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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE EUROPEAN PARLIAMENT AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE

on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU

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1. **AIM AND CONTEXT**

1. The existence within the EU of different sets of national transfer pricing rules laying down that transactions between taxpayers under common shareholder control should be taxed as if they had taken place between independent taxpayers undermines the proper functioning of the internal market and represents a large administrative burden on taxpayers.

2. In order to find pragmatic solutions to this problem, the EU Joint Transfer Pricing Forum (JTPF) was set-up by the Commission in October 2002. The Commission has reported twice on the work of the JTPF through two Communications. The first Communication\(^1\) presented a Code of Conduct\(^2\) on the Convention for the elimination of double taxation (the “Arbitration Convention\(^3\)”) to ensure that it would operate more efficiently. The second communication\(^4\) presented a Code of Conduct\(^5\) on documentation requirements for transfer pricing within the EU- the EU Transfer Pricing documentation (EUTPD.) The Code of Conduct on EUTPD sets out rules for the amount and type of documentation that Member States will request and accept for the purposes of their own transfer pricing rules.

3. Transfer pricing related disputes between a taxpayer and a tax administration frequently lead to double taxation and hence to disputes between tax administrations to relieve this double tax. While the Code of Conduct on the effective implementation of the Arbitration Convention adopted by Member States in December 2004 should in principle help to eliminate transfer pricing double taxation in the EU within a time frame of not more than three years, it would be highly desirable to avoid such disputes between tax administrations in the first place.

4. This third Communication therefore has as its main objective to prevent transfer pricing disputes and associated double taxation from arising in the first place by introducing Guidelines for Advance Pricing Agreements (hereafter: "APAs") within the EU. APAs are agreements between the tax administrations of EU Member States concerned defining how future transactions between related taxpayers established in two or more Member States will be taxed. The Guidelines are based on the best practice identified by the JTPF.

5. The Commission considers that APAs Guidelines are an efficient tool for dispute avoidance with valuable advantages for tax administrations and taxpayers. APAs will provide in advance certainty concerning the transfer pricing methodology and therefore simplify or prevent costly and time-consuming tax examinations into the transactions included in the APA; this should lead to savings for all parties involved in an APA.

6. These APAs Guidelines explain how Member States should conduct the APA process and provide guidance for taxpayers involved in the process. Following the

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\(^1\) OJ C/2004/122 of 30/04/2004 p.4
\(^2\) OJ C/2006/176 of 28/07/2006 p.8
\(^4\) OJ C/2006/49 of 28/02/2006 p.23
\(^5\) OJ C/2006/176 of 28/07/2006 p.1
guidelines will result in a quick and efficient resolution of the APA process and in turn should encourage the use of APAs in the EU, leading to more dispute avoidance and less double taxation.

2. **Activities of the EU Joint Transfer Pricing Forum from March 2005 to September 2006**

7. The full report compiled by the JTPF is contained in a staff working document. Within the overall scope of dispute resolution and avoidance, the JTPF considered several possible procedures which might lessen transfer pricing burdens on taxpayers within the EU. These were simultaneous tax examinations, expert opinion or mediation, a system of prior notification, consultation or agreement and the possibilities for APA procedures.

2.1. **Simultaneous tax examinations.**

8. These are generally considered as methods by which two or more countries combine efforts to audit taxpayers together. While the JTPF acknowledged that this might have attractions for Member States from a compliance perspective, the opportunities for resolving disputes this way were considered to be fewer than the opportunities for creating them.

2.2. **Expert opinion or mediation.**

9. The JTPF reflected upon the statement in the commentary to article 25 of the OECD Model Tax Convention that countries might seek an advisory opinion from an expert to help resolve double taxation cases. Experts from the tax administrations did not consider the idea of intervention by a third party expert as a useful tool to prevent double taxation in the light of the Arbitration Convention which already compels the resolution of cases through the medium of an independent arbitration panel.

2.3. **Prior notification, prior consultation or prior agreement.**

10. The JTPF examined the possibilities for a framework for prior agreement or at least consultation before tax administrations make transfer pricing adjustments. The interaction could be limited to the mere notification of a transfer pricing adjustment (which could speed up dispute resolution), be extended to prior consultation between tax administrations before a transfer pricing adjustment was made final (which could again speed up subsequent dispute resolution or avoid any subsequent resolution ever becoming necessary) or use of a system of prior agreement (whereby a tax administration would have to agree to provide a corresponding adjustment to eliminate any double tax before the first adjustment was made final) to prevent a dispute from coming into existence in the first place.

