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EU JOINT TRANSFER PRICING FORUM

SECRETARIAT DRAFT DISCUSSION PAPER ON KEY POINTS FOR AN EFFICIENT APA PROCEDURE

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Working document

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1. Introduction and background

1. For transfer pricing risk management, taxpayers have many options. A responsible taxpayer implements a defensible, well documented transfer pricing policy which adheres to the arm's length standard. There will be further benefits for the taxpayer and the tax administrations involved if the taxpayer's transfer pricing policy can be agreed prospectively. An APA determines an agreed methodology for calculating the arm's length price before the relevant transactions have taken place.

2. Scope of this paper

2. This document discusses how an APA application could be dealt with as efficiently as possible by taxpayers and tax administrations. Inevitably, timing and organisational issues play a great part in this. Certain issues of a more technical or detailed nature are discussed in a separate document. These include retrospection, complexity thresholds, types of transactions to be included, critical assumptions, fees, unilateral vs. bilateral APAs etc.
3. This document focuses on bilateral and multilateral APAs. The objective of this document is to identify the key elements necessary for an efficient APA procedure.

3. Advantages of APAs

4. APAs provide various advantages for both taxpayers and tax administrations. Taxpayers benefit foremost from the legal certainty concerning the agreed transfer pricing.
5. In addition, the taxpayer participates in an APA by presenting and discussing its case with tax administrations to a greater degree than in the conventional mutual agreement procedure (MAP). Due to this participation, there is an opportunity for taxpayers and tax administrations to consult and cooperate in a non adversarial spirit and environment.
6. The opportunity to discuss complex tax issues in a less confrontational atmosphere than in a transfer pricing examination can stimulate a free flow of information and agreement between all parties. This cooperative environment may also result in a more objective review of the facts than in a more adversarial context.
7. Since in an APA discussion no irreversible actions have been taken due to the prospective nature of the APA, there is more flexibility than in a transfer pricing examination or MAP. Flexibility also arises from the cooperative nature of the discussions. This increased flexibility can only help secure an outcome beneficial to all parties.
8. An agreed APA should remove the need for a transfer pricing examination of the tax issues covered by the APA. This should always be the case if the taxpayer adheres to the conditions of the agreed APA. Tax audits can be costly and time consuming for tax administrations and taxpayers, particularly if litigation becomes necessary. Given the cooperative nature of the APA process, the resources necessary to conclude an APA will often be less than those required for a subsequent tax audit. This will be even more the case when compared to the additional resources and costs necessary for a subsequent MAP or arbitration procedure

which will also be avoided in bilateral or multilateral APAs. These savings are one of the main benefits to all the parties of an APA.

9. A bilateral or multilateral APA, which agrees the tax treatment between a taxpayer and more than one tax administration, also averts the risk of double taxation. Once double taxation is avoided, taxpayers may be more flexible concerning the allocation of profits as they would in an audit. This too will encourage agreement.
10. In addition, a tax administration can enjoy the benefit of enhanced taxpayer compliance which will result from an APA.
11. APAs therefore have many advantages. However, APAs cannot be a cure for all transfer pricing problems and cross-border disputes. Even if an APA procedure is organised as efficiently as possible, APAs will still prove time consuming and resource intensive, even if over-all there is a resource saving compared to an audit and MAP. But these limitations or disadvantages of an APA become less serious when an APA procedure is organised more efficiently.

4. Documentation requirements for APAs

12. One of the benefits of a successful APA procedure should be reduced costs for both taxpayer and tax administration. Taxpayer and tax administration are both stakeholders in the APA. Both should therefore cooperate as fully as possible. In particular, documentation requirements for an APA should not be unduly onerous for the taxpayer. Nevertheless, tax administrations retain the right to request all the information and documents necessary to allow the evaluation of the taxpayer's proposal. But all information requests should recognise that one overall aim is to reduce resource implications and costs for both taxpayer and tax administration and to keep them below the resource costs of an audit. In the atmosphere of the APA, taxpayer and tax administration should work together to consider what information is available and what information would be useful. For the information to be submitted with the formal application and the functional analysis to be provided see Appendices A and B.
13. Where a taxpayer uses the EU Transfer Pricing Documentation (EUTPD) this could be used as a basis for the APA application.

Question 1: Does the Forum agree with this general approach to documentation requirements?

