



Australian Government

Australian Taxation Office

Advance Pricing Arrangement Program 2009–10** update**



MORE INFORMATION

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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 2010.

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 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, 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.

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APA processing and program update for 2009–10

OVERVIEW

We completed 39 APAs in the 2010 financial year, made up of:

- 21 renewals
- 12 new APAs encouraged by compliance activity
- 6 unprompted new APAs.

Both large businesses (with revenue of more than \$250 million) and small-to-medium enterprises (SMEs) can request APAs. In 2009–10, 18 APAs were completed with large businesses and 21 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
- mineral exports
- licensing of marketing intangibles
- financial services
- contract R&D.

The dealings were undertaken by:

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

The principal transaction covered in 26 of the 39 completed APAs was an import of goods, services or intellectual property (IP).

During the year we co-designed a number of APA initiatives with stakeholders. The changes to the way we process applications are being progressively implemented and are discussed later in more detail.

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 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.

The discussions we had in co-designing aspects of the APA Program following the review of the APA Program (see 'Review of the Advance Pricing Arrangement Program on page 9) highlighted the role of the pre-lodgment step in achieving successful applications. It is important to agree on the scope of the APA at an early stage. This can affect how we assess 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 on the nature of the issues, we may deal with them before, during or after we consider 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 when making their APA proposals. As a result, it can take applicants significantly different lengths of time to progress to lodgment.

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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 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 applicant and the foreign tax authority.

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

On average, the APAs completed in 2009–10 took 12 months to process (five months median) from lodgment to finalisation, compared to 11 months in 2008–09. Sixty-four per cent of these APAs were completed in 12 months or less and 13% took 36 months or more. On average, four months were spent conducting pre-lodgment discussions for an APA.

The average [median] time for completing:

- unilateral applications was five [three] months, compared to 10 months in 2008–09
- bilateral applications was 25 [25] months, compared to 12 months in 2008–09.

This year, on average:

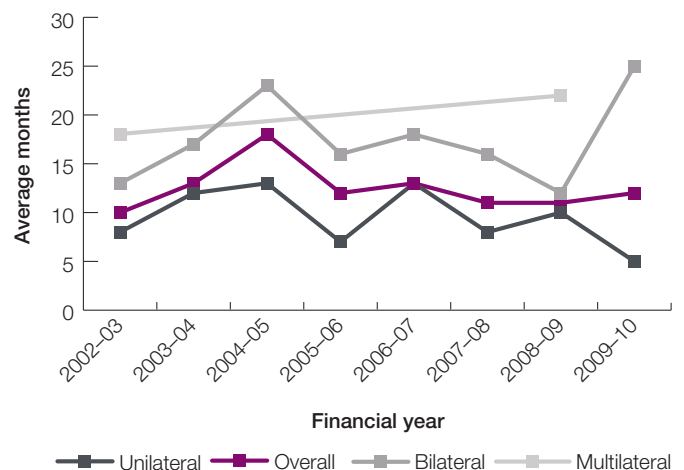
- a renewal application took 66% longer to process, compared to a new application. 13 large business and international (LB&I) APAs were renewals, which took an average of 19 months to process
- an application involving an SME taxpayer took 68% less time than one involving a large business taxpayer, compared to 66% in 2008–09. 13 new SME APAs were completed in an average time of four months.

In eight 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 we gave to streamlining SME APA processing has been successful.

In two cases, the applicant withdrew because the APA was no longer needed due to their changed needs or circumstances, including the reorganisation of the business.

Figure 1 shows our performance over eight years.

FIGURE 1: Average time in process: APAs by type



Unilateral and bilateral APAs

The strong bias towards SME unilateral APAs has kept average processing times within our target 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.

We have also been trialling the new streamlined APA processes for low value, low risk transactions described in 'Review of the Advance Pricing Arrangement Program on page 9.

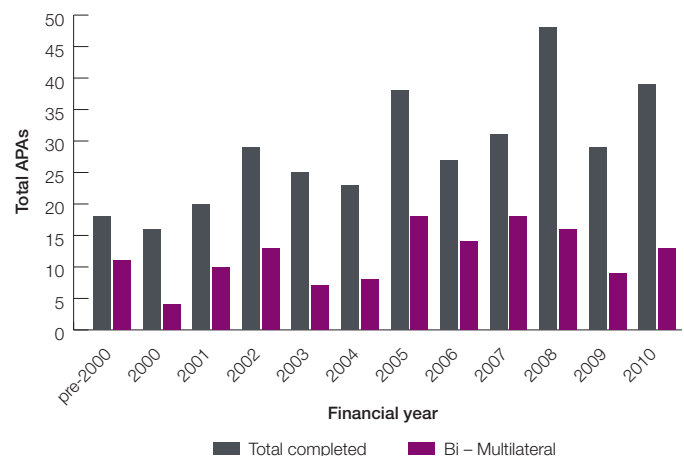
Last year's update reported that some bilateral applications in progress with various jurisdictions were delayed for a variety of reasons. Five LB&I bilateral APAs took about 36 months to complete for reasons that included:

- the other administration determining a policy position
- delays in providing or analysing information
- delays arising from the presence of different fact patterns to those disclosed in the application.

In 2009–10, bilateral APAs were completed with Korea, Japan, New Zealand, Switzerland, the USA and, for the first time, Singapore.