11. The JTPF found that, while it might be possible to do all of the above under existing mechanisms, to develop effective mechanisms would be time consuming and might well require fundamental changes in domestic laws. The JTPF felt that this might be

\[\text{Not yet published}\]
outside its remit and that its time and resources should be concentrated on developing APA procedures.

12. The Commission considers that a system of prior agreement would eliminate all double taxation within the EU and therefore is of the opinion that this issue could usefully be deepened in the future.

2.4. **Advance Pricing Agreements.**

13. An APA is an agreement between tax administrations over the way in which certain transfer pricing transactions between taxpayers will be taxed in the future. Hence an APA often prevents the need for a dispute between tax administrations over the transactions included in the APA. APAs are an exemplary method of dispute avoidance.

14. The JTPF examined the pros and cons of APAs in depth and concluded that there were significant advantages for taxpayers and tax administrations that can arise from APAs. First amongst these are the certainty over the taxation treatment of the transactions in the APA – a certainty enjoyed by both the tax administrations (which no longer have to conduct an audit to establish the correct transfer pricing; it is only the correct application of the APA that has to be checked) and the taxpayers (who know how to establish the correct transfer pricing since this has been agreed between the tax administrations involved.)

15. Given the significant advantages of APAs, the JTPF felt that it was appropriate to identify best practices for the conduct of APA procedures in the EU. These are contained in the Guidelines in the Annex to this Communication.

2.5. **What are the salient points of the EU APA guidelines?**

16. The guidelines lay down procedures for an efficient APA process and detail the stages usually found in an APA and what should ideally happen at each stage.

17. These guidelines focus on bi and multilateral APAs because they are considered as the most efficient tool to prevent double taxation. However the Guidelines also include a section on Unilateral APAs.

18. The guidelines envisage a four stage process and describe what should happen at each stage.

19. APAs start with the taxpayers' decision to request an APA. The guidelines suggest an informal approach be made to all the tax administrations potentially involved and recommend what should be done in this informal stage to ensure an efficient resolution of the APA application. Details of the type of information that should be included in the formal application are provided on the grounds that, although each APA will be different, the type of basic information likely to be necessary is often similar from case to case.

20. Once the formal application is received, the guidelines describe what should happen for the efficient conduct of the process. APAs will require that each tax administration involved checks the application to decide whether the proposed transfer pricing treatment in the application is acceptable. The precise details of the
transfer pricing treatment will also need to be negotiated and agreed between the tax administrations involved. Details of how these processes should be done are laid down in the guidelines.

21. APAs will require formal agreement between the tax administrations involved, so that they and the taxpayers involved are guaranteed certainty over the tax treatment of the transactions. The guidelines provide details over what should be in this formal agreement so that this certainty is given.

22. A typical timeline is provided in appendix of the guidelines to illustrate the conduct of the APA process.

23. The guidelines also discuss some often problematic areas which frequently arise during, or even before, APA procedures and detail ways in which these areas can be rendered less likely to impede an efficient resolution of the APA process itself. The JTPF concentrated on areas where experience has shown that the most problems arise: retrospective application of the tax treatment in the APA, fees and complexity thresholds (which could constitute an undesired barrier to the APA process) and the types and amount of transactions that should be covered by the APA.

3. **THE ARBITRATION CONVENTION AND RELATED ISSUES.**

24. The follow-up of its work on the Arbitration Convention is an on-going process for the JTPF. It is vital that Member States respect the terms of the Arbitration Convention and of the related Code of Conduct adopted in December 2004.

25. With regard to the state of play of the ratification process of the Accession Convention to the Arbitration Convention\(^7\), at the end of September 2006, twelve Member States had ratified it and the other Member States had indicated that the Convention should be ratified in the coming months.

26. The JTPF has also monitored the implementation of the recommendation included in its first Code of Conduct related to the suspension of tax collection. At the end of September 2006, sixteen Member States have confirmed that they allow suspension of tax collection during the dispute resolution procedure and the other Member States have replied that they were preparing revised texts granting this possibility. This issue will need further monitoring in the future.

