Advance Pricing Arrangements: Are Australia’s Recent Reforms Relevant to Canada?

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PRÉCIS
Les autorités fiscales du Canada et de l’Australie ont chacune un programme bien rodé d’arrangement préalable en matière de prix de transfert (APP) depuis plus de deux décennies, et ont toujours encouragé leurs contribuables multinationaux à utiliser cet outil unique pour gérer les questions controversées en matière de prix de transfert.

Le 17 mars 2011, l’Australian Taxation Office (ATO) a publié un nouvel énoncé des pratiques en matière d’APP. Avant cela, en réponse aux demandes de réforme du secteur par les contribuables, l’ATO avait non seulement demandé un examen indépendant de ses processus, mais s’était également engagé à actualiser et à transformer son programme d’APP en travaillant de concert avec l’industrie dans le but de coréaliser un programme plus efficace, plus pertinent et plus viable. La nouvelle directive renferme un certain nombre d’innovations qui élargiront les options disponibles aux contribuables qui font des opérations internationales entre affiliés.

Au Canada, l’Agence du revenu du Canada (ARC) a mis en œuvre certaines modifications à sa procédure relative à son programme d’APP au cours de la dernière année, notamment l’introduction de restrictions d’admissibilité au programme. Les conseillers fiscaux canadiens craignent que le rejet par l’ARC de certaines applications de l’APP, découlant en grande partie de contraintes de ressources, puisse nuire au programme.

Cet article traite des changements en matière de « pratique exemplaire » qui ont été instaurés dernièrement par rapport aux APP en Australie, et examine si certains de ces changements pourraient être utiles à une réforme fiscale dans ce secteur au Canada.

ABSTRACT
The revenue authorities of Canada and Australia have had well-utilized advance pricing arrangement (APA) programs in place for more than two decades, and have a shared history of encouraging their multinational taxpayers to access this unique tool for managing transfer-pricing issues.

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On March 17, 2011, the Australian Taxation Office (ATO) published a new practice statement on APAs. Prior to this, in response to taxpayer calls for reform in this area, the ATO had not only tendered for an independent review of its processes, but also committed itself to updating and transforming its APA program by working in conjunction with industry to co-design a more effective, relevant, and sustainable program. The new guidance contains a number of innovations that will broaden the options available to taxpayers with interaffiliate international transactions.

In Canada, the Canada Revenue Agency (CRA) has implemented a number of procedural changes to its APA program over the past year, including the introduction of certain restrictions on entry into the program. Canadian tax advisers have expressed concern that the CRA’s rejection of some APA applications, driven largely by resource constraints, may be detrimental to the program.

This article examines the “best practice” changes that have recently been introduced in relation to APAs in Australia, and considers whether any of these changes might be able to inform and assist tax reform in this area in Canada.

**KEYWORDS:** ADVANCE PRICING AGREEMENTS ■ TRANSFER PRICING ■ DISPUTE RESOLUTION ■ AUSTRALIA ■ CANADA ■ REFORMS

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[W]ays need to be found to simplify existing transfer pricing practices in order to limit the administrative burdens on tax administrations and taxpayers alike. . . . [T]ransfer pricing dispute resolution mechanisms need to be continuously improved so that taxpayers and tax administrations alike can achieve certain outcomes that relieve double taxation in reasonable amounts of time and at reasonable cost.

INTRODUCTION

An internationally accepted definition of an advance pricing arrangement (APA)\(^1\) is provided in the transfer-pricing guidelines issued in 2010 by the Organisation for Economic Co-operation and Development (OECD).\(^2\) The guidelines describe an APA as

> [a]n 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.\(^3\)

An APA therefore constitutes a prospective formal agreement covering an appropriate transfer-pricing methodology (TPM) to be applied to intercompany transactions between related parties, and the expected arm’s-length range of results arising from the application of the TPM to the covered transactions. The OECD guidelines explain that such an arrangement may be unilateral (involving a taxpayer and one tax administration) or multilateral (involving a taxpayer and two or more tax administrations).\(^4\) For a multinational enterprise (MNE), the main advantage of using an APA is generally held to be prospective transfer-pricing certainty,\(^5\) particularly where a bilateral or multilateral APA is involved.\(^6\)

On March 17, 2011, the Australian Taxation Office (ATO) published a new practice statement on APAs.\(^7\) In response to taxpayer calls for reform in this area, the ATO

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1. Revenue authorities in the United States and the United Kingdom refer to advance pricing agreements in their transfer-pricing literature, while revenue authorities in Australia and Canada refer to advance pricing arrangements. Since this article deals mainly with the latter two countries, the term “arrangement” is used here, although in this context “arrangement” and “agreement” appear to be interchangeable terms.


3. Ibid., glossary, at 23.

4. Ibid.

5. For example, Canada’s APA program is described as “a proactive service offered by the CRA [Canada Revenue Agency] to assist taxpayers in resolving transfer pricing disputes that may arise in future tax years. The primary objective of the program is to provide increased certainty with respect to future intercompany transfer pricing issues.” See Canada Revenue Agency, Advance Pricing Arrangement Program Report 2010-11 (Ottawa: CRA, November 2011) (herein referred to as “2010-11 CRA report”), at the executive summary.

6. According to the OECD guidelines, supra note 2, at paragraph 4.147, “[u]nlike bilateral or multilateral APAs, the use of unilateral APAs may not lead to an increased level of certainty for the taxpayer involved and a reduction in economic or juridical double taxation for the MNE group.” This is because the other tax administrations may disagree with the conclusions reached by the home-country tax administration in a unilateral agreement.

had not only tendered for an independent review of its processes, but had committed itself to updating and transforming its APA program by working in conjunction with industry to co-design a more effective, relevant, and sustainable program. The new guidance contains a number of innovations that will broaden the options available to taxpayers with interaffiliate international transactions.

