



Australian Government
Australian Taxation Office

Advance pricing
arrangement
program
2008–09 update



MORE INFORMATION

For more information about APAs and annual compliance reports:

- write to us at
The Competent Authority
Transfer Pricing Practice
International Strategy & Operations – LB&I
PO Box 9977
MELBOURNE VIC 3001
- email us at TPGatekeeper@ato.gov.au

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01

Introduction

This update provides an analysis of the Advance Pricing Arrangement (APA) Program's completed cases for the financial year ended 30 June 2009.

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 assist 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 the companies' 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, followed by a formal application. Applicants can lodge their applications electronically if they wish.

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 2008–09

OVERVIEW

We completed 29 APAs in the 2008–09 financial year, made up of:

- 13 renewals
- 9 new APAs encouraged by compliance activity
- 7 unprompted new APAs.

Both large businesses (with revenue of more than \$250 million) and small to medium enterprises (SMEs) can request APAs. In 2008–09, 16 APAs were completed with large businesses.

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

- tangible goods for personal consumption and as business inputs
- IT software and hardware
- business and management services
- metal and mineral exports
- licensing and acquisition of both trade and marketing intangibles
- guarantee fees, financial services and currency trading.

The dealings were undertaken by:

- distributors and marketers
- service providers
- manufacturers and intellectual property owners
- financial services companies.

The principle covered transaction in nine of the 29 completed APAs was an import of goods, services or intellectual property. This is a higher proportion of outbound dealings to inbound dealings when compared with our typical annual mix of case completions.

Despite changing economic conditions, the APA Program has continued to attract fresh APA applications and renewals but at a slower rate than previous years.

PricewaterhouseCoopers (PwC) Legal has reviewed the program's administration and we released their report along with our response. The review found that the APA Program enjoys strong support from stakeholders in the taxpayer and adviser community, and within the Tax Office.

Whilst the report identifies a number of areas for improvement, PwC Legal acknowledges that we proactively introduced an enhanced transfer pricing management system in mid 2007, which addresses the majority of these areas. We have also been working with stakeholders to co-design features of the APA Program for the future.

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Prelodgment 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
- their preliminary views on the transfer pricing method
- the information they will need to give us so we can look at their request thoroughly before they lodge 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.

PwC Legal's review of the program also highlighted the importance of agreeing on the scope of the APA at an early stage. 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.

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.

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APA processing times

We normally aim to complete an APA within 12 months after the application is lodged. We expect the applicant 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 applicant and the foreign tax authority.

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

APAs completed in 2008–09 took, on average, 11 months to process from lodgment to finalisation, compared with 11 months in 2007–08.

The average time for completing:

- unilateral applications was 10 months, compared with 8 months in 2007–08
- bilateral applications was 12 months, compared with 16 months in 2007–08.

This year, on average:

- a renewal application took 20% longer to process compared to a new application. 11 large business APAs were renewals, which averaged 14 months to process. Generally a renewal application takes less time than a new application. In 2007–08, they took 30% less time
- an application involving a SME took 66% less time than one involving a large business, compared to 45% in 2007–08. 13 new SME APAs were completed in an average time of five months.

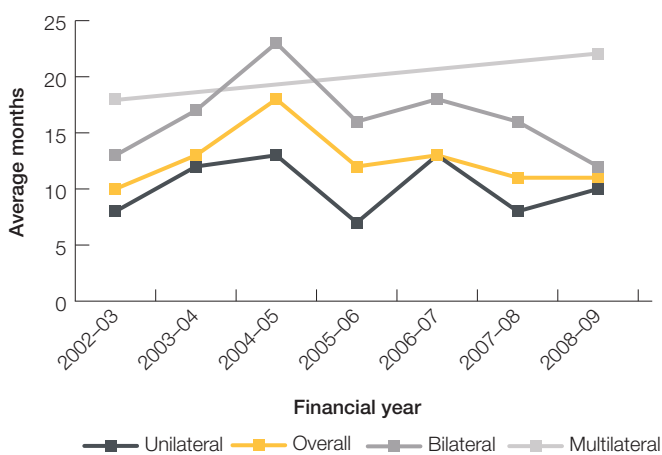
In seven SME APA applications, we undertook a compliance activity such as a transfer pricing risk assessment. Our knowledge of the businesses contributed to faster processing times for these applications, which were usually unilateral. The special attention given to streamlining SME APA processing has been successful.

