

BUSINESS

SEGMENT

BUSINESSES WITH
INTERNATIONAL DEALINGS

AUDIENCE

GUIDE

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INTERNATIONAL TRANSFER PRICING

Advance pricing arrangements



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ABOUT THIS GUIDE

This guide is part of a suite of publications about international transfer pricing produced by the Tax Office.

The other publications in the suite are:

- *International transfer pricing: introduction to concepts and risk assessment* (we recommend that you read this overview before reading the other guides)
- *International transfer pricing: applying the arm's length principle*
- *International transfer pricing: a simplified approach to documentation and risk assessment for small to medium businesses*, and
- *International transfer pricing: attributing profits to a dependent agent permanent establishment*.

This guide explains how businesses can use an advance pricing arrangement with the Tax Office to agree on how they will apply the arm's length principle in future years.

When we refer to 'you' in this guide we are referring to you as a business with international dealings.

The guide does not replace, alter or affect in any way the Tax Office interpretation of the relevant law as discussed in the various taxation rulings.

➤ MORE INFORMATION

If you need more information about international transfer pricing, you can:

- visit our website at www.ato.gov.au
- phone **13 28 66**, or
- write to us at GPO Box 9990 in your capital city.

If you do not speak English well and want to talk to a tax officer, phone the Translating and Interpreting Service on **13 14 50** for help with your call.

If you have a hearing or speech impairment and have access to appropriate TTY or modem equipment, phone **13 36 77**. If you do not have access to TTY or modem equipment, phone the Speech to Speech Relay Service on **1300 555 727**.

➤ The following Tax Office taxation rulings are relevant to the issues discussed in this guide:

- TR 92/11 – *Income tax: application of the Division 13 transfer pricing provisions to loan arrangements and credit balances*
- TR 94/14 – *Income tax: application of Division 13 of Part III (international profit shifting) – some basic concepts underlying the operation of Division 13 and some circumstances in which section 136AD will be applied*
- TR 95/23 – *Income tax: transfer pricing – procedures for bilateral and unilateral advance pricing arrangements*
- TR 97/20 – *Income tax: arm's length transfer pricing methodologies for international dealings*
- TR 98/11 – *Income tax: documentation and practical issues associated with setting and reviewing transfer pricing in international dealings*
- TR 98/16 – *Income tax: international transfer pricing – penalty tax guidelines*
- TR 1999/1 – *Income tax: international transfer pricing for intra-group services*
- TR 2000/16 – *Income tax: international transfer pricing – transfer pricing and profit reallocation adjustments, relief from double taxation and the mutual agreement procedure*
- TR 2000/16A – *Addendum – income tax: international transfer pricing – transfer pricing and profit reallocation adjustments, relief from double taxation and the mutual agreement procedure*
- TR 2001/11 – *Income tax: international transfer pricing – operation of Australia's permanent establishment attribution rules*
- TR 2004/1 – *Income tax: international transfer pricing – cost contribution arrangements*.

These rulings are available on our website at www.ato.gov.au

01

INTERNATIONAL TRANSFER PRICING AND ADVANCE PRICING ARRANGEMENTS

International dealings between related parties have been markedly increasing over the past decade. This development has provided some businesses with an incentive to structure their dealings so as to shift profits offshore, through a process known as transfer pricing.

All OECD countries have recognised the significance of transfer pricing and agreed that income and expenses should be allocated according to the arm's length principle. The arm's length principle uses the behaviour of independent parties as a guide or benchmark in allocating income and expenses in international dealings between related parties.

To enable Australia to get its fair share of tax revenue, the Tax Office must ensure that businesses operating in Australia declare a level of income that reflects a fair return for the activities conducted, the assets contributed and the risk assumed on the Australian side of the business. To do this, we maintain an extensive transfer pricing program that involves a mixture of education and enforcement activities.

The aim of the **advance pricing arrangement (APA)** program is to give businesses an opportunity to reach an agreement with the Tax Office on the **future application** of the arm's length principle in their international dealings with related parties, thereby resolving any uncertainty around these dealings.

APAs are negotiated in a cooperative environment in which the Tax Office and a business agree on a transfer pricing methodology that will result in an appropriate allocation of income and expenses between the related parties. A concluded APA generally lasts for between three to five years and may be renewed on an ongoing basis.