27. Finally an update of the 2005 questionnaire on pending mutual agreement procedure (MAPs) under the EU Arbitration Convention that was filled in by Member States tax administrations revealed that none of the 24 cases for which the taxpayer had made the request prior to 1 January 2000 was sent to an Arbitration Commission.

28. The Commission considers that the number of long outstanding transfer pricing double tax cases means that, for reasons that need to be further explored, the Arbitration Convention is not eliminating transfer pricing related double taxation in the EU as well as it is supposed to. The proper functioning of the single market is therefore impaired. The Commission intends to consider how this failing can be

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\(^7\) OJ C/2005/160 of 30/06/2005 p.1-22
addressed. It might well be that an instrument that ensures a more timely and effective elimination of double taxation, is necessary from the perspective of the single market. The Commission also notes that the AC deals only with transfer pricing related double taxation and that the new material in Article 25 of the OECD Model Treaty and attached commentary goes further by offering treaty partners a binding, compulsory arbitration procedure for eliminating all double taxation.

4. **FUTURE WORK PROGRAMME OF THE JTPF**

29. Considering these recent achievements in transfer pricing within the EU and the need to ensure a monitoring of the implementation of the new tools but also to continue the examination of several issues, the Commission has decided to renew the JTPF for a new mandate of two years.

30. The JTPF has begun examining the potential new work programme for 2007-2008.

31. Under the current work programme of the JTPF, in particular penalties and interest related to transfer pricing adjustments still need to be examined.

32. In the future, no doubt dispute avoidance and resolution will continue to feature as they are of major importance to taxpayers and tax administrations.

33. The Forum should also assist the Commission in monitoring the implementation by Member States of the Codes of Conduct and the Guidelines issued on the basis of the JTPF conclusions. Indeed Member States will have to report on the implementation of the different instruments and on practical problems ensued from their implementation. This will allow the effectiveness of these instruments in the elimination of double taxation in connection with the adjustment of profits of associated enterprises to be assessed.

34. As regards the Arbitration Convention, the Commission having received additional feedback since the adoption of the Code of Conduct, points out the following issues where clarifications should be given to ensure a better functioning of the Convention: the deadline for the setting-up of the arbitration commission, a common understanding of the definition of a serious penalty, the possible extension of the scope to more than two Member States, the deadline to implement the final decision, the role of the taxpayer, what is precisely covered by a transfer pricing adjustment (for example is thin capitalization to be considered). The Commission has finally received comments arguing for the setting-up of a permanent and independent Secretariat.

5. **COMMISSION CONCLUSIONS**

35. The Commission congratulates the JTPF for its work and its contribution to a better environment within the EU for lessening the burden of transfer pricing rules in general and dispute avoidance and resolution procedures in particular. The JTPF achievements since October 2002 have lead to a number of improvements that have facilitated cross-border trade and therefore have improved the functioning of the Single Market.
36. With regard to the work achieved by the JTPF in the field of dispute avoidance and resolution procedures, the Commission fully supports the conclusions and suggestions of the JTPF on APAs. On the basis of this work the Commission has drawn up the attached Guidelines for APAs in the EU.

37. These guidelines constitute a worthwhile blueprint for APA processes across the EU. By following the guidelines, Member States will encourage the use of APAs which will lead to better dispute avoidance, fewer disputes and less double taxation. This will help achieve a removal of tax obstacles and the primary aims of the single market: a better investment and more competitive business environment, growth and jobs.

38. The Commission invites the Council to endorse the proposed Guidelines on APAs in the EU and invites Member States to implement quickly the recommendations included in the Guidelines in their national legislation or administrative rules.

39. Member States are invited to report annually to the Commission on any measures they have taken further to these Guidelines and their practical functioning. On the basis of these reports, the Commission will periodically review these Guidelines.
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ANNEX

GUIDELINES FOR ADVANCE PRICING AGREEMENTS (APAS)
IN THE EUROPEAN UNION

1. LEGAL FRAMEWORK

1. Article 25 (3) of the OECD Model Tax Convention permits countries to enter into Advance Pricing Agreements (Hereafter APAs).

