

MODERNISATION OF TRANSFER PRICING RULES

Exposure draft of the proposed
amendments to Australia's transfer
pricing rules

AllA Response

20 DECEMBER 2012

INTRODUCTION

AIIA welcomes the opportunity to provide comment on the Exposure Draft of the proposed amendments to Australia's transfer pricing rules. AIIA notes that this is an issue of current importance to a number of international jurisdictions. While we support the Government's intention to increase alignment of Australia's arrangements with OECD guidelines, we note the absolute requirement to *avoid unintended consequences in the introduction of new rules, eliminate unnecessary complexity, and to ensure clarity and fairness in their application including the avoidance of targeting any one industry or economic sector.*

Behind the discussion is the unease of many in society that many activities that generated tax revenue in Australia are changing in such a way as to deprive the country of that income. The global and local economy is shifting from valuing labour to an emphasis on intellectual property and this may put Australia's future at risk unless we can generate that value here. Changes in the tax system will not solve the problem of underlying value being created elsewhere.

The Australian Information Industry Association (AIIA) is the peak national body representing multinational and domestic suppliers and providers of a wide range of information technology and communications (ICT) products and services. We represent over 400 member organisations nationally, including global brands such as Apple, EMC, Google, HP, IBM, Intel, Microsoft and Oracle; international companies including Telstra; national companies including Data#3, SMS Management and Technology, Technology One and Oakton Limited; and a large number of ICT SME's.

THE CONTRIBUTION OF ICT TO THE AUSTRALIAN ECONOMY

With an annual revenue exceeding \$82 billion coupled with an almost 8% contribution to GDP and some 554,700 employees¹, the Australian ICT industry has a critical place in the Australian economy. Indications are that in the next 50 years this growth will accelerate with predictions that ICT will generate some one trillion dollars of revenue by 2050.²

Increasingly our members, and all enterprises, are trading globally, recognising the impact of digital economies in all jurisdictions and the need to ensure they remain part of the global trading environment. 'Business across borders' will only increase in the future; the application of dated regulatory regimes to ever changing business models is an inappropriate policy response by government. By its own admission in the relevant

¹ Australian ICT Statistical Compendium, ACS, 2011,p11

² A snapshot of Australia's Digital Future to 2050, IBISworld 2012

Explanatory Memorandum (EM) for these proposed rules changes, the Government appears to recognise the extraordinary increase in services being delivered online under different and evolving business models which do not resemble “old world” product-based value chains. With the global transformation that is currently taking place in many industry sectors due to the disruptive impacts of digital technologies³, this is a point in time where Australia needs to actively encourage greater investment by high technology services companies, recognising the contribution made by those enterprises to such indicators as employment, productivity, spin-off business growth and exports. A key characteristic of the growing services economy and global online trading is that enterprises can quickly re-locate to more favourable jurisdictions anywhere and at any time, thus depriving the former jurisdiction of employment, innovation and productivity.

Enterprises can no longer thrive in this new global economy by adopting inward-focusing business models; AIIA members of all sizes are now utilizing the enabling potential of technologies to give themselves a presence online everywhere. In particular, larger companies drive functionality enhancements and new service offerings delivering productivity benefits *to all sectors of the Australian economy*. Economic and job growth in Australia today will be driven by large-scale services ecosystems, such as the ones surrounding the iPhone, Android, and the introduction of 4G mobile networks. This is even more the case given the inevitable end of the so-called resources boom upon which so much of Australia’s current economic planning is based and the inexorable migration to a services economy⁴.

The links between technological/services innovation and economic growth suggest that a government that encourages and supports innovation – whether by ensuring an appropriate financial architecture for growth businesses, effective use of government procurement to encourage innovative businesses, functional technology transfer policies, or support for innovative clusters and networks – can help create the environment for business growth and increased employment. There is a need for policies that facilitate the emergence of high-growth firms without requiring the government to try to pick winners. Research published by UK based NESTA (National Endowment for Science, Technology and the Arts) shows that between 2002 and 2008 the 6 % of UK businesses with the highest growth rates generated half of the new jobs created by existing businesses. While these companies came

³ See Deloitte, Digital Disruption. Short Fuse Big Bang. Mapping disruptive innovation across Australia’s digital landscape. http://www.deloitte.com/view/en_AU/au/news-research/luckycountry/digital-disruption/index.htm

