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The Manager
International Tax Integrity Unit
The Treasury
Langton Crescent
PARKES ACT 2600

By email: transferpricing@treasury.gov.au

Dear Sir/ Madam

SUBJECT: SUBMISSION ON THE EXPOSURE DRAFT LEGLISLATION – STAGE ONE TRANSFER PRICING

CPA Australia represents the diverse interests of more than 139,000 members in 114 countries throughout the world. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background we provide this submission concerning the Exposure Draft legislation and accompanying explanatory materials issued on 16 March 2012 in respect of the first stage of the Government's proposed transfer pricing reforms in respect of cross-border transfer pricing, and to the related Media Release issued by the Assistant Treasurer Mr. Bradbury on 16 March 2012.

In making this submission we also refer to our earlier submission dated 30 November 2011 in respect of the Treasury Consultation Paper entitled 'Income tax: cross-border allocation – review of transfer pricing rules' and a related Media Release made by the then Assistant Treasurer Mr. Shorten which both issued on 1 November 2011.

General comments

As set out in our earlier submission, CPA Australia strongly believes that retrospective tax policy and law changes which are detrimental to taxpayers should only be legislated in the most exceptional of circumstances where a compelling business case has been advanced as to why such changes must be enacted.

We reiterate our earlier view that no clear business case has been advanced to justify the retrospective application of proposed Subdivision 815-A of the Income Tax Assessment Act (1997) (the ITAA (1997)) which will allow the Commissioner of Taxation to raise transfer pricing adjustments from 1 July 2004 on the basis of treaty law as an alternative to Division 13 of the Income Tax Assessment Act (1936) (the ITAA (1936)).

This is an inequitable outcome for taxpayers who may be potentially subject to audit for up to 7 years on matters which they may reasonably regard as having been finalised. The enactment of these retrospective changes may also damage the international reputation of Australia as a jurisdiction in which key foreign investors can invest and trade with certainty and confidence.

However, if the above retrospective changes are enacted, it is strongly recommended that further guidance on the underlying policy intent be provided in the form of specific examples as to when it would be appropriate for the Commissioner of Taxation to apply the law retrospectively. Having regard to the potentially drastic consequences of the proposed changes, we consider that more detailed guidance should be set out in the explanatory memorandum accompanying the proposed retrospective legislation rather than be merely set out in administrative guidelines issued by the Australian Taxation Office (ATO). Similarly, the explanatory memorandum should also provide examples clarifying when it would not be appropriate for the Commissioner of Taxation to apply Subdivision 815-A in prior income years.

In this respect, CPA Australia believes that it would not be appropriate, for example, for proposed Subdivision 815-A to be applied in any transfer pricing cases involving small to medium sized enterprises. These taxpayers are unlikely to have the resources or specialist transfer pricing expertise needed to review historical transfer pricing positions taken and would need to engage advisors to do this. The potential compliance cost involved in doing this, (or in defending ATO adjustments made under these retrospective provisions), would be disproportionate to the potential revenue risk involved.

Specific comments

We make the following specific comments in respect of the exposure draft legislation and accompanying explanatory materials:

- **Profits on transactions**

Essentially, proposed section 815-30 (1) allows the Commissioner of Taxation to make a determination that a transfer pricing benefit is subject to tax by increasing an entity's taxable income, decreasing an entity's taxable loss or decreasing an entity's net capital loss.

However, paragraph 1.53 of the draft explanatory materials refers to such a determination being an 'overall adjustment' to an entity's taxable income, tax loss or net capital loss. As such, there is no direct link between the global adjustment made and adjustments to particular items of assessable income, deductions or net capital losses. The only exception to this approach is where Division 820 can apply in a particular year in which case a further determination is required under proposed section 815-30(2) specifying the extent to which the 'overall adjustment' is attributable to particular items of assessable income, deductions, capital gains or capital losses.