An APA can be concluded either bilaterally, which means it is binding on the Tax Office and the administration of another country, or unilaterally. A unilateral APA is concluded between the Tax Office and a business, but does not guarantee the agreement of the other tax administration.

This guide outlines the APA program.

➤ See TR 95/23 for more information about the APA program, particularly about the administrative procedures.

WHO CAN APPLY?

Any business with international related party dealings may apply for an APA. **Related party dealings** include any transactions, agreements or arrangements between:

- related separate legal entities
- a permanent establishment and its head office (or a subsidiary of its head office), or
- two permanent establishments of the same entity.

WHY CONSIDER AN APA?

APAs can provide significant benefits to a wide range of businesses because they can deal with real-time issues, including highly integrated operations and novel situations.

An APA may cover many different types of international dealings with related parties, including transfers of tangible or intangible property, services, cost sharing, global trading and global manufacturing. We acknowledge that intra-group dealings are often highly differentiated and/or integrated and that allocating profits and expenses between entities generally involves a degree of judgment.

In setting up an APA, we work with your business to gain a better understanding of the industry in which you operate, your business as a whole and the relative contributions of the various parties. An APA concluded in this environment provides certainty because it allows you to plan your activities and likely results over a number of years, secure in the knowledge that your transfer pricing policies conform with internationally accepted practices.

We prefer an APA to cover all of a business's international related party dealings. However, we may consider APA applications that are limited to specific groups of related party transactions.

APAS AND TRANSFER PRICING METHODOLOGIES

There are a variety of internationally accepted transfer pricing methodologies that your business can use to comply with the arm's length principle.

➤ For more detailed information about these methodologies and their practical application, see chapter 3 of TR 97/20. They are also discussed in general terms in *International transfer pricing: applying the arm's length principle* (NAT 2726).

Australia's transfer pricing rules do not prescribe any particular methodology or a preference for the order in which you apply the methodologies to arrive at an arm's length outcome. Accordingly, the use of a novel methodology may be appropriate if it achieves an arm's length outcome. The APA provides a process by which agreement can be reached on applying one specific methodology, several methodologies or a mix of methodologies in establishing the most appropriate transfer pricing method. Decisions about the suitability of a particular methodology will be based on the facts existing at the time.

CRITICAL ASSUMPTIONS

You must address any particular circumstances that are seen as central to your business operations, such that any change in them would materially affect the suitability of the transfer pricing methodology or the way it would need to be applied. They must be included in the APA as **critical assumptions**.

A critical assumption may be any fact about your business, 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 ongoing high value of an intangible asset on which a royalty payment is based. If this asset became obsolete or significantly devalued, the APA may no longer be valid.

We are administratively bound by a concluded APA, provided you comply with all the terms and conditions and there are no substantial changes to the critical assumptions. If there is a change in a critical assumption, you can apply to revise the APA.

WHAT ARE THE BENEFITS OF AN APA?

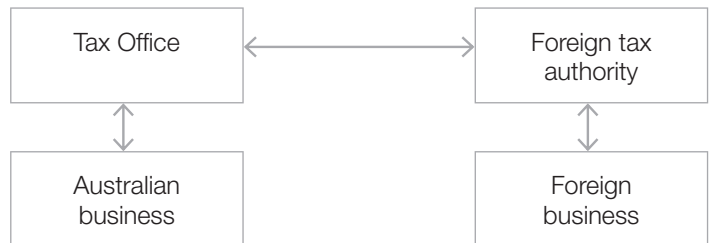
An APA is a prospective arrangement, negotiated in a cooperative environment. An APA:

- provides your business with certainty on an appropriate transfer pricing methodology, enhancing the predictability of tax treatment of your international dealings
- substantially reduces or eliminates the possibility of double taxation in the future
- provides a possible solution to situations where there is no realistic alternative way of both avoiding double taxation and ensuring that all profits are correctly attributed and taxed
- limits the prospect of a potentially costly and time-consuming examination of major transfer pricing issues that would arise in the event of a transfer pricing audit, and lessens the possibility of protracted and expensive litigation
- places your business in a better position to predict costs and expenses, including tax liabilities
- reduces the record keeping burden on your business as you know in advance what records you are required to keep to substantiate the agreed methodology, and
- reduces your business costs, as no fee is charged for the APA. The arrangement is designed to be completed within 12 months from when you lodge a formal application, providing a distinct advantage over the time and cost involved in a transfer pricing audit.