The most recent report on Canada’s APA program was issued by the Canada Revenue Agency (CRA) in November 2011.8 The report referred to the procedural changes to the program that had taken place over the past year. Previously, the CRA had promoted APAs to all taxpayers with related-party transactions; now, as a result of these changes, entry to the program would be restricted. Canadian tax advisers have expressed concern that the CRA’s rejection of APA applications, driven largely by resource constraints, may be detrimental to the program.9

This article will examine the use of APAs by the CRA and the ATO as a transfer-pricing controversy management tool. It will briefly trace the parallel history of the APA programs in Canada and Australia in their first decade, when both revenue authorities were assiduously trying to promote this new and unique way of prospectively resolving transfer-pricing disputes to MNE taxpayers. At that time, a key initiative in the expansion of existing APA programs was recognized to be the encouragement of small business taxpayers to partake in the program—an issue that revenue authorities around the world continue to grapple with. The discussion will then turn to the focus on APA reform in the second decade of these two programs, with the purpose of scrutinizing the “best practice” changes that have recently been introduced in relation to APAs in Australia, and considering whether any of these changes might be able to inform and assist future tax reform in this area in Canada.

THE USE OF APAS IN CANADA AND AUSTRALIA

The Introduction of APAs To Resolve Transfer-Pricing Disputes

The evolution of the Canadian and Australian APA programs has been intertwined for more than two decades. The idea of utilizing some sort of pricing agreement mechanism to resolve transfer-pricing disputes between revenue authorities and multinational taxpayers in a non-adversarial manner was germinated in the early 1980s. The CRA later attributed the initiation of the APA concept to “large multinational taxpayers who actively pursued a higher degree of certainty for their inter-company pricing.”10

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8 2010-11 CRA report, supra note 5.
9 See infra notes 97-103 and the related text.
In 1986, an advance resolution process for transfer pricing was discussed at a meeting of international tax officials convened to consider the reduction of controversies in this area. By the late 1980s, it was reported that several countries, including Canada, Australia, and the United States, had begun discussing the mechanics of devising APA programs. A Canadian transfer-pricing practitioner has allocated the credit for developing an advance rulings approach to the United States and Australian revenue authorities, since they were the first to confer on this issue, at a meeting of the Pacific Association of Tax Administrators (PATA) in Australia in the summer of 1989. During 1990 and 1992, Canada entered into a pilot program with the United States on two APAs on a trial basis, but the world’s first bilateral APA was completed in 1991 between the Internal Revenue Service (IRS), the ATO, and the Apple Computer Company.

Canada and Australia both commenced their APA programs in the early 1990s. The CRA defined an APA in its first APA program report as “an arrangement between a taxpayer and a tax administration that confirms the appropriate transfer pricing methodology to establish an arm’s length price for transactions between related parties.” Two years earlier, the ATO had similarly defined an APA in its first APA program report as “an arrangement between a taxpayer and a tax administration(s) on the future application of the arm’s length principle to their international dealings with related parties.” The ATO expanded on this definition by clarifying that “[t]he APA determines a Transfer Pricing Methodology (TPM) that ensures an appropriate allocation of income and expenses between related parties, given the relative economic contribution of the parties involved.”

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14 PATA was established in 1980 and was the first intergovernmental tax organization to formulate an initiative to create principles for uniform transfer-pricing documentation. Its members are the revenue authorities of the United States, Australia, Canada, and Japan.

15 2007-8 CRA report, supra note 10, under the heading “History of the APA Program in Canada.”

16 Canada Customs and Revenue Agency, APA Program Report 1993-2003 (Ottawa: CRA, June 2003). (Some documents cited herein refer to the CRA by its former name. In all other contexts, the current name, CRA, is used.)


18 Ibid.
Canada was the first of the two countries to offer specific APA guidance. In December 1994, it issued an information circular (IC 94-4) providing taxpayers with the opportunity to enter into unilateral, bilateral, or multilateral APAs.19 Australia subsequently released specific official guidance on APAs for taxpayers in June 1995,20 also offering these diverse types of arrangements. Then, in 1997, Canada and Australia participated in negotiating the world’s first multilateral APA, involving five Pacific Rim countries21 (the four PATA countries plus New Zealand).22 Canada and Australia have thus become established as leaders in APA innovation.

Unlike the situation in United States, neither the Canadian nor the Australian revenue authorities have to date charged a fee for an APA; however, in Canada, a non-refundable user charge is levied for each accepted APA request to cover anticipated out-of-pocket costs related to the APA negotiation, such as travel and accommodation expenses for the revenue officials involved.23

The First Decade of the Canadian and Australian APA Programs

During the first decade of their respective APA programs, both the Canadian and the Australian revenue authorities were active in encouraging multinational taxpayers to enter into such advance agreements. The CRA was unequivocal in its support for its APA program, clearly setting out its program development strategy in a 2002 vision statement. The program was to become the “preferred dispute resolution mechanism for transfer pricing issues” since, over time, APAs would “gradually replace the current cycle of domestic reassessment followed by competent authority consideration.”24 The ATO in turn saw such agreements as “a valuable and effective compliance product,” noting that “APAs are the better way to go.”25

19 Information Circular 94-4, “International Transfer Pricing: Advance Pricing Agreements (APAs),” December 30, 1994. The circular explained that a unilateral APA is an arrangement between the taxpayer and the CRA, while bilateral and multilateral APAs are arrangements between the taxpayer, the Canadian competent authority, and the competent authority/ies with which Canada has an income tax treaty.


21 2001 ATO report, supra note 17, at paragraph 7.

22 It has been reported anecdotally that the competent authorities of four of the five countries were able to reach agreement after a week of round table discussions in the United States, and that four months later Canada was also able to agree to this multilateral APA.


