

# ***TR 95/23 - Income tax: transfer pricing - procedures for bilateral and unilateral advance pricing arrangements***

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *22 June 1995*



## Taxation Ruling

# Income tax: transfer pricing - procedures for bilateral and unilateral advance pricing arrangements

### other Rulings on this topic

#### TR 94/14

contents	para
<b>What this Ruling is about</b>	<b>1</b>
<b>Ruling</b>	<b>10</b>
<b>Date of effect</b>	<b>34</b>
<b>Explanations</b>	<b>35</b>
<b>Detailed contents list</b>	<b>185</b>

*This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

## What this Ruling is about

### Class of person/arrangement

1. This Ruling provides guidelines to taxpayers seeking an Advance Pricing Arrangement (APA). An APA represents an arrangement between a 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 APA process is designed to resolve any uncertainties surrounding cross border 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. 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 cross border transactions, agreements or arrangements.
5. 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 appropriate for the APA to fix a particular price or range of prices, after having agreed on a TPM. Similarly, there may be circumstances where an APA focuses on a particular transaction or business activity which has no relation to a TPM (refer to paragraphs 54 and 55).

6. The information requirements, processing and finalisation of each APA will depend on the individual facts and circumstances of the case. Transfer Pricing documentation requirements and methodologies will be covered in detail in future rulings.

7. A bilateral APA provides certainty on an appropriate TPM, thereby minimising the possibility of double taxation in the future and reduces the taxpayer's ongoing compliance costs. The taxpayer is also better placed to predict future tax liabilities in the countries covered by the APA.

8. This Ruling is not meant to be exhaustive; it 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 prelodgment meeting(s) with the Australian Taxation Office (ATO) (refer to paragraphs 72 to 77).

9. At Appendix A is a flow chart which diagrammatically depicts the APA process.

## **Ruling**

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### **APA defined**

10. An APA can be concluded on a bilateral or unilateral basis, but is generally an arrangement between a taxpayer, the ATO and 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 APA. An APA generally 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 37 to 44).

11. A proposed TPM has to be in accordance with the arm's length principles reflected in the provisions of Division 13 of the Income Tax Assessment Act 1936 (the Act) and the relevant provisions of an Australian double tax agreement (DTA) (see paragraphs 104 and 105).

***Bilateral APAs***

12. An APA should, wherever possible, be concluded bilaterally through the Mutual Agreement Procedure Article under the relevant DTA(s) and/or the executive power of the Commonwealth conferred to the Commissioner. A bilateral APA would involve exchanges between the appointed 'Competent Authorities' under the relevant DTA(s), which in the case of Australia is the Commissioner of Taxation or the Commissioner's authorised representative. This also would be the case for those bilateral APAs concluded under the executive power of the Commonwealth (see paragraphs 36 to 44). The ATO will provide written confirmation of the concluded agreement reached between the Competent Authorities (see paragraph 143).

***Unilateral APAs***

13. In respect of unilateral APAs the ATO will provide written confirmation of the agreement reached between the taxpayer and the ATO (see paragraph 144).

**Scope of APA**

14. 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 Act and the relevant provisions of a DTA contained in a schedule to the *International Tax Agreements Act 1953*, where such a DTA applies (see paragraphs 48 to 55).

**Applying for an APA**

15. Any taxpayer with related party international transactions, agreements or arrangements or interests may apply for an APA. The ATO will consider applications pertaining to both tax treaty and non treaty countries subject to the limitation that bilateral APAs would be confined to cases involving countries with which Australia has concluded a DTA (see paragraphs 37 to 44 and 62).

16. The ATO will have regard to the factors discussed in paragraphs 70 and 71 in deciding whether or not to accept and deal with all APA applications and it may be necessary in some cases for applications to be rejected.

**Term of an APA**

17. An 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 63, 155 to 159, 165 to 168).

**Applying APA to prior years**

18. An APA has prospective application. 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 169 to 180).

**Withdrawing from APA process**

19. A taxpayer or the ATO may discontinue or withdraw from the APA process at any time (see paragraph 47).

**Prelodgment meeting(s)**

20. To initiate the process, a taxpayer should write to the Australian Competent Authority seeking a prelodgment meeting to discuss the requirements of the proposed APA (see paragraphs 58 to 60).

21. The request for a prelodgment meeting should include a draft outline of the taxpayer's case (see paragraphs 78 to 80).

22. The prelodgment meeting(s) with the ATO should be used to discuss the suitability of the particular case for an APA, the taxpayer's preliminary views on the TPM and the information requirements. At the prelodgment meeting(s), taxpayers can obtain more information and clarification regarding the APA process, assess the documentary requirements and ascertain the extent of information required to enable a proper determination of their request prior to lodging a formal application (see paragraphs 72 to 77).

23. A prelodgment meeting does not mean the taxpayer has applied for or been accepted into the APA program. The taxpayer is required to subsequently make a formal application for acceptance into the APA program.

**Information requirements**

24. Under the APA program, a taxpayer is required to present to the ATO the TPM that it believes to be the most appropriate for 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 APA (see paragraphs 92 to 96). The taxpayer should ensure that sufficient information and supporting evidence is supplied to enable the ATO to make a reasoned decision regarding the proposal (see paragraphs 92 to 103).

**Formal application**

25. The formal application must include full details of the proposed TPM and be supported by relevant information (including justification of the TPM) in accordance with the guidelines contained in this Ruling, subject to any agreements reached at the prelodgment meeting(s) (see paragraphs 90 and 91).

