



# TRANSFER PRICING WORKSHOP ON DISPUTE RESOLUTION AND AVOIDANCE (MAP AND APA)

**8. Advance Pricing Arrangements (APA) Introduction and Overview  
Legal Basis**



## Agenda

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- What is an Advance Pricing Agreement/  
Definition of APA
- Legal Basis of an APA
- Dealing with the TP-Methodology
- Unilateral/Bilateral/Multilateral?
- Trends in APAs: 20 Years of History
- Benefits of APAs and their Disadvantages



# WHAT IS AN ADVANCE PRICING AGREEMENT / DEFINITION OF MAP APA



# What is an Advance Pricing Arrangement?

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- APA = Advance Pricing Arrangement
  - “Advance” – sets transfer pricing treatment prospectively
  - “Pricing” – concerns any transfer pricing transaction with related party or parties
  - “Arrangement” – the taxpayer(s) and tax authority(ies) agree
- Arrangement between a taxpayer and one or more national tax authorities



# What is an Advance Pricing Arrangement?

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- OECD Definition of APA  
“An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time.”



# What is an Advance Pricing Arrangement?

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- APAs can apply
  - to transfer pricing issues between associated enterprises (Article 9 of the OECD Model Tax Convention)
  - to the allocation of profits to permanent establishments (Article 7 of the OECD Model Tax Convention)
- APA most appropriate
  - when TP methodology gives rise to questions of reliability and accuracy
  - when Transactions are unusually complex
  - after a TP examination, to solve future years on the same basis as agreed for the audited years, where audited transactions continue in the future.



## What is an Advance Pricing Arrangement?

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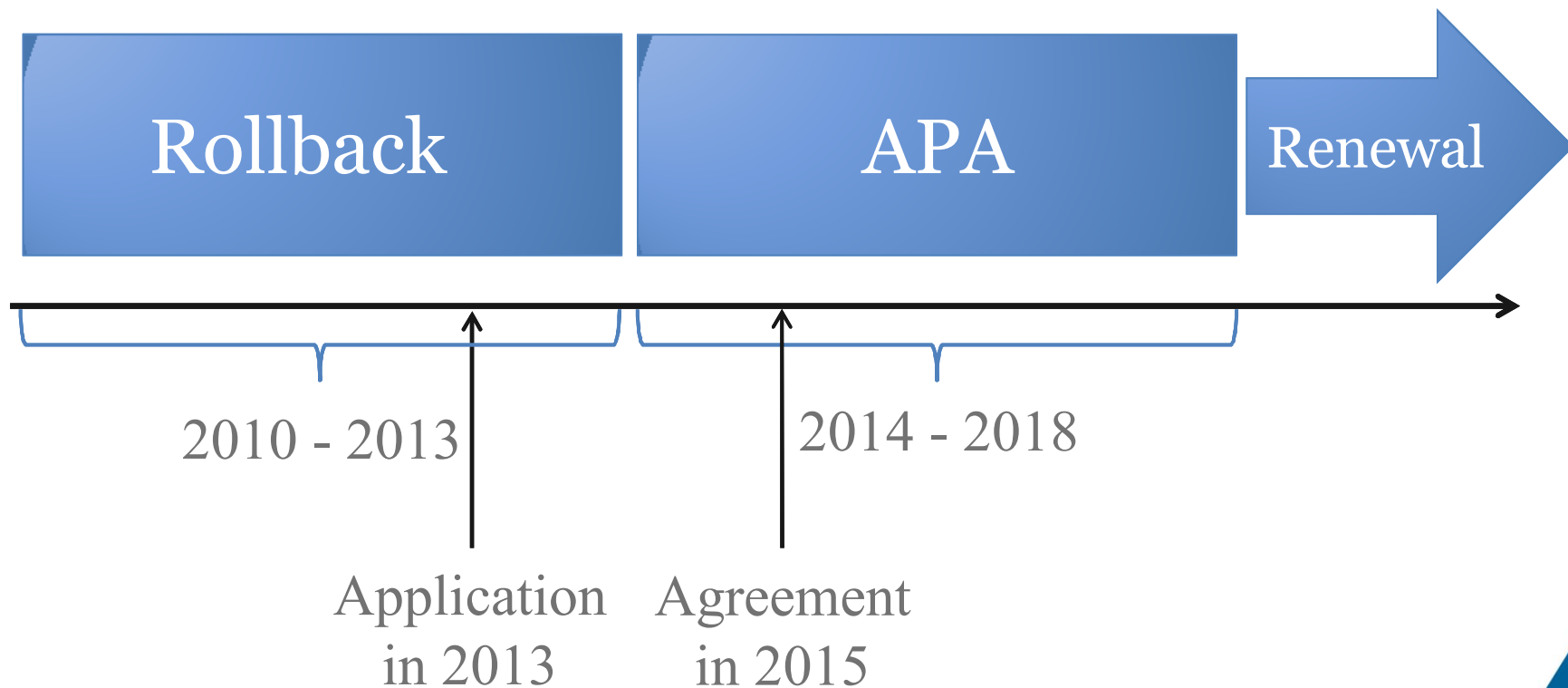
- Arrangement term usually between 3 to 5 years
  - “Rollback” to open examination years can resolve other years
- Can be renewed if no major changes
- No TP adjustments or penalties if taxpayer applies the agreed transfer pricing methodology in accordance with the APA





# What is an Advance Pricing Arrangement?

- Possible Timeline to be covered by an APA







# LEGAL BASIS OF MAP APA



## APA – Legal Basis

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- Unilateral APA
  - Domestic legislation
  - Administrative Guidelines
- Bilateral/Multilateral APA (MAP APA)
  - Article 25 (3)-type (MAP) clause of applicable double tax treaty
    - “Difficulties or doubts arising as to the interpretation or application of the Convention”
    - “Competent authorities may consult together for the elimination of double taxation in cases not provided for in the Convention”
  - Article 26-type (EOI) clause of applicable double tax treaty
  - Domestic and/or regional administrative Guidelines



## APA – Legal Basis

### Examples of Domestic Administrative Guidelines

USA	Revenue Protocol 2008-31, published 21 May 2008 (Internal Revenue Bulletin 1133)
Canada	Circular IC94-4R of 16 March 2001
Australia	ATO Taxation Ruling TR95/23 of 22 June 1995
UK	Section 85 of UK Finance Act 1999; statement of practice 3/99
Japan	Commissioner's Directive on MAP of 25 June 2001 (Office of MAP 1-39)
China	Guo Shui Fa [2009] No. 2, dated 8 January 2009
Germany	Circular Letter of 5 October 2006 (see <a href="http://bzst.bund.de">bzst.bund.de</a> )



## APA – Legal Basis

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- APA administered at the discretion of the relevant tax administration
- Tax administration not obliged to enter into a MAP APA



## APA – Legal Basis

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- What if no domestic or treaty provision for APA is in place?
- If no basis for APA is available in domestic law:
  - Article 25 (3)-type clause of applicable double tax treaty would allow APA, if transfer pricing or PE issues were otherwise likely to result in double taxation, or would raise difficulties or doubts as to the interpretation of application of the treaty
- If no treaty in place or treaty insufficient:
  - some countries may still conclude a kind of BAPA (Para. 7 OECD APA Guidelines)



# DEALING WITH THE TP METHODOLOGY



## No Determination of Transfer Price, but TP Methodology!

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- An APA does not fix the price of transactions but the **methodology** and the factors to apply the methodology
- Applying the agreed TP method will, of course, result in a specific transfer price
- To protect the taxpayer and the tax administration from the uncertainty of future developments, **critical assumptions** are built in APAs (i.e. assumptions upon which the methodology is based, the breach of which would trigger renegotiation of the agreement)



## TP Methodology vs. Transfer Price (Result)

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- APA prescribes a taxpayer's transfer pricing over a period of usually 3-5 years
- Prediction used in APA depends on:
  - Nature of the prediction
  - Critical assumptions on which prediction is based





# TP Methodology vs. Transfer Price (Result)

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- Example 1:
  - *How reasonable is an arrangement that interest rate for intra-group borrowings should remain at 6 % during the next 3 years?*
  - *How about an interest rate of LIBOR plus a fixed percentage?*
  - *Prediction would be even more reliable if an appropriate critical assumption is added, e.g. the company's credit rating (i.e. the addition to LIBOR will change if the credit rating changes)*



# TP Methodology vs. Transfer Price (Result)

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- Example 2:
  - *An arrangement concerning a contract manufacturer provides for the cost-plus method to be applied.*
  - *A specific range of mark-ups may only be agreed if sufficiently reliable comparables for the APA term (period) are available.*
  - *If this is not the case (e.g. because at a later date comparable businesses are no longer listed in databases), then a critical assumption has significantly changed and the APA may need to be renegotiated or terminated*



# UNILATERAL / BILATERAL / MULTILATERAL?



## APA vs. Private (Letter) Ruling

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- Private Rulings generally limited to questions of a legal nature and binding for a particular transaction
  - Facts underlying a Private Ruling are normally not questioned by tax administration
- APA generally deals with factual issues and several (types of ) transactions
  - Facts are thoroughly analysed and examined



# Unilateral/Bilateral/Multilateral APA

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**An APA can be unilateral, bilateral or multilateral:**

Unilateral APA → Agreement between taxpayer and one tax administration (on the basis of domestic rules of procedure)

Bilateral APA → At the request of a taxpayer, tax administration of country A agrees with tax administration of country B (on the basis of international law – tax treaty, OECD TP Guidelines etc.)

