PS LA 2015/4 - Advance Pricing Arrangements

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PS LA 2015/4
Advance Pricing Arrangements

This Law Administration Practice Statement provides guidance to staff on Advance Pricing Arrangements.

This practice statement is an internal ATO document, and is an instruction to ATO staff.

If taxpayers rely on this practice statement, they will be protected from interest and penalties in the following way. If a statement turns out to be incorrect and taxpayers underpay their tax as a result, they will not have to pay a penalty. Nor will they have to pay interest on the underpayment provided they reasonably relied on this practice statement in good faith. However, even if they don't have to pay a penalty or interest, taxpayers will have to pay the correct amount of tax provided the time limits under the law allow it.

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1. What is this practice statement about?

1A. This practice statement sets out the Commissioner's practice and procedures and provides guidance to ATO staff in dealing with requests from taxpayers to enter into an advance pricing arrangement (APA).

1B. While this practice statement deals primarily with APA requests covering cross border dealings between separate entities, ATO staff are to apply the principles in this practice statement to requests for APAs involving the attribution of profits to permanent establishments.

2. What is an APA?

2A. An APA is 'an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustment thereto, critical assumptions as to future events) for the determination of the transfer pricing of those transactions over a fixed period of time.'[1] An APA is entered into by:

- in the case of a bilateral APA, the competent authority (CA) of the relevant tax administration and the ATO CA
- in the case of a multilateral APA, the CA of each of the relevant administrations and the ATO CA
- in the case of a unilateral APA, the ATO and the taxpayer.

2B. An APA deals with conditions operating between entities that satisfy the cross border test in subsection 815-120(3) of the *Income Tax Assessment Act 1997* (cross border dealings). The term of an APA will usually be between 3 and 5 years.

3. What is the context for entering into APAs?

3A. Many Australian based entities participate regularly in the ever-evolving dynamic market that is world trade. Multi-national entities and cross border dealings are critical to this global dynamic. As a necessary consequence, there has been an increasing focus and emphasis on transfer pricing and its impacts for revenue authorities. The ATO recognises that taxpayers face transfer pricing risks internationally and domestically. In particular, Australian based taxpayers face transfer pricing risks given Australia's transfer pricing rules are self-executing as part of the self-assessment regime.

3B. Charged with administering Australia's tax system, the ATO also faces risks posed by profit shifting and transfer pricing. By entering into APAs, the ATO places an explicit emphasis on assuring Australia's tax base by working with Australian based taxpayers to ensure corporate profits are reflective of the true economic contribution made by the Australian based enterprise.

3C. The ATO and most taxpayers will seek to manage and mitigate their respective transfer pricing risks. APAs provide an opportunity for all parties to mutually manage and mitigate on a prospective basis perceived risk(s) of entities getting transfer pricing benefits in a self-assessment regime. Having regard to the totality of the cross border dealings between the entities, the APA should be a practical and commercial outcome for the Australian entity and for the ATO.

3D. ATO staff are to be mindful of this context when they deal with requests for APAs. For the ATO, APAs are a mechanism for mutual management and mitigation of risk by providing taxpayers and the ATO alike with greater certainty for covered dealings during the term of the APA.

[1] Paragraph 4.123 of the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* as at 22 July 2010.

4. Why enter into an APA?

4A. As indicated above, parties enter into APAs for various reasons but primarily to mitigate risk. In so doing, the ATO commits to fostering constructive working relationships with mutual trust through early engagement, full and frank disclosure and negotiation in a cooperative environment.

4B. APAs also provide tangible benefits by decreasing the costs of compliance over the term of an APA. In this way, APAs contribute to government efforts to reduce red tape.

4C. APAs are a pragmatic strategy that foster cooperative tax compliance and prevent escalation of transfer pricing issues into disputes. An APA channels resources towards a preventative mechanism rather than a reactive one, such as an audit. Hence, an APA delivers further cost savings to the tax system.

4D. APAs are part of the ATO's:

- focus on proper tax administration
- program of providing taxpayers with advice, and
- maintaining tax system integrity through its assurance work.

4E. APAs give taxpayers the opportunity to reach agreement with the ATO on the method of application of the arm's length principle to their covered cross-border dealings on a prospective basis. APAs can assure the ATO that the taxpayer's actual conditions in respect of which the commercial or financial relations operate are consistent with the arm's length conditions on a prospective basis.

4F. Entering into bilateral or multilateral APAs minimises the potential for double taxation, reduces the need for the ATO to enter Mutual Agreement Procedure (MAP) negotiations to eliminate economic double taxation and provides greater certainty for all stakeholders.

4G. ATO staff are to tailor an APA to address the taxpayer's circumstances in a practical way with a view to providing the taxpayer with certainty as to their Australian tax position in relation to their covered cross border dealings.

5. What mutual expectations are there in developing APAs?

5A. The APA process is a co-operative one requiring mutual trust between the parties to achieve an effective outcome. In building that mutual trust as part of a constructive relationship, expectations that stakeholders may have of each other include:

- all parties will co-operate fully with each other, including undertaking open and ongoing dialogue in the development of the APA
- each APA request will be treated on its merits according to its own facts
- each party will act transparently, in particular each party is to disclose all relevant and material facts
- each party will provide prompt and complete replies to any reasonable queries.

5B. ATO staff are to approach APA requests on this basis. The mutual expectations above extend to the resolution of collateral issues (refer to section 22).

6. What makes the ATO more likely to enter into an APA?

6A. While single indicators may point in one direction or the other, ATO staff are to consider each APA request on balance having regard to all the relevant facts and circumstances in the context described in section 3. No one indicator is, of itself, determinative. However, transparency as to the material facts is essential.

6B. The ATO may be more likely to enter into an APA where one or more of the indicators set out below are present:

- the transfer pricing methodology proposed best achieves consistency with the OECD guidelines as at 22 July 2010
- the cross border conditions between entities (actual conditions) that are the subject of the proposed APA have already been entered into and the actual conditions are unlikely to change significantly in the period of the APA
- a proposed arrangement is under serious contemplation[2] and the proposed actual conditions are unlikely to change significantly in the period of the APA
- the transfer pricing issues are complex and there is uncertainty as to how the transfer pricing rules apply
- without an APA, the probability of economic double taxation is high.

7. What makes the ATO less likely to enter into an APA?

7A. Following on from section 6, the ATO may be less likely to enter into an APA where one or more of the indicators set out below are present:

- the actual conditions are simple or routine with arm's length conditions being relatively certain

[2] That is, the proposed arrangement will be entered into at a future point.