26. The application must incorporate the terms and conditions which will govern the application of the TPM, and the suggested period of time for which the APA will apply. Data showing that the proposed TPM will produce arm's length results between the taxpayer and specific foreign related entities for specific transactions, agreements or arrangements should also be provided (see paragraphs 92 to 103).

27. The ATO will acknowledge receipt of formal applications.

**Critical assumptions**

28. An APA will define in advance those critical factors and assumptions that are so significant that neither party in an arm's length situation would continue to be bound if any of them changed (see paragraphs 108 to 110).

29. If there is a change in a critical assumption that renders the APA 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 material change in the tax law or tax treaty provisions that affect the APA (see paragraphs 155 to 159).

# TR 95/23

## **Compliance with an APA**

30. The ATO will not make any adjustments, under Division 13 of the Act and/or the relevant provisions of the DTAs, to the TPM used by the taxpayer provided there has been compliance with the terms and conditions of the APA (see paragraphs 147 to 151).

## **Annual compliance reports**

31. The taxpayer must prepare an annual compliance report for each year of the APA. The report should contain sufficient information to detail the actual results for the year, specifically address the critical assumptions and demonstrate compliance with the terms and conditions of the APA. The annual compliance report is separate to any requirement the taxpayer has regarding the lodgment of an annual income tax return. The taxpayer is still required specifically to self assess compliance with the APA. This will be one of the conditions of the APA (refer paragraphs 147 to 151).

32. Where a taxpayer fails to comply with annual reporting requirements, the ATO would not be bound to any undertaking not to conduct an audit of any transfer pricing issue covered by the APA. The ATO would consider cancelling the APA where the records did not enable the ATO to confirm readily that the critical assumptions were met or adhered to (see paragraphs 153, 155 to 159).

## **ATO audits and APAs**

33. Non factual information such as opinions, lines of argument, judgments and conclusions provided by taxpayers throughout the APA process will not be relevant to a subsequent audit. In an audit context, the ATO would have to develop its own analysis and conclusions (see paragraph 171).

## **Date of effect**

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34. 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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35. The expression 'related parties' refers to taxpayers who are parties to international dealings that may be subject to the application of Division 13 of the Act and/or the Business Profits Article or Associated Enterprises Article of a relevant DTA. The expression 'related party dealings' refers to transactions, agreements or arrangements between related separate legal entities, between a permanent establishment and its head office, or between two permanent establishments of the same entity.

### **Bilateral and unilateral APAs**

36. All references in this Ruling to an APA are, unless otherwise stated, references to either a bilateral or a unilateral APA.

37. A bilateral APA is an arrangement between a taxpayer, the ATO and one or more foreign tax authorities. The APA relates to the treatment for income tax purposes of a taxpayer's related party transactions, agreements or arrangements between those tax jurisdictions. A bilateral APA will involve separate arrangements between the taxpayer and each revenue authority plus a further arrangement between the ATO and each of the revenue authorities. A bilateral APA would be executed under the Mutual Agreement Procedure Article of the relevant DTA(s) and/or under the executive power of the Commonwealth. The taxpayer will receive written confirmation from the ATO of the concluded arrangement between the Competent Authorities.

38. A bilateral APA may be defined as being an arrangement between a taxpayer, the ATO and one or more foreign tax authorities on the TPM acceptable to each tax authority in respect of the taxpayer's relevant cross border transactions, agreements or arrangements.

39. Where the APA process does not involve or require agreement with the foreign tax authority or involves a country with whom Australia does not have a DTA, the subsequent agreement, arrangement or determination is referred to as a unilateral APA. In these cases an agreement, arrangement or determination is reached between the taxpayer and the ATO in respect of the treatment for income tax purposes of the taxpayer's relevant cross border transactions, agreements or arrangements.

40. The ATO may advise the relevant treaty partner that an APA request has been made and ask whether or not the treaty partner wishes to be involved.

41. The taxpayer must show good and sufficient reasons at the prelodgment meeting(s) for not wanting a relevant foreign tax authority involved in the APA process (see paragraph 56(f)).

### ***Bilateral APAs***

42. As soon as is administratively practicable, but no later than 30 days after receipt and acceptance by the ATO of a formal bilateral APA application, the Australian Competent Authority will notify the relevant tax treaty partner to determine whether they wish to participate in the bilateral APA process. This should not, however, discourage a foreign affiliate of the taxpayer from approaching the relevant foreign tax authority.

43. The tax treaty partner may want to be directly involved in the APA process, or rather it may prefer to review and comment on the final APA. The involvement of the tax treaty partner in the APA process at an early stage will provide greater certainty for the taxpayer in respect of its cross border dealings and help avoid protracted disputes on transfer pricing issues. It will also avoid the possibility of double taxation (e.g., due to different interpretations of key concepts by the respective tax authorities or different tax accounting treatment).

44. Following review, discussion and negotiation, the ATO will formalise a Competent Authority arrangement with the tax treaty partner and the taxpayer(s), which specifies the acceptable TPM and critical assumptions.

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

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

- (a) the foreign tax authority does not wish 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 with the approval of both the taxpayer and the ATO.

