

Advance pricing arrangement program 2010–11 update



Australian Government
Australian Taxation Office

**© AUSTRALIAN TAXATION OFFICE FOR THE
COMMONWEALTH OF AUSTRALIA, 2011**

You are free to copy, adapt, modify, transmit and distribute this material as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).

PUBLISHED BY

Australian Taxation Office
Canberra
November 2011

NAT 73225-11.2011
JS 21635

Contents

Introduction	2
APA processing and program update for 2010–11	3
New APA practice statement released	4
Pre-lodgment discussions	5
APA processing times	6
Unilateral and bilateral APAs	8
Work in progress at 30 June 2011	9
Issues and methods used	10
Managing a diverse and complex program	11
More information	12

Introduction

This update provides an analysis of the cases completed as part of the Advance Pricing Arrangement (APA) Program for the financial year ended 30 June 2011.

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. As recommended by an independent review of the program, we will continue to promote and use APAs to help in gaining cooperative tax compliance.

What is an APA?

An APA lets companies that are members of a multinational group 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 for transactions covered by the APA
- 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.

APAs are free of charge.

APAs usually begin with pre-lodgment meetings upon submission of an APA proposal, followed by a formal application once the scope is agreed. Taxpayers can lodge 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. Unilateral APAs are entered into under our administration of the income tax law.

- ❗ Bilateral and multilateral APAs are called 'MAP APAs' by the Organisation for Economic Co-operation and Development (OECD) when they are conducted under the Mutual Agreement Procedure (MAP) of a tax treaty.

APA processing and program update for 2010–11

We completed **53** APAs in the 2011 financial year, including:

- **23** renewals
- **14** new APAs encouraged by compliance activity
- **16** unprompted new APAs.

This is the program's largest number of completions in any one year. In part, the result was assisted by timely meetings with some of our treaty partners that enabled some applications to be finalised by year end. Nevertheless, in the last four years, we have experienced the three highest annual number of APA completions.

Both large businesses (with revenues of more than \$250 million) and small-to-medium enterprises (SME) can request APAs. In 2010–11, 30 APAs were completed with large businesses and 23 APAs were completed with SMEs.

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

- tangible goods for personal consumption and as business inputs
- business and management services
- IT software and hardware sales and services
- mineral exports
- licensing of trade, and marketing intangibles and software
- financial services
- contract manufacturing and research and development (R&D).

The dealings were undertaken by:

- agents
- distributor and marketers
- service providers
- intellectual property (IP) owners
- financial services companies.

About 80% of the completed APAs dealt with an import of goods, services or IP.

New APA practice statement released

On 17 March 2011, we released new guidance for taxpayers, their advisers and our staff on new processes designed to allow the APA program to cope with the increasing demand for APAs and increasing complexity of transactions for which APAs are requested. It replaces our previous guidance, Taxation Ruling TR 95/23.

For a copy of the practice statement, refer to *Law Administration Practice Statement PS LA 2011/1 ATO's Advance Pricing Arrangement Program*.

The new processes outlined in the practice statement will ensure that issues are identified upfront in the APA process and the approaches to resolving them agreed with the taxpayer to avoid surprises in the analysis phase of the APA. The statement of mutual expectations in this practice statement reflects an approach which promotes frank and open dialogue between us and the taxpayer and a joint commitment to develop an APA.

A key feature of the renewed program is to provide a differentiated program that better meets the increasing demand for APAs and the range of transactions for which APAs are being sought. We now have three APA products to deal with simple, standard and complex international related party dealings, as well as a streamlined APA renewal process.

The changes to the APA Program have been well received by Australian taxpayers, advisors, and our tax treaty partners and will ensure its sustainability into the future and its continued role in our international tax strategy.

The new APA processes in the practice statement are the result of extensive consultation and co-design with industry on the principles of the program. Following recommendations from an independent review commissioned by us, we worked closely with representatives from the accounting profession and the Corporate Tax Association to look at ways to improve the effectiveness and efficiency of the program.