25 2001 ATO report, supra note 17, under the heading “An Overview of the Past, Present and Future.”
Despite their obvious enthusiasm for their APA programs, both the CRA and the ATO expressed their disappointment that not enough taxpayers were taking advantage of this desirable new controversy management tool. In 2004, the CRA pointed out that

[d]espite the many advantages, a number of taxpayers that might benefit considerably from obtaining an APA have not yet investigated the Program. As such, the CRA continues to actively promote the APA Program. We expect that the CRA’s APA Program Development Strategy (with increased emphasis on APA promotions directly to taxpayers) and recent Program improvements, combined with steady international audit activity, will result in more taxpayers enjoying the benefits of our APA Program.26

In the same year, Canada introduced the “APA First Step” program, which involved visits by CRA representatives to large taxpayers that were not taking advantage of the APA program, in order to promote its benefits.27 Three years previously, the ATO had been quite candid regarding its initial lack of success in convincing taxpayers to enter the APA program, remarking that “[t]his was very frustrating, given the obvious benefits.”28 Taxpayer hesitancy was attributed to perceived risks in the APA process, especially for those with large exposures in relation to previous years.29 Like the CRA, the ATO envisaged that a carrot and stick approach would drive more multinational taxpayers toward using an APA, with the carrot being the benefits flowing from an APA and the threat of a transfer-pricing audit being the stick.

Canadian taxpayers were advised of the benefits of an APA, which the CRA described as its “transfer pricing compliance tool of choice.”30 These included the fact that highly skilled analysts would be involved, and thus a faster case resolution could be achieved than through the audit/double taxation appeal process, and that rollbacks of the terms and conditions might be available for open tax years, thus “resolving many years of potential tax issues in a single process.”31 An APA would also be more cost-effective and less onerous that the normal transfer-pricing documentation procedures, and a renewal could be straightforward if the facts of the initial APA had not changed significantly. Perhaps most importantly, the APA was marketed as a cooperative approach to resolving transfer-pricing disputes, where the views of the taxpayer “are given first consideration”: “in this cooperative spirit and with the open sharing

27 Deanehan et al., supra note 12, at 4.
28 2001 ATO report, supra note 17, under the heading “Marketing the APA Program.”
29 Ibid.
30 2003-4 CRA report, supra note 26, under the heading “What Are the Benefits of Entering into an APA?”
31 Ibid.
of information . . . trust and cooperation flourish—and the potentially adversarial nature of a transfer pricing audit is avoided.”32 The ATO agreed that an APA was less costly and time-consuming than an audit, and lessened the possibility of not only double taxation but also “protracted and expensive litigation.”33 Ongoing maintenance of compliance was likely to be relatively easy, and an APA had the advantage of providing “certainty for the taxpayer by enhancing the predictability of tax treatment of international transactions.”34

These benefits needed to be viewed against the backdrop of increasingly aggressive transfer-pricing audits around the world. In 2003, more than three-quarters of both parent and subsidiary respondents to a biennial global survey believed that a transfer-pricing examination would occur within their group during the next two years.35 In both Canada and Australia, more than half of all parent company respondents considered such an examination “very likely” in the next two years.36 According to the ATO, the importance of the Australian APA program was escalated by, inter alia, the marketing of APAs by professional advisers to their clients as a “low cost means of achieving certainty with respect to their international related party dealings.”37 This marketing was underscored by a warning not only of the cost of self-review, but more significantly of the number of taxpayers being targeted by the ATO’s expanding compliance program, especially the “Transfer Pricing Record Review and Improvement” project,38 which alone resulted in taxpayers paying a total of A$42.2 million in tax and penalties by the 2004-5 financial year.39

On the other side of the Pacific, Canadian taxpayers were advised that

[t]he number of transfer pricing audits continues to increase in most tax jurisdictions. Transfer pricing is often identified as the most contentious issue facing multinational enterprises. As transfer pricing audits increase and the issues identified by auditors become more complex, the APA Program is ideally situated to provide taxpayers with the most effective and efficient mechanism to resolve potential disputes.40

32 Ibid.
33 2001 ATO report, supra note 17, under the heading “APAs Provide a Number of Benefits for Taxpayers and the ATO.”
34 Ibid.
35 Ernst & Young, Transfer Pricing 2003 Global Survey: Practices, Perceptions and Trends in 22 Countries plus Tax Authority Approaches in 44 Countries (Ernst & Young, 2003), at 13 (76 percent of parent respondents and 77 percent of subsidiary respondents were of this view).
36 Ibid., at figure 6.
37 2001 ATO report, supra note 17, under the heading “Marketing the APA Program.”
38 Ibid.
40 2003-4 CRA report, supra note 26, under the heading “What Are the Benefits of Entering into an APA?”
Thus, after a decade of negotiating APAs, this mechanism was presented to both Canadian and Australian taxpayers as an ideal solution to increasingly complex transfer-pricing disputes and a safe haven from aggressive transfer-pricing audits, which often resulted in transfer-pricing adjustments and penalties.\footnote{Audits of Canadian parent companies more than doubled between 2003 and 2005, while the percentage of such audits resulting in transfer-pricing adjustments rose from 45 percent to 81 percent during the same time period. The CRA formed the Transfer Pricing Review Committee in 2004 to review transfer-pricing penalties. By May 2005, the committee had imposed penalties in over half of the cases it had reviewed. See Michelle Markham, “APAs in Australia, Canada and the United States: Current Developments and Future Directions” (2006) 34:8/9 Intertax 393-405.}

**Small Business Taxpayer Reform in Canada**

In 1995, the OECD had alerted tax administrations in its transfer-pricing guidelines that “[a]n APA program cannot be used by all taxpayers because the procedure can be expensive and time-consuming and small taxpayers generally may not be able to afford it.”\footnote{Organisation for Economic Co-operation and Development, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris: OECD, 1995), at paragraph 4.159.} The OECD transfer-pricing guidelines suggested that tax administrations could alleviate this problem by ensuring that the level of inquiry was adjusted to the size of the international transactions involved, and by providing streamlined access for small taxpayers.\footnote{Ibid., at paragraph 4.164.}

As OECD member countries with mature APA programs, Canada and Australia were aware of the need to provide simplified, less costly versions of the APA process for their small business taxpayers. This would also be a way of expanding their respective APA programs, in line with their respective visions for the future regarding the resolution of transfer-pricing disputes.