### ***Unilateral APAs***

46. Where an APA is completed on a unilateral basis, the APA will remain subject to the application of the Mutual Agreement Procedure Article under a DTA where one applies. If double tax implications subsequently develop, the Australian Competent Authority will seek to support the outcomes of the unilateral APA during Competent

Authority negotiations. A unilateral APA, however, does not preclude the reaching of an appropriate settlement or solution by the respective Competent Authorities under the mutual agreement procedures. In such cases, the Australian Competent Authority may have to deviate from the original terms of a unilateral APA in an attempt to negotiate a settlement or solution with the foreign Competent Authority.

### **Withdrawing from the APA process**

47. A taxpayer or the ATO may discontinue or withdraw from the APA process at any time. If the ATO has accepted an APA application and commenced the APA process, it is not compelled to execute or conclude the APA. In such cases, the taxpayer will be given the opportunity to meet with the ATO and discuss the reasons for the ATO's decision.

### **Purpose and scope of APAs**

48. The ATO recognises the significant benefits to taxpayers of APAs, particularly in assisting them on a prospective basis to comply voluntarily with the arm's length principle for income tax purposes in respect of dealings with related parties or permanent establishments overseas. The primary purpose of an APA is to confirm an appropriate TPM to achieve an arm's length allocation of income and expenses in respect of future dealings or continuing arrangements. However, an APA may, in certain circumstances, be used to fix a particular price or range of prices or agree on the tax treatment of a particular transaction, agreement or arrangement or business activity.

49. An APA will normally specify the particular types of dealings, transactions, agreements or arrangements that it covers, the country in which the relevant income should be taxed and may in some cases provide how much should be taxed in each.

50. An APA will apply for a specified period of time, usually 3 to 5 years, but may be subject to renewal at the end of that time.

51. An APA will apply to such transactions, agreements or arrangements as are relevant for the purposes of Division 13 of the Act, the relevant provisions of Australia's DTAs and other provisions in the Act dealing with international transactions, agreements or arrangements.

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

53. The ATO prefers that APAs cover all of the taxpayer's transfer pricing practices and will give weighting to such applications when selecting applicants into the APA program.

54. 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 usually be appropriate. For example, a taxpayer may only request an APA on its significant royalty payments to its offshore associate. However, the taxpayer may also have considerable management and service fee payments to the offshore associate. The ATO will generally require the management and service fee payments to be considered in the APA as these payments could have an impact on the taxpayer's transfer pricing practice. The ATO may nevertheless be prepared to consider APA applications which are limited to specific groups of related party transactions. The appropriateness of this approach will be discussed at the prelodgment meeting(s).

55. The ATO will adopt 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, but will be limited to matters related to cross border dealings.

### **Applying for an APA**

56. 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) the taxpayer's affiliate also enter into the APA process, although this may not always be appropriate in the case of a unilateral APA;
- (c) 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;
- (d) any agreed price(s) or methodology(ies) should be in accordance with the arm's length principles reflected in Division 13 of the Act and the relevant provisions of Australia's DTAs;
- (e) the price(s) or methodology(ies) proposed should be a reasonable one that clearly reflects an arm's length result, is supported by available and reliable data, requires few

adjustments and is reasonably capable of being efficiently administered by the taxpayer(s) and tax authorities;

- (f) where a unilateral APA is proposed by the taxpayer, the taxpayer must fully explain their reasons for not wanting the foreign tax authority involved; and
- (g) it retain the right to refuse to consider a particular request.

57. 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***

58. To initiate the process, a taxpayer should firstly seek a prelodgment meeting to discuss the requirements of the APA (see paragraphs 72 to 77). A request for a prelodgment meeting should be made in writing to the Australian Competent Authority at the following address:

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

59. The request for a prelodgment meeting should include a draft outline of the taxpayer's case (see paragraphs 78 to 80).

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

### ***No processing fees***

61. The ATO does not charge a fee for processing an APA request or for any prelodgment meeting(s).

### ***Who can apply***

62. Any taxpayer with international transactions, agreements, arrangements or interests, or contemplating investment in Australia

**TR 95/23**

may apply for an APA. A multinational enterprise does not have to have a presence in Australia before applying for an APA. The ATO will consider applications pertaining to both tax treaty and non treaty countries as well as applications that involve dealings in 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 169 to 178). It should be noted, however, that the ATO has a discretion whether or not to accept and deal with an APA application and in some cases applications may be rejected (see paragraphs 70 to 71).

**Duration of APA**

63. The APA will have prospective application only, generally for taxable years beginning after the date of the APA and will be of a specified duration. Generally, the term would not exceed three to five years, although the actual duration will be dependent upon the dealings, the type of industry and the product or transactions involved.

**APA benefits**

64. The APA process places a taxpayer in a better position to present its case and obtain an acceptable practical outcome because:
- (a) the APA process is conducted in a cooperative environment;
  - (b) APAs are prospective; and
  - (c) the ATO (and other tax authorities) wish to comprehensively deal with the matter based on appropriate and workable principles.
65. 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) limits costly and time consuming examinations of major transfer pricing issues which may arise as a result of a future transfer pricing audit and lessens the possibility of protracted and expensive litigation; and

- (e) places the taxpayer in a better position to predict costs and expenses, including tax liabilities.

66. 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.

67. The APA process is designed to be completed within 12 months of the formal application being lodged. 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 generally dealing with current data as opposed to prior year data which is often difficult and time consuming to gather.

### **Special considerations for small business**

68. The ATO recognises that taxpayers operating on a small scale may view the APA process as being time consuming and 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 may not necessarily be required for a smaller enterprise.

