formal application with the Australian Competent Authority. The taxpayer is encouraged to meet with the ATO during the preparation of its submission.

### **Lodgment of formal application**

103. The formal application should be complete with the proposed TPM and be in accordance with the information requirements contained in this Ruling, subject to any agreements reached at the prelodgment meeting. Details regarding the form and character of the "formal application" may be found at paragraphs 139 to 140.

104. The formal application should be lodged within the time frame agreed to at the prelodgment meeting (usually within 3 months).

105. The APA application should incorporate the taxpayer's proposed TPM along with the terms and conditions which will govern the application of the TPM, and the suggested time period for which the TPM would apply. Data showing that the proposed TPM produces arm's length results between the taxpayer and specific foreign related entities for specific related party transactions, agreements or arrangements must also be provided.

106. Six copies (unless otherwise agreed) of the formal application should be lodged with the ATO - five for the APA Review Team and the other for use by the Australian Competent Authority. All copies can be lodged with either the APA Review Team or the Australian Competent Authority.

107. Upon receipt of the formal application the ATO will evaluate the data submitted and any other relevant information. The ATO will contact the taxpayer and discuss and clarify the information submitted and, if necessary, request any further information deemed relevant to consider the proposed TPM. The taxpayer is entitled to confer with the ATO at any time while the request is undergoing review.

108. Following lodgment of the formal application, all subsequent correspondence and negotiations by the taxpayer should be through the APA Review Team handling the APA request.

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## **Provision of information to foreign tax authority**

109. While the ATO will, where appropriate, approach the foreign tax authority after the formal lodgment of the APA application as to whether the foreign tax authority wishes to undertake the APA process, the ATO would encourage that the taxpayer have its foreign affiliate approach the foreign tax authority prior to the taxpayer lodging its formal application.

110. The information provided to the ATO must be the same as that provided to the foreign tax authority. Where the ATO has not requested certain information but the foreign tax authority has required that it be submitted by the taxpayer's affiliate as part of the APA application, the taxpayer should advise the APA Review Team and provide a copy of this additional information to the ATO. In addition, the taxpayer should advise the ATO of cases where the foreign tax authority has asked for additional information to be provided following the lodgment of the formal application.

111. There would be a remaining degree of uncertainty associated with unilateral APAs (where a tax treaty partner will be affected by the APA but is not involved in the APA process). The ATO considers it to be desirable in those cases that the tax treaty partner be made aware of the unilateral APA and that a copy of the unilateral APA should be provided if the tax treaty partner so requests. The ATO will be seeking the consent of the taxpayer to this exchange of information in order to settle any dispute with the foreign tax authority over the TPM as soon as possible and avoid the possibility of double taxation.

## **Evaluation of APA application**

112. The APA Review Team is responsible for determining the acceptability of a taxpayer's APA proposal. In reviewing and verifying the data supplied by the taxpayer, the APA Review Team may be required to undertake fieldwork (eg, inspections of taxpayer's premises, interviews with staff, review of financial or managerial operations, etc). The APA Review Team will evaluate the request by analysing the taxpayer supplied data, together with any other relevant information it has or can obtain. During this period the ATO seeks to avoid rigid protocols regarding taxpayer contact and would allow taxpayers to confer as they feel the need.

113. The APA Review Team will advise the Australian Competent Authority as to whether an APA should be concluded and advise on the terms and conditions which are to form the basis of the APA. The APA Review Team may also undertake negotiations with the foreign tax authorities on behalf of the Competent Authority.

**Statement of proposals**

114. Prior to final negotiations/concluding the agreement, the ATO may seek to clarify any changes or amendments made to the taxpayer's original proposals. The ATO wishes to clearly know the taxpayer's views prior to concluding the agreement. The taxpayer may therefore be asked to prepare a "Statement of Proposals" setting forth the substance of the items that the taxpayer understands the ATO to be willing to incorporate as part of the terms and conditions of the APA. The "Statement of Proposals" is to be prepared as though it were a draft of the APA. It should contain information similar to that stipulated at paragraphs 196 to 200 below - "Form and Content of APA Agreement".

115. The purpose of a "Statement of Proposals" is twofold. Firstly, it is to ensure that the taxpayer and the ATO have a common understanding of the items to be agreed upon and of the terms and conditions which are to form the basis of the APA. Secondly, it is to be used by the Competent Authority as the basis for negotiation with the foreign tax authority where a bilateral APA is contemplated.

116. More than one "Statement of Proposals" may be required if negotiations between the taxpayer and ATO result in major changes to the original understanding or proposal.

117. The "Statement of Proposals" is not an agreement and the ATO cannot give any assurances that it will accept its terms. Before the ATO can agree in principle to the terms enumerated in the "Statement of Proposals", it will have to be approved by the Competent Authority, who is the official designated to approve APAs.

**Liaison with foreign tax authority**

118. The National Office of the ATO, through the Competent Authority, is responsible for liaison with the foreign tax authority and ensuring consistency of application of all APAs. All liaison with the foreign tax authority is therefore coordinated through the Competent Authority in National Office.

119. There may, of course, be times when the APA Review Team and its counterpart in the foreign country may need to liaise in order to discuss or clarify specific issues involved in APA proposals. In such cases, the Competent Authority would authorise the case manager of the APA Review Team to discuss the APA with the other tax authority's designated APA case manager. However, any discussions between authorised case managers should be confirmed in writing and communicated through the Competent Authority.

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120. Once the review of the APA proposals has been completed, the Competent Authority, or APA Review Team on his/her behalf, will commence negotiations with the taxpayer and, where appropriate, with the foreign tax authority.

