

Advance Pricing Arrangement Program

2007–08 Update

November 2008



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This publication was current at **November 2008**.

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INTRODUCTION

This update provides an analysis of the Advance Pricing Arrangement (APA) program's completed cases for the financial year ended 30 June 2008. The update is shorter than usual because PricewaterhouseCoopers Legal has reviewed the program's administration. We will release a separate report on the review shortly.

APAs continue to be an important part of our international tax strategy because they:

- provide complementary benefits to both taxpayers and us
- create greater certainty for all parties
- reduce compliance costs
- reduce the risk of audit and penalty.

Using APAs is part of our balanced program of help and enforcement.

WHAT IS AN APA?

An APA lets taxpayers reach an agreement with us on how to apply the arm's length principle in their future dealings with international related parties. The arrangement:

- establishes the transfer pricing method they must use
- generally covers three to five years
- may be reviewed if their trading circumstances change.

The APA can be:

- multilateral (between us, the taxpayer and more than one foreign tax authority)
- bilateral (between us, the taxpayer and one foreign tax authority)
- unilateral (between us and the taxpayer).

There are no fees or charges for the taxpayer. We usually hold a number of pre-lodgement meetings with them before they lodge their formal application for an APA. Taxpayers can provide their applications electronically if they want to.

Bilateral and multilateral APAs are entered into under the mutual agreement procedure article of the relevant double tax agreement, while unilateral APAs are entered into under our administration of the income tax law.

 The bilateral and multilateral APAs are called 'MAP APAs' by the OECD, as they are conducted under the Mutual Agreement Procedure (MAP).

APA UPDATE FOR 2007–08

OVERVIEW

We completed 48 APAs in the 2008 financial year, including:

- 30 renewals
- 7 new APAs encouraged by compliance activity
- 11 unprompted new APAs.

Taxpayers in both the large business and small to medium enterprises (SME) markets can request APAs, but they are mainly used by large businesses (with revenues of more than \$250 million). In the 2007–08 year, two-thirds of completed APAs were with large business taxpayers.

The completed APAs covered a wide range of related party inbound and outbound dealings including purchases and sales of:

- consumer products
- medical products
- business products
- IT software and hardware
- business and management services
- metals and minerals.

The dealings were undertaken by:

- agency permanent establishments
- distributors
- service providers
- toll manufacturers
- full manufacturers.

PRELODGMET DISCUSSIONS

We encourage potential APA participants to take full advantage of discussions with us before lodging a formal APA application. They can use the prelodgment meetings with us to discuss:

- whether their case is suitable for an APA
- their preliminary views on the transfer pricing method
- the information they will need to give us so we can properly look at their request before lodging a formal application.

Many proposals are complex or unique. Applicants must provide background material and an outline of their proposal well before the meeting, so:

- we can use the meeting time well
- we can offer considered views
- the most appropriate staff can attend.

APA PROCESSING TIMES

We aim to complete an APA within 12 months after the application is lodged. We expect the taxpayer to cooperate and provide timely, detailed and accurate information. Completing the APA process within 12 months depends on the:

- availability of information
- amount of cooperation between us, the taxpayer and the foreign tax authority.

This timeline also depends on the resources we have available to undertake the process.

➤ For more information refer to Taxation Ruling TR 95/23 *Transfer pricing – procedures for bilateral and unilateral advance pricing arrangements*, paragraphs 120–121.

APAs completed in 2007–08 took, on average, 11 months to process from lodgment to finalisation (13 months in 2006–07).

The average time for completing:

- unilateral applications was eight months (eight months in 2006–07)
- bilateral applications was 16 months (17 months in 2006–07).

Median processing times overall and for bilateral APAs were similar to the average.

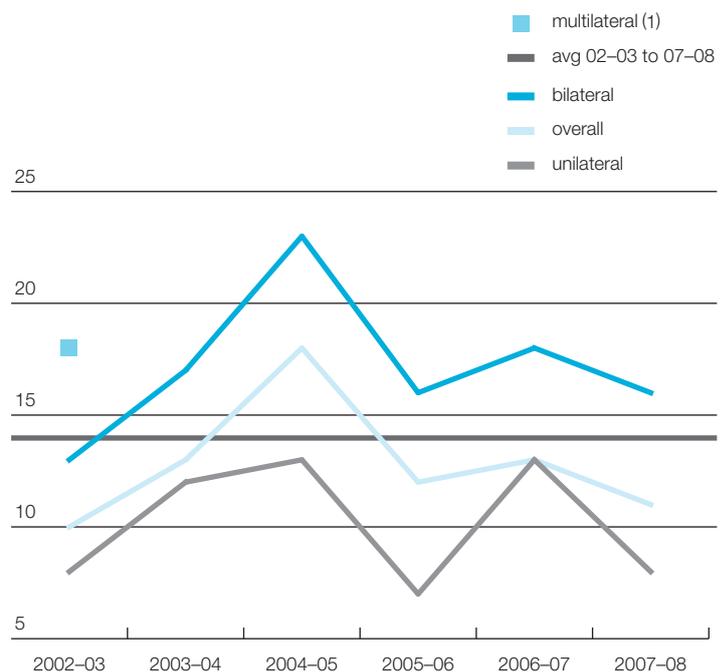
This year, on average:

- a renewal application took the same time to process as a new application (in 2006–07 a renewal application took 30% less time than a new application)
- an application involving an SME taxpayer took about 60% less time than one involving a large business taxpayer (45% in 2006–07).

SME applications were often prompted by compliance activity and were usually unilateral. Our knowledge of the businesses at the time of the applications helped faster processing times for these cases.

Figure 1 shows our performance over six years.