In our view this approach is flawed as there may be a range of individual transactions which could collectively constitute an aggregate transfer pricing adjustment which would typically arise in the case of a large multinational group which is involved in a broad array of multiple cross-border transactions with various related parties. In practice, the proposed approach will make it more difficult for taxpayers to determine the basis on which such global adjustments are made by the ATO and to establish that the consideration for particular individual related party transactions comply with the arm's length principle.

Accordingly, we recommend that proposed section 815-30(2) be amended so that in all circumstances the Commissioner of Taxation is required to make a determination that the adjustment is attributable to particular amounts of assessable income, deductions, capital gains or capital losses so that a link can be established between the adjustments made and the transactions to which they relate.

- **Interaction with thin capitalisation provisions**

We note that further retrospective changes will also apply in relation to the interaction of the proposed transfer pricing changes and the thin capitalisation provisions in Division 820 of the ITAA (1997) which will be similarly backdated to 1 July 2004 under proposed Subdivision 815-A.

We note that such retrospectivity was not expressly referred to in the Media Release issued by the former Assistant Treasurer or the related Treasury Consultation Paper which both issued on 1 November 2011, or in the Media Release issued by the current Assistant Treasurer on 16 March 2012.

In our view it is most difficult to contend that the proposed changes concerning the interaction of the above provisions relate to the 'clarification' announced in the former Assistant Treasurer's Media Release that the tax treaties provide an alternate power to making transfer pricing adjustments in addition to the domestic transfer pricing provisions set out in Division 13 of the ITAA (1936).

Conversely, if such an interaction does relate to a 'clarification' of what Parliament intended in 2004, it is unclear why the ATO deferred the issue of Taxation Ruling TR2010/7 until 27 October 2010 to address the interaction of Division 820 of the ITAA (1997) with the transfer pricing provisions rather than provide such guidance in 2004.

For the reasons detailed above we believe that such retrospective changes should not be enacted as no compelling argument has been advanced that such retrospective amendments are required.

Assuming the proposed amendments to the interaction of Division 820 and proposed Subdivision 815-A apply prospectively, we submit that proposed section 815-22(5) should be excised as the OECD Guidelines do not expressly apply the arm's length principle to determine a comparable interest rate on a loan between associated enterprises based on an amount which is less than the amount of the actual debt borrowed.

- **Record keeping requirements**

Proposed Subdivision 815-A does not impose any additional record keeping requirements on taxpayers. In our view a taxpayer who has maintained contemporaneous documentation evidencing their best endeavours to comply with the arm's length principle should expressly mitigate any penalties imposed where Subdivision 815-A is invoked to make a transfer pricing adjustment. Such an approach would be broadly analogous to the current imposition of penalties where such documentation is retained and an adjustment made under Division 13 or the associated enterprises article of a tax treaty.

Given the unexpected retrospective application of Subdivision 815-A it is submitted that any contemporaneous documentation prepared for Division 13 or tax treaty purposes be regarded as also being contemporaneously prepared for the purposes of proposed Subdivision 815-A.

- **Procedural fairness**

We submit that proposed subsections 815-30(6) and 815-45(6) are unreasonable and should be removed from proposed Subdivision 815-A altogether. These subsections state that a failure by the Commissioner to provide a copy of a determination (making a transfer pricing adjustment) to a taxpayer does not affect the validity of the determination.

If this were allowed to become law, a taxpayer considering making an objection to a Subdivision 815-A transfer pricing adjustment may have no knowledge as to what position the Commissioner has adopted as a basis for making the determination and would thus be at an inequitable disadvantage in seeking to adduce evidence to refute that position. This approach is contrary to the notion of procedural fairness in tax law administration.

- **Interaction with customs duties**

There is currently no mechanism to enable taxpayers who are subject to transfer pricing adjustments which reduce the price of imported goods for income tax purposes to in turn adjust the customs value and duty payable on those goods. Consequently, in such circumstances, there is a real risk of a form of double taxation within Australia which we believe is a broader issue which should be considered by Government in conducting this review.

If you have any questions regarding the above, please contact Mark Morris, Senior Tax Counsel, on (03) 9606 9860 or via email at mark.morris@cpaaustralia.com.au.

Yours faithfully

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