2. An APA is 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.

3. The APA should not agree precisely the actual profit which should be taxed in the future.

The APA should fix according to the arm's length principle arrangements for the determining the transfer pricing for the future transactions in the APA.

4. APAs must provide certainty for taxpayers and tax administrations. The precise way this can be done can vary depending on the law of the Member State in which the taxpayer pays tax.

5. At all times, the taxpayer is subject to the usual rules of the tax administration. Where there is an APA, a tax administration still has the right to conduct an audit. However, under normal circumstances, the audit is carried out only to check and monitor the APA by reviewing the terms and critical assumptions underlying the APA.

6. Bilateral and multilateral APAs will require agreements between tax administrations and understandings between each tax administration and the taxpayer concerned. Unilateral APAs will only require understandings between a tax administration and the taxpayer concerned.

2. ORGANISATION OF APA PROCEDURES IN MEMBER STATES

7. Tax administrations should be able to draw upon all of their skill and adequate resources to conduct an APA.

APA programmes should be centrally co-ordinated.

Tax administrations should carry out two broad roles to deal with an APA application: firstly, evaluating the application and secondly negotiating an agreement with the other tax administration.
8. The negotiations between tax administrations should be conducted by the Competent Authorities (Hereafter CAs). It is the CA's responsibility to ensure that the roles of checking and evaluating the APA and negotiating with other countries are carried out. This applies even if the CA calls upon other parts of the tax administration to provide specialist knowledge.

3. ENTRY TO THE APA PROGRAMME

9. It is up to the taxpayer to initially decide which transactions should be included in an APA application.

The tax administration can review the application and modify or reject it.

The tax administration should accept the application where all requirements have been met.

In practice, taxpayer and tax administration should work together to establish mutually acceptable terms and conditions for an APA.

A withdrawal of an APA application should not automatically trigger an audit

10. Domestic considerations will legitimately affect how a tax administration runs its APA programme.

11. Rules on fees and complexity thresholds can be used by tax administrations to ensure APAs are only made available where they are considered appropriate by those tax administrations.

4. FEES

12. It is for Member States to decide if a fee system is appropriate.

A fee should not be a precondition for an efficient service which should be provided as a matter of course.

13. If they are used, fees should be charged by reference to a lump sum amount as a pure entry fee and/or linked to the extra costs incurred by the tax administration as a result of the APA.

14. Fees are particularly appropriate where without a fee a tax administration would be unable to have an APA programme. But they should not be set so high so as to be a disincentive to apply for an APA.

5. COMPLEXITY THRESHOLDS

15. If complexity thresholds are to be used, they should be used as a guide to whether an APA is appropriate and they should be dependent on the facts and circumstances of the case so not to be too prescriptive.

Complexity thresholds should be operated consistently for all taxpayers.
16. The likely attitude of other tax administrations directly involved in any APA should also be a factor in the operation of any complexity threshold: a threshold could be lowered where other tax administrations are willing to accept an APA application.

Whether a complexity threshold will operate to deny a taxpayer entry into an APA programme should be discussed at any pre-filing meeting.

17. The number or size of transactions should not constitute an infallible guide to uncertainty or transfer pricing risk. Complexity thresholds should take into account the relative size and transfer pricing risk (to the taxpayer) of the transactions.

6. DOCUMENTATION

18. Where a Multinational Enterprise uses the EU Transfer Pricing Documentation (EUTPD), this will serve as a useful basis for any APA application.

Useful additions can be any transfer pricing policy documentation on which the application is based and any reports received on which the application relies. Documentation requirements should not be unduly onerous for taxpayers but the tax administration must be given the opportunity to fully evaluate the transactions included in the APA.

Appendices A and B provide a list of documentation that is likely to be of use for any APA application. What is actually required in the formal application should be agreed at the pre-filing stage.

19. The specific information necessary to monitor the application of the APA should always be agreed upon as part of the APA negotiation. The taxpayer must maintain documentation throughout the APA so that the tax administration can monitor the way the APA is applied.

7. CONDUCT OF THE APA PROCESS

20. Tax administrations and taxpayers should work together in as cooperative a manner as possible to ensure that the APA is conducted as efficiently as possible.