- the value of the cross border dealings is not material[3]
- the cross border dealings to be covered by the APA are only a small portion in terms of value of the total cross border dealings
- the proposed APA would not ensure there is alignment between true economic activity and profit outcomes in Australia (refer to section 4)
- collateral issues that affect the ATO's ability to enter into the proposed APA
- the arrangements that are the subject of the proposed APA appear to lack commerciality or be primarily tax driven, for example, the proposed APA covers activities which involve structures, restructuring or greenfields arrangements[4] where the commercial benefits to the Australian entity are questionable.

7B. The availability of carried-forward losses and meeting the eligibility criteria in Practical Compliance Guideline PCG 2017/2 *Simplified Transfer Pricing Record Keeping Options* do not preclude the ATO and the taxpayer from entering into an APA. However, in instances where a taxpayer has opted to apply the simplified transfer pricing record keeping options to some or all of its activities, the ATO considers that the taxpayer may be less likely to request an APA in respect of the cross border dealings covered by the simplified transfer pricing record keeping options.

7C. Where carried forward losses are available to a taxpayer, the APA team are to treat this aspect as a collateral issue (refer to section 22) and understand the reasons behind those losses being incurred.

8. What happens if an entity may get a transfer pricing benefit or anti-avoidance provisions may apply to the taxpayer requesting the APA?

8A. In identifying arm's length conditions, the law requires consideration of more than just pricing. This can include consideration of the global value chain, structures, functions, assets and risks, transfer pricing methodologies, etcetera. Consideration of such matters is part of the process of dealing with an APA request or application.

8B. In rare instances, the APA team may also need to consider whether the cross border dealings to be covered by the proposed APA might lead to:

- the Commissioner making a determination under Part IVA of the *Income Tax Assessment Act 1936* (Part IVA)[5] or,
- other specific anti-avoidance provisions may apply to the cross border dealings.

8C. Where the possible application of Part IVA or other specific anti-avoidance provisions may arise in relation to the cross border dealings to be covered by the proposed APA, the ATO will consider the transfer pricing issues arising as part of the APA request or application and the aforementioned matters concurrently. In such instances, this may result in the APA team making further enquiries in the early engagement stage.

8D. Analysis of the transfer pricing issues in tandem with the issues referred to in paragraphs 8B and 8C can potentially assist in the resolution of those issues. ATO staff are to use the most appropriate strategy and intervene as early as possible to resolve such issues and thereby reduce the potential for dispute.

8E. Consistent with the above approach, the ATO will also resolve such issues in parallel with progression of the proposed APA in instances where Part IVA or specific anti-avoidance provisions may apply to transactions other than those to be covered by the proposed APA.

8F. The APA team is to discuss the resolution of such issues with the taxpayer and factor it into the development of agreed plans (refer to section 10.4).

9. What stages does the APA process have?

9A. The APA process has three stages:[6]

- stage 1 - early engagement
- stage 2 - APA application
- stage 3 - monitoring compliance

9B. An APA request enters an early engagement stage before progressing to a formal APA application. Once the formal APA application is received, it passes to the APA application stage. After the parties have entered into an APA, there is a further stage of monitoring compliance.

9C. Stages 1 and 2 consist of a number of steps (refer to sections 10 and 13 for the steps in these stages).

[3] Refer paragraph 41 of Taxation Ruling TR 2014/8 *transfer pricing documentation and Subdivision 284-E* (TR 2014/8) for the meaning of the term 'material'.

[4] For example, direct investment where a parent company starts a new venture in a foreign country from the ground up.

[5] Decisions in relation to the application of Part IVA need to be made in consultation with the Tax Counsel Network. Refer to Law Administration Practice Statement PS LA 2012/1 *Management of high risk technical issues and engagement of officers in the Tax Counsel Network.*

[6] Refer to the process map at Attachment 1.

9D. The APA process is not necessarily a linear one. In particular instances, some steps or combination(s) of steps may need to be repeated. For example, if insufficient information is provided to support the APA request, the ATO may need to develop a greater understanding of the actual conditions or the application of the proposed methodology.

10. What happens in stage 1, the early engagement stage?

10A. Throughout the early engagement stage, ATO staff are to build the cooperative relationship essential to the entire APA process in order to reach mutually agreed outcomes. In building this type of relationship, it is necessary to align taxpayer and ATO expectations as much as possible.[7]

10B. For the ATO, this stage involves initially a robust and holistic strategic level review of the APA request and supporting documentation, including an examination of the relevant global value chain. In later steps of this stage, the ATO and the taxpayer will discuss the proposed APA in more detail. Throughout this stage and as part of planning for later steps and stages, the ATO will seek to develop a tailored product that meets the needs of the taxpayer.

10C. One of the initial steps in the early engagement stage is that the APA/MAP Program Management Unit (PMU) allocates a completed early engagement form[8] (containing the APA request) to an Operations team in Active Compliance in PG&I or PGH (APA team).

10D. In the early engagement stage, the APA team will:

- explain the APA process
- provide feedback on the APA request
- evaluate whether the taxpayer should be invited to apply formally for an APA
- develop agreed plans with the taxpayer, one for the APA request to proceed through the early engagement stage, and the other to conclude the APA itself.

10E. The steps in Stage 1 are:

- Triage
- Preliminary discussions
- APA request review workshop.

Triage

10F. Triage assists the PMU in determining whether an APA request can and should proceed further. Triage identifies whether there are material impediments to the ATO entering into an APA with the taxpayer by examining the information supplied by the taxpayer and the APA team (refer to section 10). Where necessary, the APA team may request further information, for example, where the APA team needs further clarification in respect of the cross border dealings or the global value chain.

10G. In preparation for triage, the APA team allocated with the APA request undertakes preliminary research. The APA team analyses and collates this research and the information supplied in the APA request[9] for the purpose of making a presentation at triage.

10H. The preliminary research is a profiling exercise which may include the following:

- the tax and compliance history of the taxpayer
- identifying any current interactions between the ATO and the taxpayer
- the taxpayer's performance under any prior APAs
- the taxpayer's transfer pricing documentation for the latest income year(s) lodged, where applicable
- the value of the taxpayer's total cross border dealings
- the value of the cross border dealings proposed to be covered by the APA
- other tax issues requiring consideration as part of the APA process.

10I. Whether taxpayer representations are made to the APA team in person prior to triage is at the discretion of the APA team leader.

10J. As part of providing advice to the PMU, the triage participants may:

- provide high level technical and risk advice
- examine preliminary technical analysis and review the related party transactions, the collateral issues and any relevant existing precedential ATO view documents

[7] Refer to section 5 and the web content on the Advance Pricing Arrangement page (APA Page) on www.ato.gov.au for more information regarding the mutual expectations for the APA process.

[8] While taxpayers may make an informal request for an APA via a letter or e-mail, the ATO's preferred method for taxpayers to initiate an APA request is to complete an early engagement form. The early engagement form is available from the APA page at www.ato.gov.au. This form details the information the ATO needs at this point.