5. Organisation of the tax administration dealing with APA applications

14. For bilateral or multilateral APAs the Competent Authority (CA) of each Member State will have to be involved since negotiations will be entered into with treaty partners. It is therefore preferable that Member States organise their APA programme in such a way that it is administered centrally by the CA. In this case, taxpayers should make their application to the CA.

15. A central administration of the APA programme will also have other advantages. It will aid consistency of treatment for taxpayers. It will enable faster communication between countries. And central administration by the CA will secure separation of the APA programme from the tax audit programme
16. The CA will be able to call upon expertise from elsewhere in the administration and that will include audit expertise with knowledge of the particular taxpayer or tax matter. However, it is important that the differences between an APA and an audit are recognised. And, as recommended in the OECD Guidelines, the CA function should be separate from any audit process. This separation should aid the successful conclusion of an APA since the CA, unlike the auditor, is not supposed to be constrained by national self interest but should view the case more objectively. It is recognised that tax administrations with very limited resources may only have limited options available when they organise how APAs will be dealt with. However, even with limited resources, it should be possible to organise the APA programme centrally.

Question 2: Does the Forum agree that a tax administration's APA programme should be organised centrally and separately from the audit process?

6. Fear of audit

17. One of the factors which will dissuade a taxpayer from requesting an APA is the fear that this will result in an audit, or a series of events with all the hallmarks of an audit. If this is the case then the taxpayer has little to gain from requesting an APA: the taxpayer may as well do nothing and take the chance of being subject to an audit in the normal fashion.
18. The tax administration too has gained nothing: there will be no APA and the tax administration has to carry out a risk assessment and conduct an audit and possibly an MAP in the normal fashion.
19. Another factor which may dissuade a taxpayer from requesting an APA is the concern that the tax administration might consider the agreed transfer pricing methodology as the only "correct" one and a different transfer pricing methodology applied by the taxpayer prior to the APA as not being at arm's length. A taxpayer may also fear that selective information from the APA process might be used against him in a tax audit. The audited taxpayer might, therefore, feel compelled to show that the transfer pricing methodology applied by him prior to the APA also resulted in an arm's length range of prices.
20. From the point of view of the taxpayer, an APA represents very much the high end of transfer pricing risk management. The way in which a taxpayer manages transfer pricing risk could in theory range from doing nothing and not having a transfer pricing policy at all (this is of course unlikely and does not normally represent the responsible attitude of most taxpayers), to establishing an arm's length pricing policy with evidence to substantiate what has been done. This transfer pricing policy could be in place before the transaction is entered into.

21. In an APA, the taxpayer takes the further step of asking the tax administration to agree that the transfer pricing policy will result in arm's length pricing into the future, before the transactions have been entered into. This step requires considerable commitment from the taxpayer. To encourage this commitment, tax administrations need to make the APA process as attractive as possible, so that both tax administrations and taxpayers can benefit. Having an APA process that is an audit or resembles one is a sure way of making the APA process very unattractive.
22. The tax administration should consider what is gained by conducting an audit under the auspices of an APA. The taxpayer will be likely to withdraw the enhanced cooperation present in the APA procedure, for the legitimate reason that the APA process has become an audit process. The APA application might be withdrawn, wasting the resources that have already been used by the taxpayer and also the tax administration.
23. Since an APA has clear advantages for taxpayers and tax administrations it is beneficial to both parties to make APAs more attractive and easier to obtain. This will not be the case if an APA process is an audit process in everything apart from name.
24. An APA should be a co-operative process. Both parties have much to gain from the APA in terms of relative certainty and resource saving. To gain these benefits both tax administration and taxpayer have to act in line with the cooperative nature of the APA. The taxpayer should co-operate fully in terms of provision of information and openness; the tax administration should keep in mind this co-operation when requesting information and formulate its position with the taxpayer – not against the taxpayer. An APA should never be seen by a tax administration as an opportunity to carry out an audit or to gain access to information – particularly to information about foreign affiliates – which would otherwise be unobtainable in the normal course of business.
25. With this complete taxpayer co-operation, there should be no need to carry out a full audit. Audits are very resource intensive and often combative. As such an audit can be a very inefficient way of upholding the arm's length standard, however necessary it is that audits are carried out by tax administrations in the normal course of their business. An APA should always be carried out in a less adversarial fashion than an audit to reflect the fact that, very often, the interests of the taxpayer and tax administration coincide. An APA should be a more efficient way of upholding the arm's length standard than an audit since an APA should result in the application of the arm's length standard using fewer taxpayer and tax administration resources.
26. This does not, of course, preclude a tax administration from carrying out an audit if something comes to light which requires an audit. But this should not be a normal result of every APA procedure. For example, if facts come to light during an APA procedure that indicate that serious errors have been made in the past, then the tax administration might be compelled to conduct an audit. However, tax administrations should refrain from acting as if they expect this to be the case on every occasion. This will be counter-productive and will not encourage taxpayers to seek APAs.
27. In return, taxpayers must be as open and co-operative as possible. This does not mean that tax administrations have carte-blanche to demand anything and everything and interpret non