Multilateral APA → A series of bilateral APAs involving more than two tax administrations  
*(e.g. EADS/Airbus multilateral APA in 2004 involving France, Germany, Spain and the UK)*



# Unilateral vs. Bilateral/Multilateral APA

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- Unilateral APA may affect the tax liability of associated enterprises in other tax jurisdictions
- CA of other interested jurisdictions should, therefore, be informed about the APA as early as possible to determine whether they are willing and able to consider a bilateral APA
- Bilateral APA is equitable to all tax administrations and taxpayers involved and provides greater certainty and reduced risk of double taxation to taxpayer
- Some countries, e.g. Germany, do not grant unilateral APAs
- OECD and European Commission recommend bilateral or multilateral APAs



# Unilateral vs. Bilateral/Multilateral APA

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- Unilateral APAs can be useful if
  - the other State involved in the transactions does not have an APA programme
  - the transactions take place with a large number of other countries and it is not possible to have as many bilateral (or a multilateral) APA
  - APA is requested by a Small/Medium sized Enterprise (SMEs) / simple transactions
  - only a small amount of tax is at stake
  - the tax issue is not difficult and does not require the heavier and more expensive process of a bilateral or multilateral APA
  - a country implements an APA program and wants to gain experience with APAs



## Bilateral vs. Multilateral APA

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- Benefits of multilateral APA
  - Negotiations conducted on a multilateral basis rather than a series of separate negotiations with each tax authority
  - Resulting in lower costs and greater certainty for the taxpayer
- Drawbacks of multilateral APA
  - There is no multilateral method of implementing the agreement, rather concluding a series of **separate bilateral MAP APAs**
  - Exchange of (the same) information between all affected jurisdictions problematic if not the same transaction flows or common transactions between all jurisdictions (issue of confidentiality of taxpayer information)





# TRENDS IN APAS: 20 YEARS OF HISTORY - GROWING INTEREST -



## APAs: 20 Years of History

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- 1987: Pre-confirmation procedure in Japan
- 1991: World's first APA between the U.S. and Australia



- 1991: Formal APA program established in the USA
- 2012 : countries that have a formal APA program:
  - Australia, Austria, Belgium, Canada, China, Colombia, Czech Republic, Denmark, France, Germany, Hungary, India, Indonesia, Israel, Italy, Japan, Kazakhstan, Korea, Lithuania, Malaysia, Mexico, The Netherlands, New Zealand, Pakistan, Peru, Poland, Portugal, Romania, Russia, Singapore, Slovak Republic, Spain, Sri Lanka, Sweden, Switzerland, Taiwan, Thailand, Turkey, United Kingdom, Uruguay, USA, Venezuela



## Regional/Multilateral Efforts to Develop Harmonised APA Procedures

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- In 1999 the **OECD** published its « Guidelines for conducting Advance Pricing Arrangements under the Mutual Agreement Procedure (« MAP APAs »)
- The **Pacific Association of Tax Administrators** released operational guidance to conduct bilateral APAs in 2004
- In June 2007 the **Council of the European Union** adopted Guidelines for APAs within the EU  
[http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/company\\_tax/transfer\\_pricing/COM\(2007\)71\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transfer_pricing/COM(2007)71_en.pdf)



## April 2004: Europe's first quadrilateral APA

- European Aeronautic Defense and Space Co. Airbus
- A series of bilateral APAs concomitantly signed by France, Germany, Spain and the United Kingdom



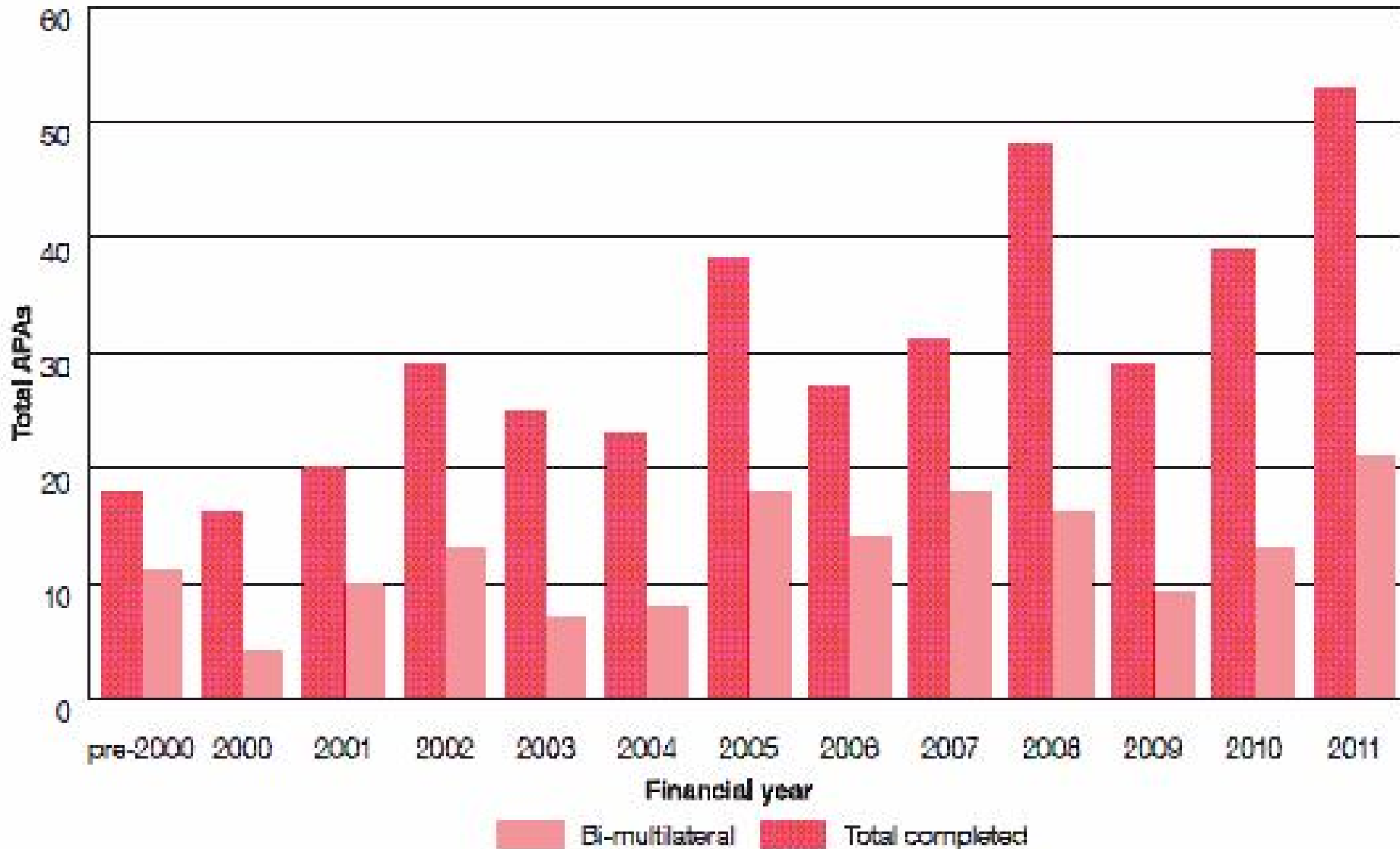


# **EVOLUTION OF THE NUMBER OF APAS (UNILATERAL, BILATERAL, MULTILATERAL)**

**IN AUSTRALIA, CANADA, CHINA,  
JAPAN, AND UNITED STATES**



# Excerpt from the Australian APA Report 2010-11





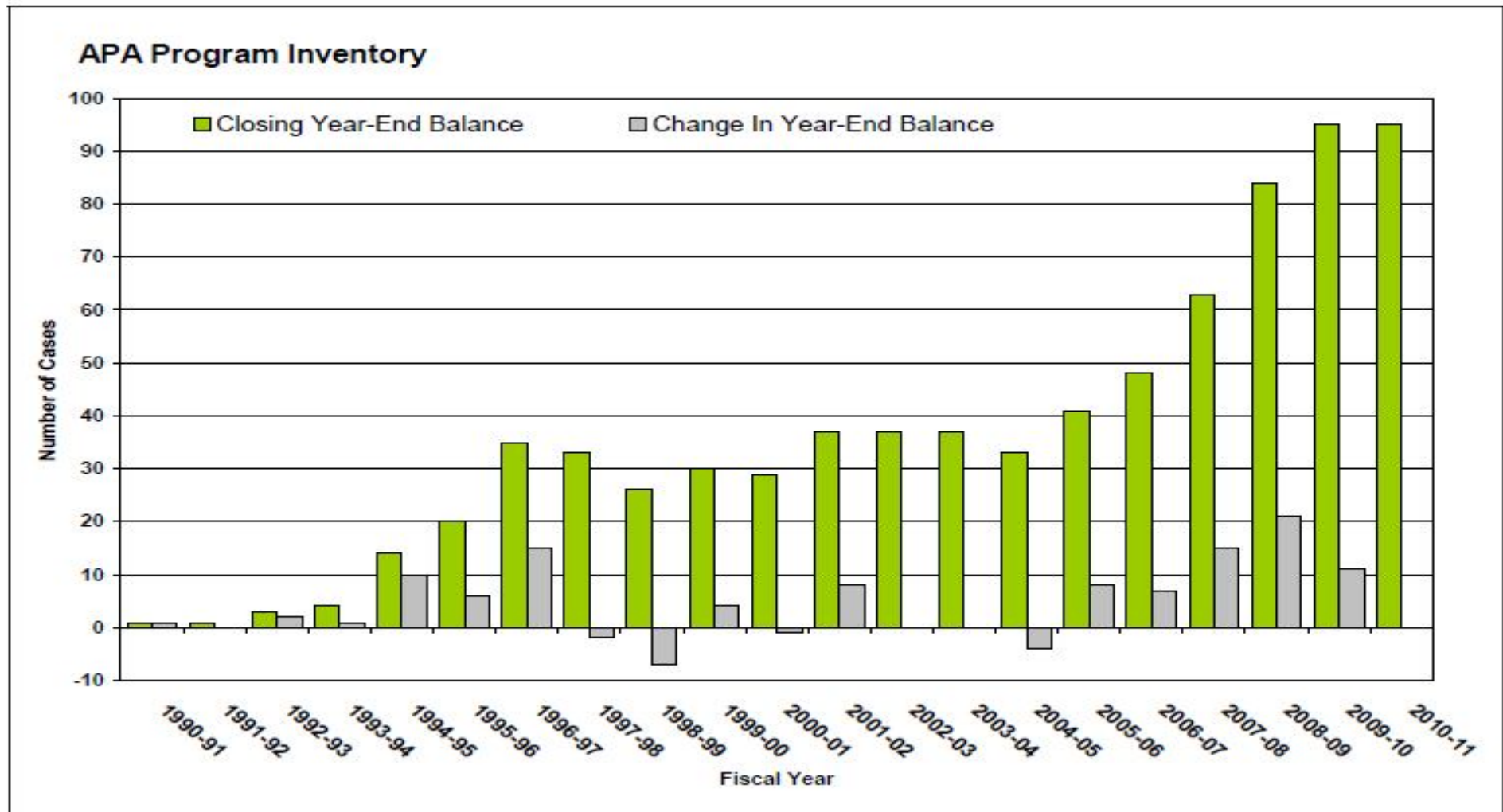
## Excerpt from Canada' Report for 2011

<b>APAs - Intergovernmental Status</b>						
Type	Completed	% of total	In Process	% of total	Combined	% of total
Multilateral	3	2%	2	2%	5	2%
Bilateral	124	78%	84	88%	208	82%
Unilateral	31	20%	9	9%	40	16%
<b>Total *</b>	<b>158</b>	<b>100%</b>	<b>95</b>	<b>100%</b>	<b>253</b>	<b>100%</b>

\* Totals may not sum due to rounding.