This year, several unilateral applications did not proceed from lodgement to completion. In one case, we withdrew because there was disagreement on the scope of the APA. The applicant wanted the APA to be limited to specific transactions while we saw the arrangement as several inter-related transactions or arrangements that needed to be examined together. In two cases, the applicants withdrew because the APA was no longer needed due to changed needs or circumstances, including the reorganisation of their business.

Consideration of one bilateral application was deferred at the request of the applicant while related issues are resolved in another jurisdiction. It is likely that this APA will be revised and re-lodged in the future.

With the agreement of another revenue authority, consideration of another application was suspended after it was agreed that the company was likely to be in breach of the proposed critical assumptions for the foreseeable future.

FIGURE 1: Shows our performance over seven years.



Unilateral and bilateral APAs

The strong bias towards SME unilateral APAs and large business bilateral APA renewals has kept average processing times within the Tax Office standard as these are typically quicker types of applications to process. SME companies often prefer to make unilateral applications as they cannot justify the preparation costs associated with preparing and submitting a bilateral application.

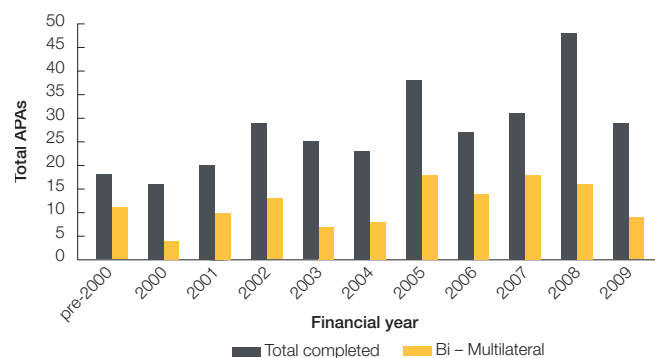
Some bilateral applications in progress with various jurisdictions are delayed for a variety of reasons, including:

- greater levels of analysis and more caution by some administrations in cases where the parent company has been adversely affected by the global financial crisis
- fewer bilateral meetings with tax treaty partners as a result of our cost constraints.

In 2008–09, bilateral and multilateral APAs were completed with Denmark, Japan, New Zealand, United Kingdom and the USA.

Over the life of the APA Program, the number of bilateral and multilateral APAs averaged 42% of the total APAs completed, but as **figure 2** shows, the proportion fluctuates year-to-year.

FIGURE 2



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Work in progress at 30 June 2009

The following table shows a snapshot of our APAs on hand at 30 June 2009 and their stages of progress.

TABLE: Current APA workload

	At 30 June 2008	At 30 June 2009
Pre-lodgment stage	20	15
Lodged and in progress	23 – includes 23 bilateral	39 – includes 30 bilateral

We frequently have preliminary discussions with companies about APAs. However, figures are only kept on formal pre-lodgment discussions.

Dealings covered and methods used

The table below shows the types of dealings covered by completed APAs covered in 2008–09. 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.

TABLE: APAs completed by type of dealing in 2008–09

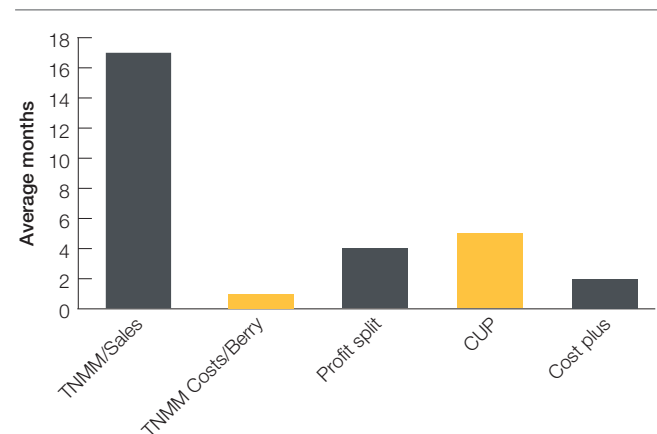
Type of dealing	Primary dealings	All dealings
Tangible property	21	21
Intangible property	3	5
Services	5	14
Total completed	29	

These three broad categories of dealings cover:

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

Figure 3 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 businesses 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.