Over the life of the APA Program, the number of bilateral and multilateral APAs averaged 41% of the total APAs completed; however, as figure 2 shows, the proportion fluctuates each year.

FIGURE 2: Bi and Multilateral APAs completed over program life (includes renewals)



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Work in progress at 30 June 2010

Figure 3 shows a snapshot of our APAs on hand at 30 June 2010 and their stages of progress.

FIGURE 3: Current APA workload

	At 30 June 2009	At 30 June 2010
Pre-lodgment stage, including bilateral	15	17
Lodged and in progress, including bilateral	39	60

Issues and methods used

Figure 4 shows the types of dealings covered by APAs completed in 2009–10. 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 4: APAs completed by type of dealing (2009–10)

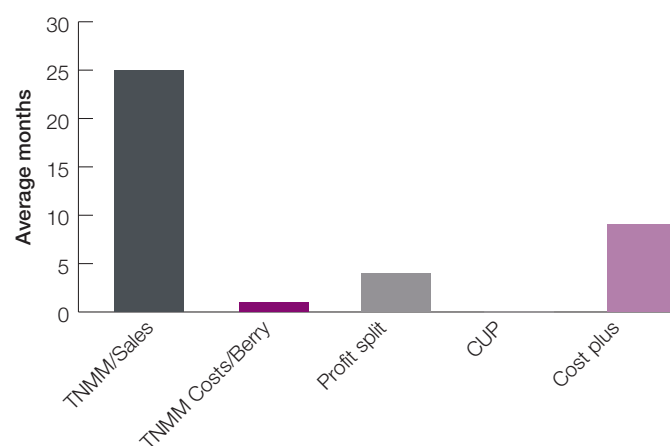
Type of dealing	Primary dealings	All dealings
Tangible property	26	26
Intangible property	3	3
Services	10	19
Total completed	39	

These three broad categories of dealings cover:

- the supply or acquisition of goods by marketers, distributors and manufacturers
- the sale of commodities
- the licensing of intellectual property
- services including selling, financial, 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 either be 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 transaction covered involved the acquisition or supply of services. Many of these were agreed using cost plus as the transfer pricing method.

FIGURE 5: APAs completed by primary method (2009–10)



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Review of the Advance Pricing Arrangement program

Following a review and evaluation of the program by PwC Legal in 2008–09, we established an APA co-design committee as a sub-committee of the National Tax Liaison Group Transfer Pricing Sub-Group to co-design aspects of the APA Program. The sub-committee was made up of representatives from the chartered accounting firms, the Corporate Tax Association and the ATO. The co-design process was highly cooperative and the stakeholder contributions have been very valuable. We have been progressively implementing the co-designed initiatives and expect to complete the implementation process by 31 December 2010. The co-design initiatives include the following:

1. Differentiating our APA processing so our level of examination matches the nature and complexity of the issues involved and the perceived level of transfer pricing risk.

We have developed the following range of new APA products that will comprise the updated program:

- Simplified APAs, APA renewal and APA term extension products developed for large and small-to-medium market taxpayers with low value and low risk international related party dealings.
- Standard unilateral and bilateral APA processes for standard international related party dealings.
- Complex APA process for complex and/or high risk unilateral or bilateral international related party dealings. These cases may have collateral tax issues that also need to be resolved.

2. The pre-lodgment phase will be expanded to better develop the scope of an APA and, where necessary, agree on the approach for the treatment of any collateral issues.

This will allow both the taxpayer and us to identify the:

- transfer pricing issues and agree to the transactions to be covered by the APA
- collateral issues to the APA and agree how and when they are to be resolved.

This should provide greater certainty while enabling applicants to understand that our examination of high risk or complex transactions will match the level of risk. This should ensure there are no surprises in the examination phase of the APA and that the application reflects the outcome of the pre-lodgment discussion.

3. A project management framework will be used for all APAs, supported by an APA case plan we jointly develop with the taxpayer.

The case plan will identify the information required from the taxpayer, the timeframes, and the milestones at which the APA is subject to internal case review.

4. Unilateral and bilateral APAs will follow a single process, led by APA Case Leaders in the LB&I industry segments and S&ME, eliminating inconsistencies of approach.

Roles and responsibilities for APA case team members including competency requirements have been developed.

5. A balanced scorecard reporting framework is being developed for the APA Program to identify and implement performance measures that will drive the behaviours to foster the success and sustainability of the APA Program into the future.

The framework is based on four focus areas, which are compliance program outcomes, transparent relationships, best practice process and governance, and people and culture.

6. A web based APA guide for the ATO's APA Program.

This guide will provide comprehensive information about the program. It will include an overview of the APA process and will highlight the key provisions and requirements, including the following:

- a more effective internal case review process that will be introduced at important milestones throughout the APA.
- the establishment of a review mechanism, which can be requested by the taxpayer when either the negotiations reach a standstill or we advise we plan to withdraw from the APA process.
- guidance on the information requirements for simplified and standard APAs, and complex and high risk APAs
- standardising the information requirements for a concise Annual Compliance Report (ACR) to minimise the compliance burden on taxpayers and ensure greater integrity of the information collected.

The APA guide will replace Taxation Ruling TR 95/23.

7. An improved training and development program is being prepared for our staff.