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Transfer Pricing Rules Amendments
Reference No. 145 Media Release

The American Chamber of Commerce is writing in response to the Announcement by the Assistant Treasurer on 1 November 2011 foreshadowing a retrospective amendment to the law in relation to transfer pricing provisions of Division 13 of the Income Tax Assessment Act with effect from 1 July, 2004.

The American Chamber of Commerce represents the interests of American companies undertaking business activity in Australia. The most significant source of foreign investment in Australia is the United States. The Chamber is concerned that the Assistant Treasurer's Announcement will have a material adverse impact upon many of its members and will significantly erode the level of foreign investor confidence in Australia.

The Announcement refers to a consultative paper describing the proposed amendments to the transfer pricing provisions of the Income Tax Assessment Act. The Chamber supports attempts to give further clarity to the interpretation of transfer pricing rules, particularly in the context of consistency between those rules operating in both Australia and the United States.

It is noted that the consultative paper makes extensive reference to the OECD model tax convention, Australia's reservations to that convention and to the transfer pricing provisions of the United Kingdom. There is almost no reference to the United States in the document. No proposal of this nature should be progressed without regard to the impact on investors from the United States and the interpretation of the Double Tax Agreement between Australia and the United States as it impacts upon transfer pricing.

The Chamber is aware of several submissions dealing with the more detailed technical aspects of the consultation paper. It is not the intention of this submission to comment on these. However, there are two aspects of the Announcement that the Chamber wishes to address. The two aspects are quoted below.

"I'm therefore introducing amendments to the law to clarify that transfer pricing rules in our tax treaties operate as ***an alternative*** *to the rules currently in the domestic law", and*

"The clarifications will apply to income tax years commencing ***on or after 1 July 2004*** *in* ***treaty cases.***"

(emphasis added)

In particular, the Chamber is concerned that:

Treaty as Alternative Taxing Provision

a) The proposal is inconsistent with the provisions of Article 1.2 of the US/Australia agreement for the avoidance of double taxation.

This provision provides *"this Convention shall not restrict in any manner any exclusion, exemption, deduction, rebate, credit or other allowance accorded from time to time by:*

a. the laws of either Contracting State, or

b. any other agreement between the Contracting States".

The commentary to this article includes the following:

"Paragraph 2 also means that the Convention may not increase the tax burden on a resident of a Contracting State beyond the burden determined under domestic law. Thus, a right to tax given by the Convention shall not be exercised, unless that right also exists under internal law. It follows that, under the principle of Paragraph 2, a tax payer's US tax liability will need not be determined under the Convention if the Code would produce a more favourable result."

It is clear, therefore, that the US interprets the treaty as limiting its right to increase US taxation on an Australian-owned entity. It is our understanding that the US would expect Australia to interpret the Double Tax Agreement similarly. Based upon this, it is ill-founded for the Assistant Treasurer to allege that the amendments proposed are consistent with Australia's Double Tax Treaties, without including an exception for the United States. Accordingly, as it impacts upon residents of the United States, any change should only be after proper consultation and agreement with the United States.

b) The Announcement refers to a consultation by Treasury which includes at paragraph 81 a change in relation to the level of debt that a foreign-owned Australian subsidiary can bear, for Australian tax purposes. Division 820 of the Income Tax Assessment Act provides certain

"safe harbours", which have been available under the law since 2001. Such provisions were not enacted in the context that the Double Tax Agreements would override their impact, as they would have been largely redundant and had no relevance to Australian entity owned by a treaty resident. The US members of the Chamber have relied upon these safe harbour provisions of the law to have confidence that the level of interest expense borne in Australia will be deductible so long as it complies with Division 820. The Announcement, if implemented, would withdraw the safe harbour that Parliament specifically enacted to give certainty to foreign investors.

c) In October 2010, the Commissioner of Taxation confirmed in Taxation Ruling 2007/10 that the transfer pricing provisions of Division 13 would only be applied to determine the rate of interest that could be paid on a related party loan, not the amount of such loan. Example 4 in that ruling particularly acknowledged that the level of debt provided for under Division 820 was eligible to give rise to interest deductions, whether or not that level of debt exceeded the amount of debt a third party lender would provide. Accordingly, this example is directly in contrast with Paragraph 81 of the consultation paper.