## **Bilateral APAs**

121. As soon as is administratively practicable, but no later than 2 months after receipt and acceptance by the ATO of a formal bilateral APA application, the Australian Competent Authority will notify the relevant tax treaty partner(s) to determine whether it wants to participate in the bilateral APA process. This should not discourage the taxpayer's affiliate from approaching the relevant foreign tax authority directly (refer also paragraph 109).

122. The tax treaty partner may decide that it wants to be involved in the APA process or it may prefer to review and comment upon the final APA. The involvement of the tax treaty partner in the APA process at an early stage helps avoid protracted disputes on transfer pricing issues and avoid the possibility of double taxation.

123. If the tax treaty partner agrees to participate in the bilateral APA, the Australian Competent Authority will seek a suitable agreement with that tax treaty partner for a bilateral APA. The general approach of the ATO is to involve the taxpayer as much as possible in the process, though there may be phases best addressed by confidential conferences between the tax authorities (refer also paragraph 190).

124. Following review, discussion and successful negotiation, the ATO will formalise the understanding by way of a Competent Authority agreement with the tax treaty partner and the taxpayer(s) specifying the acceptable TPM and critical assumptions. Where a Competent Authority agreement is executed, the taxpayer will have certainty on the TPM to be used in determining the transfer prices of the transactions, agreements or arrangements covered by the APA.

125. The taxpayer will also be assured that the ATO will not make any adjustments during the term of the APA under Division 13 of the ITAA or the relevant provisions of the double tax agreements to the TPM used by the taxpayer in relation to the transactions, agreements or arrangements provided there is compliance with the terms and conditions of the bilateral APA.

**Refusal by foreign tax authority to participate in a bilateral APA**

126. Where a taxpayer has applied for a bilateral APA, but:

- (a) the foreign tax authority is not willing to participate in the APA process; or
- (b) the ATO is unable to reach agreement with the foreign tax authority,

the matter may be concluded as though it were a unilateral APA.

127. The approval of the taxpayer to conclude the matter as a unilateral APA will be required in those cases. However, the ATO is not obliged to execute or conclude an APA in such circumstances.

**Unilateral APAs**

128. Prior to executing a unilateral APA, the taxpayer would be required to provide strong grounds for not involving a relevant tax treaty partner. Where a unilateral APA is proposed, a tax treaty partner affected by the agreement may, with the consent of the taxpayer, be alerted and be availed of the opportunity to participate in the APA. The Exchange of Information and Mutual Agreement Procedure Articles in the relevant tax treaty would allow for such discussions or negotiations.

129. While a unilateral APA provides greater certainty for the taxpayer and minimises the likelihood of a dispute in the event that the taxpayer is subsequently subject to audit, it does not provide the same certainty that would be associated with a bilateral APA, where agreement is also reached with the relevant foreign tax authority. A taxpayer having obtained a unilateral APA may still encounter double tax problems with foreign tax authorities (e.g., due to different interpretations of key concepts or timing differences arising from tax accounting treatment differences by the respective tax authorities).

130. Where an APA is completed on a unilateral basis, the agreement will remain subject to the application of the Mutual Agreement Procedure Article under a double tax agreement with a tax treaty partner. If double tax implications subsequently develop as a result of the unilateral APA, the Australian Competent Authority will as much as possible support the propositions that were adopted by the taxpayer. However, a unilateral APA should not preclude the reaching of an appropriate settlement or solution by the respective Competent Authorities under the mutual agreement procedures. The Australian Competent Authority, therefore, might have to deviate from the original terms of a unilateral APA in an attempt to negotiate a settlement or solution with the foreign country's Competent Authority.



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## **Taxpayer withdrawing from the APA process**

131. A taxpayer may discontinue or withdraw from the APA process at any time once a formal APA application has been lodged.

However, the non involvement of the taxpayer does not prevent the Competent Authorities from continuing the process and agreeing on an appropriate TPM for their respective taxpayers, if they see fit.

132. Discussions leading up to the formal APA application are on a without prejudice basis. The withdrawal by the taxpayer will not automatically result in an audit by the ATO. The ATO audit program is conducted independently and is not linked in any way to the APA process.

## **ATO withdrawing from the APA process**

133. If the ATO has accepted an APA application and commenced the APA process, it is not compelled to execute or conclude an APA. In these circumstances, the taxpayer will be given the opportunity to meet with the ATO and discuss the reasons for the ATO's decision. Further meetings may be arranged at the ATO's discretion.

## **Time frame for provision of information and APA process**

134. Having entered into the APA process, the ATO would want to have it completed within 12 months and is therefore looking at the taxpayer to cooperate and provide timely information which is well detailed and complete. Generally, the ATO would be looking for the taxpayer to provide information requested within reasonably managed and agreed time frames. If the provision of information by the taxpayer becomes too protracted, the ATO reserves the right to discontinue the APA process. The ATO, for its part, will endeavour to examine and convey conclusions regarding data and other information in a similar timely fashion.

135. In looking to have the APA process completed within 12 months much will depend on the ready availability of information and the extent of cooperation between the taxpayer, the ATO and, where appropriate, the foreign tax authority as well as the availability of suitable ATO resources to undertake the process. The ATO will be committing sufficient resources to complete the process for accepted APA applications within the desired time frame.

136. It is envisaged that the APA process will involve periods of concentrated work by the APA Review Team together with periods of elapsed time where little can be accomplished because of the need to await for additional data, comments, response from the foreign tax authority, etc. During this period, it is envisaged that the ATO and

taxpayer will be in regular contact and cooperatively working towards an agreed position.