compliance as non co-operation. Taxpayer and tax administration should wherever possible work together to study necessary information and to reach an agreed position. Hence the normal tension between tax administration and taxpayer need not be present in an APA. This benefits both parties.

28. To prevent any APA from becoming an audit, the key for any tax administration will be to ensure that a central overview is taken of all APAs. The role of the CA in any APA will also be vital. The CA can be expected to have a clear idea of the aims of the APA and, as suggested in the OECD Guidelines, the CA should not be constrained by narrow national interest. It is for these reasons that the CA should be involved at every stage of the APA.

Question 3: Does the Forum agree that a fear of audit or a fear of an APA process becoming an audit in disguise is one main reason why taxpayers do not request APAs?

Question 4: Does the Forum agree that an APA may become an audit in exceptional circumstances only?

7. Conduct of the APA process

29. In order to maximise the benefits from APAs it is necessary to organise APA procedures in the best possible way and conduct any APA application as efficiently as possible. The aim should be to encourage taxpayers to request APAs where they are appropriate; to achieve this aim it will be necessary to conduct APA negotiations as efficiently and as quickly as possible.
30. There are many possible ways in which an APA can be processed by taxpayers and tax administrations. But there are common stages present in most APAs and these stages will form necessary areas where best practice can be developed.
31. Typically existing APA procedures utilised by countries which already have APA programmes have all or some of the following features:
- a. Pre-filing stage;
 - b. Formal application;
 - c. Evaluation and negotiation of APA; and
 - d. Formal agreement of APA.
32. Each of these phases is discussed in this document. The time taken by each phase will vary depending on the complexity of the individual APA (and may increase if the APA is multilateral because of the number of tax administrations involved). As in the MAP process, excessive time taken to reach an agreement is a legitimate complaint of taxpayers and often can act as a major disincentive for taxpayers in applying for an APA. Efficient practices in

each stage of the APA will keep the time taken to conclude an agreement to the necessary minimum. Appendix E gives an illustrative time frame for these events.

7.1. Pre-filing stage / Informal application

33. Taxpayers are encouraged to approach tax administrations as early as possible when applying for an APA. This is to ensure that the advance nature of the APA remains as distant as possible in the future. This will allow negotiations to be completed either before the years the APA will cover are reached or as soon into that period as possible. This will maintain flexibility since it will allow taxpayers to behave according to any agreement reached with the tax administration. For instance, if no agreement is reached before tax returns have to be made then the taxpayer will be uncertain as to the basis on which the tax returns should be filed. Of course some balance is necessary: taxpayers must have a clear idea of their intentions in the future, so the proposed term the APA is to cover cannot be so far into the future as to preclude this certainty of intention.
34. Where possible, tax administrations should allow an initial approach from a taxpayer on an informal basis to explore the benefits, costs, requirements and transfer pricing methodology for a potential APA. The tax administration should be able to give a clear indication as soon as possible whether a taxpayer will be allowed into the APA procedure. Hence, the taxpayer will be saved the often considerable expense of a formal application if no APA is to be permitted. Expense will also be saved if a tax administration can indicate in the pre-filing meeting what it would and would not accept within an application. For instance, a taxpayer will not have to spend resources developing a transfer pricing methodology that will not prove acceptable to a tax administration.
35. The taxpayer should approach all of the Member States potentially involved. Where more than one tax administration is consulted, the same information should be provided to each (this should apply throughout the APA). There may be situations where a taxpayer prefers to approach one tax administration first to gauge its view; if this is the case then other tax administrations should be approached as soon as possible afterwards if the application is to go ahead.
36. If it is deemed necessary, as part of the pre-filing stage, CAs should consult with one another. This might be necessary, for instance, if a tax administration took a view that it would only accept a request for an APA if the relevant treaty partner would do likewise. Where such a consultation is deemed necessary, it should take place as quickly as possible in order to expedite an agreement over the treatment of an APA request.