FIGURE 3





Impact of the global financial crisis on APAs

Turmoil in global credit markets and the onset of recession in most of our trading partners' economies has, so far, only had limited impact on APAs that have been concluded and are in place. Few APAs have breached their critical assumptions but economic performance has varied considerably between industries and between industry sub-segments.

The transfer pricing methodology used in APAs frequently produce an agreed range of profit percentage outcomes calculated by reference to the revenue or costs of the business. As a result, the outcome for any one year can be within the range of profit percentage outcomes, even where the revenue or costs change. The absolute dollar value of the profits can also self-adjust but be within the agreed range of outcomes.

In most cases, APAs are written in anticipation of a business cycle over the life of the APA. Consistent results, largely unaffected by external factors, are achieved in some APAs where the tested party under the transfer pricing methodology has low or limited risks. In this situation, it is the counter-party to the dealings that experiences much greater variability in their earnings, commensurate with their higher risk profile.

Occasionally, in pre-lodgment discussions covering inbound dealings, we have had to highlight the relatively better economic performance of the Australian market from what has occurred in some other countries. Where there is particular uncertainty in the forecasts for the APA period, we have noticed some applicants have proposed shorter APA periods. In other cases, we have encouraged a sharper focus on the critical assumptions underpinning the APA. There has also been interest in deferring some APA applications until more certainty can be established where the current circumstances are too unpredictable for reliable planning. Some applicants have deferred preparing APA applications as part of their cost cutting.

Due to uncertain forecasting conditions, some applicants may need to consider a more sophisticated approach to dealing with their industry and enterprise circumstances. As long ago as 1997, we raised the prospect of flexible methodologies where the outcomes can vary according to a range of scenarios – see Appendix E of Taxation Ruling TR 97/20. This year, we have been able to reach agreement on APAs that adopt such flexible approaches, allowing them to accommodate the potential for significant changes in the businesses' economic environment.

Review of the Advance Pricing Arrangement Program

We commissioned PwC Legal as an independent third party to review and evaluate our APA Program and provide recommendations to improve its effectiveness and efficiency. The review involved seeking feedback from a variety of stakeholders, including businesses, tax advisers, industry groups and Tax Office personnel through surveys, group forums, interviews and written submissions.

The PwC Legal report identified 14 key recommendations intended to reinvigorate the program, improve its relevance to the needs of industry and make it more sustainable in the long term.

OUR RESPONSE TO THE PWC LEGAL APA REVIEW

We agree with the broad sense of the recommendations but we do not agree with each of the specific sub-recommendations.

- For more information about each of the key recommendations and our response, refer to:
 - *Australian Taxation Office – Review of Advanced Pricing Arrangement Program*
 - *Tax Office response to PwC Legal report on the APA Program review*

We plan to progressively implement the reinvigorated program until the end of June 2010.

CO-DESIGN PROCESS

The co-design process with the business community commenced in January 2009 through the APA Co-design Committee.

The APA Co-design Committee is a sub-committee of the National Tax Liaison Group – Transfer Pricing sub-group. It comprises representatives from the chartered accounting firms, peak accounting and taxation bodies and the Tax Office.

The committee is making good progress. The business community and our members are contributing equally and the process is expected to be complete by the end of the 2009 calendar year.

APA CO-DESIGN ISSUES

The APA Co-design Committee is working on a number of issues to be integrated with the Transfer Pricing Management System. These include:

- identifying, during the pre-lodgement phase, the issues that need to be agreed in advance between us and the business on the scope of an APA
- using our products to resolve other tax issues related to the covered transactions or arising during the period before the APA
- a simplified APA and a streamlined APA rollover or extension product for renewal of APAs with low risk related party dealings
- revising the present criteria for acceptance into the APA Program to focus on higher risk international related party transactions
- developing a project management framework for all APAs, whether complex or high risk, or simplified
- competency requirements and the role and responsibilities of the APA Case Leader
- the information businesses must provide to obtain an APA
- the timeframes and the decision points during the process at which the APA is subject to a review within the Tax Office
- establishing a circuit breaker or review mechanism that provides businesses with a right of review of our decisions where a standstill has been reached or we intend to withdraw from the APA process.