



- HM Revenue & Customs (<https://www.gov.uk/government/organisations/hm-revenue-customs>)

See more information about this Policy paper (<https://www.gov.uk/government/publications/statement-of-practice-2-2010>)

Policy paper

Statement of Practice 2 (2010)

Updated 8 November 2016

Contents

General introduction

HM Revenue and Customs (HMRC) has run an Advance Pricing Agreement (APA) Programme since 1999 to assist businesses in determining the most appropriate methodology to derive the arm's length outcome for complex transfer pricing issues and prevent disputes arising that may otherwise result in a Mutual Agreement Procedure being necessary later.

This Statement of Practice (SP) updates an earlier Statement on APAs, SP02/10, published in 2010 (which was itself an update of SP3/99) and is intended as general guidance as to how HMRC interprets the APA legislation and operates the UK APA Programme. HMRC is taking the opportunity to incorporate best practice identified since SP02/10 was published.

The legislation that relates to APAs appears at Sections 218 -230 of the Taxation (International and Other Provisions) Act 2010 (TIOPA). This SP is intended to provide guidance about how HMRC interprets the APA legislation and applies it in practice.

Although the same legislation is used as the basis for Advance Thin Capitalisation Agreements (ATCA). HMRC has published a separate document, SP 01/12, to provide detailed guidance about its practice in reaching advance agreements over thin capitalisation issues which have their own distinctive features and are therefore generally negotiated under an entirely separate process.

APAs - what are they and when might businesses consider one?

1. An APA is a written agreement between a business and the Commissioners of HMRC which determines a method for resolving transfer pricing issues in advance of a return being made. When the terms of the agreement are complied with, it provides assurance to the business that the treatment of those transfer pricing issues will be accepted by HMRC for the period covered by the agreement. A bilateral APA - as discussed below - will provide a similar assurance in respect of the tax administration dealing with the entity at the other end of the transaction.

2. HMRC has found that where there is considerable difficulty or doubt in determining the method by which the arm's length principle should be applied, the transfer pricing issues can be more efficiently dealt with in real time as they arise rather than retrospectively years later when, for example, key personnel in the business may have moved on.

3. Sub-section 218(2), TIOPA 2010, sets out the transfer pricing issues which can be the subject matter of an APA. An APA can be used to resolve questions relating to the following broad situations giving rise to transfer pricing issues:

- transfer pricing between separate business enterprises where questions may arise as to the determination of the arm's length provision under the rules in Part 4 TIOPA 2010
- attribution of income or profit between parts of a business enterprise which operates in more than one country where questions may arise as to the taxable income to be recognised in any such part. Note: this is conceptually a similar problem to transfer pricing and any references to 'transfer pricing issues' in the remainder of this document should be read as including such attribution issues)
- across the UK oil-related ring-fence

4. The potential scope of an APA is flexible. It may relate to all the transfer pricing issues of the business or be limited to one or more specific issues. There is no requirement that the commencement of an APA should coincide with the commencement of the arrangements which it addresses so it may apply to pre-existing issues.

5. The APA legislation does not provide for a determination that a permanent establishment (PE) does or does not exist. The determination of profits to be attributed to any PE will only be considered for inclusion in an APA once the existence of the PE through which a company has been, or is proposing to, carry on a trade in the UK is established.

6. Similarly the APA legislation also does not provide for a determination of the potential impact of the Diverted Profits Tax (DPT) or other legislation on the covered transactions. The interactions between DPT and APAs are discussed in Chapter 3 of the Diverted Profits Tax: guidance (<https://www.gov.uk/government/publications/diverted-profits-tax-guidance>).

7. HMRC's CT International & Stamps Directorate (CTIS) has responsibility for all applications. It will involve such specialists and delegated Competent Authority officials as are necessary, and will ensure the business' Customer Relationship Manager (CRM) is involved.

8. HMRC do not levy any charge on the business for their assistance during the APA process but potential applicants need to be aware that some other Administrations may do. HMRC can advise on this at the Expression of Interest stage (see below).