137. Following the initial prelodgment meeting, it is expected that the taxpayer will require some 2 to 3 months to compile and lodge its formal APA application. Several meetings to clarify and further discuss the issues during this time are also envisaged. The ATO would require some 1 to 2 months to review and analyse the APA application. This may be followed by requests for further data, some field work, further discussions with the taxpayer, etc. This follow up work may add another 1 to 2 months to the process. Once the ATO and the taxpayer have reached an understanding, there will need to be an exchange of views and information with the foreign tax authority, where appropriate, with a view to reaching an agreed position. This liaison and negotiation process can add another 3 to 4 months to the process, with another month being required to finalise all the paperwork.

#### **Final decision maker**

138. The Australian Competent Authority has the ultimate responsibility for the ATO's APA program. While the APA Review Team is responsible for evaluating and providing advice to the Competent Authority on the viability of the APA, it is the Competent Authority who is the final decision maker regarding the acceptability of the TPM and the execution of the APA.

#### **Format of APA applications**

139. The ATO does not prescribe any set format or method of presentation. However, in preparing their case, each taxpayer is required to clearly indicate in their submission the TPM employed and the reasons for adopting that TPM. All documentation should be clearly labelled, indexed and referenced.

140. The taxpayer's application should clearly state whether any of the parties to the request are residents of or conduct activities in a foreign country that has a tax treaty with Australia, and whether the taxpayer proposes a bilateral APA involving the participation of both Competent Authorities.

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## **Documentary requirements**

141. The ATO wishes to provide a service in the APA process which is flexible and which will not be too administratively onerous or expensive for either the ATO or the taxpayer. It is stressed that the information requirements stated in this Ruling are a guide only and act as a starting point as far as documentation is concerned. The onus is on the taxpayer to supply sufficient information to enable the ATO to make an informed decision regarding the TPM and APA generally.

142. In looking at the sort of information which should be submitted in relation to the TPM, regard should be had to the requirements outlined in the International Profit Shifting and Arm's Length Methodologies Ruling (which is due to issue shortly).

143. In applying for an APA, the ATO expects the taxpayer to put forward a submission providing full details of the issues surrounding the proposal. The taxpayer should clearly and fully explain what their proposal is and why it is the preferred option. Full details of how "numbers" were arrived at and the basis of calculations, together with the reasons for selecting a particular numerical proposal must also be supplied. The data supplied should enable the ATO to clearly follow the process from a descriptive proposal to the numeric functional analysis, indicating why and how the taxpayer reached their conclusions. All supporting data for the proposals should also be supplied.

144. The Statement of Auditing Practice, AUP34, Knowledge of the Clients Business, is a useful guide when determining the type and extent of information which should be submitted. AUP34 was prepared by the Auditing Standards Board of the Australian Accounting Research Foundation. It was issued in February 1993 by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia.

145. The prelodgment meeting(s) should be used to assess the scope of the documentary requirements and ascertain the extent of information required to enable a proper determination of the taxpayer's request. The taxpayer should consider the potential information requirements and advise of any information or cost concerns at the prelodgment meeting.

146. The taxpayer must be prepared to demonstrate the appropriateness of the proposed TPM with adequate documentation. In doing so, the taxpayer must submit sufficient information and documentation which will enable the APA Review Team to readily determine whether the proposed TPM satisfies the arm's length principles. It is recommended that where possible, historical data for

the last 3 years be provided. This should be compared with the proposed future transactions, agreements or arrangements and any anticipated differences in approach or results should be highlighted.

147. Any documents supporting the application should be accompanied by a narration of all material facts and an analysis of their relevance to the issue or issues involved in the application.

148. The extent of information necessary to determine an appropriate TPM will depend on the facts and circumstances of each individual case. It is therefore not considered practicable to list or define the exact nature and extent of documentation to be submitted with APA applications. As a guide, however, the following information would normally constitute the requirements for an APA application:

- (a) a complete statement of the names, addresses, and tax file numbers of all taxpayers or parties to the APA (both in Australia and overseas);
- (b) details of the company group of which the taxpayer is a member including details of share holdings;
- (c) for each party to the APA, an outline of the business and structure of the organisation, including an organisational chart showing the areas/divisions relevant to the APA transactions, agreements or arrangements and describing how those areas/divisions fit within the organisation. This would include describing the nature and extent of the areas/divisions dealings with other areas/divisions within the same organisation.;
- (d) in respect of each country subject to the APA, detailed statements describing:
  - all relevant accounting guidelines and standards;
  - a description of significant financial accounting methods adopted by the parties and how they relate to the proposed TPM;
  - requirements from regulatory boards relevant to the industry and transactions, agreements or arrangements covered by the proposed TPM; and
  - generally accepted industry practices relevant to the industry and transactions, agreements or arrangements covered by the proposed TPM.;
- (e) details of ownership, capitalisation and financial arrangements of each party to the APA;
- (f) details of principal businesses and the places where such businesses are conducted;

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- (g) details of major transaction flows and significant transfer pricing arrangements or practices;
- (h) details of the taxpayer's products and services on sale in Australia and overseas, together with details of the manufacturing processes used for those products and services;
- (i) details of suppliers/purchasers and their relationship to the taxpayer, together with a financial analysis of purchases/sales;
- (j) a list of the taxpayer's major competitors, both in Australia and overseas, indicating the respective market positions of each;
- (k) for each competitor identified, indicate which are the most comparable and why and if not comparable the reasons for this; and
- (l) any other information which may have a bearing on the current or proposed apportionment method(s) for all members of the taxpayer's controlled group, regardless of whether such members are parties to the request.

