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The history of PATA and its effect on advance pricing arrangements and mutual agreement procedures

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Abstract

In its 25 years of existence, the Pacific Association of Tax Administrators (PATA) has attempted to protect tax revenues and combat tax evasion techniques (including transfer pricing) by transnational corporations (TNCs). To that end, the tax authorities of its four member countries (Australia, Canada, Japan and the United States) have met at least annually to exchange information and identify specific deterrents to tax evasion activities that could be implemented quickly. Recently, PATA has released several documents to assist both tax authorities and TNCs in the area of advance pricing agreements, mutual agreement procedures, and transfer-pricing documentation. The study looks at the PATA's influence on tax authorities and TNC behavior in these and other areas.
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1. Introduction

More than 25 years ago, the Pacific Association of Tax Administrators (PATA—see Appendix A for relevant acronyms) was formed in response to the increased use of certain strategies and techniques by transnational corporations (TNCs) to evade taxes, including transfer pricing and tax havens. The countries comprising this intergovernmental tax group are Australia, Canada, Japan and the United States (U.S.), and are represented by their respective tax officials from the Australian Taxation Office (ATO), Canada Revenue Agency (CRA), Japan's National Tax Association (NTA), and the U.S. Internal Revenue Service (IRS). The first objective of this study is to assess the efficacy of PATA over the past 25 years. A second objective is to analyze the responses of TNCs to PATA's activities and those of their respective tax authorities.

PATA was established in 1980 and held its first meeting in the U.S. in Hawaii in 1981. At that time, its members recognized the deleterious effects on tax revenues of the increasing use by TNCs of various tax evasion techniques, particularly transfer pricing. In order to combat this behavior and to increase the collection of tax revenues, the tax officials of the four member countries agreed to exchange information and to identify specific deterrents to tax evasion activities that could be put into place promptly (Anonymous, 1981). Tax authorities were concerned with escalating losses in tax revenues due to increased tax evasion maneuvers by TNCs via transfer pricing.

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In the intervening years, PATA's mission changed, as did its timetable for providing guidance to TNCs. It was not until 2003, 23 years after its creation, that PATA produced final versions of documents providing specific guidance and procedures for TNCs regarding mutual agreement procedures (MAPs), advance pricing arrangements/agreements (APAs), and transfer-pricing documentation. MAPs and APAs involve negotiations between and among tax authorities and TNCs. What remains to be seen is what effect, if any, these documents have had, and will have on TNC transfer pricing and tax evasion behaviors. This study analyzes three areas; MAP and APA status (including usage and efficiency), the extent of TNC awareness of PATA's published guidance, and the extent such awareness affected TNCs' transfer-pricing behaviors.

The remaining sections of this article are organized as follows: Section 2 provides a brief introduction to transfer pricing; Sections 3 and 4 present a concise history of PATA's activities since 1981; Section 5 develops the survey instrument and derivation of the research questions; Section 6 provides the data analysis and discussion; Section 7 presents conclusions and recommendations.

2. Overview of transfer pricing and related strategies

2.1. Transfer pricing

Transfer pricing[1] is both a management tool and an international tax strategy used by a TNC to maximize profits while simultaneously minimizing tax liabilities in the countries in which it has a presence. This presence can be a subsidiary, division, affiliate, or other organizational unit in one or more host countries, each with its own tax authority and its own transfer-pricing regulations. Transfer prices are assigned to tangible goods, intangible assets, and services that are transferred across borders from one TNC unit to a related TNC unit. Transfer prices must be set at arm's length, meaning that the price charged for an internally transferred good or service must be comparable to the price the TNC would have charged an unrelated customer.

From the TNC perspective, transfer pricing is a tax risk management issue (Jenkins, 2007), using arbitrage to exploit differences in tax authority regulations. The most tax-efficient transfer-pricing strategy assigns prices (which maximize overall profits while minimizing the overall tax burden) to the transferred tangible products, intangible assets, and services. Approved methods are detailed in the complex transfer-pricing regulations administered by each of the involved countries' tax authorities, and can be categorized as either transaction-based or profit-based. Transaction-based methods for tangible goods include the comparable uncontrolled price (also called market) method (CUP); the resale price method; the cost plus method. Profit-based methods include the comparable profits method (CPM) for U.S.-based TNCs, the transaction net margin method (TNMM) for non-U.S.-based TNCs, and various profit split methods. In addition, other "unspecified" methods may be used. Similar methods are specified for intangible goods and services.[2]

From a tax authority perspective, transfer-pricing transactions can lead to profit-shifting by TNCs and a resulting loss in tax revenues. Tax authorities use specific criteria, such as differentials in stated and effective tax rates and in profit and taxable income, to assess the transfer-pricing risk of profit shifting for a given TNC. At a certain level of identified risk, the tax authority will audit a TNC's transfer-pricing transactions to discover evidence of profit shifting and an associated reduction in tax liabilities. For a detailed look at one tax authority's approach to risk profiling and risk assessment, see Jenkins' (2007) profile of the Australian Tax Office.

2.2. Advance pricing agreements/arrangements

APAs are negotiated between the TNC and one or more tax authorities in the host and/or home countries in which the TNC has executed transfer-pricing transactions. An APA assures the TNC that the transfer-pricing method(s) agreed to in the APA will be acceptable to one or more relevant tax authorities for a specified time period. In some cases, the

[1] For more information, see §482 of the U.S. Internal Revenue Code (IRS, 1996) and the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines (1995).

[2] Detailed discussions of each method are given in §482 of the U.S. Internal Revenue Code (IRS, 1996), and to the OECD Transfer Pricing Guidelines (1995).

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