In 2005, the CRA took the innovative step of issuing guidelines specifically for small business taxpayers seeking APAs.\footnote{Information Circular 94-4R (Special Release), “Advance Pricing Arrangements for Small Businesses,” March 18, 2005.} These guidelines set out the conditions under which a small business APA may be negotiated. For example, taxpayers must have gross revenues of less than Cdn$50 million or a proposed covered transaction of less than Cdn$10 million, and only transactions involving tangible goods and routine services are eligible.\footnote{Ibid., at paragraph 4.} Small business APA requests have a fixed non-refundable administrative fee of Cdn$5,000, and only requests for a unilateral APA without rollback will be considered under these special arrangements.\footnote{Ibid., at paragraphs 1 and 8.} However, while a taxpayer seeking an APA would normally need to provide both a functional and an economic analysis, only the former is required of eligible small business taxpayers (with the CRA performing the economic analysis), and there are reduced reporting
requirements. Unfortunately, the success of small business APAs under this CRA initiative has been limited; by the end of 2008, only “about seven” taxpayers in Canada had taken advantage of this streamlined process, and it appears that the small business APA program has not been used at all over the last few years.

While Canada had seized the initiative in relation to small business taxpayer reform on APAs, similar guidance was lacking in Australia. In 1995, the ATO had noted, rather vaguely, that “the level of information required for an APA varies from case to case and therefore the level of information required from a large multinational enterprise may not necessarily be required for a smaller enterprise.”

Three years later, the ATO considered transfer-pricing documentation issues for small business taxpayers, stating that such taxpayers need not create documents beyond the minimum necessary to demonstrate arm’s-length outcomes. (They would, however, need to create some documentation beyond that which would be created in the ordinary course of business.) Further details were not provided, since “[t]he various possible situations arising in business do not lend themselves to a code of practice or formal process being spelt out for small business taxpayers.” Small business taxpayers were thus left without any clear guidance in relation to a differentiated system of transfer-pricing documentation, and without a streamlined APA process.

However, the ATO realized that the key issue of agreements for small business taxpayers was vital to the success of any sustainable APA program. This issue would once again rise to prominence when reform measures fell under the spotlight in the second decade of the Australian program.

**The Second Decade of the Canadian and Australian APA Programs—Focus on Reform**

In the second decade of their respective APA programs, both Canada and Australia were intent on making improvements. In 2002, the CRA had outlined areas where further changes could be made, such as raising service standards by increasing feedback and communication with clients. To this end, the CRA conducted a public forum in 2006 to discuss improvements to its APA program. Of particular concern at this time were

47 Ibid., at paragraphs 7 and 10.
48 Deanehan et al., supra note 12, at 5.
49 TR 95/23, supra note 20, at paragraph 68.
51 Ibid., at paragraph 6.2.
52 2002 APA program strategy, supra note 24, under the heading “Further Improvements To Be Made.” Other listed concerns included the need “to decrease the average time it takes to complete an APA” and “to improve the negotiation process with treaty partners.”
53 Deanehan et al., supra note 12, at 5.
deteriorating competent authority negotiations between Canada and the United States. Practitioners blamed both tax authorities for the decline in the Canada–US relationship. The CRA was accused of “taking inconsistent positions designed to maximize Canadian revenue in every case, disallowing deductions for intangibles routinely permitted by other tax authorities, and failing to negotiate in good faith.”

The IRS in turn was criticized “for a lack of flexibility, a tendency to undervalue Canadian subsidiaries’ contributions to intangibles, and for failing in advanced pricing agreement negotiations to see the merit of bilateral visits to a taxpayer site.”55

In Australia, the ATO also held a consultative forum with the tax, accounting, and legal professions, in May 2006. It admitted to resource problems in dealing with new unilateral and bilateral APAs, and even with simply monitoring the annual compliance of existing APAs.56 There was a need to improve both the organizational and staffing arrangements for the program. In the following year, PricewaterhouseCoopers Legal (“PwC Legal”) was appointed by the ATO to conduct an external review of its APA program—the first fully independent review of an APA program anywhere in the world.

PwC Legal focused its review on recommendations to improve the effectiveness and efficiency of the Australian APA program, and sought feedback from both internal and external stakeholders, including taxpayers, tax advisers, and industry groups. When the report was issued in May 2008, a key recommendation was to “[u]se a co-design approach with both ATO and external stakeholders to refine/remodel specific aspects of the APA program to implement the recommendations outlined in this report.”57 In a courageous move, the ATO decided to implement this unique and, from a revenue authority point of view, quite revolutionary recommendation. The APA program co-design process commenced in January 2009 with the inauguration of the APA Co-design Committee, comprising representatives from “the chartered accounting firms, peak accounting and taxation bodies and the Tax Office.”58 There were many delays in implementing this initiative, no doubt as a result, in part, of the multitude of differing opinions being expressed; but eventually, as noted earlier, on March 17, 2011, the ATO released its new practice statement on APAs (PS LA 2011/1).59 Australian Tax Commissioner Michael D’Ascenzo referred to the revised

55 Ibid.
59 Supra note 7.
APA processes as a “great example of how co-design can have a positive result for the community.”

**AUSTRALIAN APA REFORM IN 2011**

**A New APA Strategy—Simplified, Standard, and Complex APAs**

The development of a differentiated framework for simplified, standard, and complex APAs has been described by Australian transfer-pricing practitioners as a “major initiative” and as “the most significant change to the APA Program.” Whereas previously only one type of APA process was available, with no concessions for small business taxpayers, the new program streams APAs into one of three categories, according to various criteria. Taxpayers can now tailor their APA according to the requirements of the particular product selected.

Taxpayers with low-value or low-risk international related-party transactions can take advantage of the new simplified APA procedure. With a target cycle time for a typical APA from prelodgement to finalization estimated by the ATO to be nine months, this is the quickest APA option available. A simplified APA is available to taxpayers whose gross income is less than A$250 million or whose international related-party dealings do not exceed a certain limit—A$150 million for the purchase and sale of tangible goods, A$50 million for the provision or receipt of routine services, or A$10 million for dealings involving intangible property. (Here the ATO has gone a step further than the CRA by allowing some intangible property transactions to be dealt with in a simplified APA; this is not allowed under the Canadian guidelines for small businesses.)