Question 5: Does the Forum agree that there is value in having a pre-filing stage?

7.1.1. Information to be provided at the pre-filing meeting

37. The idea of the pre-filing meeting is to allow an informal approach to establish whether an APA is appropriate and to assess the potential benefits and costs. It is not helpful that tax administrations require an onerous amount of information at this early stage. Tax administrations should also recognise that every case will be different and will require

information of a different type and amount. The information provided should of course be sufficient to allow the tax administration to give an indication of whether the APA procedure will be accepted when the formal application is received. The information will have to provide sufficient detail to permit this analysis and should at least describe the activity and transactions to be covered, the preferred methodology, desired length of the APA, any rollback and the countries to be involved.

38. Where the tax administration decides that an APA will be appropriate it is good practice for it to tell the taxpayer what information should accompany the formal application.
39. Tax administration and taxpayer should use the opportunity of the pre-filing stage to influence the nature of the formal application. For instance, tax administrations might be able to give broad agreement to the term of the APA or indicate that it would not accept a cost based methodology for a sales company.
40. The pre-filing stage will also allow a tax administration and a taxpayer to discuss the interpretation of any complexity threshold used by the tax administration, in particular where the taxpayer is concerned that any complexity threshold will mean that it is denied entry to the APA programme operated by the tax administration.

Question 6: Does the Forum agree with the above propositions on the pre-filing information?

7.2. Formal application for APA

41. Formal application for an APA should be made as early as possible in relation to the years to be covered by the APA and in particular soon after any informal approach. The taxpayer should make the request to the tax administration of its country of residence. Where more than one country is involved, taxpayers should make formal applications at the same time to all countries. Where Member States have different administrative or legal procedures concerning APAs, it is the taxpayer's responsibility to ensure that all applications are made in time. In turn, the tax administration should endeavour to tell the taxpayer whether the application for an APA has been formally accepted and to request any further documentation necessary to formulate its position as soon as possible.

7.2.1. Content of the application

42. Since every case will be different there is no ideal form for any request. But the request, if it is to be considered in a measured, timely fashion, must contain certain information. Appendices A and B contain details of the type of information that is likely to be necessary in all instances but is not necessarily a minimum and is certainly not the maximum since this will vary between cases. In its initial application, the taxpayer should try to enclose all relevant information necessary for the tax administration to consider the application and to come to a view about the methodology that will be used to later calculate the arm's length price. It is preferable that views on what this information should amount to could be exchanged at the pre-filing stage. The aim is to provide as much necessary information as possible as soon as possible without unnecessarily onerous resource implications for the taxpayer.

43. Of course, it is unlikely that a taxpayer will be able to anticipate all of the information that a tax administration will require. And it is possible that a tax administration may require supplementary information throughout the evaluation and negotiation of the APA.

Question 7: Does the Forum agree that Appendices A and B form a reasonable basis for an APA application?

7.3. Evaluation and negotiation of the APA

44. Once an APA application is received it must be evaluated by the tax administration. The taxpayer will be closely involved in this because it is the taxpayer who is in possession of the facts of the case. Once the tax administration is satisfied with the explanation of the facts and circumstances of the case then the negotiation with the other tax administrations involved can begin.
45. Some countries keep the evaluation of the APA and its negotiation separate and do not begin to negotiate any APA until it has been evaluated and their position developed. Other countries might start to negotiate the APA while they are still evaluating it. In practice the distinction between the activities is often blurred. Nevertheless, the aims of the evaluation and negotiation are distinctive. The evaluation allows the tax administration to formulate its most desirable set of terms and conditions for the APA. The negotiation is where the tax administrations involved seek the agreement of all parties and may require compromise to reach an agreement between the parties.
46. Immediately after a formal application is received the CAs of the tax administrations concerned should contact one another and seek to establish a timetable for the APA. The taxpayer should be involved in this discussion because the taxpayer will be required to produce any further information to allow the tax administrations to evaluate and negotiate the APA. The CAs should also agree on what will happen should the timetable not be adhered to. One possibility could be a referral to more senior officials of the tax administration.