[9] See the web content on the APA page on www.ato.gov.au for details of the information that should be included in an APA request.

- identify issues that may require referral to specialists such as the Economist Practice, the Technical Leadership Group (TLG) or other transfer pricing specialists in the Transfer Pricing Network to assist in progressing the APA request
- provide other important considerations and intelligence to the APA team including emerging risks or issues.

10K. Triage participants may include as appropriate:

- a representative from PMU who will lead the triage step
- the international profit shifting risk manager
- APA team members
- a CA
- a member of the team that currently manages the relationship between the ATO and the taxpayer
- a representative of the Operations Practice Manager's network
- a representative from the Economist Practice
- tax technical expert(s) from, for example, the TLG, Internationals or a special projects team.

10L. The PMU decides whether the request will proceed further based on the information it has received and advice from the triage participants. The preliminary discussion step is triggered if the PMU considers that the APA request can progress past the triage step.

10M. Where the PMU decides that the request is not to proceed further, the APA team leader will provide written reasons for that decision and notify the taxpayer that they can request an internal review if they are dissatisfied with the decision (refer to section 20).

Preliminary Discussions

10N. Preliminary discussions are held with the taxpayer as part of the cooperative relationship to explore avenues for the appropriate treatment of the covered cross border dealings and any collateral issues. Both parties will then know what to expect if and when the taxpayer lodges a formal APA application.

10O. Openly discussing the taxpayer's APA request should stimulate a free flow of information between all parties and lead to a more robust review of the request and any supporting documentation. Such discussions should better facilitate lodgment of a formal APA application and subsequent agreement to a workable and practical APA.

10P. During preliminary discussions, the APA team should:

- confirm the scope of the APA
- classify the APA (unilateral, bilateral or multilateral) and identify the appropriate APA product cycle time
- ensure appropriate ATO stakeholders are involved in the APA process (for example interpretive assistance, TLG)
- review and confirm the worldwide structure of the taxpayer group and the role of the Australian entity/(ies) within the global value chain
- identify the preferred transfer pricing method, methods or combination thereof of each party
- identify and confirm any collateral issues and agree with the taxpayer on the approach(es) to resolve those issues, for example, roll back of the APA result to income years prior to those covered by the proposed APA (refer to section 24)
- consider whether the taxpayer may need to address the exceptions to the basic rule in section 815-130 of the *Income Tax Assessment Act 1997* (ITAA 1997). If the APA team consider that it is possible that one of the exceptions to the basic rule in section 815-130 might apply, the APA team needs to discuss with the taxpayer whether this aspect needs to be addressed in the APA application
- agree with the taxpayer or their representatives an early engagement case plan up to lodgment of the formal APA application
- agree with the taxpayer a draft plan for completion of the APA after lodgment of the formal APA application
- in a bilateral or multilateral APA, keep the taxpayer informed to the best extent possible of discussions held with CA's of the other tax authority/(ies).

10Q. Once the scope of an APA is agreed, ATO staff are not to change it other than in exceptional circumstances, which may include one or more of the following:

- changes to the taxpayer's cross border dealings
- identification of a new issue with significant tax risk
- the need to interpret how the transfer pricing provisions apply to new cross border dealings
- new issues raised by the CA of a tax treaty partner.

10R. The APA team leader or CA as appropriate is to make any such change in consultation with the taxpayer.

APA request review workshop

10S. The main purpose of the APA request review workshop is to assist the APA team leader to make a decision on whether the taxpayer will be invited to lodge a formal APA application based on terms discussed previously. This workshop is an assurance process that facilitates consistency of approach across all APA requests.

10T. In developing the position to be outlined at the workshop, the APA team considers the information contained in the early engagement form, their preliminary research and the greater detail provided during the preliminary discussions. The participants[10] then review the information and the outlined position.

11. What happens after the APA request review workshop?

11A. The APA team leader decides whether the taxpayer will be invited to make a formal APA application, based on representations and discussions with the ATO. The CA[11] reviews and endorses or rejects the APA team leader's decision.

11B. Where the CA and APA team leader agree, the APA team will extend a written invitation to the taxpayer to lodge a formal APA application.

11C. Where, after discussion, the CA and the APA team leader do not agree, the APA team leader refers the matter to the head of the PMU for resolution.

11D. Where the APA team leader and CA consider that the APA request should not proceed to lodgment of a formal application but before any decision is notified, the APA team will allow the taxpayer to make further representations to the APA team leader.

11E. Where the APA team leader and CA do not accept the request, the APA team is to:

- provide written reasons for that decision, and
- notify the taxpayer that, if they are dissatisfied, they can request an internal review of the decision (refer to section 20).

[10] Participants will include to the extent possible those who participated in the triage step.

[11] In the case of a unilateral APA request, the CA acts in their capacity as an ATO employee at the EL2 level or above.

12. What does the APA team leader consider when deciding whether the ATO will invite the taxpayer to lodge a formal APA application?

12A. In determining whether the ATO will invite the taxpayer to lodge a formal APA application, the APA team leader should consider the taxpayer's relevant facts and circumstances in the context of the global value chain and other steps or arrangements with which they might be linked.

12B. The APA team leader should also consider these facts and circumstances against the matters listed below and any other relevant matters, rather than restrict their analysis only to the actual cross border conditions between entities ('actual conditions') that are the subject of the proposed APA.

12C. In addition to the indicators in sections 6 and 7, the matters the APA team leader is to consider can include whether:

- the information provided allows for a full and proper consideration by the ATO of the APA request
- there is an explanation that demonstrates that the actual conditions are relevant and material to the taxpayer's business[12]
- the transfer pricing risks and issues arising from the actual conditions warrant the allocation of resources required for an APA
- an APA is a suitable product for the taxpayer, given their classification in the Risk Differentiation Framework (RDF), the taxpayer's compliance history (locally and globally) and its performance under any previous APA
- one of the parties to the cross border dealings or an associate is likely to get a tax benefit from the structures, transactions or actual conditions that are the subject of the proposed APA and that tax benefit may be obtained to the detriment of another party to the dealings
- the transfer pricing method (TPM) proposed under the APA is unlikely to result in the taxpayer getting a transfer pricing benefit and the TPM best achieves consistency with the guidance material for the purposes of section 815-135 of the ITAA 1997
- in the absence of an APA, there is a likelihood that the actual conditions may result in double taxation or in a dispute
- a significant part of a limited life project has not yet been completed

[12] Refer paragraphs 41 and 47 of Taxation Ruling TR 2014/8 *transfer pricing documentation and Subdivision 284-E* for the meaning of the terms 'relevant' and 'material'.