The income and dealings limits for a simplified APA apply to an Australian consolidated tax group as a whole, a condition that may limit eligibility for a large number of taxpayers. The ATO has explicitly stated its intention “that the simplified APA process be available to a maximum number of taxpayers,” though it has left the door open for future flexibility in allowing individual companies in a consolidated group to apply for a simplified APA product. However, as with the Canadian small business taxpayer arrangements, such APAs are available only on a unilateral basis.

Australian taxpayers seeking a bilateral APA now have a choice between the standard and complex APA products. Standard APAs fall between simplified and complex APAs, and may include collateral issues, defined as “another administrative or tax issue

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63 PS LA 2011/1, supra note 7, at paragraph 16.
64 Ibid., at paragraph 30.
65 Ibid., at paragraph 31.
in addition to transfer pricing relating to the international related-party dealings.66 Examples of collateral issues include whether the covered international related-party dealings involve a permanent establishment, new issues on which the ATO’s view has not yet been determined, and an ATO risk review or audit currently in progress.67 Such issues will ideally be processed in parallel with the APA.68 The estimated time frame for a standard APA is 12 months for a unilateral arrangement and 18 to 24 months where a bilateral agreement is sought.

Complex APAs are likewise available for both unilateral and bilateral arrangements, but the target completion time here is 24 months in both situations, implying that the ATO estimates that the longest time that any APA should take to conclude, from prelodgement to finalization, is two years. The ATO deems the complex APA product to be suitable for international related-party dealings that are considered to be high risk.69 This may be because there are no comparables, because there is a “significant amount” of tax involved (although what would constitute such a significant amount is not defined), or because the dealings may result “either directly or indirectly, in shifting of significant profit out of Australia.”70 Practitioners have suggested that complex APAs may be particularly well suited to taxpayers undergoing business restructuring71—the new procedure specifically mentions details to be provided in the APA application where such a restructuring is envisaged.72

By dividing APA requests into three separate and distinct streams based on risk and complexity, the ATO is attempting to allocate its resources efficiently and appropriately, in order to achieve savings in both the time and the cost of APA negotiations. The target completion times are not unrealistic, and they are in line with the APA processing times reported by the ATO in 2010 (the most recent year for which data are available), when unilateral applications took, on average, 9 months while bilateral applications took 21 months.73

Clear Guidance on Key Steps in the APA Process

External survey respondents in the PwC Legal review had been highly critical of the lack of consistency and certainty in the ATO’s five-step APA process. The main criticism levelled by taxpayers with large or complex cases was that the ATO was...
abusing the supposed flexibility of pre-lodgment consultations (Step 1 in the five-stage APA process) by making onerous information requests, and also by bringing forward Step 3 of the APA process (the Analyse/Evaluation stage) in order to gain undue levels of certainty prior to any commitment by the ATO, thereby prolonging the whole pre-lodgment process unduly.74

To counter this adverse commentary, the new procedure provides a detailed overview of the APA process for each new APA product. This process is divided into five steps:

1. prelodgement,
2. lodgement of the formal application,
3. analysis and evaluation,
4. negotiation and agreement, and
5. conclusion.

The first step, prelodgement, is the only one that is common to all three products.75 Here the scope of the APA (and the likely product to be utilized) is identified along with any collateral issues. It is at this point that the taxpayer and the ATO should agree on the resolution approaches to be taken and jointly develop the APA case plan, setting out a work plan and timeline. PS LA 2011/1 makes it clear that these prelodgement meetings do not bind either party to the APA program.76 The other four steps are specifically tailored to the different APA product requirements, and thus a framework is provided for all agreements.

A Longer Life for APAs—Streamlined Renewals and Extensions

The two most frequently voiced complaints about the APA process are reported to be that APA negotiations take too long and they are too expensive.77 Where an MNE taxpayer embarks on its first APA, a considerable upfront investment is often required in order to satisfactorily document and negotiate an APA request. However, tax administrations such as the CRA have marketed APAs on the basis that an APA might offer ongoing certainty and cost savings via a renewal of the arrangement, which ideally should be a greatly expedited process.78

Prior to the APA reform of 2011, Australia’s success with renewals was somewhat haphazard. While in 2003 renewals took on average 60 percent less time than a new

75 PS LA 2011/1, supra note 7, at paragraph 26.
76 Ibid., at paragraph 29.
77 Deanehan et al., supra note 12, at 6.
78 2003-4 CRA report, supra note 26, under the heading “What Are the Benefits of Entering into an APA?”
application, by 2008 they took the same amount of time to negotiate as an original APA. In 2010, an anomalous situation arose whereby the average APA renewal process took 66 percent longer than an original APA, with delays being attributed to stalled negotiations with foreign revenue authorities on bilateral agreements.\footnote{Deloitte, “Australian APA Program Booming,” \textit{The Benchmark}, November 2010.}

The ATO has attempted to reinvigorate the long-term cost effectiveness of APAs by introducing a new streamlined renewal process alongside the traditional renewal process, and by adding a new APA extension process. The streamlined renewal can be used for both unilateral and bilateral arrangements (where the treaty partner agrees to this).\footnote{PS LA 2011/1, supra note 7, at paragraph 158.} However, it is available only where no material changes have occurred in respect of the covered international related-party dealings or in the terms of the original APA, and where it is unlikely that any material changes will occur over the period of the renewed APA.\footnote{Ibid., at paragraph 159.} If a taxpayer meets the qualifications for a streamlined renewal, then significantly less information is required compared to the usual renewal procedure (which is used where the terms of the existing agreement have changed).\footnote{Ibid., at paragraph 162.}

The new APA extension process is very similar to the streamlined renewal, and also requires significantly less information than is the case where there are changed APA terms in a standard renewal.\footnote{Ibid., at paragraph 167.} The only difference between the two new procedures seems to be that for a streamlined renewal the taxpayer is required to update the arm’s-length benchmarks in line with the current performance of comparable companies, while for the extension process no updating is required, since it must be clear that the arm’s-length benchmarks used for the original APA remain valid.\footnote{Ibid., at paragraphs 161(b) and 165(c).}

The use of either of these two new options should increase the efficiency and effectiveness of the original APA investment by decreasing processing times and expenses for subsequent renewals/extensions where no material changes to the terms of the agreement are envisaged.