Unilateral, Bilateral or Multilateral Agreement

9. A binding agreement between a UK business and HMRC in accordance with Section 218, TIOPA 2010, is referred to as a "unilateral APA". Although this agreement confirms the tax treatment in the UK, it does not determine how the issues are to be resolved in any other country involved. Consequently, it does not normally eliminate the risk of double taxation in relation to the transfer pricing issues it addresses. In order to achieve that comprehensively in the case of cross-border transfer pricing issues where a Double Taxation Agreement (DTA) exists between the UK and the other country containing a Mutual Agreement Procedure article, HMRC would have to reach agreement also with the Administration of the other country: this is referred to as a 'bilateral APA' or 'MAP APA'.

10. Businesses operating in several countries may wish to seek APAs that involve all the relevant Administrations affected by the transfer pricing issues. The term, "multilateral APA," has been used to describe such agreements, but there is no discrete mechanism for reaching multilateral agreements, and multilateral APAs are strictly multiple and complementary bilateral APAs.

11. Multilateral agreements may be more appropriate where there is essentially only one activity, but several enterprises or parts of enterprises contribute to it. For example, where an enterprise of the UK is engaged in global financial trading through branches in countries X and Y, it may be appropriate for similar agreements to be reached between HMRC and country X and HMRC and country Y in order to determine how the profits from the activity are to be allocated to each of the three countries in order to eliminate double taxation. In such a situation HMRC will adapt the bilateral framework in order to reach agreement on a trilateral basis, subject to the acquiescence of the other Administrations and any constraints on exchanging information imposed by the relevant DTAs. This may include use of multilateral instruments for exchanging information.

12. HMRC expects that APA applications are bilateral rather than unilateral except where:

- the other party to the transaction is resident in a jurisdiction with which HMRC has no treaty or where HMRC is aware that the treaty partner has no APA process; or
- HMRC consider there is little extra to be gained by seeking a bilateral agreement. For example where the UK is at the hub of arrangements with associated enterprises in many different countries and where the trade flows involved with any one particular country are relatively modest in scale

13. As unilateral APAs are generally of less value to both HMRC and potential applicants and provide less transparency, applications for unilateral APAs are less likely to be accepted into the APA programme. However each case will be considered on the basis of its facts and features.

14. HMRC's ability to give effect to a mutual agreement reached with a treaty partner to eliminate double taxation under the terms of a treaty will not be restricted by the terms of a unilateral APA. Any APA agreement reached will be exchanged with relevant treaty partners and other parties in accordance with HMRC's exchange of information obligations.

Who may apply for an APA?

15. An APA may be requested by any:

- UK resident business, including a partnership, with transactions to which the provisions of Part 4 TIOPA 2010 apply
- any non-resident trading in the UK through a permanent establishment
- any UK resident trading through a permanent establishment outside the UK

16. Every APA request will be considered on the basis of its particular facts and features, but generally HMRC will be looking at the following factors taken together, whether:

- the transfer pricing issues are complex rather than straightforward. To HMRC 'complex' means there is real doubt as to how the arm's length standard should be applied. Conversely, where market comparables can be readily identified for the transaction(s) in point in accordance with the OECD Transfer Pricing Guidelines HMRC is likely to regard such a situation as 'straightforward'. HMRC will be willing to consider an innovative proposal providing that there is not a more appropriate and straightforward method, it is compliant with OECD Guidelines, and not one that HMRC considers it or its Treaty Partners would regard as being overtly tax aggressive
- without an APA there is a high likelihood of double taxation
- HMRC consider that it is a good use of taxpayer and governmental resources

17. APAs will not be declined solely by reference to the size of the transactions giving rise to the transfer pricing issues because HMRC recognises that complex transfer pricing issues can be encountered by smaller businesses as well as by large multinationals. However many small and medium enterprises are exempt from the UK transfer

pricing legislation by virtue of Section 166 TIOPA 2010 and so there may be limited occasions where the APA process will be appropriate for smaller businesses.