69. To accommodate small businesses contemplating an APA, the ATO will attempt to streamline the process. Small businesses should use the prelodgment meeting(s) process to discuss the APA requirements and voice any concerns regarding the cost and practicality of entering into an APA. The prelodgment meeting(s) may be used by taxpayers to determine the feasibility of entering into the APA process.

### **Criteria for inclusion in the APA program**

70. In deciding which cases should be included in the APA program, the ATO will give weight to cases where:

- (a) the taxpayer is seeking a bilateral APA;

**TR 95/23**

- (b) the other country involved in the APA request is a tax treaty partner that is willing to consider the APA request and enter into a bilateral APA;
- (c) the conclusions reached under the particular APA will assist industry wide guidelines and approaches;
- (d) a substantial part of the taxpayer's activities involve related party dealings with tax treaty countries;
- (e) the cross border dealings can be considered in the overall context of the business and other steps or arrangements with which they might be linked;
- (f) a significant part of a limited life project is yet to be commenced;
- (g) the TPM proposed under the APA is likely to comply with the Act and/or relevant tax treaty provisions, and be consistent with ATO and OECD guidelines on transfer pricing;
- (h) the transactions, agreements or arrangements are not of a hypothetical nature and are seriously contemplated; or are of a continuing nature; and
- (i) sufficient information for proper and full consideration of the request is provided.

71. If rejection of an APA request is contemplated by the ATO the taxpayer will have an opportunity to make representations before a final decision is made.

**Prelodgment meeting(s)**

72. Cases which are suitable for an APA will require varying levels of detail and information as part of the APA application. Applications should be comprehensive - on a holistic approach (refer paragraphs 54 and 55). More than one TPM may be outlined in an application. The prelodgment meeting(s) 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 prior to reaching a decision concerning lodgment of a formal APA application.

73. 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 prelodgment meeting is required to determine the suitability for an APA, the TPM or determine the extent of information to be lodged by the taxpayer.

74. Prelodgment meetings should be used to clarify up front what both sides expect from the APA process. The taxpayer should be able to advise at the prelodgment meeting(s) the information requirements they would not be able to satisfy.

75. Prelodgment meetings should also be used to:

- discuss the extent of documentation and analyses required;
- determine whether there is a 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.

76. The taxpayer should be aware as to whether its foreign affiliate is prepared to submit all information required under the foreign country's APA procedures and whether its affiliate is presently under examination by the foreign tax authority. The taxpayer should be aware of the standing of its affiliate with the foreign tax authority, in particular whether there is existing or contemplated litigation or whether there are outstanding tax debts.

77. The Competent Authority or designated representatives (usually the APA Review Team) will normally attend the prelodgment meetings. If there is not sufficient time to select the APA Review Team prior to the first prelodgment meeting further meetings may be required once the APA Review Team is established.

#### **Draft outline of case**

78. The taxpayer will be required to provide a broad outline of its case at the time of lodging its expression of interest/request for a prelodgment meeting. The draft outline will be used as the basis for discussions at the prelodgment meeting(s). 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.

79. 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);
- an explanation of 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
- an indication of any potential conflicts or differences in interpretation of legislation etc between Australia and the other foreign tax administration in relation to issues covered by the APA.

80. 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(s) and/or the formal lodgment of the APA application.

### **Preparation and lodgment of formal application**

81. Following the prelodgment meeting(s), 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 relevant ATO officers during the preparation of its submission. They would welcome the opportunity to review drafts, tables and data included in the preparation of the submission.

82. The formal application should provide details of the proposed TPM and be in accordance with the information requirements contained in this Ruling, subject to any agreements reached at the prelodgment meeting(s).

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

84. The APA application should also incorporate the proposed 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.

85. Six copies (unless otherwise agreed) of the formal application are required to 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.

86. 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.

87. 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.

88. The APA Review Team is responsible for the evaluation 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 relevant fieldwork (e.g., 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.

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

### **Format of APA applications**

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

91. 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.

**Documentary requirements**

92. The information requirements stated in this Ruling are a guide only and taxpayers are encouraged to use the prelodgment meeting(s) as an opportunity to determine the documentary requirements for their particular case.

93. 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.

94. Applicants need to submit full details of the issues surrounding their proposals. They should clearly and fully explain why their proposal is the preferred option. Full details of 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 a numeric functional analysis, indicating why and how the taxpayer reached their conclusions.

95. 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. The taxpayer should outline the history of dealings continuing to have significance between itself and related parties to the APA. It is recommended that relevant historical data covering an appropriate period be provided. This period could generally be expected to be for the last 3 years but could be more or less depending on the taxpayer's industry and circumstances. That period will be discussed at the prelodgment meeting. The historical data for that period should be compared with the proposed future transactions, agreements or arrangements and any anticipated differences in approach or results should be highlighted. In cases where historical data is not available, for example where the taxpayer has just started up operations, the taxpayer would be expected to provide details of expected future dealings with related parties to the APA.

96. 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, and subject to any agreements

reached at the prelodgment meeting(s), the following information would normally constitute the requirements for an APA application:

- (a) a complete statement of the names and addresses 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 bodies 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;
- (g) details of major transaction flows and significant transfer pricing arrangements or practices;
- (h) details of the taxpayer's products and/or services on sale in Australia and overseas, together with details of the manufacturing processes used for those products and/or services;
- (i) details of suppliers/purchasers and their relationship to the taxpayer, together with a financial analysis of purchases/sales;

**TR 95/23**

- (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, views as to which are the most comparable, less comparable and least comparable and the reasons for these views; and
- (l) any other information which may have a bearing on the current or proposed TPM for all members of the taxpayer's controlled group, regardless of whether such members are parties to the request.