Retrospectively Back to 2004

d) Any change that is undertaken to amend domestic law in such a material way to adversely impact upon international investment in Australia, should be undertaken prospectively and with an appropriate level of industry debate and consultation. To do otherwise is inconsistent with the common practice of Australian Governments of the past and also inconsistent with the approach that the Australian Government publically states to encourage foreign investment. We are aware of several members which will suffer material adverse impact of retrospectivity of in excess of $100m each.

e) The proposed amendments, although of application to all foreign investment, is of particular concern for American investment in Australia. This is because American investment in Australia represents the single most significant source of investment. Furthermore, the Double Tax Treaty specifically contemplates that provisions in the Double Tax Treaty do not override the provisions of domestic law to increase the level of taxation otherwise payable under domestic law. We are aware that it has been suggested by those supporting the proposals that the Neutral Agreement Procedures in Australia's Double Tax Agreements should ensure that there is no double taxation arising from the proposed amendments. As the interpretation of the transfer pricing provisions of the US Internal Revenue Code Section 482 by the Internal Revenue Service, particularly in relation to intra group funding, may not be consistent with the approach discussed in the consultation paper, there remains a real risk of double taxation. If the DTA is applied to deny interest expense as deductible, it does not automatically result in the US lender not being taxable on the interest in the US.

Adverse Impact Exclusively On Treaty Residents

f) It is a particular concern that the Announcement will only impact Australian subsidiaries of companies resident in countries with a double tax treaty with Australia. The domestic law

under Division 820 entitles foreign investors to rely upon the safe harbour for levels of debt. The proposal described in the Assistant Treasurer's Announcement would apply to override this safe harbour only for Australian subsidiaries of treaty resident investors, Accordingly if, as is often the case, an investor in another jurisdiction has chosen to use a foreign intermediate company that is not within a treaty-resident country, then the "treaty override" is not available and the reliance upon Division 820 for prior years can remain. It is common knowledge that companies resident in China adopt a Hong Kong subsidiary to make investments into Australia. It would appear that interest expense paid from an Australian subsidiary of a foreign investor to a Hong Kong group company, will not be the subject of the adverse impacts of the Assistant Treasurer's Announcements. In contrast, the same amount of interest paid to a US lender would be so caught.

Contrary to the Special relationship between the United States and Australia

(g) On 16 November the Assistant Treasurer wrote the following on the Daily Telegraph website:

MORE than anything else, the Australia-US alliance is a mateship between the Australian and American people....

When American friends of mine always remark positively about unique Australian institutions they don't just mean the kangaroo, emu and platypus. Our constant striving for a fair go counts, too.

I believe former Labor leader Kim Beazley was right when he reflected some years ago that it is vastly more important to be the ally the US needs than the ally any particular American administration might want. Beazley says that honest advice on the wisdom of a course of action is what delivers the respect of our friends, because mates talk straight.

Such a statement would seem to be inconsistent with the Assistant Treasurer's Announcement that has such material adverse effect on foreign investment in Australia, of which it is acknowledged by the Assistant Treasurer the US is the most significant participant.

Conclusion

1. Any change to the domestic law in relation to transfer pricing should be undertaken only after not only appropriate public consultation, but also only after specific discussion with US Treasury officials and the resolution of the apparent inconsistency between the proposals and Article 1.2 of the Double Tax Agreement between the United States and Australia.

2. Any change to the transfer pricing rules must be on a prospective basis. To do otherwise, not only is unreasonable and contrary to the normal friendly relationships between the United States and Australia, but is clearly inconsistent with the basis upon which many members have been assessed by the Australian Taxation Office for the last ten years.

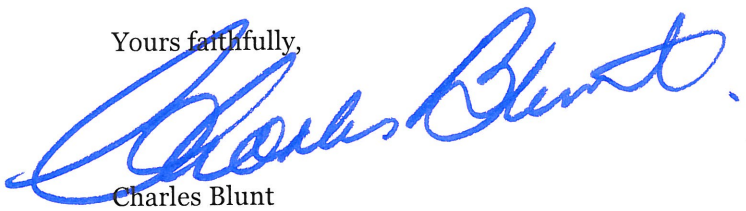
3. Any proposal which renders an unfavourable impact upon the subsidiaries of residents of treaty jurisdictions, but does not have such an adverse impact upon subsidiaries of residents of non-treaty jurisdictions, is inappropriate and should be reconsidered.

The American Chamber of Commerce accordingly submits that:

a. any change to the law in relation to transfer pricing be undertaken on a prospective basis, after appropriate public consultation; any such proposed changes including, we would suggest, with US Treasury officials, and

b. any proposal gives unfavourable impact to residents of treaty jurisdictions, in contrast with residents of countries that do not have a treaty with Australia, is inappropriate and should be reconsidered.

Yours faithfully,



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On behalf of
the American Chamber of Commerce in Australia
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