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EU JOINT TRANSFER PRICING FORUM

SUMMARY OF BUSINESS REPLIES TO THE APA QUESTIONNAIRE

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Background Document

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Q1) Which legal or practical problems form the main obstacles to the provision of an APA?

Practical problems:

- The amount of work involved was a large practical problem (but there was a general acknowledgement that the work involved should be less than that required in a transfer pricing audit.)
- Length of time necessary to complete the APA negotiation.
- Possibility that taxpayers would be locked into the APA process once an initial APA had been negotiated and expected or forced to make a renewal.
- Fear of provoking either an actual audit or a process that was an audit in all but name.
- The amount of work involved would lead to substantial costs, especially if outside advisors were used.
- The possibility that work done would be wasted if there was no ultimate agreement.
- Few Human Resources available in tax administrations to conduct a skilled transfer pricing examination. General lack of experience in tax administrations. General negative attitudes of tax administrations.
- Tax administrations organise APA programmes in different ways from each other and this leads to many practical problems on timing of requests, provision of information, difference in treatment between administrations etc.
- The necessity of having a stable business model for the APA application. If this is not the case, then no application can be made.
- Unilateral APAs not very valuable because they do not provide certainty.

Legal problems:

- Lack of legal certainty available in some jurisdictions.
- Lack of statutory powers available to tax administrations to allow the binding effect of the APA.
- Unclear internal procedures in tax administrations
- Lack of clear procedures for bi and multi-lateral negotiations.

Q2) In general, what do you think has dissuaded taxpayers from applying for an APA?

- If a taxpayer believes that an APA will be an audit and will require the same amount of work as an audit then there is no point in making an APA application.
- Lack of uniformity in tax administrations' APA procedures is a disincentive.
- An APA represents a very high level of transfer pricing risk management for a taxpayer. There may be cheaper ways of managing this risk than an APA. The possibility of an audit will be a factor in this risk management.
- For an APA to be worthwhile there must be a significant possibility that tax administrations will have different views over the application of the arm's length principle.
- The possibility that no agreement will be reached.
- Fear that a tax administration will use APA information outside the APA process
- Fear that an APA application will be used by tax administrations as an invitation to commence an audit.
- Mistrust that a tax administration will not be objective.
- Time taken to conclude an APA.
- Volatility of business models.
- Excessive information requirements.
- Balance of time and costs versus legal certainty on offer.
- Lack of taxpayer involvement in bi-lateral negotiations leading to a fear that the taxpayer might end up stuck in the middle between tax administrations and be forced to accept an unpalatable distribution of taxing rights.

Q3) Is there any particular reason that taxpayers experienced which meant that an application did not result in an APA being concluded?

- There was general agreement that once the APA process is begun in earnest (when a formal application is accepted), then an agreement has been reached at some stage in the large majority of cases.
- The main exception to this has been when applications have been turned down at the pre-filing stage. But it was acknowledged that this is one of the reasons for having a pre-filing stage.
- Complexity thresholds might preclude an APA application from being accepted by a tax administration.

- Where formal applications did not lead to an APA being concluded, the main reason was a break down in the negotiations between CAs. One reason for this was when tax administrations each wanted to use a different transfer pricing methodology. On some occasions taxpayer and tax administration were unable to agree how to interpret facts. Sometimes excessive information requirements lead to a taxpayer withdrawing from the process.

Q4) Does the experience of negotiating APAs differ radically between countries? Do you think any one country has some good practice which other countries should adopt?

- Differences in practice arise from the internal conditions of a tax administrations and were therefore understandable if not always desirable.
- The specialisation of APA or transfer pricing expertise within a tax administration aids the APA process.
- An APA team separate to any audit team helps the process.
- The involvement of the CA throughout the APA process is seen as good practice.
- Having no formal demarcation or handing over between local inspectors, APA teams and CA was seen as giving great flexibility and helping the over-all process.
- To be helpful, good practices must be carried out by all tax administrations in the process or else the bi-lateral negotiations will be difficult for the taxpayer to manage.
- Where APA procedures did exist, it would be helpful if they were published. Where targets were in place, details of actual performance against targets should be published.
- Negotiations run more smoothly where there are well defined and published procedures and where there is mutual trust.

Q5) It is reasonably safe to say that, outside the US, few bilateral or multilateral APAs have been concluded. Why do you think this is?

- The size of the US economy means that the IRS has been faced with large-scale globalisation issues, leading to many transfer pricing audits. As a result US MNEs have had to consider APAs as a way of managing transfer pricing risk.
- The legal framework in the US can provide certainty thus making APAs attractive.
- APAs have not been entered into in the same degree in other countries because of a lack of a legal framework, lack of procedures or a lack of access to an APA procedure.

Q6) The benefits of an APA are often described as "more certainty." Do you think this is actually important? What benefits would you expect to derive from a successful APA? What is the most critical risk that would feature in your decision to apply? Once you have applied, what is the most critical risk you become subject to?