- the ATO anticipates that the parties will agree all aspects of the APA in a timely manner
- collateral issues are capable of being resolved prior to or in parallel with the APA (refer to section 22).

12D. This list is not exhaustive. No one matter is determinative. Rather, any decision is to be made on balance after considering all relevant circumstances. Furthermore, one matter does not necessarily have any greater weighting relative to another.

12E. Such decisions involve the APA team leader using professional judgment in light of the APA team's analysis of these matters in relation to each taxpayer's facts and circumstances.

13. What happens in stage 2, the APA Application stage?

13A. Once the taxpayer accepts the ATO's invitation to lodge a formal APA application, the APA Application stage commences. In this stage:

- the APA team analyses critically and evaluates the APA application, including any associated documentation and comparability analysis
- the APA team develops an APA document containing the initial ATO position with which to enter negotiations
- the initial ATO position is quality assured at a workshop
- the terms and conditions of the APA are negotiated with a view to reaching agreement (refer to section 16)
- where agreement is reached, the relevant parties enter into an APA (refer to section 19).

13B. Accordingly, the steps in stage 2 are:

- Analysis and evaluation (sections 14 to 15).
- Negotiation (sections 16 to 18).
- Agreement (sections 19 to 20).

13C. The first two steps in stage 2 are iterative in that any initial ATO position may be developed further through the quality assurance workshop and the negotiation step.

ANALYSIS AND EVALUATION

14. How does the APA team analyse and evaluate the APA application?

14A. The APA team analyses critically and evaluates the APA application and the information in support[13] with the aim of verifying that:

- the proposed APA results in arm's length outcomes for the cross border dealings to be covered, thereby mitigating any transfer pricing risk
- there is sufficient information in support of the APA application so as to allow the ATO to fully evaluate it
- the proposal in the APA application is consistent with the taxpayer's request and preliminary discussions in the early engagement stage.

14B. To verify that the aims stated in paragraph 14A are satisfied, the APA team checks the APA application in respect of the matters listed below:

- transactions to be covered by the APA
- structures and the allocation of functions within different parts of the global group
- taxpayer's analysis of its functions, assets and risks
- resultant characterisation of the relevant cross-border dealings
- TPM proposed
- comparability analysis
- arm's length outcome proposed
- critical assumptions proposed

14C. The APA team can be guided by TR 2014/8 as to the extent of the documentation that the team can expect to be reviewing.

14D. If the APA team considers the aims listed in paragraph 14A are satisfied, further enquiry may not be necessary.

14E. However, when verifying whether the proposed APA results in an arm's length outcome and having regard to the totality of the cross border dealings between the entities, the APA team may need to make further enquiries of the taxpayer, such as:

- additional information requests to either the Australian business, offshore business, or both
- interviews with key personnel of the taxpayer or the tested party

[13] Refer the web content on the APA page on www.ato.gov.au for the list of information to be provided.

14F. Where the proposal in the formal APA application is not consistent with details arising from preliminary discussions, the APA team may request from the taxpayer an explanation as to the differences. Where there is insufficient information for the APA team to conduct a full evaluation of the APA application, the APA team are to request the information it needs.

14G. The APA team reviews the taxpayer's functional analysis, comparability study and, where applicable, suggested arm's length range. In verifying that the outcome(s) arising from the APA application is (are) consistent with the arm's length principle, the APA team may seek assistance from relevant specialists as necessary.

14H. If the APA team does not agree with the contentions in the APA application, the APA team negotiates with the taxpayer with a view to reaching agreement on the functional analysis, a comparability set and the arm's length outcome. If no agreement is possible, the ATO will withdraw from the APA negotiation.

15. How does the QA workshop examine the APA team's draft position on the APA?

15A. In the QA workshop, participants will:

- review the initial ATO position contained in the APA document and the information used by the APA team in the development of that position to verify that the content of the APA request demonstrates an arm's length outcome.
- assist the APA team leader to determine or revise the negotiation parameters for the APA, for example, the upper and lower limits of the matters to be included in the APA (refer to section 14)
- review progress of the resolution of collateral issues to ascertain whether these issues provide any impediment to entering into the APA.

15B. If, as a result of negotiations (refer to section 16), agreement cannot be reached within the original negotiating parameters, then the APA team leader or CA, as appropriate, is to seek further guidance from the QA workshop with a view to resetting the negotiation parameters.

NEGOTIATION

16. What approach is used in negotiating an APA?

16A. Negotiation is a mutual discussion and arrangement of the terms of a transaction or agreement.[14] In the context of an APA, negotiation refers to mutual discussions and an arrangement in respect of the transfer pricing of cross border dealings.

16B. In negotiating the terms of the APA, the APA team or the CA are to apply the skills and attributes of an effective negotiator. These include:

- full, frank and open communication
- consideration in the sense of being able to appreciate the perspective of others
- problem solving being the ability to creatively generate possible solutions and assess their appropriateness for the actual situation
- flexibility, in the sense of being open to adaptation or modification and having the willingness to yield at appropriate times, rather than having a fixed view or rigid attitude
- planning and organising by becoming familiar with the relevant information and determining the objectives
- acting professionally, including in particular exercising good judgement and appropriate discretion
- assertiveness, being the willingness to state the ATO's objectives and strive to reach agreement in a constructive and positive way.

16C. In negotiating an APA with each of the relevant parties, the APA team need to have regard to the totality of the arrangements between the entities and the APA being:

- one method by which a perceived risk of a transfer pricing benefit can be managed and mitigated in the self-assessment regime
- an inherently commercial and practical outcome for the Australian entity to which the ATO will commit.

17. Who negotiates an APA?

17A. In the case of a bilateral or multilateral APA, the Australian CA, in consultation with the APA team leader, will negotiate with the CA of the tax treaty partner(s).

[14] McMillan Publishers Group Australia, Macquarie Dictionary, viewed 23 June 2015; https://www.macquariedictionary.com.au

17B. Any exchange of information between CAs during the course of their negotiations is conducted in accordance with the Exchange of Information Article of the relevant taxation treaty. Exchanges between CAs of position papers in the course of negotiations are considered to be part of government – to – government business. Although the APA team will explain to the taxpayer the ATO's position, the position paper(s) of the CA of the tax treaty partner will not be supplied to taxpayers.

17C. In the case of a unilateral APA, the APA team leader will negotiate with the taxpayer, endeavouring to reach agreement on the terms of the APA.

18. What happens if no agreement can be reached?

18A. If, after using best endeavours, the CAs cannot reach agreement on the terms of a bilateral or multilateral APA in a reasonable time-frame, the CAs may request review by a senior official of the respective tax authorities.

18B. Similarly, if after using their best endeavours, the ATO and the taxpayer do not reach agreement on the terms of a unilateral APA, the ATO will withdraw from negotiations and finalise the APA request.