# Excerpt from Canada's 2011 APA Report

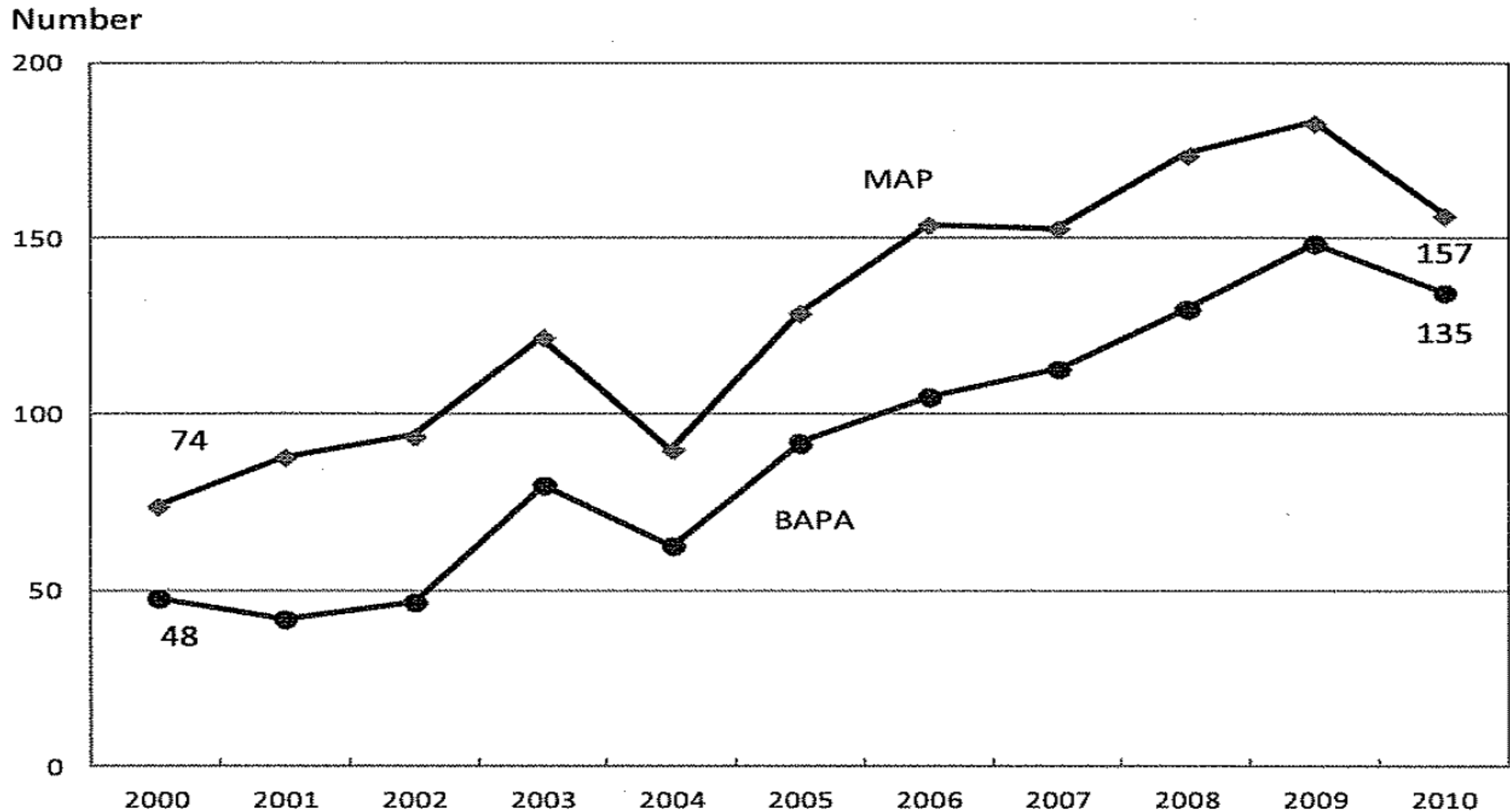






# Excerpt from the 2011 MAP Report of the Japanese NTA

Chart 1 Trends in the number of MAP and BAPA cases received





## China's APA Program

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- 1998: the APA concept is introduced in China's transfer pricing regulations
- 1998-2008: approx. 180 unilateral APAs completed in China
- 2005: first bilateral APA between China and Japan
- 2007: first bilateral APA between China and the United States
- 2009: first bilateral APA between China and EU Member State (Denmark)



## Excerpt from China's 2012 APA Report

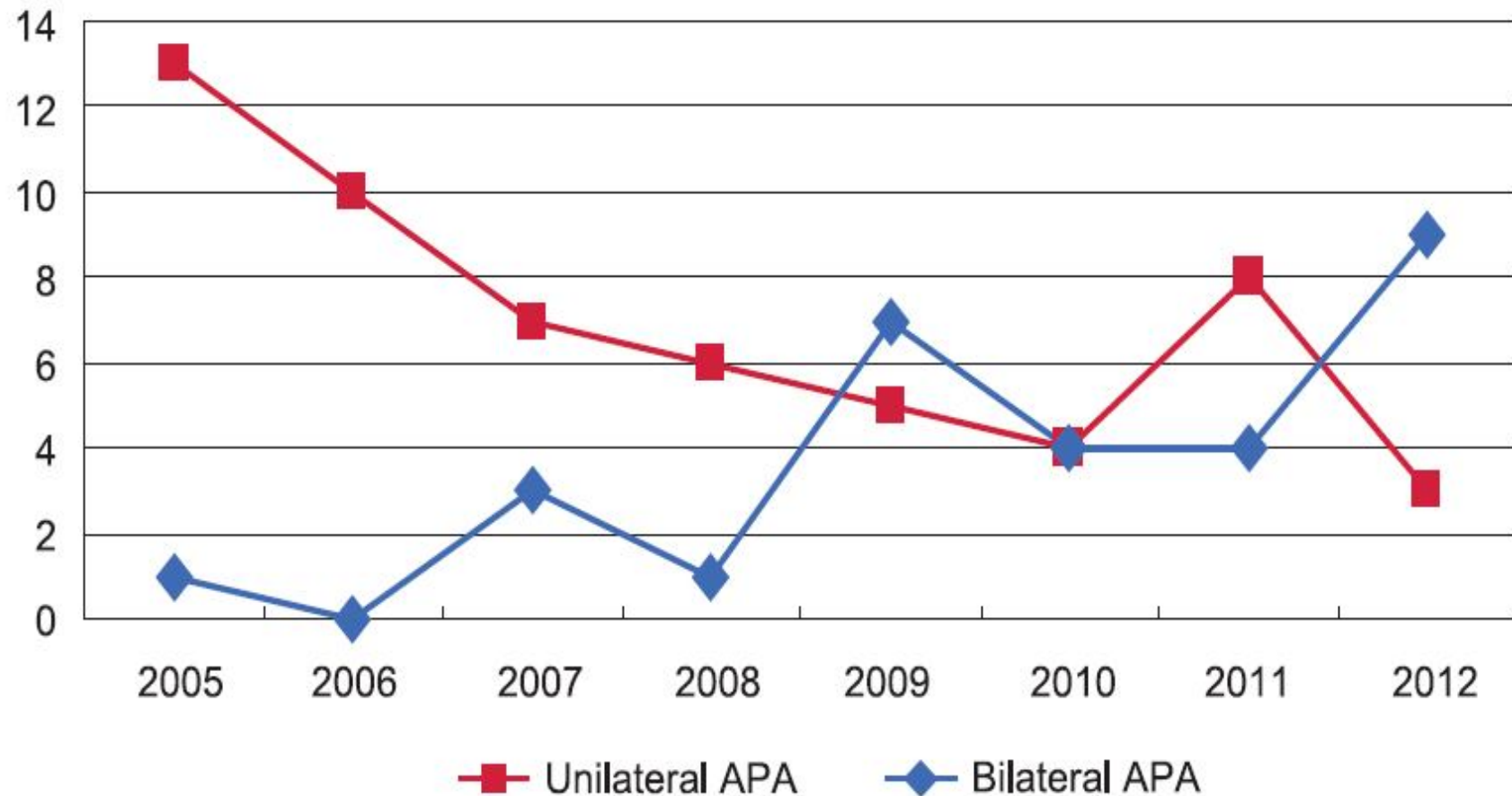


Chart 5-1 Number of APAs Signed 2005 - 2012



## Excerpt from HMRC's 2012 TP Report

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	<b>2009/10</b>	<b>2010/11</b>	<b>2011/12</b>
Applications made during year	32	49	32
Applications turned down	3	1	0
Applications withdrawn	2	2	1
APAs agreed during year	20	35	32
APAs in force during period	56	67	66



**APAS BY INDUSTRIES AND TYPES OF  
TRANSACTIONS:  
GENERALLY REFLECT THE  
COUNTRY'S ECONOMIC  
CONDITIONS**



## Excerpt from Australian 2010 – 2011 APA Report

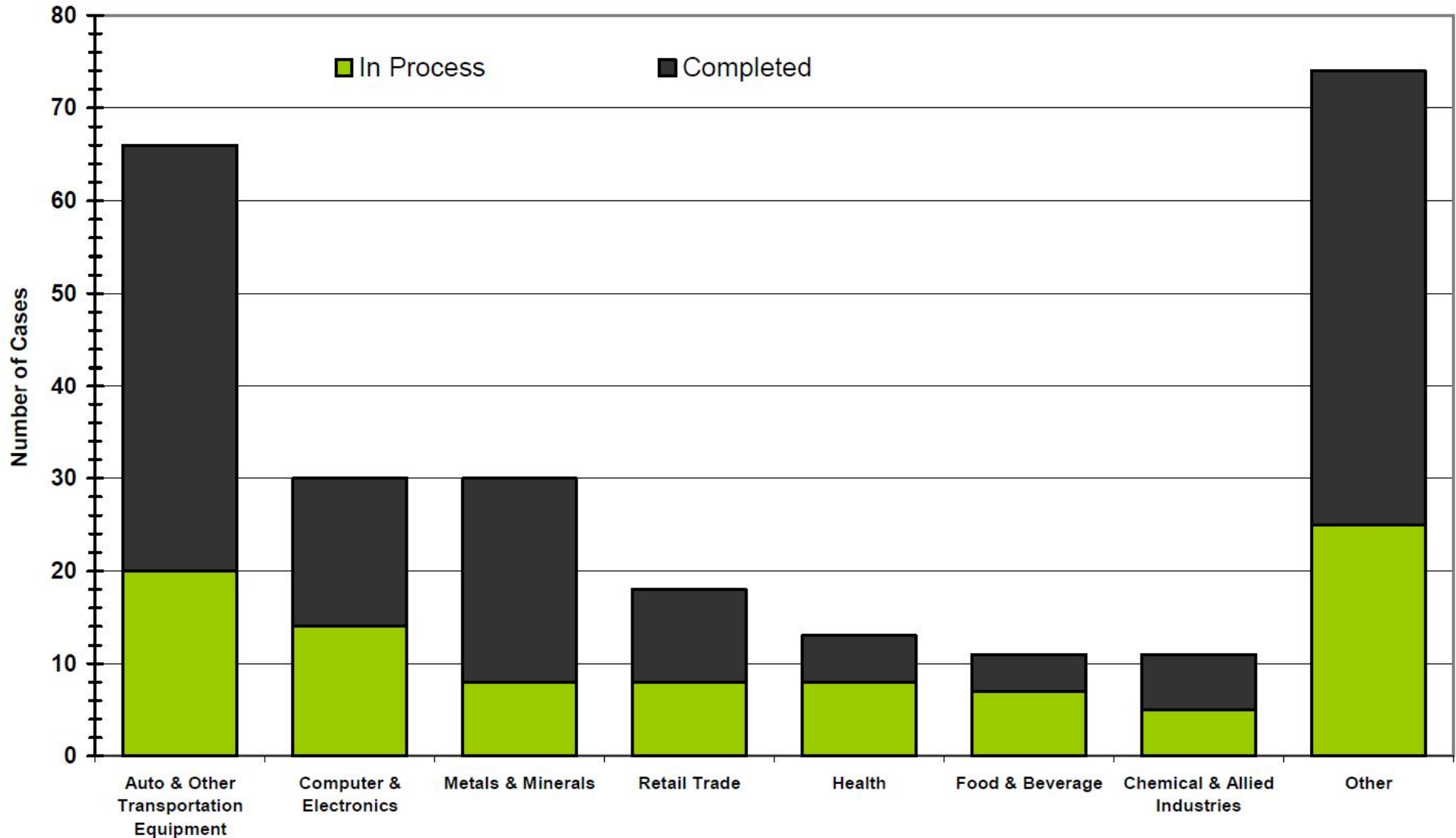
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- The completed APAs covered a wide range of related party inbound and outbound dealings including:
  - tangible goods for personal consumption and as business inputs
  - business and management services
  - IT software and hardware sales and services
  - mineral exports
  - licensing of trade, and marketing intangibles and software
  - financial services
  - contract manufacturing and research and development (R&D).