⁴ *A Snapshot of Australia’s Digital Future to 2050*, IBISWorld,, Chapter 4

from a range of sectors all had one factor in common: they were far more likely to be innovative.⁵ Consistent with this the UK government has developed the Enterprise Capital Funds program, a public/private venture which provides venture capital investment for early-stage, innovative SMEs with high growth potential.⁶

Ensuring that we have effective markets for venture capital and growth finance is equally important for us. *And making sure that companies that want to expand in Australia do not face unnecessary barriers to expansion including from the tax or regulatory system is crucial.*

RESPONSE TO PROPOSED AMENDMENTS TO TRANSFER PRICING RULES

AIIA supports the objective of these proposed rules changes, namely to ensure that the Australian tax outcomes for an entity accord with the application of the arm's length principle consistent with the transfer pricing articles in Australia's tax treaties and internationally accepted guidance on their interpretation. Greater consistency with international standards reduces uncertainty and the risk of double taxation; it will also assist in minimising compliance and administration costs. While this objective should be relatively easy to achieve, AIIA is concerned that there may be unintended consequences occurring because of the drafting, the uncertainty in definitions and application, and the possibility that the changes will not in fact be aligned with the OECD Guidelines in some aspects.

Self-Assessment

AIIA notes these provisions will be self-executing, thus bringing the transfer pricing rules in line with the overall self-assessment model of Australia's tax regime (Subdivisions 815 –B and C). This is a welcome development, but if true alignment with self-assessment is to be achieved, then the provision must allow a taxpayer to self-assess on the basis of *any tax outcome, be it an increase or a decrease*. This is in fact the self-assessment model for other parts of the tax regime in Australia, such as personal income tax. If the Commissioner retains the (current) right to adjust *and negate* a transfer pricing benefit, this will operate unreasonably and unfairly for a taxpayer who is supposed to be using the self-assessment approach. If moving from a declaratory regime to a self-assessment one, the Commissioner must abide by self-assessment principles; he cannot have it both ways.

⁵ **The vital 6 per cent** How high-growth innovative businesses generate prosperity and jobs. NESTA 2009

⁶ <https://www.gov.uk/government/policies/making-it-easier-to-set-up-and-grow-a-business--6/supporting-pages/encouraging-private-sector-investment>

Further, the ability to negate a benefit without attribution to any amount of income or expense is not in line with current practice under section 815-30(2). There seems to be no explicit policy reason for removing this requirement on the Commissioner; again, if the Commissioner retains rights, which potentially operate unfairly on a taxpayer, he must show cause as to why the adjustment was made.

OECD Guidelines

There are several examples in the draft of slight departures from the OECD Guidelines language and terminology, and where there are such departures, uncertainty has been created. We suggest that the draft should not attempt to paraphrase the Guidelines, but rather refer to them (without repeating them or duplicating the language) or clearly state the nature of the departure no matter how apparently trivial. An example is the addition of “and reliable” to the OECD language of “most appropriate method...” in section 815-125. More importantly, examples of potential reconstruction or re-characterisation by the Australian Tax Office (ATO) of taxpayer arrangements may fall outside the parameters contemplated by the Guidelines. This in itself is cause for concern and compromises both tax design principles and the proposed objectives of the changes. As paragraph 1.64 of the OECD Guidelines states, *“In other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them. Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.”* (emphasis added).

Documentation and Penalties

AIIA suggests the drafts be re-drawn to provide more clarity regarding the (RAP) provisions as they relate to documentation; it is uncertain whether, under current drafts, a taxpayer can argue a RAP with relevant documentation. In addition, the draft is unclear on penalty provisions, especially given the already stated Commissioner’s views on penalty remissions in TR 98/11. We would seek better guidance on penalty remissions under the proposed rule changes.

CONCLUSION

Finally, AIIA seeks consultation on the tests for anti-avoidance, including further discussions on the definition and how it is to work to make sure there is a clear understanding of what the provision means and the intention of the definition. Members also suggest these proposals avoid retrospective application because such tax design techniques create uncertainty for business which is unwelcome while Australia is aiming to attract investment and shift the economy to growth sectors including a more services based economy. We

would be pleased to provide a more detailed briefing about the changes implicit in moving from an economy that makes 'things' to an economy based on IP, to help policy-makers better shape thinking around tax reform.