149. In addition, sufficient information showing how TPMs have been determined and whether the TPMs are affected by special conditions inconsistent with the arm's length principle should be supplied. This information should include details of the functions performed and risks taken by the various parties to the APA. Where intangibles are present, the taxpayer should provide information showing the method of calculation of the value of the intangibles. The taxpayer should clearly show how much intangibles are worth and why and who has added the value to the intangibles and how.

150. The APA application should also state whether any of the parties to the request have pricing or other commercial arrangements with any other related or unrelated entity that are or may be similar to the current or proposed apportionment methods cited in the application. If so, the other entity should be identified and the pricing or other commercial arrangement explained.

151. Support for the taxpayer's proposal will be further enhanced by the submission of analyses performed by the taxpayer. Such a study could encompass an economic analysis of the industry and market to be covered by the APA. The analysis should attempt to identify uncontrolled businesses with economic activities performed, assets and resources employed and economic costs and risks incurred, which are comparable or similar to those of the taxpayer.

152. The taxpayer should also provide sufficient information to clearly show the taxable and financial position of all parties involved in the APA for the last three years. Such information should include summarised financial and tax data of the parties for the last three years, including sales, cost of goods sold, operating expenses, profit before taxes, assets, liabilities, number of employees plus any other relevant data. A detailed statement describing how the organisation is taxed at each location which is to be covered by the APA should also be provided. This statement should indicate similarities or contrasts in taxation treatment between the taxing jurisdictions and how they relate to the proposed TPM.

### **Cost sharing**

153. Where an APA request relates to cost sharing arrangements, the ATO will require similar information as required above. It is likely that further information concerning each party's contribution to the arrangement (tangible and intangible), measurement of benefit to the parties, which costs are shared or excluded, ownership rights, provisions for buy-ins, etc will also be required.

### **Information requirements of foreign tax authorities**

154. It should be noted that the foreign affiliates will need to comply with the information requirements of their respective country's tax authority, even though some information may not be deemed necessary by the ATO.

155. Where the foreign tax authority requests information additional to that submitted to the ATO, the taxpayer is required to advise the ATO of those requests and advise the extent of additional information provided to the foreign tax authority. Full copies of the additional information/documentation submitted to each party are to be made available upon request.

### **Further information requests**

156. The ATO will verify and evaluate the supporting data relevant to the APA and, if necessary, request additional information to complete its evaluation. It is essential that information be presented on a timely basis. The ATO is not prepared to be involved in drawn out negotiations as to the relevance of documents. Where the taxpayer is concerned as to the relevance of information required such concerns should be openly discussed - taxpayers are asked to advise the areas in which they would not be able to supply information or areas where

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they might think the ATO requests could be excessive or of marginal relevance.

157. The ATO may also specify a date at which time no further factual information will be accepted. This date will usually be when the ATO and the foreign tax treaty partner enter into final negotiations by way of exchanging position papers on the taxpayer's proposed TPM. The ATO will not allow the APA process to become one where parties involve themselves in tactical manoeuvring.

## **Issues other than TPM covered by APA**

158. Where, as part of the APA request, the taxpayer has asked that the ATO accept or provide an agreement in relation to the treatment of other dealings or business arrangements (ie, not in relation to a TPM), the taxpayer should supply sufficient information to allow the ATO to make a reasoned decision regarding the matter(s). The information requirements outlined in this Ruling for the support of the proposed TPM, should be used as a guide in determining the information requirements to support the non TPM issues in question.

159. The ATO will give such requests due consideration but is under no obligation to consider or accept non TPM issues as part of the APA process. (See also paragraphs 53 and 54 above).

## **Voluminous documents**

160. If the records or documents to be produced are too voluminous, they need not be submitted with the application. However, the documents must be described, referenced and their location stated. The taxpayer must undertake that the documents will be made available upon request by the ATO.

## **English language**

161. All documents submitted in a foreign language must be accompanied by an English translation.

## **Ownership of information submitted with APA applications**

162. The ATO will become the owner of all documentation submitted as part of the APA application. Original documents required by the taxpayer should therefore not be submitted as these will not be returned.

**Conformity with 'arm's length' principle**

163. A proposed TPM has to comply with the provisions of Division 13 of the ITAA and be in accordance with the arm's length principles reflected in the relevant provisions of Australia's double tax agreements.

164. The TPM agreed upon has to be consistent with the arm's length standard, be supported by available and reliable data, and be easily applied and administered. It should produce, with as little adjustment as possible, an anticipated range, where applicable, of arm's length results.

165. There is no universal list of items, issues or records that will be determinative in calculating what is arm's length. Types of documents which may be sought include:

- (a) documents supporting negotiation of consideration and outcomes from the taxpayer's related party dealings of the same type as found in arm's length dealings;
- (b) pricing policies, documents relating to product profitability, relevant market information and profit contributions of each party;
- (c) documents establishing the economic justification for entering into the relevant international agreements;
- (d) documents establishing the reasons for the company selecting a particular pricing methodology or methodologies;
- (e) details of other methodologies considered for use by the company and rejected, including reasons for any rejection (to be useful to the ATO these documents should be created at or around the time the pricing decisions were made, not at a later time);
- (f) documentation establishing the structure and nature of the company and the multinational group to which it belongs;
- (g) documentation establishing the enterprise's sales and operating results and the nature of its agreements with related parties; and
- (h) documentation setting out the company's marketing and pricing strategies, including market penetration strategies.



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## **Critical assumptions**

166. An APA will define in advance changes in circumstances that are so significant that neither party would continue to be bound by the APA. These changes in circumstances are known as critical assumptions.

167. A critical assumption, for example, might consist of a substantial change in the business or economic relations between the parties, such as a change from the taxpayer's affiliate acting as a distributor of the taxpayer's product to that of a commission agent; the failure of a substantial product line; the deletion of a manufacturing activity of the affiliate where previously manufacturing and distribution was handled; etc.