# Excerpt from Canada's 2010 APA Report

## APAs - Industrial Sector - Ranked



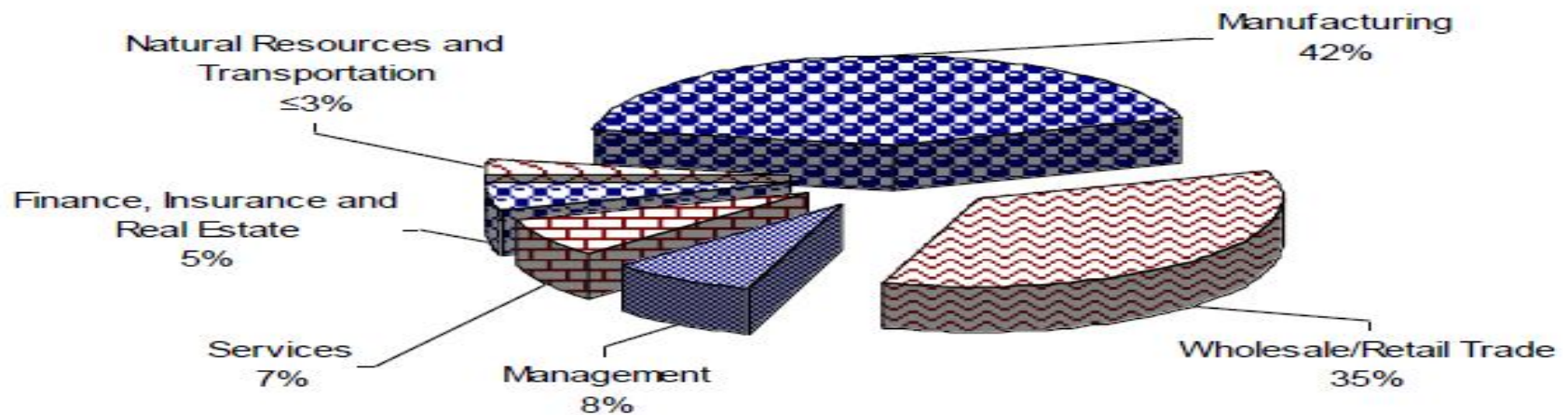


# Excerpt from the US 2012 APA Report

**Table 4: APAs Finalized or Renewed by Industry  
§ 521(b)(2)(C)(viii)**

Industry	
Manufacturing	59
Wholesale/Retail Trade	49
Management	11
Services	10
Finance, Insurance and Real Estate	7
Natural Resources and Transportation	4

**APAs Finalized or Renewed by Industry**







## Excerpt from Korea's 2010 APA Report

### Industries covered

Type of Business	Unilateral		Bilateral		Total	
	2008	2009	2008	2009	2008	2009
Computer/LCD/Mobile phone	1	1	2	4	3	5
Automobile/Transportation Equipment	1	2	1		2	2
Chemicals/ Pharmaceutical	2	8	4		6	8
Finance/Securities	3				3	
Apparel		3				3
Food & Beverage	3				3	
Publishing/ Software		1	2		2	1
Machinery	2	2	1	2	3	4
Service	3		1		4	
Wholesale	1	2	1	1	2	3
Semiconductor		1	2		2	1
<b>Total</b>	<b>16</b>	<b>20</b>	<b>14</b>	<b>7</b>	<b>30</b>	<b>27</b>

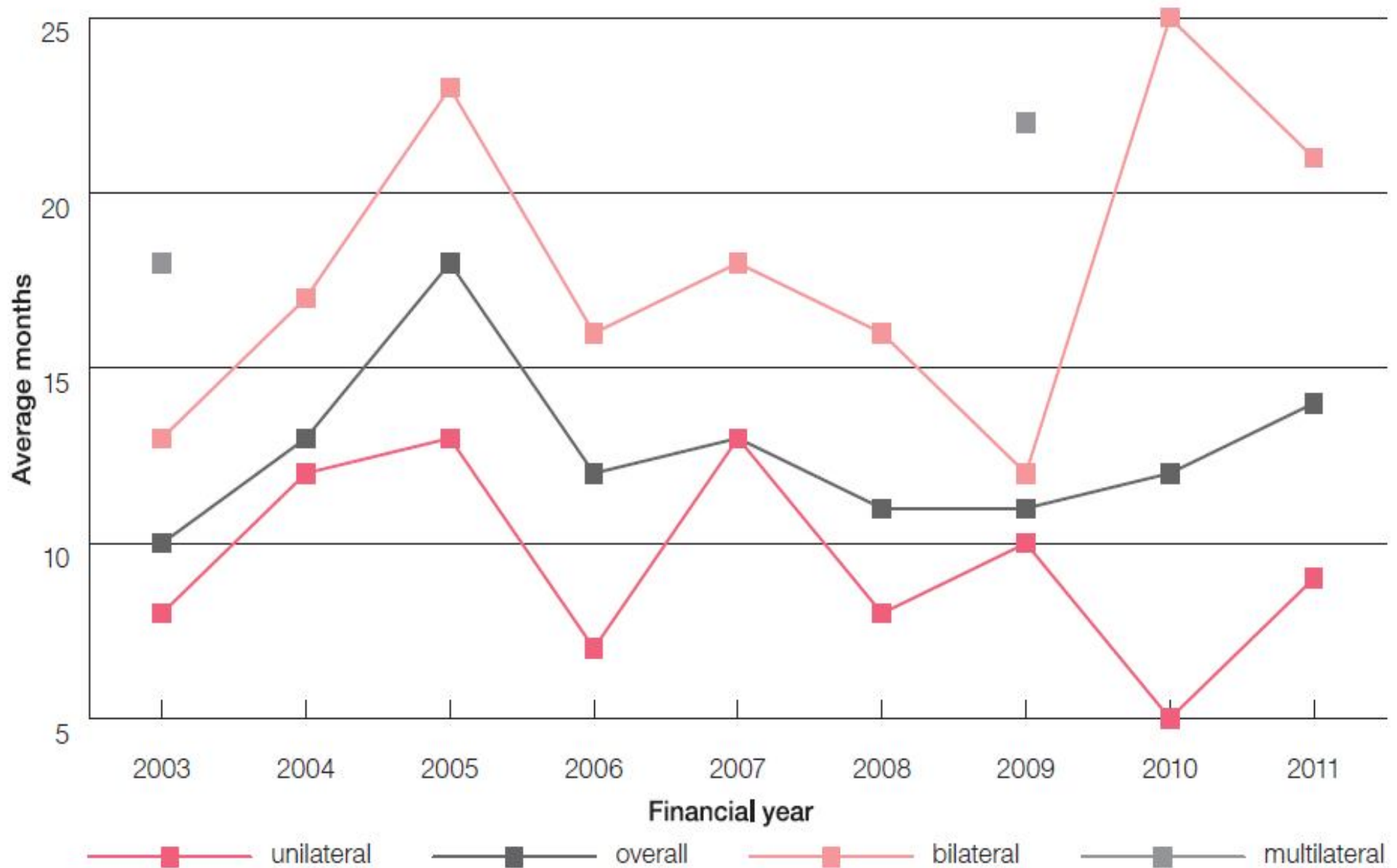


# TIME NEEDED TO PROCESS AN APA

BASED ON DATA FROM AUSTRALIA,  
CANADA, CHINA AND THE UNITED  
STATES

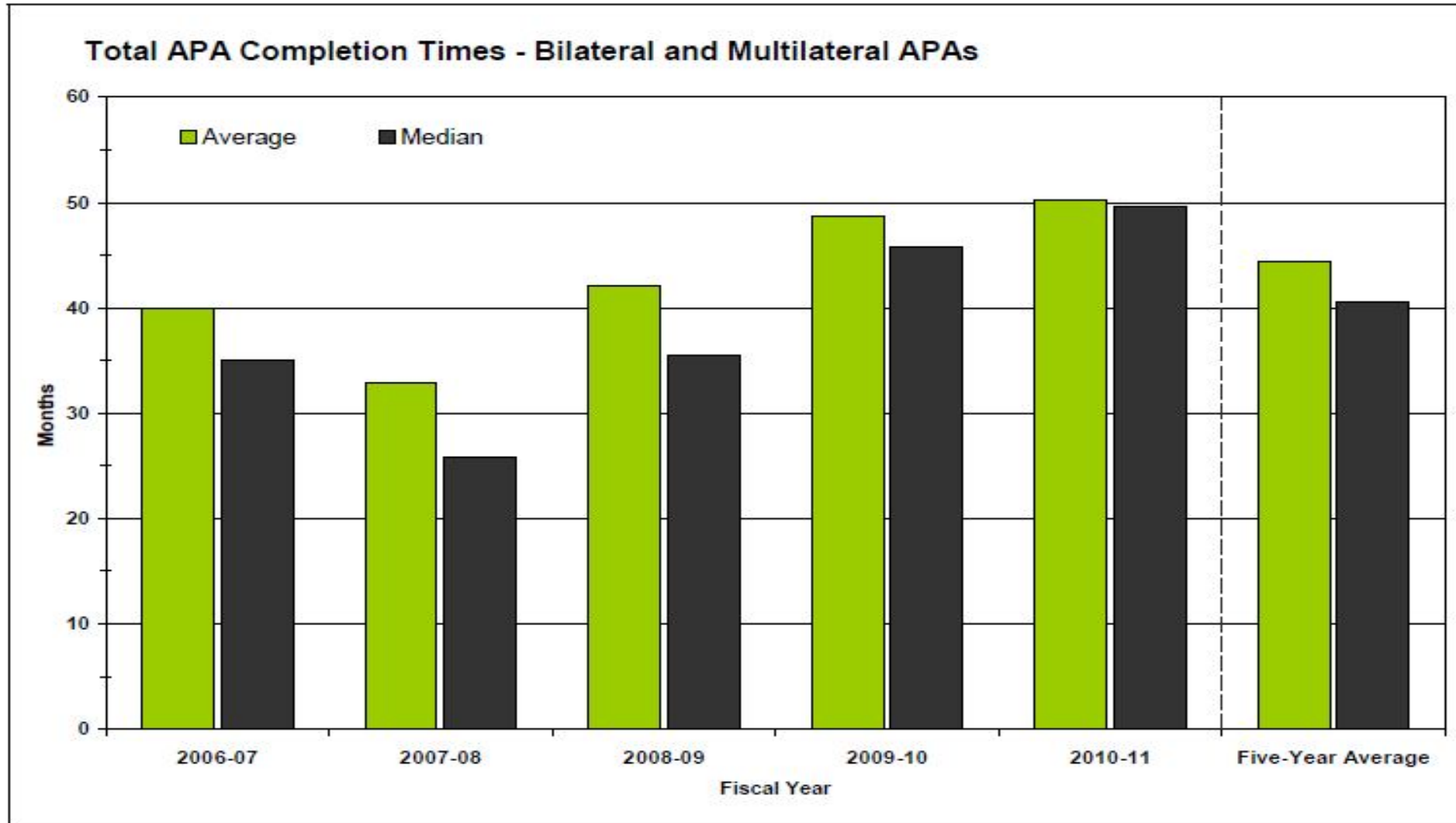
# Excerpt from Australia's APA Report 2010-11