18. Since April 2004 UK-to-UK transactions have been subject to transfer pricing legislation: but, HMRC does not generally see such transactions as likely to warrant an APA. However some UK-to-UK transactions, for example oil-related ring fenced trades, are specifically provided for in legislation.

19. When a UK business does obtain an APA and the provision in question is made or imposed with a related UK business Section 222 TIOPA 2010 enables the other UK business to claim to have their profits adjusted in line with the APA where they are disadvantaged. However, HMRC seeks to avoid such issues by encouraging the business to agree wherever possible that the transfer pricing methodology will determine the commercial charge for the provision as well as the charge for tax purposes.

The initial contact - the expression of interest process

20. The APA process is initiated by the business but HMRC always strongly recommend that an enterprise interested in applying for an APA contacts it first to informally discuss its plans before presenting a formal application. This is to ensure that the resources of the business are not wasted on an unsuitable application and to ensure that the detailed work that will need to be undertaken by the business in finalising its application is focused on relevant issues. It also gives HMRC an opportunity to outline a realistic anticipated timetable for agreeing an APA based on past experience, or to discuss other practical 'process' issues with the business.

21. The contact details for an Expression of Interest in an APA and for making an APA application is:

APA Lead (Nick Stevart)
CTIS Business International
11th Floor East, Euston Tower
286 Euston Road
London NW1 3UH

Telephone: 03000 585659

Email: nicholas.stevart@hmrc.gsi.gov.uk

Where the enterprise has a CRM they should also make the CRM aware of their interest in an APA and cc them on correspondence.

22. The Expression of Interest should generally cover:

- the nature of the transfer pricing issues intended to be covered by an APA
- details of the tax residence of the parties involved and the importance to the wider business of the transactions intended to be covered
- a description of the proposed transfer pricing method
- an indication of the nature of any current transfer pricing enquiries, competent authority claims, and any other relevant issues that the business is aware of in the context of the suggested APA including the potential of Diverted Profits Tax to apply to the covered transactions

HMRC's experience is that discussion of these issues at a meeting is much speedier and more productive than correspondence. This meeting may be by phone where more efficient. HMRC is usually able to indicate at the conclusion of an Expression of Interest discussion whether it will be prepared to consider an application for an APA.

Provision of details of the proposed covered transactions and any slide presentation intended to be given to HMRC beforehand will help make the Expression of Interest meeting as productive and informative as possible.

23. An Expression of Interest can best be evaluated where the identity of the business is known and HMRC's experience is that there is little to be gained from entering discussions without knowing the identity of the business including because HMRC cannot make any commitment over acceptance into the APA Programme until the identity of the business is known.

24. In the event that HMRC considers that an application should not be admitted into the APA Programme, HMRC will advise the business of the reasons why HMRC takes that view, and will allow the business the opportunity to make further representations. However there is no right of admission into the APA Programme.

Term of the agreement and 'Roll-Back'

25. An APA will be operative for a specified period from the date of entry into force as set out in the agreement. The business should propose a term for the APA taking into account the period over which it is reasonable to assume that the method for dealing with the relevant transfer pricing issues will remain appropriate. Typically the term is from three to five years and a longer term will only be considered in exceptional circumstances.

26. It is possible that a chargeable period to which the APA relates may have ended before agreement is reached. Section 224, TIOPA 2010, allows the APA to be effective for that chargeable period and the agreement may set out any adjustments to be made for tax purposes as a consequence of the agreement.

27. An APA is intended to cover periods in advance of those where a return is already made at the date of application. In situations where returns for that APA period are later made during the APA process HMRC may be willing to consider extending the APA term. Whether this extension is appropriate would depend on the particular facts and circumstances surrounding that application and the views of the treaty partner(s) involved in the process.

28. The agreed transfer pricing methodology may be relevant for an earlier period and to the resolution of any transfer pricing enquiries raised for earlier periods if the particular facts and circumstances surrounding those years are substantially the same. Consequently, in such circumstances, the business may wish to consider requesting that the bilateral APA also covers this earlier period and is used as a basis for amending their self-assessment return for those years. This possibility is dependent on the ability and willingness of both Administrations to 'roll back'.