18C. In instances where agreement is not reached, the ATO may use subsequently the factual information disclosed during the APA process. ATO staff are not to use non-factual information provided by the taxpayer in the course of the APA process in any subsequent risk or compliance activity. This non-factual information includes opinions, lines of argument, judgements or conclusions about the operation and effect of the APA.

AGREEMENT

19. What does an APA contain?

19A. After negotiating the terms and conditions of a proposed APA with the relevant parties, the parties will usually have reached agreement at least on the matters set out below:

- the names, addresses and countries of residence for taxation purposes of the parties to the APA
- terms of the APA
- the cross border dealings covered by the APA
- the agreed TPM and how it is to be applied
- the arm's length amount, rate, range or other arm's length outcome
- critical assumptions any breach of which need to be notified to the ATO in writing
- a definition of each of the key terms in the APA
- a statement of the accounting standards on which the taxpayer's financial statements are based, for example, AIFRS
- procedures for making a compensating adjustment, if necessary

19B. Such matters are then stated in the APA. The APA or other associated agreement(s) also state(s) the taxpayer's documentation obligations for its 'annual compliance report' (ACR) (refer to section 21).

19C. An APA will define in advance any factors or assumptions that are so significant that neither party to an arm's length situation would continue to be bound by the APA if any of them changed. A critical assumption can be a fact about the taxpayer, an affiliate, a third party, an industry or general economic conditions that, if changed, would significantly affect the appropriateness of the substantive terms of the APA.

19D. The APA team determines the suitability of a particular transfer pricing method and its application on the basis of the facts, including projected facts.

19E. If the APA team considers that any changes in particular circumstances would materially affect the suitability of the transfer pricing method or its application under the APA, the APA team must include in the APA these circumstances as 'critical assumptions'. Critical assumptions should be included in the APA even where they are not within the taxpayer's or the ATO's control. This may include the APA team using a range of 'profit level indicators' (PLIs) to test whether or not the level of profit implied by the application of the entity's transfer pricing method results in outcomes that are replicated by outcomes observed in the open market. In formulating or reviewing proposed critical assumptions, the APA team needs to have regard to the areas within the global group that contribute to its profit, including the profit forecasts over the APA term.

19F. The APA needs to contain terms requiring a compensating adjustment(s) to account for instances where the tested party's actual result falls outside the agreed arm's length outcome as to price, range or result, but is within the critical assumption boundaries. These compensating adjustments are made to the tax position to achieve a price, point in the range or result that reflect the agreed arm's length outcome(s).

19G. Where necessary in the negotiation step, the APA team will have discussed with the taxpayer how a compensating adjustment is to be effected and the tax consequences of that adjustment.

20. What happens if the taxpayer is dissatisfied with a decision made by the APA team leader or the PMU?

20A. Where a taxpayer is dissatisfied with a decision of the APA team leader or the PMU and the issue cannot be resolved by the parties, the taxpayer may seek internal review. For example, the ATO:

- does not accept the APA request
- and the taxpayer do not reach agreement on the scope of the APA
- withdraws from the APA
- and the taxpayer reach a standstill in the APA process.

20B. This review is undertaken by the head of the PMU, or another senior officer with no prior involvement in that APA process. If the taxpayer is still dissatisfied after this internal review, they can seek a further review by the head of the APA Program.

21. What happens in stage 3, the monitoring compliance stage?

21A. Under the terms of the APA, the taxpayer prepares and lodges annually an ACR signed by the public officer for each income year covered by the APA. The ACR need contain only sufficient information to detail the actual results for the relevant year and to demonstrate compliance with the terms of the APA. This level of documentation should provide cost savings to taxpayers.

21B. The ACR is reviewed within a PGI Operations or PGH team (ACR reviewer). This review includes:

- checking whether any of the critical assumptions listed in the APA have been breached, and
- confirming that the terms of the APA have been met.

21C. Where the ATO is of the opinion that one or more critical assumptions or terms of a bilateral or multilateral APA have been breached, the CA[15] will inform the CA of the tax treaty partner that the ATO is of that opinion. The CAs will discuss how to treat the breach under the MAP article of the relevant tax treaty(s).

21D. Where a critical assumption(s) or a term(s) of a unilateral APA is (are) breached, the ACR reviewer will inform the taxpayer and enter into discussions to obtain an explanation. The ACR reviewer determines how to treat the breach. In appropriate instances, the ACR reviewer may revise, modify, suspend or cancel the APA, for example, where the breach is a material one.

21E. The ACR reviewer should examine the ACR to determine:

- if the taxpayer is reporting results below or at the low end of any ranges specified in the terms of the APA without sufficient evidence demonstrating that external factors have caused this to occur
- where applicable based on results that are outside any of the agreed ranges, whether the taxpayer has made compensating adjustments so as to effect a move to the closest point in the relevant ranges.

21F. The ACR reviewer examines these compensating adjustments to verify they achieve a price, point in the range or result that is consistent with the agreed arm's length outcomes; for example, in instances where a profit fell outside the agreed arm's length range under the transaction net margin method.

21G. The ACR reviewer also needs to check whether the type of results specified in section 21 are occurring consistently over the term of an APA. In such instances, the ACR reviewer is to note this for an APA team to take into account when dealing with any renewal request on similar terms.

22. What is a collateral issue and how does the APA team deal with these?

22A. A collateral issue is:

- an administrative or tax issue in relation to the taxpayer's affairs
- in addition to the cross border dealings the subject of the APA, and
- relevant to, and can potentially affect, the outcomes of the APA.

22B. The existence of collateral issues (for example, the possible applicability of anti-avoidance rules) may make it inappropriate for the ATO to proceed with an APA.

22C. Where possible, collateral issues should be addressed and resolved in parallel with the development of the APA. The APA team should attempt to ensure that any collateral issues are resolved on or before the ATO enters into the APA. If this is not possible, then the APA team must ensure that the issue is being dealt with appropriately within the ATO.

[15] The CA may consult the officer reviewing the ACR and, if necessary, the APA team in coming to this opinion.

22D. The taxpayer and the ATO will need to discuss at the preliminary discussion step how collateral issues are to be addressed. Options for the APA team in getting collateral issues addressed may include:

- recommending that a request for a private binding ruling, or other interpretive assistance product, be lodged by the taxpayer
- referral to TLG and/or Tax Counsel Network (TCN)
- referral for risk assessment according to normal business line procedures.

22E. Where the taxpayer requests a private binding ruling in relation to a collateral issue, the APA team is to ensure they are aware of any implications the outcomes of the private binding ruling may have on the APA request.

22F. Where there is no ATO view in respect of a collateral issue or that issue has implications beyond the APA under consideration, the APA team leader is to escalate the technical issues using normal business line procedures.