FIGURE 2: Average time in process: APAs by type





# Excerpt from Canada 2011 APA Report





## Excerpt from China's 2012 APA Report

### Exhibit 5-4 APAs (2012) by Time Taken

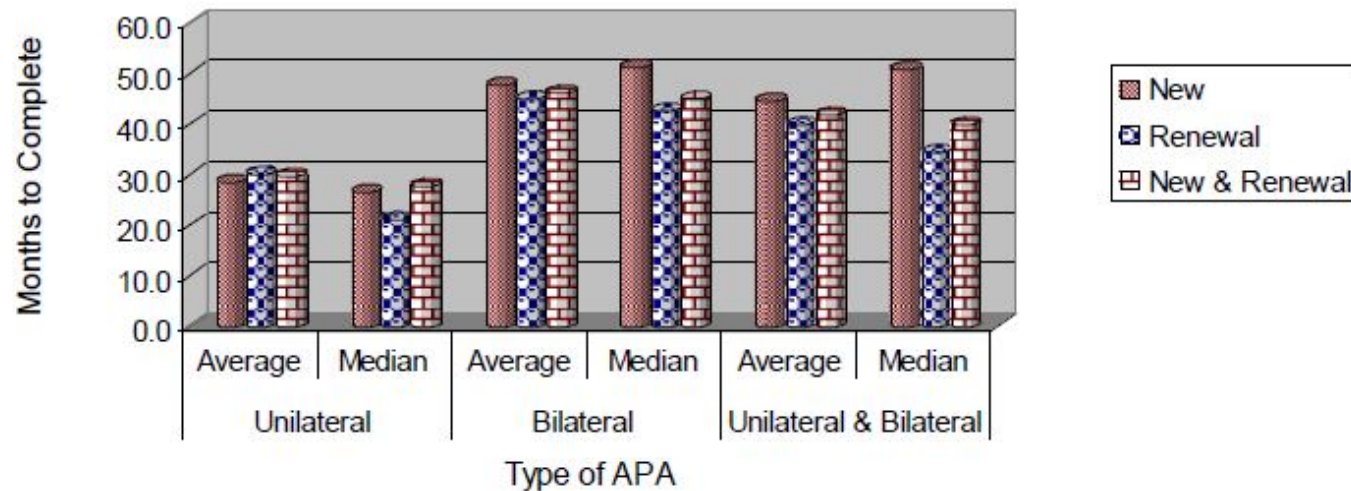
Type	from Application to Conclusion				Total
	< 1 year	1-2 years	2-3 years	>3 years	
Unilateral	2	1	0	0	3
Bilateral	6	0	1	2	9



# Excerpt from the US 2012 APA Report

**Table 6: Months to Complete New and Renewal APAs  
§ 521(b)(2)(E)**

	Unilateral		Bilateral		Unilateral & Bilateral	
	Average	Median	Average	Median	Average	Median
New	28.4	26.5	47.5	51.2	<b>44.5</b>	<b>50.6</b>
Renewal	30.1	20.8	44.8	42.4	<b>39.8</b>	<b>34.5</b>
<b>New &amp; Renewal</b>	<b>29.7</b>	<b>27.8</b>	<b>46.0</b>	<b>44.9</b>	<b>41.7</b>	<b>39.8</b>





## Excerpt from HMRC 2012 TP Report

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	<b>2009/10</b>	<b>2010/11</b>	<b>2011/12</b>
Average time to reach agreement:	20.3 months	22.7 months	16.9 months
50% agreed within:	16.5 months	14.0 months	10.7 months



## Conclusion

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- APAs still involve in most cases a lengthy and resource intensive process (especially bilateral APAs),
- but one which is remarkably short compared with **transfer pricing examinations + litigation + MAP** to resolve double taxation





# THE SUCCESS OF APAS IS DUE TO A COMBINATION OF FACTORS



# Multinational Enterprises are under Pressure

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- From tax authorities:  
increasing audit activities in the transfer pricing area, huge amounts at stake, heavy penalties, lengthy process, uncertainties
- From boards of directors/ accountants / financial markets:  
effective tax rate must be explained and should be sustainable, tax risks increasingly need to be disclosed => companies do not like double taxation, do not like uncertainties



APAs can be part of a more constructive dialogue between taxpayers and tax authorities

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- Voluntary process (each party can withdraw at any time)
- Non-controversial
- Co-operative environment
- In advance of the transactions → not an archive digging
- Only transfer pricing (or PE issues) and agreed scope of selected transactions → more focused than examinations in general



# BENEFITS OF APAS AND THEIR DISADVANTAGES



# Major Benefits of APAs

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## For Taxpayer

- ✓ Legal certainty (up to 5 years + possible renewal) and planning reliability
- ✓ If bilateral or multilateral: eliminates of risk of double taxation
- ✓ Limits costly and time consuming transfer pricing examinations in future tax audits
- ✓ Reduction of MAP/litigation risk
- ✓ Multiplier effects



# Major Benefits of APAs

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## For Tax Administrations

- ✓ Profits are correctly attributed and taxed;
- ✓ Enhanced taxpayer compliance
- ✓ Better insight into complex transactions and improved industry and taxpayer knowledge → development of specialist skills
- ✓ Reduced risk of time consuming MAP/litigation
- ✓ Less time needed to reach agreement as current data are available as opposed to prior year data that may be difficult and time-consuming to produce
- ✓ Limits costly and time consuming TP examinations in future tax audits



# Possible Disadvantages

## For Tax Administrations

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- Unilateral APAs can be more disadvantageous than bilateral/multilateral APAs
  - Risk of corruption
  - Disagreements between tax administrations
  - Corresponding adjustments difficult
- Initial resource costs can be substantial
- Attractive to compliant taxpayers but can divert resources from less compliant taxpayers
- Specialist area resource

*APA fees may overcome burden on tax administration's financial resources*



## Possible Disadvantages For Taxpayers

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- „Dining with the taxman“
- No firewall between APA teams and tax auditors
- An APA request may be rejected
- Consultancy costs, fees
- Reduction of entrepreneurial flexibility during the APA period
- Renunciation of tax avoidance
- Certainty, but no minimisation of tax liabilities





# CONCLUSION: WHAT DOES THE FUTURE HOLD?



More APA programs?

More focused APAs in countries with mature programs?

More multilateral APAs?

Joint APAs with customs ?

Simplified / streamlined APAs for SMEs?



# TRANSFER PRICING WORKSHOP ON DISPUTE RESOLUTION AND AVOIDANCE (MAP AND APA)

**9. Advance Pricing Arrangements (APA)  
Conduct of the MAP APA Process**



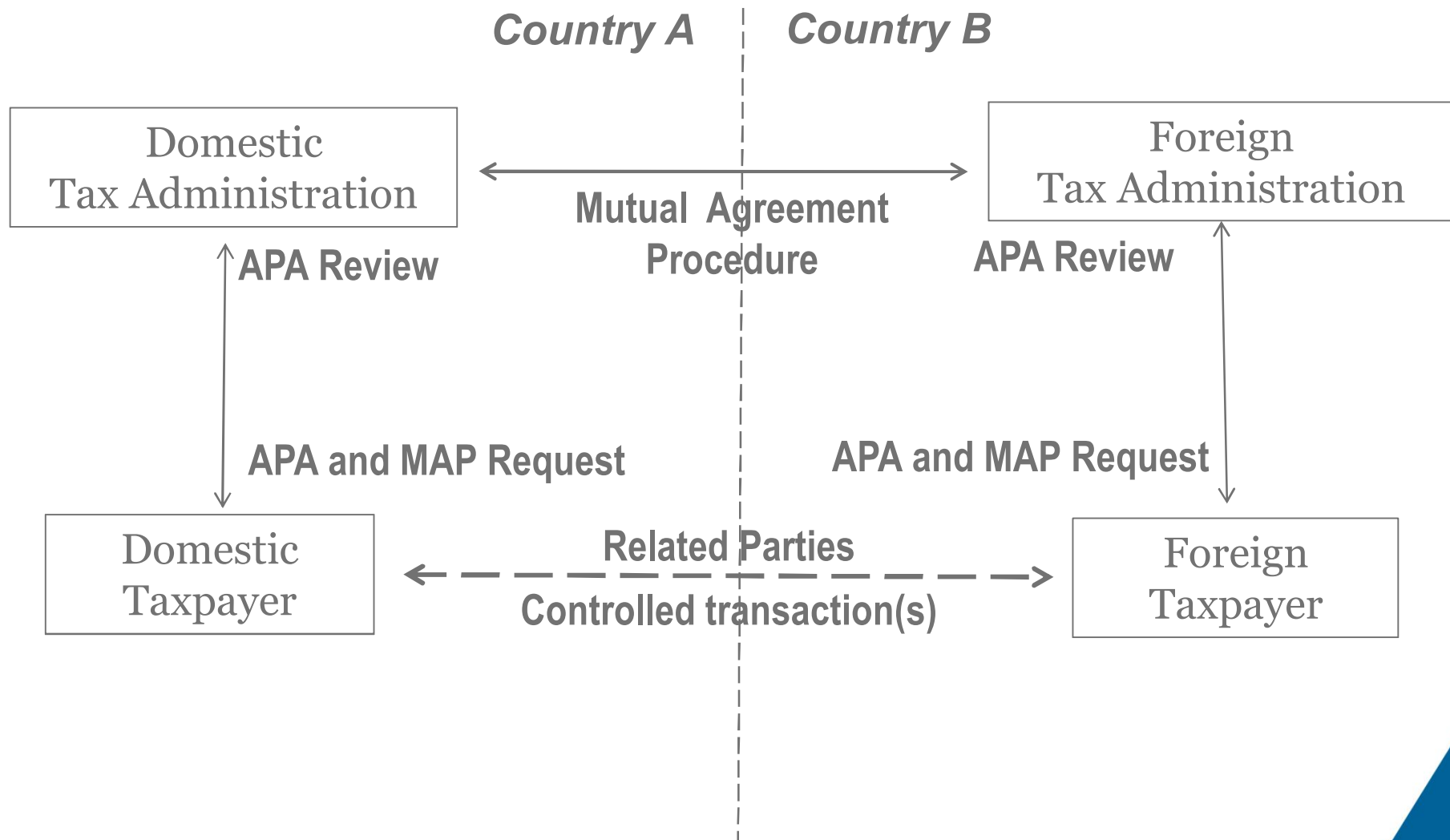
## Process for Conducting MAP APAs

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- An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations.
  - **It is never imposed on a taxpayer!**
- Tax authorities are not obliged to conduct an APA process