7.3.1. Evaluation by the tax administration

47. Before entering into negotiations with another country a tax administration must have its own position (the "country position") in mind. To reach this position it will have to consider relevant information. This process could be considered the evaluation stage of the APA and the consultation with another country the negotiation stage. However, since the final APA will always involve inter-action with another country it seems sensible for all the CAs to consult with one another as early as possible in the process and not merely at the end. This will allow them to exchange preliminary views and perhaps issue joint information requests or more tailored requests. This consultation could range from a face to face meeting to an exchange of emails or a telephone conversation. This inter-action between CAs can be an ongoing process or could only happen at the start of the application and then after both country positions have been established. The best approach for the specific APA should be adopted. In some cases, it may not be necessary for CAs to consult periodically before country positions are established. But in most cases it will be more effective for CAs to reach

provisional agreements together as early as possible even if the agreements have to be revised in the light of subsequent facts.

48. However, where a tax administration deems it unnecessary to consult in depth with another before establishing its own position, it should endeavour to finalise its position as early as possible in the process and hence open CA negotiations as soon as possible.
49. It is unwise for a tax administration to formulate its position without any consultation between CAs at all. At the very least CAs should consult very soon after an application is received to establish a timetable for the APA. Likewise it will often be better for them to consult throughout the time their respective country positions are being established. However, it may also be unwise in some cases for the CA negotiation to run in parallel to the evaluation and information seeking stage of the APA: this may actively work against each country finalising its position at all.
50. It might well be that, after examining the information provided, the tax administration may agree completely with the application submitted by the taxpayer. In this case, the country position will be the same as the position of the taxpayer submitted in the original application. The agreement of the taxpayer with this can be assured (unless events since the application have taken an unexpected course but this should be unlikely).
51. However, in many cases the Member State will not agree with everything in the taxpayer's application and it will be necessary to establish a different, agreed position between taxpayer and tax administration. It is to be expected that this exchange of views and information will take time.

7.3.2. The APA procedure and the role of the tax auditor

52. In the more traditional atmosphere of a transfer pricing audit and a MAP, it could be seen that the role of the auditor is to establish a position that, while being fully commensurate with the arm's length principle, is the best position possible for his tax administration. Likewise, it could be seen that the function of the CA, acting as an officer of the double tax treaty under the MAP or exchange of information article, is to view the arm's length principle objectively under the tax convention and to find agreement between CAs.
53. But this separation of the powers, recommended in the OECD Guidelines as best practice, is not always fully distinct in an APA situation which is essentially co-operative between the taxpayers and the countries involved.
54. Without compromising the traditional role of the CA and the auditor, in many circumstances it will be better for both to work together to establish a country position, while keeping in mind their respective roles. This is because it may ultimately save time if the auditor and CA consult with one another to establish a position. There is little point in the auditor pursuing his own enquiries to establish a view which will then have to be altered radically by the CA later before the country position is formally established and the position made known to the other tax administrations.
55. Indeed, some countries organise their APA casework completely separately from both their usual audit work and their CA by having a separate APA unit to conduct the APA. Some

countries keep the APA in the hands of their CA throughout the application. This would help prevent the APA from becoming de facto an audit. Best practice should allow the tax administration to draw upon all of its expertise to conduct the application as effectively as possible.

56. Whatever this practice is, the role of the CA in negotiating the APA with another country should always be paramount. In general, the CA should have the power and authority to alter the auditor's position to create the formal country position before exchanging this with another CA or at a later stage during the negotiation.
57. The evaluation of an APA application can be a lengthy process since it involves the gathering and consideration of information, possibly from a number of sources. Tax administrations and taxpayers should work together in an APA to minimise any delay, in particular by making timely requests for necessary information and supplying information in a timely manner. Making joint/common requests for information by the tax administrations involved could further minimise delays.

Question 8: Does the Forum agree that the evaluation stage is especially vulnerable to delay and therefore all parties should take care to keep any delays to a minimum?