BILATERAL OR UNILATERAL APAS

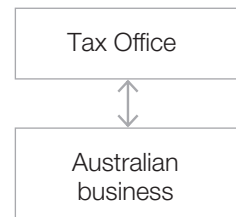
Bilateral APA

A bilateral APA is an arrangement between a business, the Tax Office and one or more foreign tax authorities. In bilateral APAs we negotiate with the other tax authority to reach an agreed position, as shown in the following flowchart. A bilateral APA provides certainty for businesses seeking to avoid double taxation.



Unilateral APA

Where an APA does not involve or require agreement with a foreign tax authority, or involves a country with whom Australia does not have a double tax agreement, the arrangement between a business and the Tax Office is called a unilateral APA. If there is a subsequent need for negotiations between the Tax Office and a foreign tax authority on the tax implications of the international dealings, the unilateral APA will form the basis of our negotiating position.



The following flowchart outlines the APA process. The key points are discussed in more detail on the following page.

STEP 1 PRE-LODGMET MEETINGS

The purpose of pre-lodgment meetings is to:

- discuss the suitability of an APA
- allow a business to provide a broad outline of the proposed transfer pricing methodology
- discuss whether the APA will be unilateral or bilateral
- discuss the required documentation and analysis
- determine whether independent expert advice is required
- discuss Tax Office audit activity (if an APA is to flow on from audit)
- agree on a date for lodging a formal application
- agree on the APA timetable, and
- discuss the process for evaluating the application.

Pre-lodgment meetings do not bind either party to the APA program.



STEP 2 LODGMET OF FORMAL APPLICATION

If proceeding with the APA, a business will be required to lodge a formal application.

The APA application should include:

- details of the proposed transfer pricing methodology, supported by relevant information
- terms and conditions governing the application of the transfer pricing methodology
- data showing that the transfer pricing methodology will produce arm's length results
- a discussion and analysis of the critical assumptions, and
- a suggested period of time for which the APA will apply.

For bilateral APAs we normally advise the treaty partner's tax authority once the application has been accepted.



STEP 3 ANALYSIS/EVALUATION

We evaluate the data submitted and other relevant information, and seek additional information where necessary. We normally have numerous meetings with a business.



STEP 4 NEGOTIATION AND AGREEMENT

For a bilateral APA, the relevant tax administrations exchange position papers outlining the acceptability of the proposed transfer pricing methodology. A written confirmation of the concluded agreement is provided to the business.

For a unilateral APA, we provide written confirmation of the agreement we reach with the business.



STEP 5 CONCLUDED APA

A concluded APA contains at least the following information:

- the transactions, agreements or arrangements covered by the APA
- the period and tax years covered by the APA
- the agreed transfer pricing methodology and the critical assumptions on which it is based
- the definition of key terms that form the basis of the methodology (for example, sales, operating profit)
- if applicable, a range of arm's length results, and
- the business's obligations as a result of the APA.

PRE-LODGMET MEETINGS

Pre-lodgment meetings are used to clarify what a business and the Tax Office expect from the APA process and what the business is trying to achieve. They give your business an opportunity to discuss with the Tax Office what information should be supplied and how to best present your case for an APA before lodging a formal application.

We generally prefer to have a number of pre-lodgment meetings so that the formal application more closely reflects an agreed position between the business and ourselves.

You may approach the pre-lodgment meeting anonymously, although the key facts and circumstances of the related party dealings will need to be provided for a meaningful discussion.

FORMAL APPLICATION

The application must incorporate the terms and conditions that will govern how the transfer pricing methodology is applied. The specific requirements of the formal application are discussed in detail during the pre-lodgment process.

WITHDRAWING FROM THE APA PROCESS

A business may withdraw from the APA process at any time.

HOW TO APPLY

To initiate the process, you should first request a pre-lodgment meeting to discuss the requirements of the APA. Your request should be made in writing to:

**The Competent Authority
International Strategy & Operations
Australian Taxation Office
PO Box 900
CIVIC SQUARE ACT 2608**

APAS AND AUDITS

The APA process is not intended to be used to determine matters relating to past years. However, we recognise that there may be situations where the principles developed in concluding an APA might provide a useful basis for resolving issues raised in any years subject to audit, as well as past years not yet under audit.

SECRECY AND DISCLOSURE

The information generated by the APA process relates directly to the income tax affairs of a particular business and is therefore subject to the same secrecy and privacy safeguards as if it was obtained during an audit or advising process.