168. A critical assumption can be any fact about the taxpayer, an affiliate, a third party, or an industry that, if it changed, would significantly affect the substantive terms of the APA or the basis upon which it was agreed. Critical assumptions should be noted even where these are not within the taxpayer's control.

169. Where a unilateral APA is concluded, the acceptance of the terms and conditions by the relevant foreign tax authority will obviously be a critical factor in ensuring that double tax implications do not arise. This factor should be built in to any unilateral APA.

170. The taxpayer should state in its proposal what events should be taken into account when considering critical assumptions.

## **Compensating payments**

171. Provided the taxpayer's annual operations remain within the negotiated range of expected results, the related party pricing or dealing will be considered to satisfy the arm's length principle and the ATO will not propose any adjustments during the agreement period.

172. The APA process envisages the use of compensating payments where the result falls outside the agreed price or result but is within the critical assumption boundaries. Compensating payment type adjustments after the close of the taxable year would be allowed to bring the taxpayer's pricing transactions back within range. For example, assuming a methodology agreed in part to a gross profit of 13-15% of sales for the foreign affiliate. However, the result was 12% and within the critical assumption boundaries. It would therefore be necessary to adjust the cost of goods sold to bring the result up to the agreed range. The Australian taxpayer would have to acknowledge an overcharging of the goods and the affiliate acknowledge an increase in gross profit.

173. It will therefore be necessary for the Australian taxpayer to put into place an agreement with the affiliate so that any compensating payments received or incurred are recognised pursuant to sections 25 or 51 of the ITAA in order to remain within the agreed range for that tax year.

### **Independent expert opinion**

174. The taxpayer may be requested by the ATO to provide, at its own expense, an independent expert mutually acceptable to the taxpayer and the ATO (and, where appropriate, the foreign tax authority) to review and evaluate the taxpayer's proposed apportionment method. Note, however, that an independent expert will not be required in all cases.

175. The function of the independent expert would be to provide an opinion that represents a critical analysis of the taxpayer's proposal. The opinion would comment on the adequacy of the taxpayer's economic study, address the questions and concerns of the taxpayer and the ATO (and, where appropriate, the foreign tax authority) and conclude whether the proposed method is supportable and fairly represents the interests of all parties to the APA. The expert opinion may put forward a revised version which meets all requirements and supports and produces an arm's length approach.

176. The expert opinion will be considered by the ATO in examining the TPM but will not determine its acceptability or bind the ATO (or the taxpayer, or foreign tax authority) in accepting or rejecting the proposed TPM.

177. The ATO will discuss the need for an expert at the prelodgment meeting or at a subsequent meeting with the taxpayer following lodgment of the formal APA application. While the ATO may not be in a position to determine whether an expert is required until reviewing the formal application, the taxpayer may provide commentary in the formal application as to whether an independent expert is required.

178. The ATO may wish to engage its own expert to review the taxpayer's proposal or that of the independent expert. In such cases, the ATO will be responsible for engaging the expert.

179. An independent expert should have access to all information provided under the APA process and should be subject to the secrecy provisions contained in the ITAA.

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## **Competent Authority considerations**

180. Where a bilateral APA is sought, the success of the APA process depends to a great extent on the ability of the Australian Competent Authority and the Competent Authority of the foreign tax authority reaching agreement on the proposed TPM. The purpose of them reaching agreement is to avoid potential double tax implications which might otherwise be caused as a result of applying a particular TPM.

181. The Australian Competent Authority will make its best endeavours to reach an agreement. However, where the Competent Authority cannot reach agreement with the foreign Competent Authority, the taxpayer and the ATO can still proceed to finalise the APA on a unilateral basis, that is, without the involvement or consent of the foreign tax authority.

182. Where a unilateral APA has been executed, the taxpayer may be able to seek mutual agreement procedure action under a double tax treaty in later years. While such a situation does not provide certainty for the taxpayer or revenue authorities, the Competent Authorities may be better suited because of hindsight to reach agreement in later years under the provisions of the Mutual Agreement Procedure Article.

## **Competent Authority agreement**

183. Where the Competent Authority reaches agreement with the foreign country's Competent Authority on the TPM, a Competent Authority agreement to this effect is executed. The Competent Authority negotiations and agreement are authorised by and would be achieved by applying the mutual agreement procedures set out in the relevant double tax treaty.

184. The Competent Authority agreement will form the basis of the bilateral APA between the ATO and the Australian taxpayer. The taxpayer gains certainty in that the bilateral APA is underpinned by the Competent Authority agreement. As long as the taxpayer abides by the terms and conditions of the APA, the ATO will not propose adjustments to the TPM under Division 13 or relevant provisions of the double tax treaty. The taxpayer will also be reassured that the TPM will not be challenged by the other tax authorities which are a party to the APA.

185. The Competent Authority agreement may be in any form agreed to by the Competent Authorities. For example, it may be in the form of an exchange of letters stipulating the accepted or agreed to terms and conditions. Alternatively, the agreement may be a more formal document.

**Exchange of information**

186. In processing a bilateral APA, communication between tax authorities will usually be through the exchange of "position papers". The "position papers" will normally outline the terms and conditions which each tax authority is prepared to accept and also highlight any concerns which may exist with the proposed APA. The "Statement of Proposals" may be used as the basis for preparing the ATO's "position paper".

187. A meeting between each tax authority is only envisaged in those cases where there are significant issues upon which agreement cannot be reached.