7.3.3. Agreement between the taxpayer and the tax administration

58. Since no party is engaged in an audit, nothing can be imposed. For instance, the taxpayer cannot be compelled to include particular transactions in an APA. The tax administration could form a view completely different to that of the taxpayer but in that case the taxpayer would be free to withdraw the APA application. Both parties would have wasted their resources. To keep the potential for wasted resource to a minimum, the tax administration should try as early as possible to indicate areas of broad agreement – even at the pre-meeting. Given the advantages of an APA, it is in the interests of all parties to keep the proceedings on track to a mutually acceptable conclusion.
59. Whether the taxpayer will finally agree to an APA is of course dependent on the outcome of the negotiation of the CAs. But obtaining the taxpayer's consent at every stage of the proceedings will minimise the risk of failure of agreement at the end. And where the agreement between the CAs eliminates the possibility of double taxation then the taxpayer is likely to accept the APA.
60. Experience has shown that major delays in the APA process arise during the period when a tax administration is seeking information to form its position. Therefore tax administrations should make every effort to keep this period to a minimum by requiring only pertinent information; taxpayers should in turn provide any information requested as quickly as possible. In general, it should be possible to agree what information is relevant. In practice, tax administrations should work with not against taxpayers to reach an agreement in the APA.
61. All information provided to one administration should also be provided to the other administrations involved. Details of what information has been requested should also be exchanged. A convention should be established for each APA to say whether the taxpayer

will do this or, through exchange of information, the tax administration. This openness will add to the cooperative spirit of the APA and, by establishing trust between all the parties, help find a mutually acceptable conclusion.

7.3.4. Negotiation between CAs

62. One of the main causes of delay in the APA process is a failure to start full CA negotiations at the appropriate time. Member States should therefore make every effort possible to do this as soon as possible. This means that fact finding etc should be completed expeditiously so that CAs can exchange position papers as early as possible.
63. Ideally inter-action between CAs should be an ongoing process but on a case by case basis this is not always possible. At the very least CAs should try to maintain contact while the APA is being evaluated to exchange views and information.
64. The formal exchange of country positions should take place by an exchange of position papers. Wherever possible, CAs should seek to exchange position papers as soon as possible after the formal application for an APA is received. For this target to be met, the co-operation of the taxpayer in providing information and replying to questions quickly is essential.
65. It is good practice for each CA to produce a stated position at the start of the final CA negotiations. Negotiations should only begin when all tax administrations involved have developed their position. The existence of two position papers will help to clarify the differences between CAs.
66. To preserve the separation of audit and CA, the auditor should not take part in the CA negotiations. However, each CA is of course free to call upon the auditor as a consultant if it becomes necessary.

Question 9: Does the Forum accept this division of roles between Competent Authority and tax auditor?

7.3.5. Contents of the position paper

67. It might be that one tax administration can accept the position contained in the taxpayer's application without alteration. In this case the CA position paper needs only refer to this application and highlight the most salient points but it should also contain argument as to why the taxpayer's application is accepted unaltered, together with any additional evidence seen as relevant. Exceptionally, both administrations might accept the application unaltered in which case no CA negotiation may be necessary except for a formal exchange of views.
68. Once negotiations have commenced CAs should agree a timetable to resolve any outstanding issues. If more than one meeting is necessary – as is often necessary in more complex cases – then the taxpayers should be kept informed of any developments. This will enable them to make suggestions or provide information quickly to resolve any dispute between CAs. Appendix C lists some suggested contents of a CA position paper.

Question 10: Does the Forum agree that the contents of Appendix C are appropriate for the CA position paper?

7.4. Final agreement between CAs and the taxpayer

69. The final agreement between CAs and taxpayer will be a legally binding document and it will govern the behaviour of all parties. There will be an agreement between each tax administration and the taxpayer resident in that administration. There will also be another agreement between the CAs. All these agreements should detail the terms and conditions of the APA. The taxpayers will require legal certainty that, provided the relevant terms of the APA are met, then the chosen transfer pricing methodology will be acceptable for all agreed transfer pricing purposes and that the transactions between associated enterprises will not be subject to a further transfer pricing audit. This will amount to a binding agreement between the parties. The taxpayer is entitled to a legal agreement to provide this certainty. Tax administrations should ensure that they are able to provide this legal certainty.
70. In return, the legal agreement gives the tax administration comfort that, providing the terms and conditions of the APA are met, the taxpayer's transfer pricing is arm's length. Audit resources can be directed elsewhere. Appendix D contains some of the details necessary in an APA agreement between a taxpayer and a tax administration.

Question 11: Does the Forum agree that the details in Appendix D are necessary for an APA agreement?