97. The Statement of Auditing Practice, AUP34, *Knowledge of the Clients Business*, is a useful guide (so far as it is relevant) 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.

98. In addition, sufficient information showing how TPMs have been determined and whether the TPMs are affected by special conditions which renders them inconsistent with the arm's length principle should be supplied. This information should include details of the functions performed, assets used and risks taken by the various parties to the APA. In respect of an intangible or intellectual property the taxpayer should provide information showing:

- who owns it;
- who is it used by;
- who developed it;
- how is it used;
- how it adds value to the activities of the enterprise; and
- how its contribution has been valued for the APA.

99. 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 foreign entities that are similar to the current or proposed TPM cited in the application. If so, the other entity should be identified and the pricing or other commercial arrangement explained.

100. The guidelines provided at paragraph 96 could normally be expected to require that the taxpayer undertake 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. In any event a taxpayer's case will be strengthened by the inclusion of supporting analyses performed by the taxpayer.

101. 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 3 years. Such information should include summarised financial and tax data of the parties for those years, including sales, cost of goods sold, operating expenses, profit before taxes, assets, liabilities, number of employees plus any other relevant data.

102. 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.

103. In cases where historical data is not available, for example where the taxpayer has just started up operations, the taxpayer should provide, for the period to be covered by the APA, details of its expected taxable and financial position.

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

104. The TPM agreed upon has to be consistent with the arm's length principle, be supported by available and reliable data, and be reasonably capable of being applied and administered. It should produce, with as little adjustment as possible, an anticipated price or result or a range of prices or results, consistent with the arm's length principle.

105. There is no universal list of documents or information that will be determinative in calculating what is arm's length. The documents or information 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;

**TR 95/23**

- (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 any market penetration strategies.

**APAs and cost sharing**

106. If the APA is to involve cost contributions for centralised services and/or Research and Development (R&D) activities, it will be necessary to provide the ATO with sufficient information to determine:

- (a) that the Australian taxpayer(s) contributions are a fair and reasonable proportion of the centralised expenditure, having regard to the benefits or expected benefits to be obtained by the Australian taxpayer(s); and
- (b) the deductibility of the payments (for example, exclusion of capital expenditure) under Australian law.

107. For this purpose, the ATO would require details of the centrally incurred expenditure (or a budgeted expenditure), the nature of the expenditure (for example specific R&D projects) and the method of allocation to Australia and other members of the group.

**Critical assumptions**

108. Decisions about the suitability of a particular TPM will be made on the basis of the facts existing at the time. If particular circumstances are seen as central to the decision such that any changes in them would materially affect the suitability of the TPM or the way in which it would need to be applied, these circumstances will need to

be addressed by the taxpayer and be included in the APA application as 'critical assumptions'.

109. 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. For example, a critical assumption might be the existence of a certain product line. If this product line was discontinued the APA would no longer be valid.

110. Critical assumptions should be noted even where they are not within the taxpayer's control.

### **Independent experts**

111. The taxpayer may be requested by the ATO to provide, at the taxpayer's 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 TPM. However, an independent expert will not be required in all cases.

112. The function of an independent expert would be to provide an opinion that represents a critical analysis of the taxpayer's proposal. The independent expert 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 TPM is supportable and fairly represents the interests of all parties to the APA. The independent expert may put forward a revised version which meets all requirements and supports and produces an arm's length approach.

113. The independent expert's opinion will be considered by the ATO in examining the TPM but will not bind the ATO, the taxpayer or the foreign tax authority, in accepting or rejecting the proposed TPM.

114. Whether an independent expert is likely to be required will be discussed at the prelodgment meeting(s) 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, in their opinion an independent expert is required.

115. The ATO may (at any stage of the APA process) engage its own expert, at its own expense, to review the taxpayer's proposal or that of the independent expert. In such cases, the ATO will advise the taxpayer. This expert will have access to all information provided under the APA process having regard to confidentiality and conflict of

interest considerations and will be made bound by the secrecy provisions contained in the Act.

**Information requirements of foreign tax authorities**

116. Foreign affiliates of the taxpayer will need to comply with the information requirements of their respective country's tax authority. 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 should be provided to the ATO.

**Confidentiality**

117. 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 Act and the applicable Exchange of Information provisions in the DTAs (refer also to paragraphs 133 to 136).

**English language**

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

**Domestic time limits**

119. Most of Australia's DTAs provide that a solution reached under the mutual agreement procedure shall be implemented notwithstanding any time limits in domestic laws. However, there are a number of DTAs where there is no express overriding of domestic time limits in the mutual agreement procedure article. The domestic time limits imposed are generally 4 years. Given the prospective nature of an APA, it is not envisaged that domestic time limits are likely to cause problems in practice. Relevant amendment and crediting provisions will be addressed more fully in the later rulings on correlative adjustments and the mutual agreement procedure.

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

120. After having received the formal application, the ATO would normally aim to have the APA completed within 12 months and expects the taxpayer to cooperate and provide timely, detailed and accurate information. If the provision of information by the taxpayer

becomes too protracted, the ATO reserves the right to discontinue the APA process. The ATO will also endeavour to examine and convey conclusions regarding data and other information in a timely fashion.