188. It is important that both tax authorities agree to a timetable for the exchange of position papers, etc and the conclusion of an agreement. The ATO will endeavour to ensure communications between Competent Authorities are undertaken on a timely basis so as to ensure that where ever possible the APA is completed within 12 months of the formal lodgment of the APA application.

189. The exchange of information between Competent Authorities will be undertaken pursuant to the Exchange of Information Article of the relevant double tax agreement, which limits its use and disclosure (see also paragraph 191).

**Taxpayer representations**

190. While the taxpayer may meet with the ATO (a number of times) the taxpayer does not have a right to be present at the Competent Authority negotiations. Taxpayer representation at Competent Authority meetings is only possible where the approval of all relevant Competent Authorities is obtained. If a taxpayer wishes to be present at a meeting between Competent Authorities, the ATO will contact the relevant Competent Authorities on behalf of the taxpayer and seek their approval for the taxpayer's (or its representative's) presence at the meeting.

**Disclosure**

191. Any information received or prepared by the ATO, including information provided by the taxpayer or the related foreign entity, will be subject to the restrictions on disclosure provided by section 16 of the ITAA and the applicable Exchange of Information provisions in the double tax treaties (refer also to paragraphs 240 to 242).

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## Rejecting an APA request

192. The ATO is committed to providing taxpayers with an improved and innovative service for promptly resolving transfer pricing issues regarding international transactions, agreements or arrangements. However, it must be recognised that practicable circumstances may mean the ATO cannot process and accept all APA applications while still maintaining a level of quality service to all taxpayers. The ATO will be allocating sufficient resources to the APA program to provide a high level of service, but its use of available resources for this purpose has to be balanced against the need to also maintain an appropriate level of service in other areas and ensure other programs (including audits) are not compromised to such an extent as to jeopardise voluntary compliance by those taxpayers not seeking APAs.

193. Due to the complexity of multinational enterprises and the markets in which they operate, it may also not be appropriate for some taxpayers or specific transactions, agreements or arrangements to be considered as part of an APA. Accordingly, the ATO will exercise its discretion as to the substantive areas in which it will entertain APA requests, and it may decline to consider specific or designated types of proposals. In exercising its discretion, the ATO will give weight to applications which contain a bulk of the following key characteristics:

- (a) applications for bilateral APAs;
- (b) the other country involved in the APA request is a tax treaty partner and that country is willing to consider the APA request and enter into a bilateral APA;
- (c) taxpayers who are one of a number of participants in an industry and the conclusions reached under the particular APA will have wider application to similar companies;
- (d) a substantial part of the taxpayer's activities involve related party dealings with tax treaty country parties;
- (e) the business as a whole can be looked at rather than an individual product line;
- (f) a significant part of a limited life project is yet to be commenced;
- (g) the TPM proposed under the APA complies with the ITAA, ATO policy and guidelines and generally with the OECD guidelines on transfer pricing;
- (h) transactions, agreements or arrangements to be covered under the APA are not of a hypothetical nature and are seriously contemplated; and

- (i) applications providing sufficient information which enable proper and full consideration of the request.

194. Prior to rejecting an APA request the ATO will give the taxpayer the opportunity to make representations. The ATO is not obligated to give the taxpayer more than one opportunity to make representations prior to rejecting the APA request.

### **Effect of APAs with other countries**

195. There may be occasions where the taxpayer, or its affiliate, may have already completed an APA (be it a bilateral or unilateral APA) with tax authorities other than the ATO (eg, an APA between the taxpayer's affiliate and the revenue authorities in the United Kingdom and the United States). The taxpayer may wish to extend the principles of this APA into an agreement with the ATO. While the APA with the foreign tax authorities will be a useful guide, the ATO will not be bound to accept the terms or conditions of that APA.

### **Form and content of APA agreement**

196. The APA Review Team, with assistance from appropriate areas, will draw up an appropriate APA, which may be in any form acceptable to the taxpayer and the ATO and which will clearly spell out the terms and conditions for accepting the TPM. The APA may incorporate terms substantially identical to those in the "Statement of Proposals" and/or the Competent Authority agreement. Where a unilateral APA is completed, the APA will normally be in the form of a Private Binding Ruling.

197. The APA should contain the following minimum information:

- (a) the names, addresses and tax file numbers of parties to the agreement;
- (b) the transactions, agreements or arrangements covered by the APA;
- (c) the period and tax years covered by the APA;
- (d) the agreed TPM and, if applicable, the rates of gross profit and net operating profit margins;
- (e) a definition of relevant terms which have formed the basis of calculating the TPM (eg, sales, cost of sales, operating profit, etc);
- (f) the basis of financial statements;
- (g) critical assumptions upon which the TPM is based;

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- (h) if applicable, a range of expected arm's length results;
- (i) procedures to account for minor economic, market, or product changes, that allow the taxpayer to make adjustments to its operating results to avoid unnecessary revisions to the APA;
- (j) procedures to be followed if it is necessary to make compensating payments; and
- (k) the taxpayer's obligations as a result of the APA (eg, the need to lodge annual reports with the Competent Authority, taxpayer's record keeping requirements, etc).

198. The critical assumption provisions of the APA may provide that a critical assumption that changes (and/or fails to materialise) will result in either:

- (a) cancellation of the APA;
- (b) modification of the APA; or
- (c) an automatic adjustment to the TPM results.

199. The APA should also provide for an annual review of the operation of the APA and the filing of an annual report by the taxpayer with the ATO.

200. The APA Review Team cannot issue or endorse an APA unless it has been approved by the Australian Competent Authority.

## **Annual Reporting**

201. The taxpayer will be required, as part of the APA, to prepare an annual report, for each year of the APA, containing sufficient information to detail the actual results for the year and to demonstrate compliance with the terms and conditions of the APA. The annual report is separate to any requirement the taxpayer has to lodge an annual income tax return.