An APA application should typically have four distinct stages:

(a) Pre-filing stage/Informal application

(b) Formal application

(c) Evaluation and negotiation of the APA

(d) Formal agreement

7.1. Pre-filing/Informal application stage.

21. The pre-filing meeting should allow all parties to assess the likely success of the APA. The tax administration should be provided with sufficient information to
permit this assessment. This information should at least describe the activity and transactions to be covered, the taxpayers concerned, the preferred methodology, desired length of the APA, any rollback and the countries to be involved.

The pre-filing stage must allow the tax administration to make a reasoned judgement on whether the application will be acceptable.

Taxpayers should approach the tax administrations as early as possible once they are clear about their intended actions when considering an APA.

22. Tax administrations might consider anonymous approaches from taxpayers but nothing binding can be agreed on an anonymous basis. At any rate, the taxpayer's intentions should be relatively fixed for the anonymous meeting and as such an anonymous approach should not be a protracted process.

23. The tax administration should give a clear indication as soon as possible whether a taxpayer's subsequent formal application is likely to be accepted and also indicate, where possible, which aspects might be more controversial.

24. The taxpayer should approach all of the Member States directly involved in the envisaged APA. Where more than one tax administration is consulted, the same information should be provided to each (this should apply throughout the APA process).

25. As part of the pre-filing stage, CAs should consult with one another where necessary. Where such a consultation is deemed necessary, it should take place as quickly as possible.

In the pre-filing stage, the taxpayer and tax administration should discuss what documentation should be included with the formal application. Any complexity threshold should also be discussed. The tax administration should also use the pre-filing stage to influence the content of the application where this will aid an efficient outcome of the application.

7.2. Formal application for APA

26. 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 formal application to the tax administration where it pays tax and at the same time to all other countries concerned. 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. The tax administration should endeavour to tell the taxpayer as soon as possible whether the application for an APA has been formally accepted for processing and to request as soon as possible any further documentation necessary to evaluate the APA and to formulate a position.

Content of the formal application

27. In the initial formal application, the taxpayer should try to enclose all relevant information necessary for the tax administration to evaluate the application and to come to a view about the methodology that will be used later to calculate the arm's
length price. Appendices A and B contain details of the type of information that might often be necessary in all instances but is not necessarily a minimum and is not the maximum. The precise information necessary for the formal application should be tailored to the specific case.

28. A tax administration has the right to ask for supplementary information to evaluate the APA application.

7.3. Evaluation and negotiation of the APA

29. The aims of the evaluation and negotiation are distinct even if it might sometimes be appropriate to carry out these tasks partly together. A balanced approach should be adopted to ensure that the evaluation takes place as quickly as possible and the negotiation begins as soon as possible.

In the evaluation, the tax administration should formulate its preferred terms and conditions for the APA. The negotiation with the other tax administrations concerned should resolve any differences which arise between tax administrations so that one set of terms and conditions can be provided to all the taxpayers involved.

30. As soon as possible after a formal application is received, the CAs of the tax administrations concerned should contact one another and establish a timetable for the APA. The taxpayer should be involved in the creation of the timetable and a model timetable is contained in Appendix C. In multilateral APAs, the CAs could agree that one CA takes the lead in organising the procedure.

31. The taxpayer should help the tax administration to evaluate the application through the provision of information. The evaluation should be completed as soon as possible to allow negotiation to be started.

32. Tax administrations should make every effort to keep the burden of the evaluation to a minimum by requiring only pertinent information; taxpayers must in turn provide any information requested as quickly as possible. It should be possible to agree what information is relevant.

33. All information provided to one tax administration should also be provided to the other tax 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 or, exceptionally, the tax administration through exchange of information will do this.

34. Where a tax administration forms an evaluation different from the taxpayer's application, then its evaluation should be discussed with the taxpayer.

35. As part of the evaluation process, the tax administration should try to obtain the taxpayer's agreement with the position of the tax administration. It is advantageous for tax administration and taxpayer to work together to keep the proceedings on track to a mutually acceptable conclusion.

36. 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. Tax administrations should always
consider making joint/common requests for information when this will further minimise delays.

37. As soon as its evaluation is complete, a tax administration should endeavour to begin negotiations and, if necessary, the other tax administration involved should endeavour to complete its own evaluation so that negotiations can begin.

38. The evaluation stage should involve CA inter-action where this will aid reaching an APA. Provisional agreement should be reached where possible. However, it is preferable that a tax administration has in mind at least a preliminary evaluation before actual CA negotiations begin.