**CANADA’S APA PROGRAM IN 2011**

The CRA’s 2010-11 APA program report\footnote{Supra note 5.} (the most recent available at the time of writing) provides an overview of the operations of the program, including statistical analyses of agreements completed and in progress.

A key finding of the report is that in 2010-11 bilateral APAs continued to be the mechanism of choice for Canadian taxpayers seeking prospective transfer-pricing certainty. (An earlier CRA report noted that there is a clear preference among revenue
authorities, including the CRA, for a bilateral or a multilateral APA since these provide the highest degree of certainty.86 Over 90 percent of all APA cases in process at the end of the 2011 financial year involved taxpayers seeking an APA on a bilateral or multilateral basis.87 The average time to conclude a Canadian bilateral APA in 2010-11 was 50.3 months.88

The fact that the average processing time for a bilateral Canadian APA is now more than four years is obviously a cause for concern, particularly given that the average APA term is only five years. The current OECD transfer-pricing guidelines make it clear that for all APA participants, “[t]he usefulness of the process . . . will be significantly diminished if the MAP [mutual agreement procedure] APA is not agreed until the period proposed to be covered in the taxpayer’s request has nearly expired.”89 The OECD recognizes that some delays are inevitable, owing to the fact that most APAs deal with large taxpayers with complex issues; however, tax authorities are encouraged to allocate sufficient resources and skilled personnel to the process to ensure that cases are settled promptly and efficiently.90 It should be noted that by far the majority—76 percent—of all completed Canadian APAs have been with the United States, while Japan is Canada’s second-largest bilateral agreement partner, with 9 percent of all completed APAs. Australia and the United Kingdom are tied in third place, each claiming 6 percent of all completed Canadian APAs.91

The CRA’s 2010-11 report mentions the progressive popularity of the APA program and the active promotion of APAs by the CRA, and suggests that the high number of APA renewals is “a tribute to the program’s increasing maturity and success.”92 The report also discusses the new procedural changes referred to earlier, which may restrict the suitability of the program for many potential APA applicants. The CRA has introduced increased due diligence at the pre-filing stage, explaining that this is a way to “reduce the risk of APA cases/transactions being un-negotiable or, with respect to cases with the United States, ending up in arbitration.”93 Anecdotal evidence suggests that the CRA is wary of being outgunned when it comes to arbitration by the greater resources of the IRS—especially in light of the recent reorganization of the IRS’s new Large Business and International Division, and the significant increase in

86 2003-4 CRA report, supra note 26, under the heading “APA Type.”
87 2010-11 CRA report, supra note 5, under the heading “Intergovernmental Status.”
88 Ibid., under the heading “Completion Times.”
89 OECD guidelines, supra note 2, annex to chapter IV, “Guidelines for Conducting Advance Pricing Arrangements Under the Mutual Agreement Procedure (‘MAP APAs’),” at paragraph 52.
90 Ibid., at paragraphs 52-53.
91 2010-11 CRA report, supra note 5, table entitled “Bilateral and Multilateral APAs—Foreign Jurisdiction.”
92 Ibid., under the heading “Application Statistics.”
93 Ibid., under the heading “Closing Remarks: Procedural Changes to the APA Program.”
its resources. Since the entry into force of the fifth protocol to the Canada-US tax convention on December 15, 2008, taxpayers seeking a bilateral Canada-US APA have the ability to compel the competent authorities of both countries to refer their dispute to binding arbitration. The CRA is consequently hesitant to accept difficult APAs with the IRS out of concern that these could lead to arbitration.

The report also states that the CRA “will not accept business restructuring transactions or the valuation/ownership issues that result from a restructuring during or before the APA period.” The view now is that APAs are best suited for transactions that are likely to experience little or no change over the duration of both the immediate pre-APA period and the APA period itself.

These changes have the effect of restricting entry to the program, marking a significant departure from the CRA’s former policy of promoting APAs to all taxpayers with related-party transactions. Canadian tax advisers have expressed concern that the CRA’s rejection of APA applications, driven largely by resource constraints, may be detrimental to the program. For example, a 2011 Tax Management Transfer Pricing Report quotes comments by Chris Raybould of Baker & McKenzie in Toronto regarding the CRA’s evident reluctance to accept cases that could become eligible for arbitration. In Raybould’s view, any attempt to exclude difficult cases on this basis “subverts the original purpose of the APA program: specifically, to give taxpayers and tax administrations a means to identify and resolve difficult issues contemporaneously.”

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94 In August 2010, the IRS announced the realignment of its Large and Mid-Size Business Division (LMSB) “to create a more centralized organization dedicated to improving tax compliance.” This new organization, termed the Large Business and International Division, as of October 1, 2010, was promoted as enhancing the current international program, “adding about 875 employees to the existing staff of nearly 600”; most of these additional employees were former specialists on international issues within other parts of the LMSB. See Internal Revenue Service, “IRS Realigns and Renames Large Business Division, Enhances Focus on International Tax Administration,” News Release IR-2010-88, August 4, 2010.

95 The Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007, articles XXVI(6) and (7) (added by article 21 of the fifth protocol). The effective dates for cases referred to the competent authorities under these provisions are set out in article 27 of the fifth protocol (Protocol Amending the Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital Done at Washington on 26 September 1980 as Amended by the Protocols Done on 14 June 1983, 28 March 1984, 17 March 1995 and 29 July 1997).

96 2010-11 CRA report, supra note 5, under the heading “Closing Remarks: Procedural Changes to the APA Program.”


