

TAXREP 4/99

ADVANCE PRICING AGREEMENTS (APAs)

*Letter submitted by the Tax Faculty to the Inland Revenue in January
1999 in response to a consultation paper issued in December 1998*

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ADVANCE PRICING AGREEMENTS (APAs)

Introduction

1 We refer to your letter and enclosures of 17 December 1998 and our recent telephone conversation. We thank you for the opportunity to meet you informally and we welcome the opportunity to now comment on the draft clauses and Statement of Practice. Our comments on the draft clauses are set out below.

Clause 1(2) - Scope of APAs

2 We believe that the scope of APAs should be extended to include, in particular, the following situations:

- thin capitalisation under section 209(2)(da) ICTA 1988.

- the "special relationship" circumstances contemplated by section 788(3)(c)(ii). There are two points which need to be made. Firstly, we believe that an APA should cover the relatively few cases where there may be a special relationship within section 788(3)(c)(ii) even though there is not the necessary degree of connection to bring Schedule 28AA into play. Secondly, where Schedule 28AA does apply but has been covered by an APA, we believe that the Revenue should not have the power to invoke section 788(3)(c)(ii) to override the APA.

3 We believe that consideration should also be given to APAs in relation to matters which may give rise to chargeable gains and capital allowances.

Clause 1(2)(b) - Definition of 'permanent establishment'

4 It is unclear whether the reference in this clause to a "permanent establishment" is a reference to an "establishment" as defined in section 788(3)(c)(i) ICTA 1988. We believe the problem could be resolved by the deletion of the word "permanent".

Clause 1(4)

5 This clause makes it clear that new clauses 1(2)(d) and (e) are specifically related to schedule 28AA (transfer pricing rules). However, we believe that the other parts of new clause 1(2) (ie (a), (b) & (c)) should refer to sections 11(2) and 788(3)(c) ICTA 1988 and section 126(2) FA 1995.

Clause 1(5)(a)

6 We are confused by this sub-clause, and various opinions have been expressed as to what it is meant to say. One view is that the clause appears to suggest that the scope of an APA might vary the normal legal/tax consequences of a transaction. This is not what we understand to be the purpose of APAs. Their purpose is simply to agree what is essentially a matter of quantification, and should not give an administrative power to the Revenue to change the rules on a case by case basis. We suspect that this is not the intention of the clause.

7 Another, more likely, view is that a taxpayer is being asked to venture an opinion on what would be the outcome without an APA, when the whole point is that the taxpayer has applied for an APA to resolve an area of doubt and uncertainty. This appears to put the taxpayer in an impossible position which, on the face of it, might prejudice his APA application. We believe that a taxpayer can only reasonably be expected to put forward his APA proposal, disclosing fully the circumstances, terms and nature of the transactions, with the objective of reaching agreement with the Revenue.

8 We would be grateful for an explanation as to what this sub-clause is designed to achieve. We suspect that it will need to be redrafted to make its intentions clearer, but our preference is for it to be deleted.

Clause 2(2) - Revocation

9 Taxpayers should be able to rely on an APA where they have complied with the terms of the agreement. If a binding agreement is made on the basis of proper disclosure, we are concerned that there should be no general power of revocation by the Revenue until the facts change. It is, of course, likely that changes in the facts will be identified by the periodic monitoring information which will need to be supplied by the taxpayer under the terms of the agreement.

10 Although we are opposed to a general power of revocation, in any event the question of revocation should be capable of appeal to the Special Commissioners, including where the points referred to in clauses 2(2) and 2(5) are in issue. Although such disputes would essentially be contractual in nature, an appeal to the Special Commissioners would provide a suitable forum for review which is relatively inexpensive and which would avoid the necessity for the taxpayer applying for a judicial review. For the avoidance of doubt, we believe that this is a separate issue from the normal rights of appeal referred to in paragraph 44 of the draft Statement of Practice.

Clause 2(4) - Information requirements

11 We understand that the information requirements set out in this clause mirror the corresponding rules in the US tax code. However, the requirements do not fit easily with self assessment for companies. In principle, the normal rules should apply so that taxpayers with APAs should self-assess their liability. If any ongoing information is required, beyond the normal self assessment information, then this should be specified clearly at the outset in the APA and there should be no general power given to the Revenue. Therefore, we are of the view that the words “or by virtue of any request made by an officer of the Board in accordance with the terms of the agreement.” should be deleted.

12 If the taxpayer does not comply with the APA and/or does not make suitable disclosure, then we would have thought that the taxpayer will face penalty consequences in the normal way. We would be grateful for clarification of the penalty position as it is intended to apply to APAs.

Clause 2(5) - False and misleading information

13 The provisions of this paragraph need to be moderated. The consequences set out are acceptable where there is fraud or negligence, but do not take into account incorrect information provided innocently in good faith. In addition, the paragraph takes no account of the materiality/gravity of the ‘offence’. In particular, if information is innocently provided and is not material then the agreement should not be void. Similarly, if the information, although false or misleading, did not affect the decision of the Revenue staff in agreeing the APA, it should not void the contract.

Clause 3(1) - Effect of APAs on non-parties

14 Section 3(1) appears to permit agreements which are at variance with the arms length rule in schedule 28AA ICTA 1988. We believe that the section should provide that a question determined in accordance with the agreement is deemed to be in accordance

with para 1 schedule 28AA or any other applicable statutory provision. Accordingly, we do not think that it should disapply any part of that schedule.

Clause 3(2)

- 15 We believe that it is wrong in principle that an APA between the Revenue and, say, Company A can effectively bind Company B, even though Companies A & B will be connected within the expanded definition of Schedule 28AA. This contrasts with, for example, the position under paragraph 12(4) of Schedule 28AA, where Company B is entitled to be heard in Company A's appeal. The logical outcome is to exclude any transactions with UK counterparties or to include those counterparties in a tripartite agreement (as contemplated by clause 3(4)).

Concluding remarks

- 16 We would be delighted to discuss this further with you, if that would be helpful. We have a number of points which we wish to raise in respect of the draft Statement of Practice and we will write to you under separate cover shortly.
- 17 We appreciate your advance offer of a further meeting to discuss these points. May we suggest that we first finalise our points in relation to the Statement of Practice, and that we then have a meeting. However, if you would like to have a meeting to discuss the above points beforehand, we will be happy to do so.

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