# Diagram of the MAP APA Process





# Typical Process for Bilateral APAs

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# Step 1: Pre-Filing Meeting

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## Step 1: Pre-Filing Meeting (2)

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- Attendants:
  - Taxpayer and /or taxpayer's consultants
  - Tax administration representatives (CA / MAP APA Office etc.)





## Step 1: Pre-Filing Meeting (3)

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- Objectives:
  - Explore issues and requirements for submission
  - Tax administration to explain APA process
  - Presentation of case, suitability of case for an APA, first information on documentation needed and the scope of the analyses
  - e.g. extent of functional analysis of affiliated enterprises, selection and adjustments of comparables, need and scope of market, industry and geographic analyses)
  - Opportunity for taxpayer to discuss concerns regarding disclosure and confidentiality of data
  - Determine rough time frame for evaluating and concluding APA



## Step 1: Pre-Filing Meeting (4)

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- More than one pre-filing meeting may be held
- Anonymous pre-filing meetings possible in some countries (e.g. China, Germany, USA, Japan, others)
- Competent Authorities involved may consider (informal) early exchange of views whether MAP APA is appropriate



## Step 2: Formal Application

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## Step 2: Formal Application (2)

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- Written application (APA proposal) by taxpayer to be submitted to local tax office or CA/MAP office
  - In some countries (e.g. USA, Germany, Japan, others) APA request must be submitted no later than deadline for filing of taxpayer's tax return for the first year to be covered by APA



## Step 2: Formal Application (3)

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- Explanation by taxpayer of justifiable interest in the APA
- Documentation → see separate slide
- Review and acceptance of the APA application
- Term of the APA → see separate presentation



## Step 2: Formal Application (2)

### - Documentation -

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- **Key elements**

- 1) Enterprises, PEs involved and country(ies) that have been requested to participate
- 2) Transactions and fiscal years covered (and which transactions excluded and why)
- 3) Functional analysis: business description, organisational structure, markets, functions, assets, risks, description of covered transactions
- 4) Proposed transfer pricing methodology: description and justification
- 5) Availability and identification of internal and/or comparable prices or margins and expected range of results, comparability adjustments, etc.
- 6) Critical assumptions
- 7) Background factual and legal items
- 8) Financial statements, tax returns



## Step 2: Formal Application (3)

### - Documentation -

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#### **OECD recommended list (non-exhaustive and non-prescriptive)**

- a) Transactions, products, businesses or arrangements covered by the proposal; (including, if applicable, a brief explanation of why not all of the transactions, products, businesses or arrangements of the taxpayer(s) involved in the request have been included);
- b) Enterprises and permanent establishments involved in these transactions or arrangements;
- c) Other country or countries which have been requested to participate;
- d) Information regarding the world-wide organisational structure, history, financial statement data, products, functions and assets (tangible and intangible) of any associated enterprises involved;



## Step 2: Formal Application (4)

### - Documentation -

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#### **OECD recommended list (non-exhaustive and non-prescriptive)**

- e) Description of the proposed transfer pricing methodology and details of information and analyses supporting that methodology, e.g. identification of comparable prices or margins and expected range of results etc.;
- f) Assumptions underpinning the proposal and a discussion of the effect of changes in those assumptions or other events, such as unexpected results, which might affect the continuing validity of the proposal;
- g) Accounting periods or tax years to be covered;
- h) General description of market conditions (e.g. industry trends and the competitive environment);





## Step 2: Formal Application (5)

### - Documentation -

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#### OECD recommended list (non-exhaustive and non-prescriptive)

- i) Discussion of any pertinent ancillary tax issues raised by the proposed methodology;
- j) discussion of, and demonstration of compliance with, any pertinent domestic law, tax treaty provisions and OECD guidelines that relate to the proposal; and
- k) Any other information which may have a bearing on the current or proposed transfer pricing methodology and the underlying data for any party to the request.

***“Content of proposal and extent of necessary supporting information and documentation depends on facts and circumstances of each case and requirements of the individual participating tax administrations.”***

*(Para. 38 OECD MAP APA Guidelines)*



## Step 2: Formal Application (6)

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- Taxpayer encouraged to provide same information to evaluate APA proposal and undertake MAP to foreign tax authority
  - Taxpayer may submit APA proposal directly to all CAs
  - Domestic CA may forward taxpayer's APA application to other CAs involved



## Step 3: Evaluation of APA Proposal

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## Step 3: Evaluation of APA Proposal

### Is the MAP APA appropriate?

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- Key consideration by tax administration:
  - Advantage to be gained by agreeing a method for avoiding the risk of double taxation in advance.
- Requires exercise of judgement and need to balance the efficient use of limited financial and human resources with the desire to reduce likelihood of double taxation.



## Step 3: Evaluation of APA Proposal

### Is the MAP APA appropriate?

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- Audit or examination in progress should be no impediment
  - Outcome of TP audit in progress in relation to past years where fact pattern substantially similar to APA proposal may be expedited by MAP APA.
  - Terms of APA could be applied to inform or resolve the audit and any unresolved mutual agreement procedures for earlier years.



## Step 3: Evaluation of APA Proposal (2)

### Is the MAP APA appropriate?

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#### Examples of items to be considered by tax administration:

- Methodology and other terms and conditions of the APA proposal in line with OECD TPG?
  - *If not, taxpayer to revise the proposal accordingly, in order to increase the chances of reaching a mutual agreement.*
- Are the APA issues likely to significantly increase the risk of double taxation and so justify the use of resources to settle any problems in advance of the proposed transactions?



## Step 3: Evaluation of APA Proposal (3)

### Is the MAP APA appropriate? (cont'd)

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#### Examples of items to be considered by tax administration:

- Are the transactions in question seriously contemplated and not of a purely hypothetical nature?
  - *The process should not be used to find out the likely views of the tax administration on a general point of principle - there are other established methods for doing this in many countries.*



## Step 3: Negotiation of APA Proposal

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## Step 3: Negotiation of APA (2)

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- Each tax administration normally forms an “APA-team”
- Exchange of position papers between CAs
- Initial position paper based on domestic regulations, OECD TP Guidelines and treaty provisions
- Competent Authority negotiations mainly based on OECD TP Guidelines and treaty provisions



## Step 3: Negotiation of APA (3)

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- Open and simultaneous exchange of information between both CA
- Involvement of the taxpayer at each time of the evaluation (presenting facts, review proposals)
- Taxpayer should provide both CAs with the same information at each time of the evaluation
- Taxpayer does not attend CA meetings



## Step 3: Negotiation of APA (4)

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- Negotiations between CAs can take different forms:
  - Face-to-face meetings (often several times a year)
  - Exchange of views by e-mail, fax, telephone
- CAs draft tentative agreement once they reach consensus on the terms of the APA
- Tentative agreement is sent to taxpayer for approval
  - If the APA agreement conforms with the taxpayer's APA proposal, a notice of APA confirmation may be sent to the taxpayer



## Step 4: Formal (Mutual) Agreement

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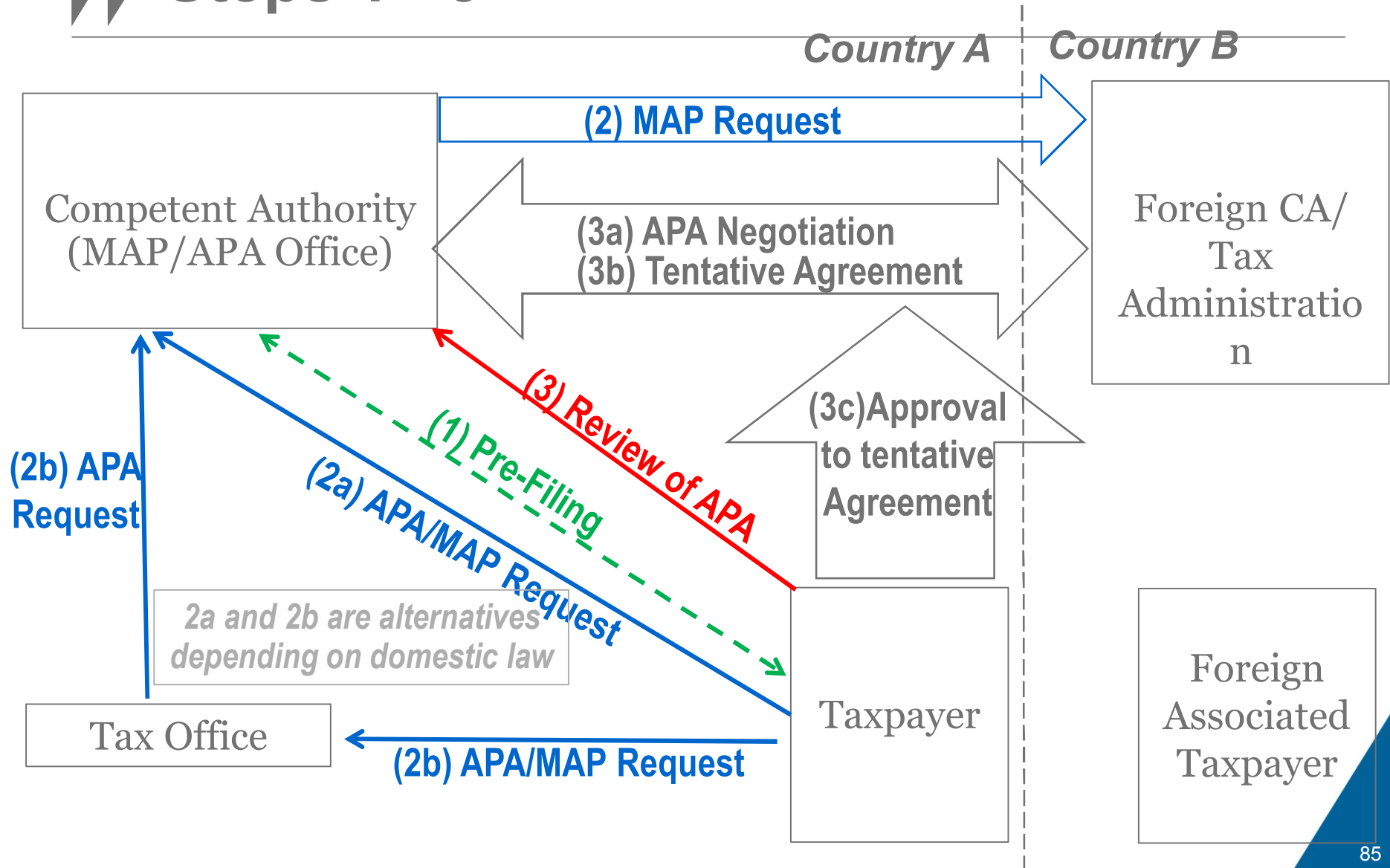