98 Ibid., at 435 (quoting Raybould).
The same report quotes comments by François Vincent of KPMG LLP in Ottawa, one of the initial architects of the Canadian APA program and co-author of the original and revised APA guidelines. Vincent has confirmed that “the APA program was meant to tackle difficult issues,” and has suggested that denying access to the APA program in more complex cases could result in more cases going to competent authority as a MAP request.99 Indeed, the CRA has indicated that it will not accept APAs where the proposed covered transactions are with trading partners in countries without a prior history of MAP cases with Canada.100 While the CRA is struggling to manage its caseloads, this particular move may be counterproductive, since ultimately the choice for taxpayers is to resolve the matter either immediately through the APA program or at a later stage through the MAP. In either case, the same CRA competent authority team will have to deal with the case. In this situation, the taxpayer is seeking to voluntarily comply with the CRA through the APA program, but is being turned away to suffer the potential burden of uncertain tax liabilities and a lengthy audit defence, which may not be in the best interests of either party. In Raybould’s opinion, cases are generally better addressed “while access to all relevant people and data is readily available rather than waiting for years to start an audit and risk it becoming more difficult to resolve as people change jobs or leave and records go into storage.”101

Practitioners have also noted that these new policies seem to put the CRA’s APA program out of step with Canada’s major treaty partners, who consider an APA the ideal mechanism to address situations such as business restructuring.102 Fred O’Riordan of Ernst & Young LLP in Ottawa, who was the CRA’s assistant commissioner of appeals from 2007 to 2010, and head of the International and Large Business Directorate when it was created in 2006, is quoted as noting that the United States has encouraged taxpayers with restructuring issues to apply for an APA, and that rejecting such cases is inconsistent with recently released OECD guidance.103 (The OECD issued a report on the transfer-pricing aspects of business restructurings in July 2010, which adopted the premise that the arm’s-length principle does not and should not apply differently in the case of business restructuring than in other transfer-pricing contexts.)104 O’Riordan also noted that CRA resource constraints were driving the new policies; although international audit resources had increased

99 Ibid. (quoting Vincent).
100 Ernst & Young, “Transfer Pricing Remains a Key Audit Focus for Tax Authorities: Ernst & Young Survey” [August 2012] no. 37 Tax Alert—Canada 1-5, at 3.
101 Schuster, supra note 97, at 435 (quoting Raybould).
103 Schuster, supra note 97, at 435-36 (quoting O’Riordan).
significantly from 2006 onward, the same was not true for competent authority resources.

**ARE THE AUSTRALIAN APA REFORMS RELEVANT TO THE CANADIAN APA PROGRAM?**

The CRA is clearly experiencing resource problems in its APA program, and finds itself in a similar situation to the ATO prior to the PwC Legal review. While allocating additional resources might be one solution, another might be to focus on the most efficient organization of current resources. This is particularly the case given that in the 2012 federal budget, the Canadian government called for a 6.9 percent reduction in the CRA’s operating budget, with the goal of phasing in Cdn$250 million in annual savings by the 2015-16 fiscal year.\(^\text{105}\) That is not to say that in Canada, there should not be an increase in resources in proportion to the rise in demand for the APA program. Other jurisdictions (such as Australia, the United States, certain EU countries, and certain Asian countries) have increased or realigned their tax administration resources toward transfer pricing, and APAs in particular. If Canada does not do likewise, this may result in an unwillingness to engage in some APAs, and may lengthen negotiation timelines as a result of longer times needed to prepare functional and economic analyses.

The creation of differentiated types of APAs would allow the CRA to speed up its processing on “simple” or straightforward international related-party transactions. As discussed above, Canada’s APA program includes a small business APA procedure; thus, the framework for a simplified type of agreement is already in place, and this could be adapted and updated to meet current APA requirements. A procedure for standard APAs is also available, but the introduction of an APA product for complex APAs along the lines envisaged by the ATO would allow specialized concentration on issues such as business restructurings and intangibles, and allow expertise to develop in these areas.

The CRA has noticed a gradual shift from APA applications involving transactions of tangible goods to those covering transactions involving intangibles. It has previously observed that this transition “is to be expected as transactions involving intangibles are complex and will often generate very difficult audit issues that can result in a wide range of opinions—something the APA Program is well suited to resolve.”\(^\text{106}\) Moving these complex issues away from audit toward a “complex” APA stream would be in line with the CRA’s own expressed goal of “enhancing overall compliance by shifting more international files from enforced compliance to assisted and voluntary compliance.”\(^\text{107}\)

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1062003-4 CRA report, supra note 26, under the heading “APA Issue.”

1072002 APA program strategy, supra note 24, under the heading “Program Goals.”
Revised Guidance?

There have been calls from Canadian transfer-pricing practitioners for an update of the CRA’s current guidance on APAs; IC 94-4 was last revised in 2001. An updated guideline, taking note of some of Australia’s APA reforms that may be relevant to the Canadian situation, may be a way of overcoming some of the current difficulties with the application of the APA program. For example, IC 94-4R refers to the following 10 stages of the APA process:

1. pre-filing meeting(s);
2. the APA request;
3. the acceptance letter;
4. the APA submission;
5. preliminary review of the APA submission and establishment of a case plan;
6. review, analysis, and evaluation;
7. negotiations;
8. agreements;
9. the post-settlement meeting; and
10. APA compliance.

Clearer guidance could be provided about exactly what is required at each stage, particularly the controversial pre-filing stage. O’Riordan has commented that if entry into the APA program is now being restricted at the pre-filing stage, “taxpayers should be given clear criteria with examples so they can decide accordingly whether or not to apply.”

One recommendation made by PwC Legal in its independent review of the Australian APA program was the use of a “stage-and-gate” process to progress through the stages of an APA: at the end of each step in the APA process, an interim stage-and-gate review panel should review and reach agreement on the achievements of the previous step, then agree on a detailed plan for the next step. Once the previous step has been reviewed, the door should close on issues raised during that step, and those issues should not be revisited except as part of a process agreed upon with the taxpayer up front as part of the project plan.