8. Conclusion

71. APAs are a tool for providing certainty of treatment for taxpayers and tax administrations. Both parties receive the advantage of this certainty and also benefit from resource savings. Tax administrations should ensure that APAs are available in such a manner that these advantages will arise without excessive resource burdens. An over-all resource and cost saving will result from efficiently conducted APAs for all parties, compared to those spent in a transfer pricing audit and subsequent MAP and possibly arbitration. Tax administrations are free to choose whether APAs will be offered to taxpayers but where they are offered they should be conducted as efficiently as possible. This will persuade taxpayers to apply for more APAs because the benefits will be more apparent and will increase. It is also true that as tax administrations carry out more transfer pricing audits in a more sophisticated manner, the advantages of APAs for taxpayers will become more apparent.
72. Appendix E contains a suggested timeline for any APA procedure. The timeline features all of the key elements required in any APA mentioned in this document.

Question 12: Does the Forum agree that Appendix E could form a basis for the time frame for an APA procedure?

Question 13: Do Forum Members think that this paper sufficiently covers the key points for an efficient APA procedure or are there any other key issues the Forum wishes to add?

Appendix A: Information to be submitted with formal application

This is a list of the type of information that is likely to be relevant for all APAs but since every case is different it should not be viewed as prescriptive.

1. Name and address of all associated enterprises in the APA.
2. A group structure showing all entities involved in the trade of these enterprises
3. A description of the business conducted by the associated enterprises. This should amount to a functional analysis (see Appendix B) of the entities involved but can be tailored to the specific case. For instance, it may not be necessary for a complete functional analysis if only some and not all transactions are to be included in the APA. In such a case it might be sufficient to make available background details of all activities but provide more detail for the transactions to be included in the APA.
4. The critical assumptions integral to the APA
5. The years the APA is to cover, including any request for rollback.
6. Details of the tax position of each entity involved for these years, e.g. tax return agreed, submitted but not agreed, submitted and under audit etc. Details of any MAP process still open and an analysis of the time limits laws in place in each relevant jurisdiction to show whether years of assessment are capable of being adjusted under the APA should be included.
7. A description of the transactions to be included in the APA. This should be as complete as possible and could include details of:
 - a. the activity involved in each transaction;
 - b. which entity carries out this activity; and
 - c. the relative importance of each activity and who each entity buys from and sells to.

If certain transactions are to be excluded from the APA, the taxpayer's reasoning should be stated.

8. Details of the proposed methodology for the covered transactions and evidence for the view that this produces results consistent with the arm's length principle. Depending on the methodology and how it was to be applied, this could include:
 - a. economic data;
 - b. database searches for comparable companies and details of comparable uncontrolled prices; and
 - c. evidence which lead to the rejection of other methodologies etc.

The onus is on the taxpayer to show that its method will produce the arm's length price but the tax administration should construe whatever evidence is produced in the light of the APA

procedure not being an audit. Unless there are indications to the contrary, the taxpayer's co-operation can be assumed.

9. Suggestions for a timetable for the APA.

10. Suggestions for a possible renewal.

11. Financial information:

- a. statutory accounts for the previous five years;
- b. an analysis of product lines showing gross and net margins with associated costs for products to be included in the APA; and
- c. an analysis to show all transactions with associated enterprises. Any marketing or financial studies for the business should also be provided if relevant.

12. Industry and market analysis:

- a. an analysis of industry and market trends which are expected to affect the business; and
- b. details of competitors.

13. Legal agreements between all associated enterprises: any agreement which exists which governs or permits behaviour between affiliates, for instance, licence agreements, purchase agreements, distribution agreements, R&D service agreements.

Appendix B: Functional Analysis

The functional analysis is the key tool for any transfer pricing work including APAs. The contents should be tailored to the specific taxpayer and the transactions in the APA but the following should be viewed as a general guide of what should be included. It should be applied to the taxpayers in the APA and any other relevant connected entity which trades with any company in the APA. The APA application should therefore show which entity carries out what functions in the overall business of the MNE. Tax administrations should keep in mind that they are not evaluating entities which are not in the APA and should therefore require less information about these entities. This information will however have to be sufficient for them to understand both ends of the transactions under review.