- Competent Authorities agree on terms of the MAP APA
- If taxpayer approves terms: → Mutual Agreement between CAs (to be implemented in MAP APA)



# Flowchart of MAP APA Process

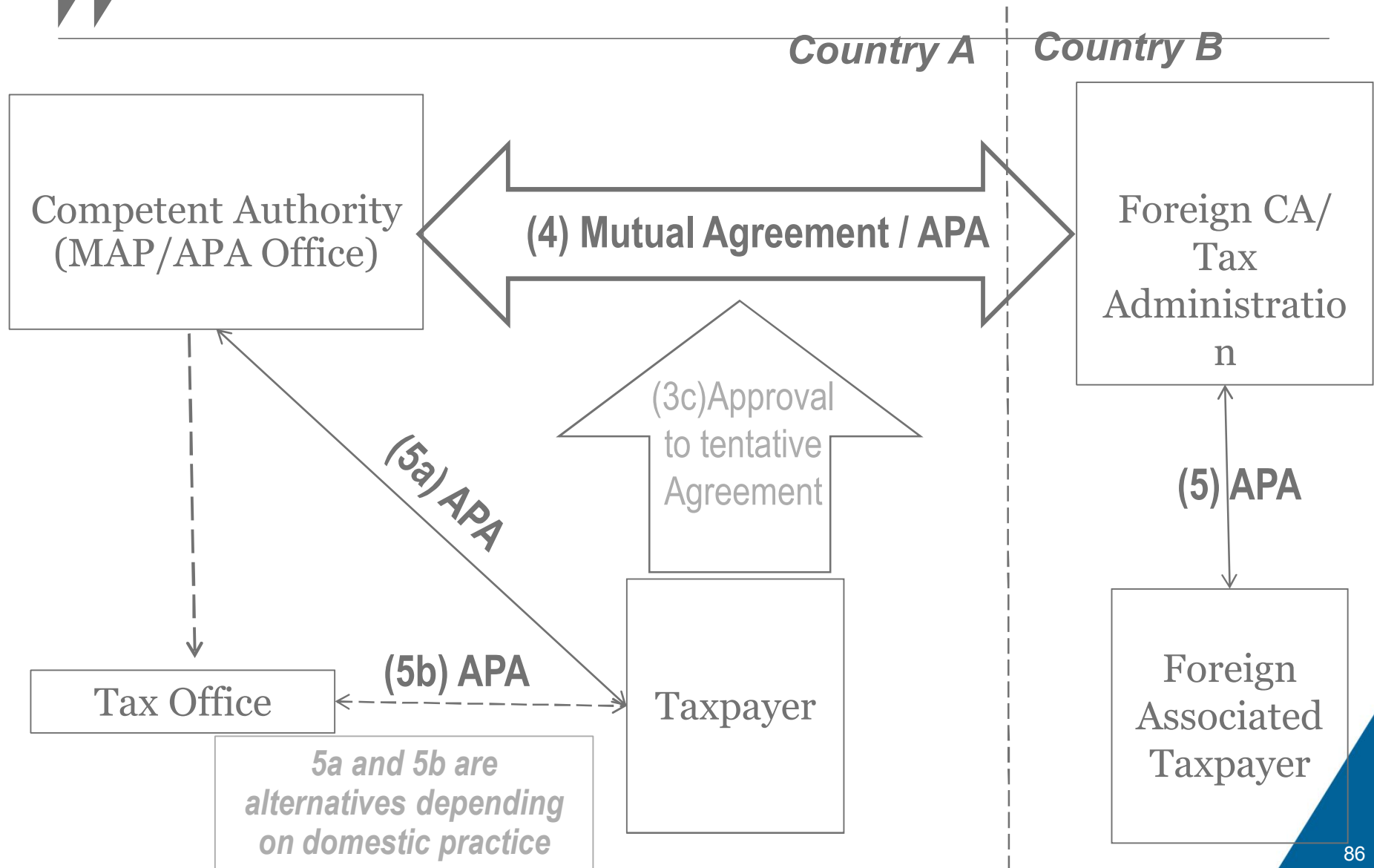
## Steps 1 - 3





# Step 4: Formal (Mutual) Agreement

## Step 5: Implementation of MAP APA





## Taxpayer participation

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- Taxpayer participates in the APA process by
  - presenting the case and his position
  - being involved at each time of the evaluation
  - providing necessary documents and information to all tax authorities involved at broadly the same time and without undue delay
  - arrange for necessary translations
  - negotiating with the tax administration concerned
  - reaching agreement on the TP issue



## Taxpayer participation (2)

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- Taxpayer does not attend CA negotiations
  - but may be given the opportunity of presenting its position to both CA and discussing it with them (“joint fact finding meetings”); this may expedite the APA procedure
- Taxpayer should be kept informed about progress





# Q & A



# TRANSFER PRICING WORKSHOP ON DISPUTE RESOLUTION AND AVOIDANCE (MAP AND APA)

**10. Advance Pricing Arrangements (APA)  
Finalisation of the MAP APA**



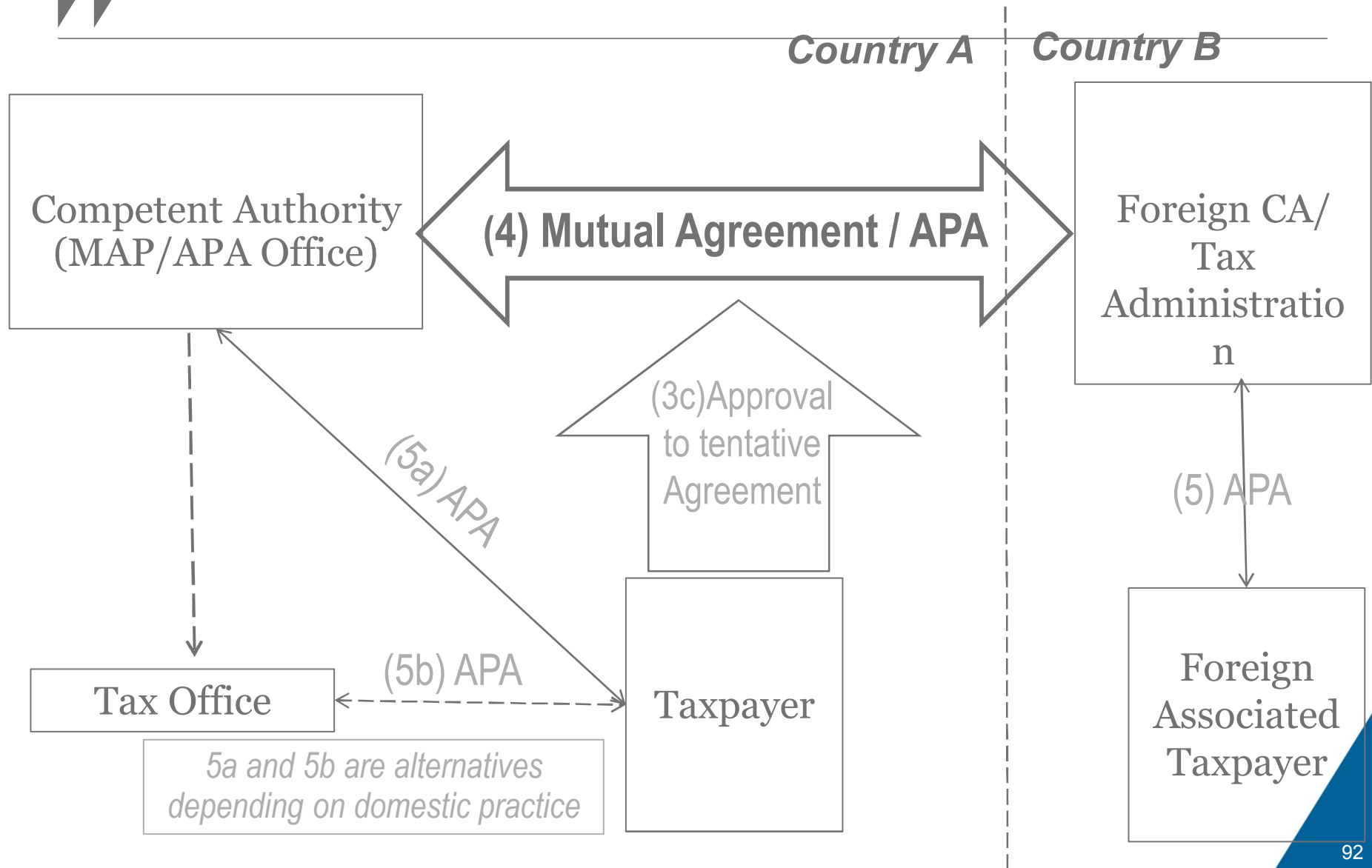
## Step 4: Formal Agreement

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# Step 4: Formal (Mutual) Agreement





## Step 4: Formal Agreement

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- MAP APA is a written document
- Competent Authorities agree on terms of the APA and draft tentative APA
- Taxpayer approves tentative APA
- If taxpayer does not approve, tentative APA may be renegotiated or APA refused
- If acceptable to taxpayer and CAs, agreement between the CAs will be incorporated into APA



## Term (Duration) of the APA

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- Term of the APA
  - Depends on industry, products, transactions involved, economic climate
  - Generally 3-5 years
  - First year generally the fiscal year in which the APA request is filed or an earlier fiscal year for which the tax return has not yet been filed
- Short period means less degree of certainty and less degree of cost efficiency as compared with regular audit
- Long period makes predictions of future conditions on which APA is based less accurate




# Formal Agreement

## Contents of APA

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- a) Names and addresses of the enterprises that are covered by the arrangement;
- b) Transactions covered
- c) Term of the APA;
- d) Description of the agreed methodology and other related matters such as agreed comparables or a range of expected results;
- e) Definition of relevant terms which form the basis of applying and calculating the methodology (e.g., sales, cost of sales, gross profit, etc.);
- f) **Critical assumptions** upon which the methodology is based, the breach of which would trigger renegotiation or termination of the agreement;




## Formal Agreement Contents of APA

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- g) Any agreed parameters/mechanisms to deal with changes in the factual circumstances;
- h) Taxpayer's compliance obligations (e.g., annual reports, record keeping, notification of changes in critical assumptions etc.);
- i) Confirmation by the tax authorities involved in the APA process regarding confidentiality of taxpayer information






## Critical Assumptions

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- Assumptions about future operational and economic conditions that will affect the arm's length transfer pricing of the controlled transactions covered by the APA.
- Taxpayer should describe in the APA proposal the assumptions on which the TP methodology is based and how the selected TP methodology will cope with any changes in those assumptions.