While this recommendation has not been fully implemented in Australia, the APA case leader (a new role introduced by PS LA 2011/1) is now responsible for referring the APA to the Transfer Pricing Review Panel (an internal ATO review body

108 IC 94-4R, supra note 23.
109 Ibid., at paragraph 10.
110 Schuster, supra note 97, at 436 (quoting O’Riordan).
111 The APA case leader will be a “specialist” with sufficient technical transfer-pricing expertise and project management capabilities to run the APA. The case leader’s role encompasses accountability for ensuring that milestones and time frames for each step of the APA process are met. See PS LA 2011/1, supra note 7, at paragraphs 186-87.
that oversees the standard of technical and case management decision making in transfer-pricing casework) at key milestones\textsuperscript{112} of the APA for review. There may be merit in the CRA’s increasing its due diligence at the pre-filing stage, in order to make an informed assessment before the CRA and the taxpayer commit substantial resources to the process; however, practitioners have commented that “[b]ased on our experience . . . this due diligence can continue well after the APA submission has already been filed.”\textsuperscript{113} A stage-and-gate process, or at the least a clear delineation between the steps of the APA, could obviate this blurring of APA requirements and assist in overcoming current delays at the pre-filing stage, which drain CRA resources.\textsuperscript{114} Streamlined APA renewal and extension processes, along lines similar to those now provided in Australia, could further result in an efficient use of CRA resources to remove the current backlog of cases. Such reform is particularly apposite in relation to recent record levels of closing APA inventory.\textsuperscript{115}

Canadian reformers should bear in mind that while Australia may have been the first country to diversify its APA products into a three-tier risk-based approach, the idea of a fast-track APA is gaining ground on a global basis. The OECD is concentrating on transfer pricing and simplification, with the current head of the Transfer Pricing Unit at the Centre for Tax Policy and Administration recently highlighting APA processes as a future focus of the OECD’s simplification project.\textsuperscript{116} At the beginning of 2012, the American Bar Association’s Section of Taxation also recommended that the IRS further streamline the small business taxpayer APA process.\textsuperscript{117} (The United States introduced special procedures for small business taxpayer APAs in 1998.)\textsuperscript{118} In the United Kingdom, there have been reports of increased pressure on Her Majesty’s

\textsuperscript{112} Ibid., at paragraph 187(c). Key milestones might be the acceptance of the APA case by the ATO, agreement of the scope of the APA with the taxpayer, the selection of the most appropriate TPM, and the resolution of collateral issues.


\textsuperscript{114} Following the release of the 2010-11 CRA report, supra note 5, Patricia Spice, the previous director of the CRAs Competent Authority Services Division, commented that increased due diligence at the application stage of the APA process had probably caused a recent decline or delay in the number of cases entering the program. See Peter Menyasz, “Practitioner Says Canada, U.S. Conducting First Ever Joint Audit” (2012) 21:6 Tax Management Transfer Pricing Report 211-12.

\textsuperscript{115} See PricewaterhouseCoopers, supra note 113, at 2, noting that “[t]he CRA ended the year with a closing inventory of 95 cases, matching the all-time high set in 2010.”


\textsuperscript{118} Notice 98-10, 1998-6 IRB 9.
Revenue & Customs (HMRC) “to think about introducing a leaner fast track system for settling cases and agreeing APAs (ideally multilaterally).”\footnote{119}

Reforming the Canadian APA program along the lines suggested above, including a fast-track system of APAs, would enable the CRA to build on the innovations of other countries, including Australia, and to review and improve on what has been proven to work elsewhere. A 2012 survey of tax directors from 25 MNEs across seven countries, which explored current perceptions and experiences with APA programs globally, found widespread support for the view that tax authorities should adopt expedited APA processes to supplement existing programs, since doing so “could boost participation in these programs and increase the efficiency of transfer pricing administrations, for the benefit of all concerned.”\footnote{120}

**CONCLUSION**

Canada and Australia have both had well-utilized APA programs for more than two decades, and have a shared history of encouraging their multinational taxpayers to access this unique transfer-pricing controversy management tool. As co-members of PATA, with a number of Canadian-Australian bilateral APAs adding to their joint APA experience, these two countries are uniquely placed to benefit from reforms introduced by their respective revenue authorities; such reforms can potentially be utilized in both jurisdictions by adaptation to national requirements and circumstances.

In Canada, as in Australia, demand for APAs is increasing. This is driven both by domestic demand and greater accessibility to the APA option worldwide. One caveat is the CRA’s ability to meet the increase in demand. The majority of Canadian APAs have been concluded with the United States, and now that arbitration is possible for APAs, the CRA seems less inclined to accept contentious APAs that may possibly lead to arbitration. However, the IRS has recently announced increased resources and ambitious case completion times for both its APA and MAP programs,\footnote{121} and it is anticipated that this will put further pressure on the CRA to streamline its APA procedures.

The situation is viewed by transfer-pricing practitioners as creating an opportunity for both the CRA and the IRS to revisit their APA procedures. As noted in a 2012 *Tax Management Transfer Pricing Report*, Paul Mulvihill, a former APA team leader and manager of competent authority cases with the CRA, has commented that the opportunity to make those changes is now wide open, with new leadership at the helm of the CRA’s Competent Authority Services Division, and the appointment of the first director of the IRS’s new Advance Pricing and Mutual Agreement (APMA)
program.122 Under this new leadership, the CRA is reported to have begun making changes as to how it views cases, by assessing them on the basis of risk and determining what level of resources to commit.123

There is optimism that reforms of Canada’s APA program, perhaps by focusing on increased sustainability and efficiency along Australian lines, could enable the CRA to keep pace with the IRS’s APMA program, especially if the CRA were to reallocate some of its audit resources to APAs. As Mulvihill suggests,

[...]n investment in the Canadian APA program would likely make more economic sense than the CRA’s consideration of real-time or joint audits, which would be new initiatives for the agency, as opposed to investing [in or] revamping a program already proven around the world to be an effective dispute resolution tool.124

122 See Gregory, supra note 105, at 317 (quoting Paul Mulvihill).
123 Ibid.
124 Ibid., at 318.