29. Except where 'roll-back' is being considered, the request for an APA in respect of future years will not in itself affect any transfer pricing enquiry into earlier years. However, to the extent such an approach is appropriate and feasible, HMRC will co-ordinate the APA request in respect of future years with any transfer pricing enquiry in respect of prior years in order to improve overall efficiency and reduce duplication of enquiries.

The formal APA application

30. Where, following HMRC's indication that it is willing to consider the APA proposal, the business wishes to proceed, it should submit a formal written application within 6 months or such longer period explicitly agreed at the expression of interest meeting. This APA application should also be copied to the business' primary business contact at HMRC - usually the business' Customer Relationship Manager. If there is a delay in submitting a written application HMRC reserves the right to not accept it.

31. Annex 1 (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/565860/SP2-16annex1.pdf) to this document contains full details of the information that should be incorporated in the formal application. HMRC may, in practice, agree to be flexible with such requirements where the circumstances of the particular case mean that a different approach will make for a better process. In a bilateral case, HMRC is often able to agree to work

from the same format application as is mandated by the other Administration's procedures. These are issues best discussed with HMRC at the Expression of Interest stage. The application should ideally be made before the start of the first chargeable period proposed to be covered by the APA, but HMRC may exercise discretion over this, for instance, when a bilateral is sought and the other Administration is prepared to allow the business more time to lodge its' application.

32. In the case of a bilateral APA the business will be expected to ensure that all information provided in the application supplied to one Administration is made available at the same time to the other Administration involved.

33. APA information is subject to the same rules of confidentiality as any other information about taxpayers. Information exchanged with treaty partners - for instance, in the course of reaching agreement on bilateral APAs - is also protected from disclosure by the terms of the Exchange of Information Article in the relevant DTA. Therefore in complying with its obligations under the EU Directive on Administrative Cooperation in the field of taxation, 2015/2376/EU, HMRC will not disclose the details of a bilateral APA reached with a jurisdiction that is not a Member State of the EU. It will however disclose the relevant details of the formal application.

Evaluation

34. On receipt of an application HMRC will evaluate its contents and will seek clarification and further information from the business as necessary. The examination of the application should be a co-operative process in which the transfer pricing issues are discussed openly and access to relevant supporting information and documentation is made available. Lack of co-operation in these respects may result in HMRC declining to give any further consideration to the application.

35. Where a bilateral APA is being sought, HMRC will expect the business to continue to make relevant information available at the same time to each Administration involved, and in turn will itself keep the treaty partner informed about the progress of its examination of the APA request, will seek to discuss with the treaty partner key issues arising at the earliest opportunity and will keep the business informed about the progress of the bilateral process. Whilst the finalising of a bilateral agreement with a treaty partner is a government-to-government process, HMRC is generally prepared to participate in, and encourages, joint meetings involving the business and the other Administration(s) to assist in the exploration and evaluation of key factual issues.

Reaching agreement

36. The agreement between HMRC and the business will be made subject to its terms being observed. The terms will include:

- a commitment from the business to demonstrate adherence to the agreed method for dealing with the transfer pricing issues during the term of the APA in the form of a regular compliance report (an 'Annual Report') as required by Section 228 TIOPA 2010
- the identification of Critical Assumptions bearing materially on the reliability of the method and which, if subject to change, may render the agreement invalid. This will generally include an assumption that the relevant transfer pricing law and OECD Guidelines remain materially the same

37. A sample 'plain vanilla' agreement is included as an annex to this Statement Annex 2 (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/565863/SP2-16annex2.pdf). Normally the person responsible for signing the agreement on behalf of the business would be the person responsible for signing a tax return, subject to that person having authority within the multinational group to commit the group to the terms of the APA.

