

# SP02/10 - Advance Pricing Agreements Annex 1

## – Information to set out in the Formal Application

1. The application should fulfil the requirements of Section 223, TIOPA 2010 and set out:
  - a. the applicant's understanding of the effect of the relevant legislation including the effect of any DTA in relation to the transfer pricing issues under consideration;
  - b. the areas where, because of the difficulty of the transfer pricing issues, clarification of that effect is required; and
  - c. a proposal for clarifying the effect of the legislation in accordance with the applicant's understanding.
2. The intention is to ensure that any agreement about the practical treatment of specified transfer pricing issues is formed from a proper understanding of the relevant principles of the Taxes Acts. Thus, where the transfer pricing issue concerns, for example, pricing between associated enterprises, the application might include an explanation of why the transfer pricing rules at Part 4 TIOPA 2010 are applicable, and would acknowledge that the effect of those rules, which are to be construed in accordance with OECD Transfer Pricing Guidelines, is to require the substitution of the arm's length provision for tax purposes. The application might then go on to explain in what ways the establishing of the arm's length provision requires clarification, and submit a proposal for establishing the arm's length provision in accordance with the requirements of the effective provisions. This guidance should be adapted to attribution issues involving Permanent Establishments (where OECD has latterly issued separate guidance in the form of Parts 1-4 of the Report on the Attribution of Profits to Permanent Establishments) in accordance with the general intention of ensuring that there is a proper understanding of the relevant principles of the applicable law from which an agreement about the practical treatment of a specified issue can be formed.
3. The centre-piece of the proposal will be a description of the method by which it is proposed to determine the transfer pricing issues in accordance with the arm's length principle, and an analysis demonstrating how the application of that method satisfies the terms of the UK's legislation, including the effect of any DTA, and is consistent with the OECD Transfer Pricing Guidelines. The nature of the detailed information supporting the proposal should be tailored to the specific features of the business and of the transfer pricing issues and should take into account discussions with HMRC at the Expression of Interest stage.

4. All proposals will also generally need to be supported by the following information:
  - a. the identification of the parties and recent accounts (generally for the previous 3 years);
  - b. a description of the transfer pricing issues proposed to be covered in the APA and analysis of the functions and risks of the parties and actual and projected financial data of the parties in relation to the issues;
  - c. a description of the world-wide organisational structure, ownership, and business operations of the group to which the company in question belongs, the place or places where such operations are conducted, and all the major categories of transaction flows of the parties to whom the APA is intended to apply;
  - d. a description of the records which will be maintained to support the transfer pricing method proposed for adoption in the APA and the information which it is proposed will be supplied each year to demonstrate that the tax return conforms to the terms of the APA;
  - e. a description of any current tax enquiries or competent authority claims that are relevant to the issues covered by the proposed APA;
  - f. the chargeable periods to be covered by the APA;
  - g. the identification of assumptions made in developing the proposed transfer pricing method which are critical to the reliability of its application under the arm's length standard; and
  - h. where appropriate, a request for competent authority assistance in reaching a bilateral or multilateral APA.

5. The formal proposal should identify the assumptions made in proposing the method for dealing with the transfer pricing issues and which are critical to the reliability of that method. The method should be sufficiently robust to accommodate some changes in the commercial and economic climate from that reasonably foreseeable when the proposals were made and still be capable of replicating an arm's length outcome. However, the accuracy of the method is likely to be predicated on assumptions in respect of particular factors fundamental to its application, such as the continuing nature of the functions performed, accounting policies and practices, the terms of contractual agreements impacting upon the covered transactions, or levels of market share. Critical assumptions are designed to protect both the business and the HMRC from the risk that the agreement may become inappropriate, but they should not be so tightly drawn that the certainty provided by the agreement is jeopardised. Setting parameters for acceptable divergence for some assumptions can help to retain flexibility. Where there is a change, or a change greater than any relevant parameters set, to circumstances that both parties have identified as critical to the agreement, a reconsideration of the agreement is then activated and may lead to its cancellation or modification depending on the terms of the agreement.