39. If it would aid the APA procedure, preliminary negotiations should begin before the evaluation is finalised but this should not permit tax administrations to inappropriately postpone finalizing the evaluation.

40. For most APAs, each CA should produce a position paper containing the tax administration's evaluation. The formal exchange of positions should take place with an exchange of CA position papers. This should be done as soon as possible after the application is received.

41. Where appropriate, CAs do not need to exchange position papers if this makes the APA process more efficient and faster. But in most cases having all CAs prepare position papers before full negotiations begin will help to identify and thus resolve any disputes quickly and efficiently. Where one CA has prepared a position paper, any other CA involved in the negotiation should at least set out what disagreement exists.

*Contents of CA position papers*

42. The contents of a position paper should set out the view of the tax administration involved in the APA. Appendix D lists some of the details that are likely to be necessary in a CA position paper.

43. Negotiations should be started by the sending of CA papers. A timetable should be agreed for the negotiations. Taxpayers should be kept informed of all significant developments.

If the CAs agree, taxpayers should be allowed to attend CA meetings to address factual matters by making a presentation.

44. If beneficial, CAs should arrange regular meetings to keep the whole APA programme up-to-date but this should not impede arranging and conducting meetings on individual cases.

7.4. *Formal agreement of APA*

45. The formal APA should be given effect by formal agreements between the tax administrations involved (in a multi-lateral APA there could be one agreement between all tax administrations or a series of bilateral agreements between each tax administration).
All agreements should detail the terms and conditions of the APA.

46. These agreements should give certainty to those involved in the APA and provided the relevant terms of the APA are met, then the transfer pricing for the transactions will be as determined in the APA and that the transactions will not be subject to a different interpretation by the tax administration. Tax administrations should ensure that they are able to provide this certainty.

47. Appendix E contains information which is likely to be necessary for all APA formal agreements.

8. **APAs: Specific areas.**

8.1. **Transactions and Participants in the APA.**

48. It is up to the taxpayer to initially decide which transactions and which group entities he wants to have included in the APA. But it is the decision of the tax administration whether it accepts the taxpayer's application.

49. It is important that tax administrations are as flexible as possible in allowing the taxpayer to include what he wishes in the APA. It is recommended that the taxpayer's logic for excluding as well as including companies and transactions is explained in the application.

50. A tax administration should exchange information (EOI) spontaneously (subject to any domestic law limitations) with another tax administration which the first tax administration feels should be included in the APA. The taxpayer would need to be consulted about which tax administrations to involve in the APA since the taxpayer's agreement to the terms and conditions of the APA needs to be obtained.

8.2. **Critical Assumptions**

51. The taxpayer should describe in the application the assumptions on which the ability of the methodology to accurately reflect the arm's length pricing of future transactions are based.

52. Critical assumptions are by their nature vital to the APA and should be drafted carefully to ensure the capability of the APA to reflect arm's length pricing.

53. Taxpayers and tax administrations should attempt to identify critical assumptions that are based where possible on observable, reliable and independent data.

54. Critical assumptions should be tailored to the individual circumstances of the taxpayer, the particular commercial environment, the methodology and the type of transactions covered.

55. Critical assumptions should not be drawn so tightly that certainty provided by the APA is jeopardised but should encompass as wide a variation of the underlying facts as those involved in the APA feel comfortable with.
56. The APA agreement should include parameters for an acceptable level of divergence for some assumptions in advance and only if these parameters are exceeded should a renegotiation become necessary.

57. Taxpayers should inform their tax administrations if critical assumptions are not met. All those involved in the APA should consult with each other to examine the reasons why a critical assumption has not been met and to see if the APA methodology is still appropriate.

An attempt should be made renegotiate the APA if at all possible.

8.3. Rollback

58. Rollback – when provided for in domestic legislation – can be considered where it will resolve disputes or remove the possibility of disputes in earlier periods.

59. Rollback should only be a secondary result of the APA and should only be carried out where it is appropriate to the facts of the case. Similar facts and circumstances to those in the APA should have existed for previous periods in order for rollback to be appropriate.