121. Completion of the APA process within 12 months will nevertheless 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.

122. 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 will normally require some 2 to 4 months to review and analyse the APA application. This may be followed by requests for further data, relevant field work, further discussions with the taxpayer, etc. This follow up work may add another 1 to 4 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 8 months to the process, with another month being required to finalise all the paperwork.

### **Further information requests**

123. The ATO will evaluate the supporting data relevant to the APA and, if necessary, additional information may be required. It is essential that additional information be presented on a timely basis.

124. The ATO may also specify a date at which time no further information will be accepted. This date will usually be when the ATO and the foreign tax authority enter into final negotiations by way of exchanging position papers on the taxpayer's proposed TPM.

125. Where 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.

### **ATO liaison with foreign tax authority**

126. 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 authorities is therefore coordinated through the National Office.

127. 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 will 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.

128. 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.

### **Statement of proposals**

129. Prior to final negotiations, the ATO may seek to clarify any changes or amendments that have been made to the taxpayer's original proposals. 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 143 to 146 below - 'Form and Content of concluded APAs'.

130. 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.

131. 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.

132. 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.

**Exchange of information**

133. In processing a bilateral APA, communication between tax authorities will usually be through the exchange of final position papers. The position papers will 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 prepared by the taxpayer may be used as the basis for preparing the ATO's final position paper. The ATO will provide a copy of the position paper to the taxpayer. However, this would be subject to whether confidential third party information (including information that the other Competent Authority is not prepared to release) is contained in the position paper. If this were the case, an appropriately edited version will be provided.

134. A meeting between the tax authorities is only envisaged in those cases where there are significant issues upon which agreement cannot be reached.

135. The ATO will endeavour to ensure communications between Competent Authorities are undertaken on a timely basis to ensure that wherever possible the APA is completed within 12 months of the formal lodgment of the APA application.

136. The exchange of information between Competent Authorities will be undertaken pursuant to the Exchange of Information Article of the relevant DTA (see also paragraph 117).

**Taxpayer representations**

137. The taxpayer does not have a right to be present at the Competent Authority negotiations. However, where the approval of all relevant Competent Authorities is obtained the taxpayer may make a presentation to the Competent Authorities. Where approval has not been obtained from the foreign Competent Authority, the taxpayer will be given an opportunity to present their case to the ATO. Taxpayers would need to take note of the point made in paragraph 124 when considering a presentation.

**Final decision maker**

138. The Australian Competent Authority has the responsibility for the ATO's APA program. Whilst the APA Review Team is responsible for evaluating and providing advice to the Competent Authority on the viability of the APA, the Competent Authority remains the final decision maker regarding the acceptability of the TPM and the execution of a bilateral APA. Unilateral APAs may be concluded by the Competent Authority or by the Assistant

Commissioner, International Tax Division (ITD), for the Northern or Southern region. In exceptional cases, it may be necessary for the final decision on a unilateral or bilateral APA to be taken by the First Assistant Commissioner (ITD).

### **Competent Authority arrangement**

139. Where the Competent Authorities involved reach agreement on a TPM, a Competent Authority arrangement to this effect is executed. The Competent Authority negotiations and agreement are authorised by, and would be executed by, applying the mutual agreement procedures set out in the relevant DTA or by use of the executive powers conferred on the Commissioner where the treaty is not appropriate or where a treaty is not applicable.

140. The Competent Authority arrangement will form the basis of the bilateral APA between the ATO and the Australian taxpayer. If the taxpayer abides by the terms and conditions of the APA, the ATO will not propose adjustments to the TPM under Division 13 or the relevant provisions of the DTA.

141. The Competent Authority arrangement 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 arrangement may be a more formal document.

142. Where the Competent Authorities cannot reach agreement the taxpayer and the ATO may nevertheless agree to finalise the APA on a unilateral basis.

### **Form and content of concluded APAs**

143. The APA Review Team will draw up an appropriate APA which will clearly spell out the terms and conditions for the agreed TPM. However, the APA Review Team cannot issue or endorse an APA unless it has been approved by the Competent Authority. In respect of bilateral APAs, the ATO will provide written confirmation of the concluded arrangement between the Competent Authorities.

144. Where a unilateral APA is completed, the ATO will provide written confirmation of the concluded arrangement between the ATO and the taxpayer. The ATO will not provide a Private Binding Ruling for bilateral or unilateral APAs because such arrangements are not considered to fall within the scope of the Private Binding Ruling System. The ATO would consider itself administratively bound in any event by the terms of an APA providing the taxpayer complies with all

the terms and conditions and providing that there are no substantive changes in the critical assumptions.

145. A concluded APA may generally be expected to contain the following minimum information:

- (a) the names, addresses and tax file numbers of the parties to the APA;
- (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 (e.g., sales, cost of sales, operating profit, etc.);
- (f) the basis of financial statements;
- (g) critical assumptions upon which the TPM is based;
- (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 (e.g., the need to lodge annual reports with the Competent Authority, taxpayer's record keeping requirements, etc.).

146. The critical assumptions provision of the concluded APA will require any changes to be referred to the Competent Authority as soon as possible and will result in either:

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

#### **Annual compliance reporting**

147. The taxpayer will be required as part of the APA to prepare an annual compliance report, for each year of the APA, containing

sufficient information to detail the actual results for the year and to demonstrate compliance with the terms and conditions of the APA. The annual compliance report is separate to any requirement the taxpayer has to self assess and lodge an annual income tax return.