FIGURE 1: Average time in process: APAs by type (2007–08)



UNILATERAL AND BILATERAL APAS

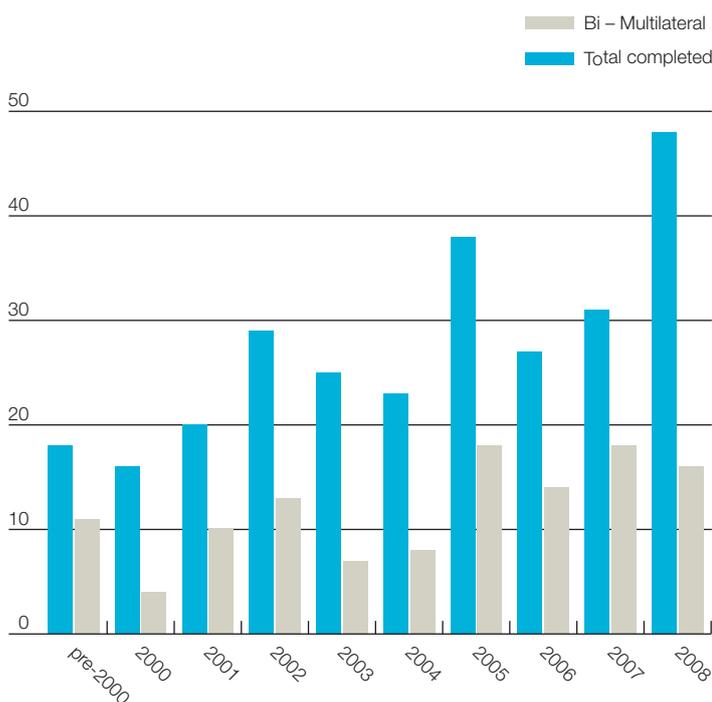
The higher than usual proportion of unilateral APAs arose from:

- a unique joint venture arrangement where bilateral APAs were inappropriate and
- SME companies who could not justify the costs of submitting a bilateral application.

In 2007–08, bilateral APAs were completed with Canada, Japan, New Zealand and the USA.

Over the life of the APA program, the number of bilateral and multilateral APAs has averaged approximately 43% of the total APAs completed, but as figure 2 shows, the proportion fluctuates.

FIGURE 2: Proportion of bilateral and multilateral APAs completed over program life (includes renewals)



WORK IN PROGRESS AT 30 JUNE 2008

Figure 3 shows a snapshot of our APAs on hand at 30 June 2008 and their stages of progress.

FIGURE 3: Current APA workload

| | At 30 June 2007 | At 30 June 2008 |
|------------------------|-------------------------|-------------------------|
| Discussion stage | 18 | 22 |
| Prelodgment stage | 3 | 20 |
| Lodged and in progress | 41 | 23 |
| | (includes 18 bilateral) | (includes 23 bilateral) |

ISSUES AND METHODS USED

Figure 4 shows the types of dealings completed APAs covered in 2007–08. Several APAs covered more than one type of dealing, for example, selling tangible property and receiving management services. In these cases, the primary dealing is listed first and all covered dealings are totalled in the right-hand column.

FIGURE 4: APAs completed by type of dealing (2007–08)

| Type of dealing | Primary dealings | All dealings |
|------------------------|------------------|--------------|
| Tangible property | 36 | 36 |
| Intangible property | 3 | 5 |
| Services | 9 | 18 |
| Total completed | 48 | |

These three broad categories of dealings cover:

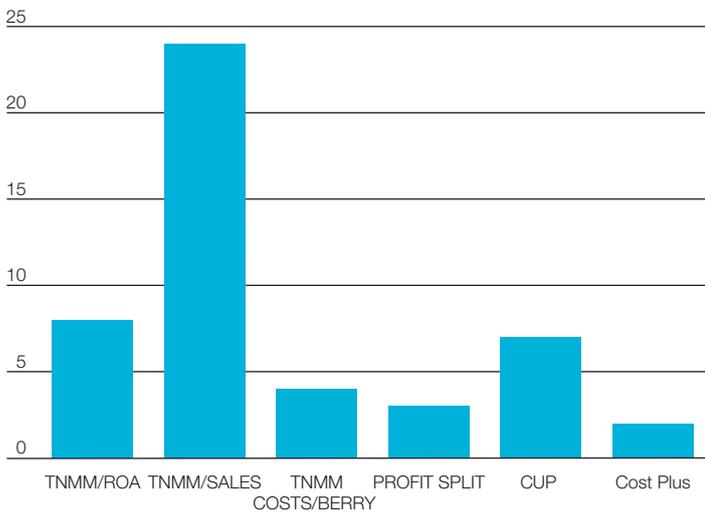
- sales and purchases of goods by marketers, distributors and manufacturers
- sales of commodities and semi/completed goods
- licensing intellectual property
- services including financial services, research and development
- management and other support services.

Figure 5 shows the primary methods applied in the APAs completed during the year. As in previous years, the transactional net margin method (TNMM) is most commonly used. This is mainly because taxpayers have ready access to independent comparable data in Australia and elsewhere to show that related party dealings achieve an arm's length outcome. The tested party may be either in Australia or overseas depending on the case. TNMM can also be used to establish routine returns in a residual profit split.

REVIEW OF THE ADVANCE PRICING ARRANGEMENT PROGRAM

PricewaterhouseCoopers conducted a wide ranging review of the APA Program's administration during 2007-08. It looked at the purpose and benefits of the program against our objectives and stakeholder needs. Further details about the review will be released separately.

FIGURE 5: APAs completed by primary method (2007-08)



MORE INFORMATION

For more information about APAs and Annual Compliance Reports:

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