Pre-lodgment discussions

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

- whether their case is suitable for an APA
- the scope of the transactions that are to be covered
- 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.

It is important to agree on the scope of the APA at an early stage. This can affect the level of our analysis of the application. The application should reflect the outcome of the pre-lodgment discussions and should contain no surprises. Sometimes other issues (for example, capital gains or income and expense recognition) may need to be considered either separately or in conjunction with the APA. How and when these matters are addressed is best agreed at the start of the process. Depending upon the nature of issues we may deal with them before, concurrently or after considering the APA.

The length and nature of the APA pre-lodgment process is largely responsive to the needs of the potential applicant and the nature of their proposal. Applicants enter pre-lodgment discussions at different stages of preparedness in making their APA proposals. As a result, it can take applicants significantly different lengths of time to progress to lodgment.

APA processing times

Our past practice has been to aim at completing an APA within 12 months after the application is lodged. However, in March 2011, we introduced new APA products with different targeted completion times.

FIGURE 1: Target cycle time from pre-lodgment to finalisation (months) for new APA products

Types of APA products	APA products			
	Simplified	Standard		Complex
	Unilateral	Unilateral	Bilateral	Unilateral/bilateral
Target cycle time from pre-lodgment to finalisation (months) ^(a)	9	12	18–24	24

(a) It is expected that the pre-lodgment phase would take between one to three months depending on the type of APA product.

We expect the taxpayer to cooperate and provide timely, detailed and accurate information. Completing the APA process within the target timeframe months depends on the:

- length of time the applicant takes to lodge the application
- availability of information
- amount of cooperation between us, the taxpayer and the foreign tax authority.

This time taken can also depend on the resources we have available to undertake the process. All of this year's completed APAs were commenced prior to the release of the new practice statement.

On average, the APAs completed in 2010–11 took 14 months to process (16 months median) from lodgment to finalisation, compared to 12 months in 2009–10. 57% of APAs were completed in 12 months or less and 6% took 36 months or more. On average, seven months was spent in pre-lodgment.

The average [median] time for completing:

- unilateral applications was 9 [six] months, compared to five months in 2009–10
- bilateral applications was 21 [24] months, compared to 25 months in 2009–10.

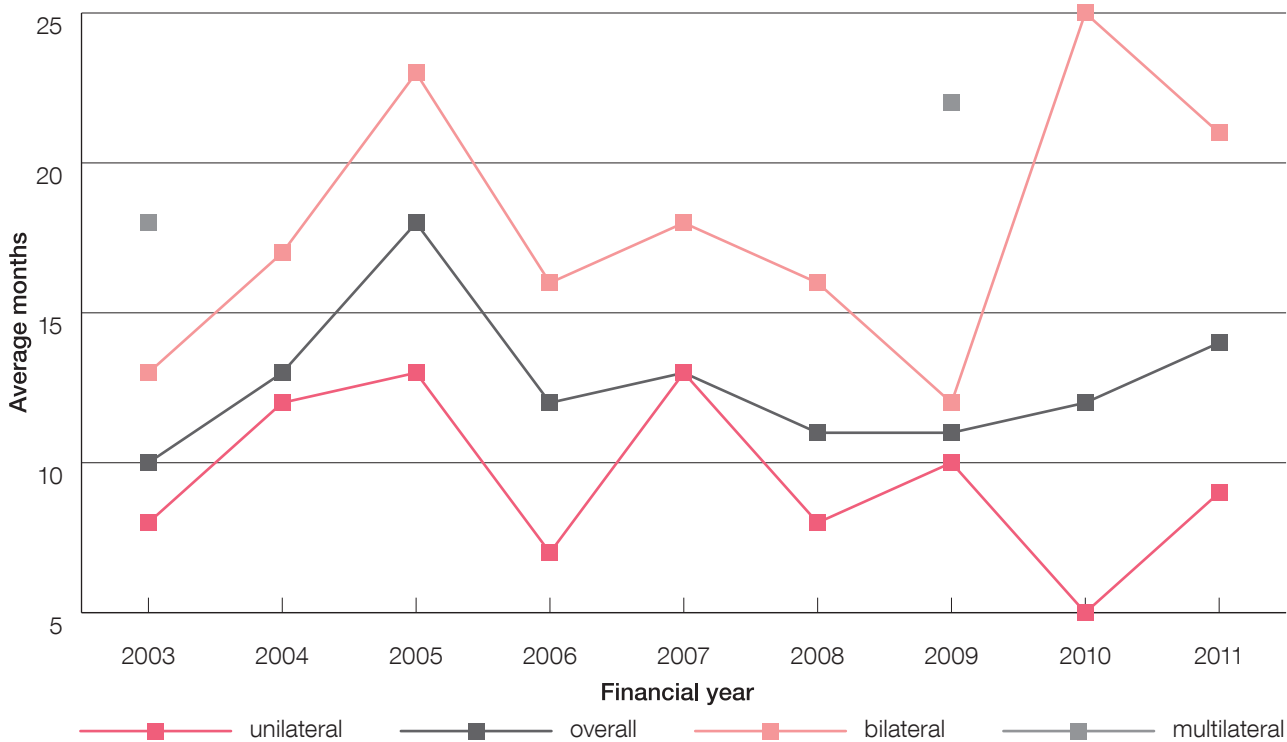
This year, on average:

- a renewal application took 25% less time to process compared to a new application – 14 large business and international (LB&I) APAs were renewals, which took an average of 17 months to process
- an application involving an SME taxpayer took 70% less time than one involving a large business taxpayer, compared to 68% in 2009–10 – 14 new SME APAs were completed in an average time of eight months.

In nine SME APA applications, we had undertaken compliance activity such as a transfer pricing risk assessment. Our knowledge of the businesses contributed to faster processing times for these applications, which were usually unilateral. SME piloted our simplified processes in a number of applications.

Figure 2 shows our performance over the last nine years.

FIGURE 2: Average time in process: APAs by type



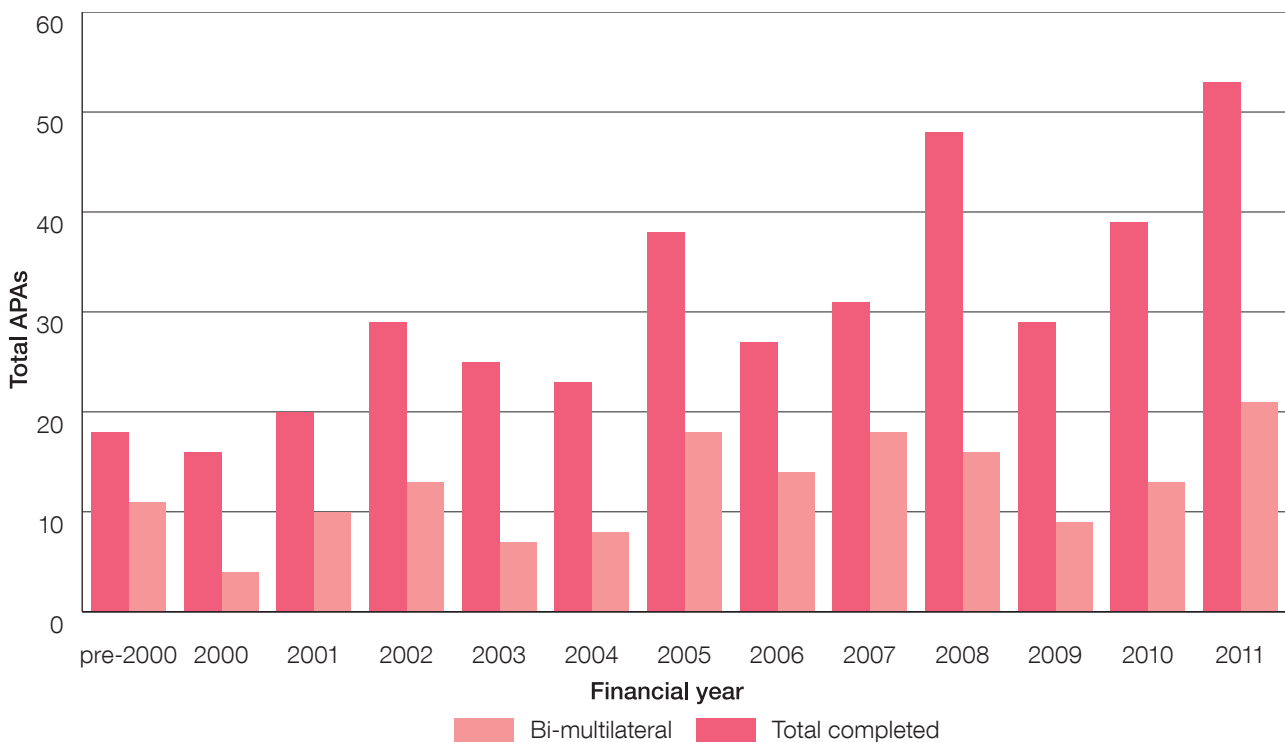
Unilateral and bilateral APAs

The relatively large proportion of SME unilateral APAs in the program has kept average processing times within our target as these are typically quicker types of applications to process. SME companies sometimes make unilateral applications for this reason, and because the preparation costs can be lower compared with those associated with preparing and submitting a bilateral application.

In 2010–11, bilateral APAs were completed with Japan, New Zealand, Singapore, Switzerland, the United Kingdom and the United States of America.

Over the life of the APA program, the number of bilateral and multilateral APAs averaged 41% of the total APAs completed; however, as figure 3 shows, the proportion fluctuates year to year.

FIGURE 3: Bi and multilateral APAs completed over program life (includes renewals)



Work in progress at 30 June 2011

Figure 4 shows a snapshot of our APAs on hand at 30 June 2011 and their stages of progress.

FIGURE 4: Current APA workload

	At 30 June 2010	At 30 June 2011
Pre-lodgment stage	17	24
Lodged and in progress	60	61
	(includes 37 bilateral)	(includes 52 bilateral)

Issues and methods used

Figure 5 shows the types of dealings covered by completed APAs covered in 2010–11. Several APAs covered more than one type of dealing, such as selling tangible property, and receiving or providing management and technical services. In these cases, the primary dealing is listed first and all covered dealings are totalled in the right-hand column.

FIGURE 5: APAs completed by type of dealing (2010–11)