23. What are the roles of the officers involved in developing an APA?

23A. Many ATO staff, who effectively form a multidisciplinary team, contribute to the development of APAs. In performing their role, each staff member needs to focus on using a pragmatic approach to develop an APA. Entering into an APA not only enables all parties to mitigate potential transfer pricing risk(s) but it also delivers mutual benefits such as cost savings and enhanced relationships over the term of the APA.

23B. In order to reach agreement, officers must build collaborative relationships with each of the relevant stakeholders based on mutual trust and transparency.

23C. A description of some of the roles of such officers is set out below.

APA team leader

23D. The APA team leader has overall responsibility for the APA request. Specific roles and responsibilities of the APA team leader include:

- deciding in consultation with other APA team members whether the proposal results in practical outcomes acceptable to all stakeholders
- communicating the ATO position, reasoning and status of the APA application to the taxpayer
- in consultation with the taxpayer/advisor, settling on tailored APA case plans for the early engagement and APA application stages, in particular the timeframes for developing the APA
- being accountable for the APA team actively managing the request and application, ensuring milestones, timeframes and assurance and reporting requirements are met
- setting the negotiation parameters subsequent to consultation at the QA workshop
- settling the content of position papers and the terms of the APA for endorsement by the CA
- arranging QA workshops as required to consider the progress of the APA request
- involving and co-ordinating the input of technical specialists,[16] as required
- co-ordinating the resolution of collateral issues with the APA process
- a functional analysis
- engaging with case leadership or other senior ATO staff early, particularly where significant blockers or delays are encountered.
- seek further information to support the APA request at the triage stage, if required.

23E. The APA team leader can empower APA team members to perform particular tasks as applicable and appropriate.

The APA team

23F. The APA team performs the day to day activities of developing the APA. The members of the team assist the APA team leader in carrying out the tasks involved in developing an APA as listed in paragraphs 10F – 10H, 10P and 22D. See also the tasks at section 12.

The economist

23G. An economist from the ATO's Economist Practice assists the APA team leader, the APA team and, where applicable, the Competent Authority to critically analyse whether the taxpayer's proposed actual conditions are likely to be consistent with arm's length conditions. More specifically, an economist may assist by:

- evaluating the related party transactions in the context of the taxpayer's business, industry and global value chain
- analysing the arrangement's important functions, assets and risks and other factors of comparability that may affect arm's length conditions

[16] For example, the economist practice, special advisors, ISAPS, TLG or TCN.

- advising on the transfer pricing method (and its application) that best achieves consistency with the OECD Guidelines
- where necessary, select and apply the most appropriate transfer pricing method and performing related benchmarking analyses; and
- identify any other economic aspects that may affect the alignment of a taxpayers Australian economic activity with its profit outcomes.

23H. The extent of involvement of an economist is determined on a case-by-case basis and is dependent on the factors listed at paragraph 24 of PS LA 2013/2.

The senior tax official/CA

23I. The CA is authorised to enter into a bilateral or multilateral APA. The CA negotiates the terms of the APA with the CA of the relevant tax treaty partner within the parameters set by the APA team leader.

23J. In a unilateral APA, an ATO staff member authorised as a CA, but acting in their capacity as an ATO employee, can endorse the decision of the APA team leader and signs the APA. In these instances, the CA's role is to ensure the consistency and acceptability of the approach the ATO applies to each APA.

23K. In instances where there is disagreement between the APA team leader and the CA, rather than the endorsement referred to above, the matter should be escalated to the head of the PMU or the head of APA program, as appropriate.

The PMU

23L. The PMU has overarching responsibility for the administration of APAs. This includes:

- allocate an APA request to an APA team
- identify participants, convene and chair the triage workshop
- determine whether the request can progress past the triage workshop

23M. The head of the PMU reviews decisions regarding suitability for an APA if required.

24. When will the ATO apply to prior income years the transfer pricing methodology used in an APA?

24A. Transfer pricing issues that arise in income years prior to the commencement of the APA should be treated as collateral issues (refer to section 22). Where the principles developed in concluding an APA provide a reasonable basis, one approach to dealing with such issues may be to apply the methodology used in the APA to the prior income years (roll-back).

24B. The APA team leader should consider whether the principles developed in concluding an APA provide a reasonable basis for resolving transfer pricing issues in prior years. This would depend on the availability of all relevant information in respect of the prior years and whether there are any material changes in the taxpayer's circumstances in those years.

24C. The ATO's practice in relation to roll-back depends on the taxpayer's circumstances. However, matters involving prior income years are to be resolved using an active compliance product. Any decision on whether roll-back for years prior to an APA is made on a risk assessment basis.

24D. So as to leverage outcomes as much as possible, officers considering roll-back are to apply the matters set out in the next paragraph.

24E. Subject to the facts and circumstances of a particular case, the general rules are that the ATO:

- will not seek roll-back where the transfer pricing issues for prior years are rated as low risk under business line risk assessment procedures
- will be more likely to seek roll-back for a lesser number of years in the case of a voluntary APA request than it would be for a case resulting from ATO compliance activity
- is likely to seek roll-back for issues rated as high risk.

24F. The APA team leader, the taxpayer and, where applicable, the audit team leader should agree how and when the prior years' issues should be resolved.

24G. ATO staff are to treat as a voluntary disclosure any amendment to prior years arising from roll-back where the following are satisfied:

- active compliance has not already been commenced, or
- the ATO has not initiated compliance or risk activity with respect to the prior year returns, and
- as a result of providing information for an APA, there is a need to amend a prior year return.

25. What are the interactions between APAs and ATO audits?

25A. An APA does not preclude a taxpayer from a risk review or audit (active compliance product) of its business overall. ATO staff are to treat active compliance products and APA development separately, unless the taxpayer's facts and circumstances are sufficiently similar to enable the methodology used in the APA to be applied to the income years under active compliance review.

25B. However, leaving aside the annual compliance review process (refer to section 21), the ATO will not undertake active compliance in relation to cross border dealings which are the subject of an APA unless it has reason to believe that the taxpayer has omitted or provided incorrect information that is material and relevant. Furthermore, the ATO will not duplicate in an active compliance product work already undertaken as part of the annual compliance review process.

25C. Where an APA does become part of the focus of active compliance product, ATO staff may verify that the:

- taxpayer has complied with the terms of the APA
- agreed transfer pricing methodology has been correctly applied
- taxpayer's APA application and associated documentation reflect appropriately the material facts.

25D. ATO staff are not to have such active compliance products involve the acceptability of the transfer pricing methodology agreed as part of an APA unless the omitted or incorrect information mentioned above affects such matters.

25E. ATO staff are, generally, not to discontinue or postpone active compliance activity in respect of certain income years where the taxpayer applies for an APA in respect of subsequent income years.