148. The annual compliance report is to be forwarded by the taxpayer to the Australian Competent Authority within 90 days after the completion of each year covered by the APA. Since the dealings are cross border a like annual compliance report may also be required by the foreign tax authority involved. One of the conditions of the APA will be that the taxpayer is required to self assess their compliance with the APA.

149. The annual compliance report should 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.

150. The Competent Authority, with the assistance of the APA Review Team, will review the annual reports and, if necessary, may request further information to verify that the taxpayer has complied with the terms and conditions of the APA. If the taxpayer fails to provide an annual compliance report or supply the additional information requested within a reasonable time, the Competent Authority may cancel the APA. These possible consequences would be reflected in the APA itself as a condition of its continuance.

151. Where 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 other than by way of an acknowledgment letter. The taxpayer will only be contacted where it is necessary to clarify the contents of the annual report or to request further information. If it is discovered that the annual report was incorrect or misleading, the previous issue of an acknowledgment letter will not prevent follow up action by the ATO (see also paragraphs 163 to 170).

### **Record keeping requirements**

152. The taxpayer must retain all records relied upon in concluding the APA and all supporting data referred to in any annual compliance report. The APA may specify the record retention period or specifically provide that certain records need not be kept.

153. Unless otherwise stated in the APA, the taxpayer is required to keep all records in accordance with the record keeping requirements under the Act (e.g., sections 262A, 462, 462A, etc.). Upon request, any records needed by the Competent Authority for the purpose of monitoring the APA are to be made available to the Competent Authority within a reasonable time. The ATO will consider cancelling the APA for any remaining term if it is found that any of the critical assumptions and conditions have not been adhered to or where the records do not enable the ATO to readily confirm that such assumptions and conditions have been met.

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

154. There may be occasions where the taxpayer or its affiliate/s may have already completed an APA (bilateral or unilateral) with a foreign tax authority. The taxpayer may wish to extend the principles of this APA into a similar arrangement with the ATO. While the APA with the foreign tax authorities will provide guidance, the ATO is not bound to accept the terms or conditions of that APA.

### **Revision of APA**

155. 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.

156. 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 reasonably have been expected to foresee or anticipate the event at the time the APA was entered into and, if so, whether the agreed TPM would have taken this into account.

157. APAs should be drafted in such a way that they minimise 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 arrangement due to the change in circumstances.

158. 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.

159. 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.

### **Compensating adjustments**

160. Provided the taxpayer's annual operations remain within the negotiated range of expected results, the related party pricing or dealings that are the subject of the APA will be considered to satisfy the arm's length principle and the ATO will not propose any adjustments during the APA period in relation to that pricing or those dealings.

161. The APA process envisages the use of compensating adjustments where the result falls outside the agreed price or result but is within the critical assumptions boundaries. Australia's domestic tax laws will determine the treatment to be afforded to compensating payments for the purpose of calculating taxable income for Australian tax purposes. For example, assume that the Australian taxpayer incurs a further liability after the close of the taxable year because their actual results exceeded the top of an agreed range or result. Generally, that further liability will only be allowed as a deduction in the year in which it is incurred despite the fact that the adjustment may relate to transactions undertaken in the previous year. However, a deduction would be allowable for the previous year if the liability had been incurred prior to the close of that taxable year and the subsequent adjustment was merely a calculation exercise. Assume 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 assumptions 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.

162. 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 Act in the tax year to which the compensating adjustment relates.

### **Omissions or false or misleading statements**

163. The ATO would seek to either review, revise or cancel an APA 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 in either the APA application or any other submission, report, information or documentation regarding or

supporting the APA application. Such action would occur irrespective of whether the false or misleading statement (or omission) is made due to an honest mistake or is made carelessly, recklessly, knowingly or fraudulently. Generally speaking, an APA would only be cancelled if the false or misleading statement (or omission) related to a material particular. In addition to cancelling the APA, the ATO may amend the taxpayer's returns and impose appropriate penalties. Obviously, such adjustments would be subject to the usual objection and appeal provisions of the law.

164. The APA may also be revised 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.

### **Renewal of APA**

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

166. 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 APA and the period for which it is to be renewed.

167. 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.

168. 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.

### **ATO audits and APAs**

169. The APA process does not exempt the taxpayer from audit. The Commissioner has extensive statutory powers and obligations, 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.

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

**TR 95/23**

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 agreed TPM has been correctly applied; and
- (c) the information supplied in the taxpayer's APA application and the annual compliance report reflect accurately all material facts.

171. In the event that agreement on an appropriate TPM cannot, for whatever reasons, be reached or the taxpayer withdraws from the APA process or prior years are audited, the taxpayer is not insulated from subsequent use by the ATO of the factual information disclosed during the APA process. Non factual information such as opinions, lines of argument, judgements and conclusions provided by taxpayers throughout the APA process will not be relevant to a subsequent audit. In an audit context the ATO would have to develop its own analysis and conclusions.

172. The fact that a taxpayer may be under audit does not prevent the taxpayer from applying for an APA in respect of future years. The fact that a taxpayer has applied for an APA should not automatically result in the audit activities in relation to the prior years being discontinued or postponed.

173. 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 information may be shared between the Audit Team and APA Review Team.

174. Where an audit is in progress and a taxpayer requests an APA, the audit of the issues relevant to the APA 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 helpful in determining the audit issues.