60. Rollback of the APA should only be applied with the taxpayer's consent.

61. A tax administration has recourse to the usual domestic measures if, as part of the APA process, it discovers information which would affect the taxation of earlier periods. But tax administrations should advise the taxpayer of any such intended action to give the taxpayer the opportunity of explaining any apparent inconsistency before making a tax re-assessment concerning previous periods.

8.4. Publication of statistics

62. The publication of some statistical information on APAs by each tax administration would be useful.

8.5. Unilateral APAs

63. Although there may be circumstances where the taxpayer has good reasons to believe that a unilateral APA is more appropriate than a bilateral, bilateral APAs are preferred over unilateral APAs. Where a unilateral APA may reduce the risk of double taxation to some degree, care must be taken that unilateral APAs are consistent with the arm's length principle in the same way as bilateral or multilateral APAs.

64. In the first instance the taxpayer has the right to decide whether a unilateral or bilateral APA is required.

65. The option of including another MS in the APA could be considered by the MS preparing for a unilateral APA. Taxpayers however should not be forced into a bilateral APA.
66. Tax administrations are entitled to turn down requests for unilateral APAs where the tax administration feels that a bilateral or multi-lateral APA is more appropriate, or feels that no APA at all is appropriate.

67. The rights of other tax administrations and taxpayers should not be affected by the existence of a unilateral APA. When a unilateral APA is concluded, a MAP should not be excluded afterwards.

68. With the "Code of Conduct" (Business Taxation), Member States have committed themselves to spontaneously exchange details of concluded unilateral APAs. The Exchange of Information (EOI) should be made to any other tax administration directly concerned by the unilateral APA and should be done as swiftly as possible after the conclusion of the APA.

8.6. Facilitating APAs for SMEs

69. Tax administrations should use their experience of the problems faced by SMEs to facilitate access to APAs for SMEs where APAs are useful for dispute avoidance or resolution.
Appendix A – A list of the type of information that is likely to be necessary with the formal application for a bilateral or multilateral APA.

The actual information will vary depending on the facts of the case and would need to be discussed between the taxpayers and tax administrations, ideally at the pre-filing meeting.

This information can be considered as two broad types: information about the past—historical information—which might already exist in some format but will need to be compiled for the APA and information that may need to be created specifically for the APA.

When considering historical information, MS should keep in mind that APAs concern the future and that historical information may have less relevance for future periods. That said, historical information will be necessary to place the APA in perspective and to allow better judgements about the future to be made.

The pre-filing stage is a useful time for tax administration and taxpayer to decide what information should accompany the formal application. The aim should be to strike a balance between the tax administration having enough information to consider the application properly and the taxpayer not being required to produce unnecessarily onerous amounts of information.

In all cases the tax administration has the right to require further information and the taxpayer has the right to submit further information.

1. Names and addresses of all associated enterprises (including all permanent establishments) in the APA.

2. A group structure showing all entities involved in the trade of the enterprises in the APA.

3. An analysis of industry and market trends which are expected to affect the business. Any marketing or financial studies for the business which lead to this expectation should also be provided where relevant. An outline should be provided of the business strategy expected to be used for the period of the APA and, where different, of the strategy employed for previous periods. This might include projections used in the plan for the future, management budgets, information on expected business trends and competition, future marketing, production or R&D strategy. Details of who has the power and responsibility of developing and dictating business strategy could be provided.

4. The period for which the taxpayer desires that the APA should apply, including any request for rollback.

5. A functional analysis (see Appendix B) of the parties and transactions to be covered by the APA.
6. The reason why the taxpayer feels an APA is appropriate for these particular transactions.

7. The critical assumptions integral to the APA.

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 is to be applied, this evidence could include:

   (a) A review of the five OECD comparability factors including comparables and any adjustments made to achieve comparability.

   (b) Reasons why the method in the APA application was selected

   (c) A demonstration by reference to financial information of how the proposed methodology is to be implemented.

9. A list of any APAs already entered into by any of the associated enterprises involved in the APA which relate to the same or similar transactions if not already available to the tax authorities.

10. Details of financial information of the entities in the APA for the three years prior to the APA. This could embody:

    (a) the three years statutory accounts.

    (b) an analysis of product/service lines showing gross and net margins with associated costs for the products/services to be included in the APA, if available and useful.