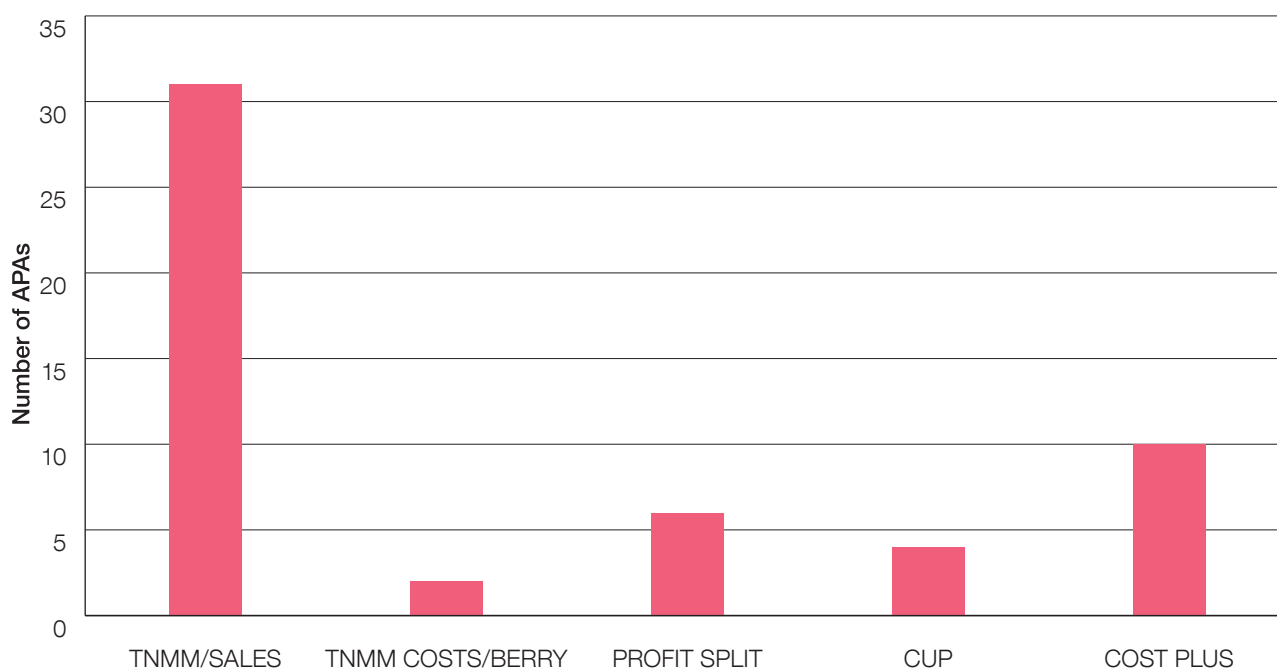
Type of dealing	Primary dealings	All dealings
Tangible property	31	32
Intangible property	8	9
Services	14	24
Total completed	53	

These three broad categories of dealings cover:

- the supply or acquisition of goods by agents marketers, distributors and manufacturers
- the licensing of intellectual property
- services including selling, financial, management and other support services.

Figure 6 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. This year we completed more APAs where the principal covered transaction involved the acquisition or supply of services. Many of these were agreed using cost plus as the transfer pricing method.

FIGURE 6: APAs completed by primary method (2010–11)



Managing a diverse and complex program

We have also been looking at the APA program through four focus areas of compliance:

- outcomes
- transparent relationships
- best practice process and governance
- people and culture.

As we end our transition year to modified APA procedures, we notice that compliance outcomes indicators generally show:

- some growth in the size of the program, particularly for situations where we have raised potential transfer pricing problems with taxpayers
- overall, once in the program, taxpayers' financial and tax performance tends to rise
- the value of the program's coverage of international related party dealings remains steady, which is helped by the routine renewal of expiring APAs
- completion times are favourable in the context of similar programs conducted by peer tax administrations.

We have increased the transparency of the program by issuing our PS LA 2011/1 ATO's Advance Pricing Arrangement Program, which describes our revised processes, including:

- arrangements for simplified and more complex cases
- ways for dealing with collateral issues to the covered dealings of the APA.

The introduction of a circuit breaker/review mechanism for stalled cases provides an opportunity to directly address relationship problems.

The PSLA 2011/1 ATO's Advance Pricing Arrangement Program also serves to embed best practice. The process steps we use have also been incorporated into revisions to the case management support systems used by APA teams.

Managing an APA program of our size with such diverse and complex related party dealings APAs is always challenging. With more staff members undertaking APA work and sustained pressure on expert staff, we are continuing to invest heavily in staff training. This is directed beyond the procedural and technical aspects of the work to include an emphasis on the desired behavioural features we are looking to have the parties bring to an APA and which our revised processes seek to express.

GOING FORWARD

The implementation of our new APA practice statement has our processes more transparent and the evaluation of APA application is now more predictable. The changes we have made provide clear procedural steps that are underpinned by agreed and meaningful case plans.

We are also able to offer a variety of APA products that better match the facts, circumstances and complexity of the applicants' international related party dealings.

With a substantial pipeline of work in progress, we anticipate continued strong interest in the APA program.

MORE INFORMATION

For more information about APAs and annual compliance reports:

- write to us at
Australian Taxation Office
GPO Box 9977
MELBOURNE VIC 3001
- email us at TPGatekeeper@ato.gov.au