175. The decision to continue with, hold in abeyance or cease the audit or part thereof will be made by the Audit Case Manager and the Competent Authority who will consider the facts and circumstances surrounding the particular case. This decision would 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;
- whether conclusion of the APA will assist in concluding the audit;
- whether the taxpayer is able to demonstrate that it will be to the ATO's advantage to hold the audit in abeyance; and
- whether the taxpayer can also produce an outline of the APA showing timelines that will be met.

176. It may be suitable in some cases to defer some part of the audit for a short period pending completion of the APA. However, 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.

177. 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 DTAs should be used to resolve the matter.

178. 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.

**Prior year examinations**

179. The ATO will not give an undertaking that prior years will not be audited after the APA process is completed. However, it is not intended that the APA process be used for determining the TPM or results for transactions, agreements or arrangements relating to past years (i.e., an APA does not have retrospective application). TPMs and tax outcomes for past years will generally be determined as part of the audit process on the basis of events that have already occurred and the ATO will form a view of the TPM and the arm's length results on the basis of information available or obtainable at that time. The ATO can envisage situations where the principles developed in concluding an APA might provide a basis for resolving issues raised in prior year audits, as well as past years not yet under audit. This would depend on the availability of all relevant information in respect of the prior years and whether there are any changes in the taxpayer's circumstances or the process by which it will be worked out.

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

**Secrecy and disclosure**

181. The ATO recognises that the information requirements for an APA are significant and may include sensitive and confidential business information, including trade secrets. The information generated by the APA process relates directly to the income tax affairs of the taxpayer and will therefore be subject to the same secrecy and privacy safeguards as if it were generated from the audit process.

182. The ATO is legislatively bound by the *Privacy Act 1988*, section 16 of the Act and, where relevant, the DTAs, to safeguard taxpayer information.

183. While the Commissioner is bound by the *Freedom of Information Act 1982* (FOI), it is considered that the provision of information under an FOI request pertaining to an APA application 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**

184. Taxpayers can, if they wish, announce publicly that they have applied for, or have entered into, an APA. Such information or specific details regarding APAs will not be made public by the ATO.

## **Detailed contents list**

### 185. Detailed contents list:

	<b>Paragraph</b>
<b>What this Ruling is about</b> .....	<b>1</b>
Class of person/arrangement .....	1
<b>Ruling</b> .....	<b>10</b>
Annual compliance reports.....	31
APA defined .....	10
Applying APA to prior years.....	18
Applying for an APA.....	15
ATO audits and APAs .....	33
Bilateral APAs.....	12
Compliance with an APA .....	30
Critical assumptions .....	28
Formal application.....	25
Information requirements .....	24
Prelodgment meeting(s).....	20
Scope of APA .....	14
Term of the APA .....	17
Unilateral APAs.....	13
Withdrawing from APA process .....	19
<b>Date of Effect</b> .....	<b>34</b>
<b>Explanations</b> .....	<b>35</b>
Annual compliance reporting .....	147
APA benefits.....	64
APAs and cost sharing.....	106
Applying for an APA.....	56
ATO audits and APAs .....	169
ATO liaison with foreign tax authority .....	126
Bilateral and unilateral APAs.....	36
Bilateral APAs.....	42

**TR 95/23**

Compensating adjustments.....	160
Competent authority arrangement.....	139
Confidentiality.....	117
Conformity with the 'arm's length' principle .....	104
Criteria for inclusion in the APA program.....	70
Critical assumptions .....	108
Detailed contents list.....	185
Documentary requirements .....	92
Domestic time limits .....	119
Draft outline of case .....	78
Duration of APA .....	63
Effect of APAs with other countries .....	154
English language .....	118
Exchange of information.....	133
Final decision maker .....	138
Form and content of concluded APAs .....	143
Format of APA applications.....	90
Further information requests .....	123
How to apply .....	58
Independent experts .....	111
Information requirements of foreign tax authorities .....	116
No processing fees .....	61
Omissions or false or misleading statements .....	163
Prelodgment meeting(s) .....	72
Preparation and lodgment of formal application.....	81
Prior year examinations.....	179
Public disclosure by taxpayer.....	184
Purpose and scope of APAs .....	48
Record keeping requirements.....	152
Refusal by foreign tax authority to participate in a bilateral APA.....	45
Renewal of APA.....	165
Revision of APA .....	155
Secrecy and disclosure .....	181
Special considerations for small business.....	68
Statement of proposals .....	129
Taxpayer representations .....	137
Time frame for provision of information and APA process .....	120
Unilateral APAs .....	46
Who can apply.....	62
Withdrawing from the APA process .....	47

**Commissioner of Taxation**

22 June 1995

ISSN 1039 - 0731

ATO references

NO 94/5817-4; 95/4257-4

BO

Previously released in draft form as  
TR 94/D32

Price \$4.00

FOI index detail  
*reference number*  
I 1016565

*subject references*

- advance pricing arrangement
- arm's length price
- arm's length principle
- bilateral APA
- competent authority
- competent authority arrangement
- critical assumptions
- double tax agreement
- exchange of information
- foreign tax authority
- international transactions
- multinational enterprise
- mutual agreement procedures
- tax treaty
- transfer pricing
- transfer pricing methodology
- unilateral APA

*legislative references*

- ITAA 16
- ITAA 262A
- ITAA 462
- ITAA 462A
- ITAA Pt III Div 13
- Income and Fringe Benefits Tax  
(International Agreements) Act 1953