11. A list of any legal agreements between any associated enterprises which affect the transactions in the APA. For example, licence agreements, purchase agreements, distribution agreements, R&D service agreements.

12. For any years where a rollback is requested – where possible in domestic law - 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., together with 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.
Appendix B: Functional Analysis

The functional analysis is the key tool for any transfer pricing work. The contents should be tailored to the specific taxpayer and the transactions in the APA. Dependant on the situation, the APA application should also show to a certain extent which entity carries out what functions in the overall business of the MNE. Tax administrations however should keep in mind that they are not evaluating transactions which are not in the APA. This information will have to be sufficient for them to understand both ends of the transactions under review.

Activities and Functions

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

Risks

The risks assumed by the entity with regard to the transactions in the APA should be described and assessed. Typical risks might include product, technological, obsolescence, market, credit, foreign exchange and legal.

Assets employed

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

There will be further details necessary if intellectual property right (IPR) is used in the transactions in the APA. Information should be provided on how the IPR was created within the group or acquired by the group. It should be made clear which entity now owns the IPR and how it came to do so, how it is utilised and what value it adds to the business.
Appendix C: Tentative time frame for concluding an APA

Every APA is different; therefore, there are inherent dangers in stipulating a common timetable for every APA. Best practice is for all parties to formulate a timetable as early as possible once the APA application has been received. Tax administrations can help keep the time to negotiate an APA as short as possible by examining information quickly and efficiently; taxpayers can help to keep the time to negotiate an APA as short as possible by providing complete information quickly. The timetable below is illustrative, but contains all the stages typically found in APAs.

Pre-filing stage – informal application – month 0

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 whether 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 explores what methodology will be appropriate.

Months 1-3

The formal application is received by each tax administration. The CAs establish in month 1 a timetable to evaluate and negotiate the APA. Both tax administrations conduct an initial review independently and issue information requests if necessary.

Months 4-12

Tax administrations continue to evaluate independently with the full cooperation of the taxpayers. A first full face to face meeting could take place with a presentation to all involved parties by the taxpayer. The CAs consult as appropriate. The taxpayer is involved in this evaluation and is consulted. 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 14.

Month 13

Each CA evaluates the other CA's position paper and obtains further information where necessary. (Alternatively, in month 12 one CA issues a position paper and in month 13 the other CA issues a position paper rebutting the position and suggesting alternatives.)

Months 14-16

Discussions occur between CAs. Further clarifications are obtained from the taxpayer who is kept informed of the CA negotiations.

Month 17
The CAs reach agreement. The taxpayers are consulted and indicate their agreement.

Month 18

The APA is formally agreed between the CAs. Formal documents are exchanged. The taxpayers receive assurances that the APA is acceptable.

More complex cases may take longer, but, with the cooperation and planning of all parties, the time taken to conclude an APA should be kept to a minimum.
Appendix D: Contents of the CA position paper

Since each case will be different position papers will vary. But below 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 commence CA negotiations most often through 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 or modification of the taxpayer's initially 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. Suggestions on how the APA should be monitored.

7. A description of the Treaty law and domestic law that will govern the APA and provide certainty for the taxpayer.
Appendix E: Details likely to be necessary in an APA agreement

1. The duration of the APA and day of entry into force.
2. Details of the methodology acceptable for determining transfer pricing and the critical assumptions (see appendix F) that must be followed for the APA to apply.
3. An agreement that the APA will be binding on the tax administrations involved
4. An agreement of how the APA is to be monitored
5. An agreement of what documentation is to be maintained throughout the APA to allow monitoring to take place, for example an annual report.
7. Any circumstances which will require the APA to be revised.
8. Any circumstances which will result in the APA being rescinded prospectively or even retrospectively (for instance if false information has been provided.)
APPENDIX F – Critical assumptions

Critical assumptions will vary depending on the APA itself but it is possible that assumptions will need to be made about some of the following areas:

1. the relevant domestic tax law and treaty provisions;
2. the tariffs, duties, import restrictions and government regulations;
3. the economic conditions, market share, market conditions, end-selling price, and sales volume;
4. the nature of the functions and risks of the enterprises involved in the transactions;
5. the exchange rates, interest rates, credit rating and capital structure;
6. the management or financial accounting and classification of income and expenses;
7. the enterprises that will operate in each jurisdiction and the form in which they will do so.