25F. However, the active compliance product may be deferred or discontinued where all parties agree that the APA will assist in resolving these issues.

25G. The active compliance case manager and APA team leader or CA, as appropriate make such decisions after consideration of:

- the taxpayer's facts and circumstances
- any advice and recommendations from the APA team, and
- the factors listed in the next paragraph.

25H. The decisions referred to above about how the ATO is to co-ordinate APA and active compliance processes requires consideration of the following factors:

- the co-operation and assistance provided by the taxpayer
- the stage of completion of the active compliance activity
- the issues in question
- the similarities between the facts and circumstances in respect of the income years under active compliance review and the APA request.
- the relevance of information supplied as part of the APAS request to the prior income years
- whether there is likely to be any significant differences between the outcomes under the active compliance activity and the APA and the reasons for any differences.
- whether it is possible to finalise part of the active compliance activity and leave the issues related to the APA in abeyance
- whether entering into an APA will assist in resolving the issues in the active compliance activity.

26. What does the APA team do when they receive a renewal request?

26A. While an APA renewal request goes through the same stages and steps outlined above for an initial request, the APA team are to:

- seek the consent of all parties to the renewal of the APA
- where appropriate and as much as possible having regard to the totality of the cross border dealings between the entities, streamline the process so as to reduce the time involved and documentation provided in dealing with such requests.

26B. The circumstances where it may be appropriate for the APA team to streamline an APA renewal process include:

- there have been no material changes to the covered cross border dealings or the role of the Australian entity/(ies) within the global value chain
- there are no proposed changes to the terms of the APA, and
- it is unlikely there will be material changes to the dealings over the course of the period of the renewed APA.

26C. In a streamlined process, generally the APA team would only need to assure itself that:

- entering into an APA with the taxpayer is still appropriate, including the proposed APA producing arm's length outcomes
- the previous APA produced arm's length outcomes
- there have been no material changes to the covered dealings
- the updated benchmarks are appropriate, and
- the taxpayer has complied with the terms of the existing APA, as evidenced by the ATO's review of the ACRs lodged.

27. When might the ATO use independent experts?

27A. ATO staff are to seek independent expert advice only in exceptional circumstances, for example, where all parties agree that a greater understanding of the relevant industry is needed. The APA team will discuss this aspect with the taxpayer in the triage step or application stage.

27B. The APA team is to share the expert's advice with the taxpayer. However, its release depends on finalisation of the ATO position in respect of the expert's advice and any confidential third party information in that advice.

28. When might the ATO revise or cancel an APA?

28A. Despite the co-operative environment built on mutual trust being an essential part of the APA process, taxpayers may in rare instances omit or not provide correct information.

28B. Where ATO staff have reason to believe that the taxpayer has provided information or made statements in relation material matters that are false or misleading or omits matter(s) without which make the information or statements false or misleading, ATO staff are to review the APA with a view to determining whether it should be revised or cancelled.

Date issued 23 July 2015

Date of effect 23 July 2015

29. What is the authority for entering into an APA?

29A. The Commissioner can enter into a unilateral APA by virtue of the general power of administration conferred on the Commissioner by section 1-7 of the *Income Tax Assessment Act 1997*.

29B. An authorised CA signs and enters into a bilateral or multilateral APA under the MAP Article of the relevant tax treaty.

29C. The Commissioner has delegated his power to act as a CA to officers in specified positions under written instruments. Those delegated officers have also authorised nominated officers to exercise the power as CAs on his or her behalf. This power includes the ability of the CA to negotiate an APA directly with the CA of a tax treaty partner.

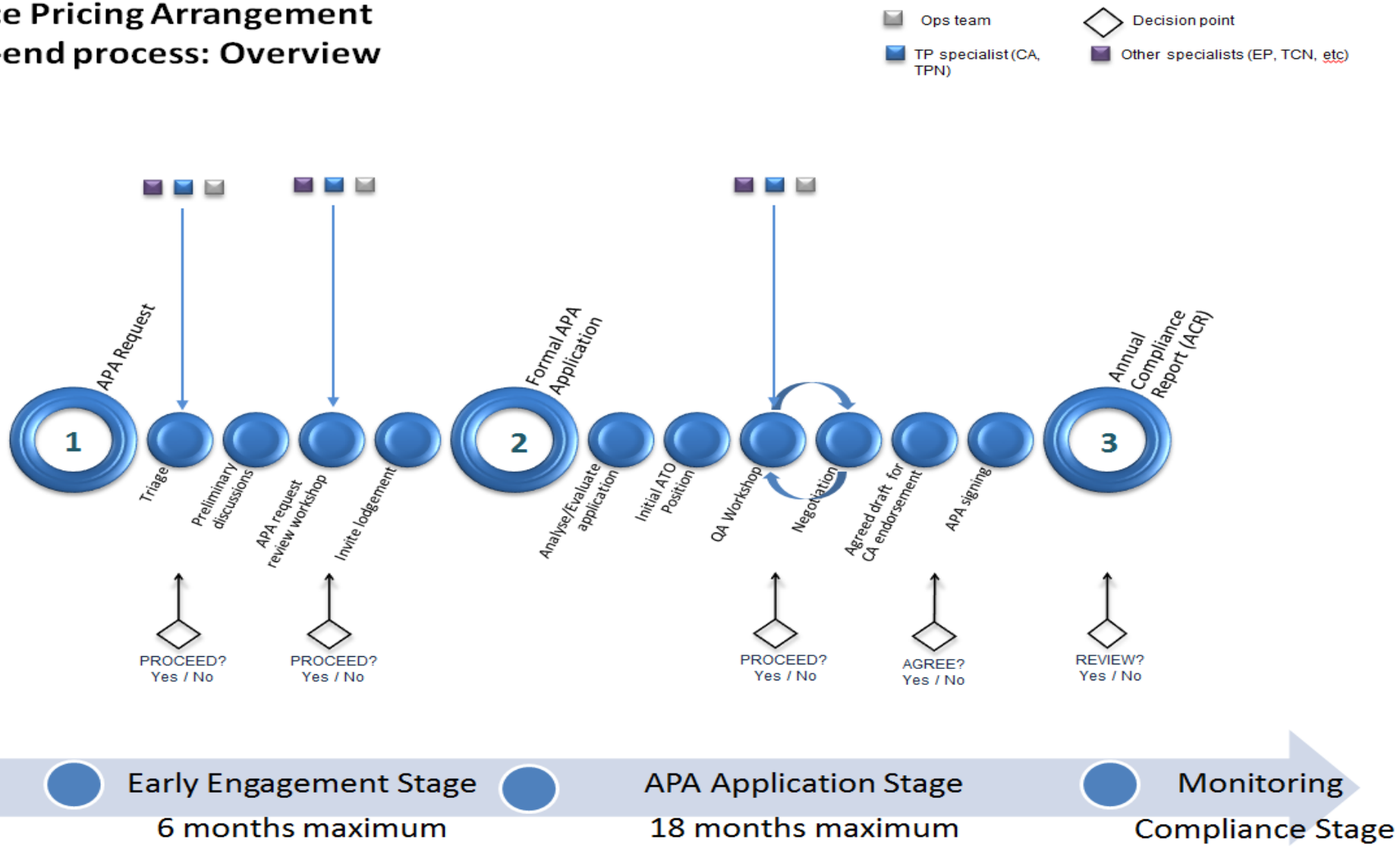
30. Process Map

30A. An end-to-end map of the APA process is contained in Appendix 1.