202. The annual report is to be forwarded by the taxpayer to the Australian Competent Authority, together with a copy of the taxpayer's income tax return for the period. The annual report should be forwarded within 30 days of the final date for lodgment of the taxpayer's income tax return.

203. The annual report should generally include the following:

- (a) details showing how the TPM was applied for the year;
- (b) details of and reasons for any changes to the critical assumptions (or, if there have been no changes, a statement to that effect);

- (c) details of any compensating adjustments to be paid; and
- (d) any other information which may be appropriate to the taxpayer's particular circumstances.

204. The Competent Authority, with assistance of the APA Review Team, will review the annual reports and, if necessary, may request further information so as to be satisfied that the taxpayer has complied with the terms and conditions of the APA. If the taxpayer fails to provide an annual report or supply the additional information requested, then the Competent Authority may cancel or revoke the APA.

205. If the ATO is satisfied that the taxpayer has complied with the terms and conditions of the APA, it will make no further contact with the taxpayer. The taxpayer will only be contacted where it is necessary to clarify the contents of the annual report or request further information.

### **Record keeping requirements**

206. The taxpayer must retain all records relied upon in reaching the APA and all supporting data referred to in any annual report. The APA may specify the record retention period or specifically exclude the requirement to keep certain records.

207. Unless otherwise stated in the APA, the taxpayer is required to keep all records in accordance with the record keeping requirements under the ITAA (eg, sections 262A, 462, 462A, etc). Upon request, any records pertaining to the APA are to be made available to the ATO within a reasonable time.

### **Compliance with an APA**

208. The ATO will enter into APAs and will treat APAs as administratively binding in accordance with the policy expressed in Taxation Ruling. TR 93/1.

209. Generally, unilateral APAs will take the form of Private Binding Rulings, although, depending on the content matter, this may not be possible in all cases. Where a unilateral APA is undertaken, irrespective of whether it is in the form of a Private Binding Ruling, the ATO will be bound by the terms of the APA in the same way that the ATO is bound by a Private Binding Ruling.

210. An APA differs from a traditional Private Binding Ruling because unlike a Private Binding ruling which tends to be limited to questions of a legal nature based on facts presented by the taxpayer, an APA generally deals with factual issues. The facts underlying a



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Private Binding Rulings are generally not questioned by the ATO, whereas in an APA request, the facts are thoroughly reviewed and analysed.

211. Where a bilateral APA is executed, the ATO is bound by the terms of the Competent Authority agreement, arrangement, determination or solution, which is binding in law. The Competent Authority agreement, arrangement, determination or solution therefore creates rights for the taxpayer involved. In such cases, the taxpayer will usually receive a letter confirming the agreement, arrangement, determination or solution reached by the Competent Authorities, although there may be occasions where a Private Binding Ruling is also appropriate.

212. APAs involving the Competent Authority of a tax treaty partner country are within the scope of the Mutual Agreement Procedure in the relevant Article of the applicable double tax agreement (cf. Article 25 of the OECD Model Double Tax Convention). This is because bilateral APAs have as one of their objectives the avoidance of double taxation. The Exchange of Information Articles of the double tax agreements (cf. Article 26 of the OECD Model) are also relevant as they provide for cooperation between Competent Authorities in the form of exchanges of information.

213. The taxpayer will be reassured that provided the terms and conditions of the APA are abided with, the TPM used by the taxpayer will not be challenged. In addition, the taxpayer may, as part of the APA, be exempted by the ATO from keeping certain records (see paragraphs 206 and 207).

214. In all other respects, the taxpayer's taxation obligations remain unchanged.

215. The APA will apply only to the transactions, agreements or arrangements or other items agreed to and which form part of the APA. Only those taxpayers who are a party to the APA can rely on the APA for income tax purposes. An APA cannot be relied upon by other taxpayers or be extended to include other transactions, agreements or arrangements or issues or other parties without prior approval from the Competent Authority.

## **Audit**

216. The APA process does not exempt the taxpayer from audit. The Commissioner has extensive statutory powers and it would not be appropriate to limit these. Any audit that may be undertaken would follow the Commissioner's published guidelines on the conduct of Large Case and Complex Audits.

217. While the audit may examine the taxpayer's business activities as a whole, it will not be a re-evaluation of the acceptability of the

previously agreed TPM. However, the audit may focus on establishing whether:

- (a) the terms and conditions stated in the APA have been properly complied with by the taxpayer;
- (b) the taxpayer's representations upon which the APA and the annual reports are based reflect an accurate statement of all material facts; and
- (c) the transactions, agreements or arrangements are actually carried out substantially as proposed (for example, critical assumptions have not changed).

218. The audit would also test the accuracy and consistency of how the TPM is applied along with the related supporting data, as well as the continuing relevance and soundness of critical assumptions.

219. If the taxpayer complies with the terms and conditions of the APA, the ATO will regard the results of applying the TPM as satisfying the arm's length principles.

220. Where the taxpayer is found not to have complied with the terms and conditions of the APA, or is found not to have met any other requirement, the APA may be cancelled or revoked and appropriate adjustments (including penalties) made to the taxpayer's returns.

### **Prior year examinations**

221. The ATO will not give an undertaking that prior years will not be audited after the APA process is completed. However, as previously mentioned, the ATO has its own audit plan which is not driven by the results of the APA process. It is not the ATO intention to obtain information from the APA process for use in the audit of prior year returns.