38. HMRC aims to complete the APA process within 18-21 months from the date of the formal submission. This objective is dependent on the complexity of the case and, in the case of bilateral or multilateral applications, may be dependent on the working practice of the Administration(s) in the other country or countries. It is also, of course, dependent on co-operation from the applicant. HMRC may view significant delay on the part of the business as indicative of a lack of co-operation or a loss of interest in agreeing an APA and may then terminate the APA process as a result.

39. HMRC expects the business to facilitate an efficient process by providing timeously all the information necessary to consider the application properly and reach agreement. This extends to the enterprise's co-operation in ensuring that the formal APA agreement and any associated procedural paperwork are finalised shortly after the finalisation of the transfer pricing method and/or, in a bilateral or multilateral process, the concluding of agreements with treaty partner(s).

40. The Tax Administrations cannot give effect to, and the enterprise cannot rely upon, the MAP APA reached between the Competent Authorities on its case unless, and until, the necessary domestic paperwork has been completed. In the UK a written agreement between the Commissioners (or their representatives) and the UK person(s) covered is required by the APA legislation.

41. If agreement on the terms of an APA cannot be reached with the business, HMRC will issue a formal statement recording the reasons. HMRC does not consider it has any obligation to continue discussion beyond the point at which it has determined that agreement cannot be reached.

42. A business may withdraw an APA request at any time before final agreement is reached.

43. HMRC, and generally its treaty partners, will expect the actual pricing of the transactions covered by an APA to be consistent with the TP methodology and terms defined within it. Adjustments arising within the tax computation are expected to also be made in the accounts, thereby ensuring the economic and tax position of the arm's length price is aligned.

APA monitoring and review - Annual Reports

44. The Annual Report will generally accompany the business' tax return. The report should be sent to the CRM or, where there is no CRM, the HMRC office responsible for the business' tax affairs and monitoring the APA using the email address: msb.customerengagementteam@hmrc.gsi.gov.uk. A copy does not need to be sent to CTIS.

45. The particular requirements of each report will be set out in the finalised agreement and will focus narrowly on the issue covered by the APA. The broad intention is that Annual Reports should demonstrate in a concise format whether the business has complied with the terms and conditions of the APA.

Nullifying and revoking APAs and penalties

46. In accordance with Section 225, TIOPA 2010, an APA may be revoked by HMRC in accordance with its terms, where the business does not comply with the terms and conditions of the agreement, or where the identified critical assumptions cease to be valid. In practice, when considering nullifying, revoking or cancelling a bilateral APA HMRC will consult with the business and with the Competent Authority of the treaty partner involved. In some cases, a change in the agreement may be possible - see also Paragraph 48 below. Where a date of cancellation of the APA needs to be determined it will be determined by the nature of the event that led to the cancellation.

47. Where false or misleading information is supplied fraudulently, or negligently, in connection with an application for, or in the process of monitoring, an APA, penalties may be applied, and the APA might be nullified (see Sections 226 and 227 TIOPA).

Revising and renewing APAs

48. In some cases the APA may provide for modification of its terms in specific circumstances; for example, a particular agreement may provide that where there has been a change which makes the agreed methodology difficult to apply, but which does not go as far as to invalidate a critical assumption, the agreement may be modified with the consent of the parties to resolve that difficulty. In such cases the APA may be revised in accordance with Section 225, TIOPA 2010 after consultations between the business and HMRC and, in the case of bilateral agreements, the Competent Authority of the other country involved.

49. Where the facts and circumstances have not changed the business may request renewal of an APA for an additional fixed period ideally not later than six months before the expiry of its current term, but HMRC will not rule as out of time requests made before the end of the first chargeable period affected by the renewal or, in the case of bilateral cases, later, if the other Administration is prepared to allow further time. HMRC will consider interest in a renewal in light of current international thinking and HMRC's practice at the time. It will also consider whether the previous APA methodology and its monitoring requirements for all parties have functioned as well as intended. There is no expectation that a renewal will always be worthwhile and any renewal process is also dependent on the view and approach of the relevant treaty partner(s).