31. More information

31A. For further information, please refer to the web content on the APA page at www.ato.gov.au.

Advance Pricing Arrangement end-to-end process: Overview



Australian Government
Australian Taxation Office

APA process – Stage 1

Applicant

Contact ATO at InternationalsGatekeeper@ato.gov.au

- Taxpayer/advisor to provide summary of APA request including:
  - Outline of application
  - Global group structure
  - Role of Australian entity within the global value chain
  - Parties involved
  - Covered cross border dealings
  - Extent of all cross border dealings
  - Transfer pricing methodology proposed
  - Collateral issues
- Commit to mutual roles / responsibilities
- Ensure appropriate client personnel in attendance
- Documentation to be provided
- Arrange discussions / meetings as required to progress application in line with agreed case plans
- Issues / concerns communicated in a timely manner
- Provide additional information if required
- Focus is on timely, comprehensive and relevant information / documentation
- Have resources available to prepare APA application
- Focus is on timely, lodgement of APA application with relevant information / documentation
- APA application lodged with agreed to accompanying documentation.
- Sufficient information to enable ATO to fully understand the transactions and the context in which they occur

Triage | **Preliminary discussions** | **APA Request Review Workshop** | **Accept into APA Program / Invite Lodgement** | **Formal APA Application Lodged**

Start

ATO

Outline process, objectives and summary information required

Profile taxpayer and review summary information provided with a view to deciding:

- Whether to invite CA to attend
- Any education & assistance required for the taxpayer
- Whether APA early engagement is to proceed
- Whether collateral issues and/or other tax technical issues/risks require consideration
- Whether any further information is required for a further triage

- The scope of the APA
- Commit to mutual roles / responsibilities
- Agree on early engagement case plan and a draft plan for completion of the APA
- Ensure involvement of appropriate specialists
- Ensure key ATO Stakeholders attend (inc. CA)
- Consider whether the exceptions in section 815-130 may need to be addressed
- Consider whether the proposed APA should be unilateral or bilateral
- Identify information & documentation needs, including any key decision makers to be interviewed.
- Arrange discussions / meetings as required to progress application in line with agreed case plans.
- Ensure any Issues / concerns are communicated in a timely manner

Review summary and any other information and decide:

- Whether taxpayer will be invited to lodge an APA application
- Scope of the proposed APA, including dealings covered, term of APA, unilateral or bilateral
- Collateral issues to be addressed and the appropriate mitigation process
- Transfer pricing methodology preferred by the ATO

- Advise taxpayer of outcomes of QA workshop
- Invite lodgement of APA application

- Acknowledge application
- Process application in accordance with draft APA plan.
- For bilateral APAs, advise tax treaty partner of the application.

Australian Government
Australian Taxation Office

APA process – Stage 2

Applicant

Analyse/Evaluate APA Application	Initial ATO Position	Quality Assurance	Negotiation	Agreed Draft for CA Sign-off	APA Signed
▪ Provide additional information if required ▪ Focus is on timely, comprehensive and relevant information / documentation ▪ Arrange discussions / meetings as required to progress application in line with agreed case plans ▪ Issues / concerns communicated in a timely manner	▪ Provide additional information if required ▪ Ensure all requirements for dealing with collateral issues have been met ▪ Ensure that foreign affiliates meet the requirements of the APA process in the other jurisdiction ▪ Issues / concerns communicated in a timely manner	▪ Provide additional information if required	▪ For unilateral APAs the taxpayer will use its best efforts to arrive at an agreement for the APA ▪ Provide the same information to each treaty partner ▪ Cooperate fully with the ATO and the other treaty partner in the negotiation of the APA.	▪ Issues / concerns communicated in a timely manner ▪ Provide additional information if required	▪ Taxpayer to consider negotiated APA and sign or reject APA

ATO

Analyse/Evaluate APA Application	Initial ATO Position	Quality Assurance	Negotiation	Agreed Draft for CA Sign-off	APA Signed
Review APA application with a focus on: ▪ Verifying there is sufficient information for the ATO to fully understand the transactions and the context in which they occur ▪ Updating the case plan ▪ Identifying & engaging relevant stakeholders and experts ▪ identifying tax technical and international issues / risks ▪ Identifying and addressing collateral issues ▪ Verifying that the proposed methodology is appropriate	▪ Determine the initial ATO position on the APA for negotiation with the taxpayer (unilateral) or with the other tax authority (bilateral) ▪ Confirm treatment strategy for collateral issues in parallel to the APA where appropriate ▪ Determine the initial ATO position on other tax technical and international issues / risks	Review initial ATO position and decide: ▪ Scope of proposed APA, including dealings covered, term of APA, unilateral or bilateral ▪ Collateral issues and appropriate mitigation process ▪ Whether the initial position represents the ATO view ▪ The negotiating parameters ▪ Other tax technical and international issues/risks	▪ CA is responsible for negotiating a bilateral APA with the tax treaty partner ▪ The APA team will negotiate a unilateral APA on behalf of the ATO ▪ For bilateral APAs, if negotiations fail to advance the CA will consider seeking senior officer review ▪ Identify and agree any critical assumptions ▪ Have QA team endorse any negotiated changes to the previously agreed terms of the draft APA.	▪ APA team to draft the APA incorporating the negotiated elements	▪ CA to process APA in a timely manner and provide to taxpayer for signature

Australian Government
Australian Taxation Office

APA process – Stage 3

Applicant

Taxpayer/advisor to provide an Annual Compliance Report for each year of the APA by the agreed due date including:

- Actual results for the year
- Information to demonstrate compliance with the terms of the APA
- Annual Compliance Report Summary Document in the approved format
- Statements and any supporting documents to demonstrate that critical assumptions are still applicable
- Any further information requested by the ATO if required

Annual Compliance Report

ATO

Review Annual Compliance Report with focus on:

- Whether the taxpayer has complied with the terms of the APA
- Whether the critical assumptions were met or adhered to