## Critical Assumptions

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- Assumptions are “critical” if the actual conditions at the time the transactions occur diverge from those in the APA to the extent that the TP methodology does no longer reflect arm’s length pricing.
  - Example:  
*Fundamental change to the market arising from new technology, government regulations, or widespread loss of consumer acceptance. In such a case, the APA would need to be revised or cancelled.*
- “Critical” assumptions need to be agreed between the taxpayer and the tax authorities affected




# Critical Assumptions

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- **Examples:**

- a) assumptions about the relevant domestic tax law and treaty provisions;
- b) assumptions about tariffs, duties, import restrictions and government regulations;
- c) assumptions about economic conditions, market share, market conditions, end-selling price, and sales volume;
- d) assumptions about the nature of the functions and risks of the enterprises involved in the transactions;
- e) assumptions about exchange rates, interest rates, credit rating and capital structure;
- f) assumptions about management or financial accounting and classification of income and expenses; and
- g) assumptions about the enterprises that will operate in each jurisdiction and the form in which they will do so.



## Critical Assumptions

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- For the APA to be flexible, it should contain **parameters** (ranges) for an acceptable level of changes in the assumptions
- Only if the divergence from the assumptions exceeded the parameter would the assumption become “**critical**” and action considered.
- The APA should therefore also contain **mechanisms** for compensating adjustments to account for changes in the assumptions that have become “critical”



## Unexpected Results

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- What if results of applying the TP methodology agreed in the MAP APA do not fulfil the expectations of one of the parties?
  - That party may question whether the critical assumptions, and the methodology which they support, are still valid.



# Unexpected Results

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- To cope with likely changes in the facts and circumstances the proposed methodology could include, for example:
  - price adjustment clauses or allowing prices to vary with volume;
  - an acceptable range of results in advance
  - acceptable royalty as long as it falls within a certain % of profits



## Step 5: Implementation

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## Step 5: Implementation of APA

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- MAP APA has been finally agreed, participating tax authorities need to **give effect** to the agreement in their own jurisdiction.
- Confirmation or agreement between tax authority and respective taxpayer varies from country to country and exact form depends on particular domestic law and practice.





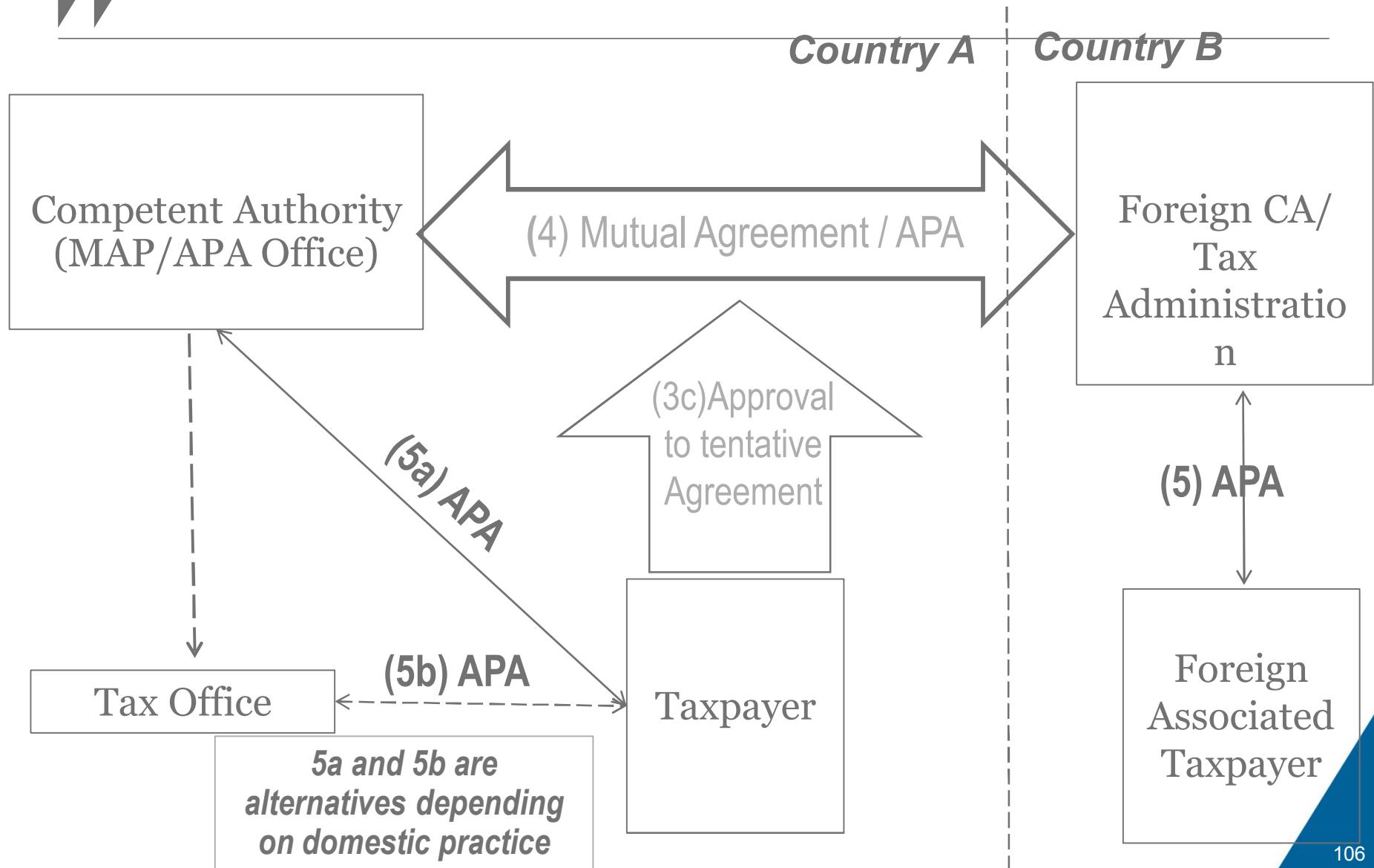
## Step 5: Implementation of APA


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- Confirmation or agreement by tax authority provides taxpayer with certainty that no transfer pricing adjustment is made as long as the taxpayer complies with the terms and conditions of the APA
  - Exception: taxpayer made false or misleading statements during the APA process or in his annual compliance reports
- Some countries require taxpayer to waive appeals for the APA to become effective



## Step 5: Implementation of MAP APA





## Step 5: Implementation of APA - Rollback -

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- An APA applies to future transactions
- **Rollback** possible in some countries
  - E.g. to cover the years between opening and completion of the procedure
  - Sometimes jointly with the resolution of a transfer pricing examination of prior years
  - Rollback depends also on domestic law, for example with regard to time limits



# Q & A



# TRANSFER PRICING WORKSHOP ON DISPUTE RESOLUTION AND AVOIDANCE (MAP AND APA)

**11. Advance Pricing Arrangements (APA)  
Monitoring, Renewal, Cancellation of  
MAP APA**



## Step 6: Extension/Renewal of APA

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## Step 6: Monitoring

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- **Monitoring** is an essential feature of the MAP APA procedure
  - Record keeping and annual reports required from taxpayers
  - Examinations limited to whether the terms of the APA were respected and critical assumptions still valid
- Consequences of non compliance or changes in circumstances:
  - a) Revoking a MAP APA (retrospectively)*
  - b) Cancelling a MAP APA (for the future)*
  - c) Revising a MAP APA*



## Step 6: Monitoring

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- Taxpayer provides tax administration with **annual compliance reports**
  - fulfilment of the transfer pricing conditions and the critical assumptions
- Compliance reports are examined
- In cases of deviation of critical assumptions:
  - Re-negotiation or termination of the APA
- Tax authorities not allowed to make TP adjustment if taxpayer applied TP methodology as agreed in the APA and critical assumptions do not exceed agreed level





## Step 6: Monitoring - Examinations/Audits -

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- Examination of transactions covered by the MAP APA are limited
  - to determining the taxpayer's compliance with terms and conditions of the APA and
  - whether the circumstances and assumptions necessary for the reliable application of the selected TP methodology continue to exist



## Step 6: Monitoring - Examinations/Audits -

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- Tax administration may require the taxpayer to establish that:
  - a) Taxpayer has complied with the terms and conditions of the MAP APA;
  - b) Representations in the proposal, the annual reports and in any supporting documentation, remain valid and that any material changes in facts or circumstances have been included in the annual reports;
  - c) TP methodology has been accurately and consistently applied in accordance with the terms and conditions of the MAP APA; and
  - d) Critical assumptions underlying the transfer pricing methodology remain valid.




## Step 6: Monitoring

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### **Consequences of Non-Compliance or Changes in Circumstances:**

- Tax administrations may agree to continue applying the MAP APA even in case of non-compliance or changes in critical assumptions, for example where the effect of the failure to comply is not material.



## Step 6: Monitoring

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- If they do not agree to continue applying the MAP APA, there are 3 possible consequences:
  - **Revocation:** the MAP APA never existed. The revocation is retroactive to the beginning of MAP APA period.
  - **Cancellation:** the MAP APA is cancelled prospectively from a certain date. The MAP APA will no longer have any further force on the affected taxpayer(s) and the other tax administration from the date of cancellation.
  - **Revision:** the MAP APA remains effective for the whole period but its terms may be changed prospectively.
- Action to be taken is depends on seriousness of the non- compliance.



## Step 6: Extension/Renewal of APA

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## Step 6: Renewal of APA

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- Format, processing, and evaluation of renewal application usually similar to initial MAP APA application.
- Level of detail may however be reduced with the agreement of the participating tax administrations, particularly if there have not been material changes in the facts and circumstances of the case.
- Renewal of a MAP APA is not automatic and depends on the consent of all parties concerned and on the taxpayer demonstrating, compliance with the terms and conditions of the existing MAP APA.
- Methodology and terms and conditions of the renewed MAP APA may differ from those of the previous MAP APA.



# Q & A