- Certainty is a key feature. Certainty means that the tax profile of a company will not fluctuate and a tax department can plan its use of resources accordingly. Because of this, investment in an APA will be better than having to meet a succession of aggressive audits.
- An agreed APA forces the Business units of a company (as opposed to the tax department) to keep to an agreed method of operating the business.
- All parties benefit from the lack of confrontation. Agreements can be concluded faster than during an audit.
- All parties benefit from the absence of double taxation in a successful APA.
- A successful APA removes exposure to penalties.
- After application, the possible risks are an unexpectedly lengthy time to conclude the APA leading to unexpected costs, the risk that negotiations might break down possibly resulting in an audit, the risk that burdensome amounts of information might be necessary and the risk that information will be used outside the APA process.

Q7) In your experience, where does the APA process break down? During the pre-filing stage? During the negotiation with the one tax administration? During the negotiation between tax administrations? Or somewhere else? What causes the procedure to break down?

- Once an application had been formally accepted, it was rare for the process to break down. Where this did happen it could be because of a failure at the evaluation stage or at the negotiation stage. "Failure" more often occurred in terms of delays in the agreement of the APA.
- Failure might occur because of tax administrations taking radically different views, the taxpayer and a tax administration being unable to agree on an interpretation of fact or else because of the taxpayer withdrawing its application, either because of lack of agreement or because of excessive information requirements.
- A failure might result from unequal treatment of one tax administration over another in the application.
- A failure might result from the development of a competitive not cooperative approach between tax administrations.

Q8) In percentage terms, how many APA procedures have you been involved in where an agreement was not successfully negotiated? Whose decision was it to withdraw: the taxpayers or the tax administrations?

- Very few complete breakdowns in process occur once the decision has been taken to proceed at the pre-filing stage.
- For some advisors, the percentage of applications that had not resulted in an APA was 0%.
- For particular taxpayers, as opposed to advisors, the failure rate could be much higher – for example, 25% - 30%
- Where applications were withdrawn, it was most often by mutual consent.

Q9) What reasons have affected a taxpayer's decision to apply or not to apply for an APA?

- Fear of audit
- Fear that the taxpayer would be adversely affected by the APA.
- The likely (excessive) time taken to conclude any APA.
- The ability to manage the likely transfer pricing risk in other ways.
- The fear that the APA application will give the tax administration a "route-map" into the inner workings of the company.
- The time and expense that will be required measured against the benefit.
- If there is no doubt over the interpretation of the arm's length principle then an APA will not be worthwhile.
- The volatility of the business model and uncertainty over whether the APA model will be flexible enough to accommodate the volatility.
- A desire to avoid having to provide burdensome amounts of information.
- An APA is advisable for major business operations where waiting for an audit is not worthwhile.
- An APA is advisable where a previous outcome at MAP has been undesirable for the taxpayer.

Q10) Will more flexibility within the terms of an APA lead to more taxpayers applying for APAs? For instance, should it be possible to revise critical assumptions within an APA?

- Commentators generally agreed that only a limited flexibility could be built into critical assumptions
- However, it was seen as a good idea if an APA could be re-examined not withdrawn if critical assumptions changed.
- Any APA process should be as flexible as possible but not to the degree that certainty would be eroded.

Q11) Do you consider that it is important for an APA to offer the possibility of rollback?

- Rollback can be very useful and can make the cost/benefit analysis for an APA more attractive
- It is very helpful if rollback can be included in an APA to finalise tax treatment in earlier periods
- However, it might not always be viable to rollback an APA. If the circumstances of the taxpayer were different in the past, rollback will be inappropriate.
- Often an APA is appropriate when business models change. In which case, rollback would be inappropriate.
- Fear of rollback being imposed on a taxpayer was sometimes a disincentive to apply for an APA.

Q12) Does the possible duration of an APA (perhaps limited by statute) influence your decision to apply?

- Most commentators agreed that APAs should be available for 3-5 years. Any shorter periods would make APAs unattractive due to the costs involved.
- The length of an APA should be linked to the timescale of any business model.
- Taking three years to negotiate a three year APA was seen as very unattractive.
- For stable businesses, longer APAs were more attractive

Q13) How often has the possibility of renewal made the whole proposition of an APA more attractive?

- Renewal makes the whole proposition of an APA more attractive
- The possibility of renewal weighs the cost/benefit analysis more in favour of having an APA. Renewal spreads the cost of the investment.
- Where business models have remained essentially the same, renewal negotiations should not involve the same amount of work as the original application.
- It was seen as wrong if a taxpayer was forced or pressured into making a renewal.

Q14) What is the average length of time taken to conclude an APA negotiation?

- The average length of time to conclude an APA was between two and three years.
- This was seen as unnecessarily long.
- One company's APA negotiation had taken 5 years. Another company's had taken 8 years.
- Simpler APAs took less time to negotiate.
- Unilateral APAs were faster to negotiate but provided less certainty so the cost/benefit analysis was unchanged.

Q15) What are your thoughts on publishing some details of APAs?

- Publication of numbers of APAs, timescales, time taken to negotiate, procedures etc was seen as helpful.
- Some actual details of concluded APAs should be published to give taxpayers an idea of what transactions could be included in an APA.
- However, whatever was published must remain anonymous.