Activities and Functions

All the activities of the entity should be described (Research and development, manufacturing, distribution, marketing, the type of service activity carried out.) The economic and entrepreneurial worth of these activities should be made clear. How these activities inter-act with those carried out by other group entities should be described. The market and the level in the market place of the entity should be described. The type of customer and also competitors should be described. What product is sold, how it is developed or acquired, who it is acquired from and sold to should be described.

There will be further details necessary if intellectual property right (IPR) is used. Information should be provided on how the IPR was created and by whom. It should be made clear which entity now owns the IPR and how it came to do so. The IPR should be valued and an explanation provided of how it is utilised and what value it adds to the business.

Risks

The risks taken by the entity should be described. Typical risks might include product, technological, obsolescence, market, credit, forex, legal. The risks should be described and assessed in importance.

Capital employed

The amount and type of working capital, tangible and intangible assets utilised should be described. Again the relative importance of these in the trade should be analysed if possible.

Business strategies

The strategy employed for previous periods and expected to be used for the period of the APA should be described. Projections used in the future plan should be provided together with any information used to produce the plan. This might include management budgets, information on expected business trends and competition, future marketing, production or R&D strategy. Details of who has the power and responsibility to dictate all business strategy should be provided.

Appendix C: Contents of the CA position paper

Since every case will be different position papers will vary. But there is general guidance which should be applicable for the contents of all position papers. The key to concluding an APA procedure without unnecessary delay will always be to issue a position paper as soon as possible after the application is received.

It will often be appropriate for a position paper to contain:

1. The conclusion of the CA together with a rationale. This should include details of the preferred methodology and the reasoning for this.
2. Reasons for any rejection of the taxpayer's preferred method.
3. Details of the facts considered as most relevant in forming the above conclusion. If relevant, special consideration should be given to any facts which came to light during the APA process as opposed to in the original application.
4. Details of the critical assumptions that the APA will be dependent on.
5. A position on any retrospective element and on the future length of the APA.
6. Considerations for a possible renewal.
7. Suggestions on how the APA should be monitored.
8. A description of the Treaty law and domestic law that will govern the APA and provide certainty for the taxpayer.

Appendix D: Details necessary in an APA agreement between taxpayer and tax administration

1. The duration of the APA.
2. Details of the methodology acceptable for determining transfer pricing.
3. The critical assumptions that must remain true for the APA to continue to apply
4. A statement from the tax administration that while the APA remains in force the pricing of the transactions concerned will not be subject to audit apart from any adjustments necessary to comply with the APA. Nor will penalties be imposed.
5. An agreement of how the APA is to be monitored by the taxpayer and tax administration.
6. An agreement of what documentation is to be maintained throughout the APA
7. Any agreement on any retrospective treatment.
8. An agreement over who will resolve any disputes (for instance over interpretation) under the APA if these arise.
9. Any circumstances which will require the APA to be revised.
10. Any circumstances which will result in the APA being rescinded prospectively or even retrospectively (for instance if false information has been provided.)

Appendix E: Time frame for concluding an APA

Every APA is different therefore there are inherent dangers in stipulating a common timetable for every APA. Nevertheless, a typical time frame for an APA might be:

Month 1

An informal approach is made by a taxpayer to two tax administrations, requesting an APA. The tax administrations listen to the statements made and indicate that the particular case merits an APA. The tax administrations consult with one another to ensure both will agree. Each has brief discussions with the taxpayer over what information should be provided in the first instance and what methodologies would definitely not be acceptable.

Months 1-2

The formal application is received by each tax administration. The CAs establish a timetable to evaluate the APA. Both tax administrations conduct an initial review independently and issue separate information requests.

Months 3-9

Tax administrations continue to evaluate independently with the full cooperation of the taxpayer(s). The CAs consult as appropriate by email. The taxpayer is involved in this evaluation and is consulted over various matters. By the end of this period each tax administration has formulated its position. The CAs are able to exchange position papers. They agree to meet to discuss these in Month 11.

Month 10

Each CA evaluates the other CA's position paper and obtains further information where necessary.

Month 11

The first full face to face discussions occur between CAs. Further clarifications are obtained from the taxpayer who is kept informed of the CA negotiations.

Month 12

The CAs reach agreement. The taxpayers are consulted and indicate their agreement. Legal documents are exchanged.

Many APA procedures may last longer in more complex cases. But with the cooperation and planning of all parties the time taken to conclude an APA should be kept to the minimum possible.