### **Retrospective application of APAs**

222. Neither the ATO nor the taxpayer is compelled to apply the TPM agreed as part of the APA to prior year returns. Arrival at an appropriate TPM for the prior years would depend on the particular facts and circumstances surrounding those years.

223. Where, as a result of providing information for the APA, there is a need to amend a prior year return to apply the newly agreed TPM, any amendment will be treated as though the taxpayer had made a voluntary disclosure provided audit activities had not already been commenced and the ATO had not made contact with the taxpayer or their representative(s) with respect to the prior year returns. Where

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audit action has not commenced, additional penalty taxes, if any, will be calculated on the basis of a voluntary disclosure having been made by the taxpayer in relation to each prior year. Where audit action has commenced, the normal penalty provisions apply to any adjustments made to those years under review.

## **Revision of APA**

224. If there is a change in critical assumptions underlying the APA that would result in the APA ceasing to be binding (see paragraphs 166 to 170), the taxpayer, the ATO and, where appropriate, the foreign tax authority should enter into discussions to revise the APA or alternatively cancel the APA if agreement on a revised TPM cannot be reached. Similarly, an APA may be revised or cancelled if there is a significant change in the tax law or tax treaty provisions.

225. As with the request to commence the APA process, any request to revise the APA should initially be forwarded to the Australian Competent Authority (see paragraph 79).

226. The taxpayer's notification to the ATO that a change in critical assumptions has taken place, together with supporting documentation and a request to revise the APA may be lodged at any time during the financial year giving rise to the event. Any request to revise or review an APA should be lodged separately from any other return (e.g., income tax return) or the APA annual report.

227. However, in looking at such circumstances as compelling business reasons, including general or economic downturn, the ATO would look to whether arm's length parties could have foreseen or anticipated the event at the time the agreement was entered into and, if so, whether the agreed TPM would have taken this into account.

228. APAs should be drafted in such a way that they avoid as far as possible the likelihood of revision or cancellation. In such situations the arm's length test would be used to determine whether arm's length parties would have renegotiated such an agreement due to the change in circumstances.

229. If a revised APA cannot be negotiated, the APA will be cancelled. Unless otherwise agreed, the APA will be cancelled as from the beginning of the income year in which the event giving rise to the change in circumstances occurred.

230. If the APA is revised, the effective date of the revised APA will be stated in the new APA. The revised APA should also note the date on which the original APA is no longer effective.

**Annulment or cancellation of APA**

231. Where a taxpayer makes a statement that is false or misleading or omits from a statement any matter or thing without which the statement is false or misleading, the ATO would seek to revoke or cancel the APA. The APA would be revoked or cancelled where the false or misleading statement (or omission) is found to be present in either the APA application or any other submission, report, information or documentation regarding or supporting the APA application. The APA may be revoked or cancelled irrespective of whether the false or misleading statement (or omission) is made carelessly, recklessly, knowingly or fraudulently.

232. Where a taxpayer is found to have made a false or misleading statement (or omission), in addition to revoking or cancelling the APA, the ATO may amend the taxpayer's returns and impose appropriate penalties.

233. The APA may also be revoked or cancelled where the taxpayer is found not to have complied with the terms and conditions of the APA, including the failure to provide additional information or annual reports within the prescribed period.

**Term of APA**

234. The APA will have prospective application only, generally for taxable years beginning after the date of the Competent Authority APA agreement and will be of limited, specified duration. The initial term of the APA will be negotiated with the ATO. Generally, the term should not exceed three to five years. Actual duration will be dependent upon the type of industry, product or transactions involved.

**Renewal of APA**

235. An APA may be renewed with the consent of all parties to the initial APA. A request for renewal of an APA should follow the same procedures that apply to the initial APA request.

236. A request to renew the APA may be lodged at any time prior to the expiration of the initial term of the APA, bearing in mind the need for sufficient lead time between the expiration of the old APA and the period for which the new APA is to commence.

237. When requesting a renewal of an APA, the taxpayer must establish to the satisfaction of the ATO that the terms and conditions of the APA were substantially complied with and all material facts were disclosed and properly stated. If the material facts, critical

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assumptions or computations have altered, updated studies, analyses and supporting documentation should be submitted.

238. Where the material facts, critical assumptions or computations remain valid, the ATO may still require new or updated economic studies, analyses and supporting documentation before it agrees to any extension. However, it is not anticipated that the renewal application will need to be as detailed as the original submission.

239. The taxpayer will need to show that the TPM will continue to produce an arm's length result.

## Secrecy and disclosure

240. The ATO recognises that the information requirements for an APA are significant and may include sensitive and confidential business information and trade secrets. The information supplied or generated by the APA process relates directly to the income tax affairs and liability of a taxpayer. All information supplied or generated by the APA process would therefore be subject to the same secrecy and privacy safeguards as if it were obtained or generated using the audit process.

241. The ATO is legislatively bound by the *Privacy Act 1988*, section 16 of the ITAA and, where relevant, by the double tax treaties to safeguard taxpayer information and prevent the unlawful disclosure of such information.

242. While the Commissioner is bound by the *Freedom of Information Act 1982* (FOI), it is considered that the provision of the information required under an FOI application would not expose the taxpayer to disclosure requirements any more likely than if the information is gathered under audit and later requested under FOI. In other words, access could properly be denied on the grounds that disclosure would prejudice the proper administration of the law or involve unreasonable disclosure of personal information.

## Public disclosure by taxpayer

243. Taxpayers can, if they wish, announce publicly that they have applied for, or entered into, an APA. However, given the ATO's secrecy provisions, the ATO may only comment with the consent of the taxpayer. In such cases, the ATO's comments would be limited to general comment and acknowledgment that the APA request has been received or executed. Specific details regarding the APA would not be made public.

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