CPA Australia Ltd
ABN 64 008 392 452
Level 20, 28 Freshwater Place
Southbank VIC 3006
Australia
GPO Box 2820
Melbourne VIC 3001
Australia
Phone 1300 737 373
Outside Aust +613 9606 9677
Website cpaaustralia.com.au

30 November 2011

The Principal Adviser
International Tax and Treaties Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: transferpricing@treasury.gov.au

Dear Sir/ Madam

SUBJECT: SUBMISSION ON THE CONSULTATION PAPER ON THE REVIEW OF THE TRANSFER PRICING RULES

CPA Australia represents the diverse interests of more than 132,000 members in 111 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 Treasury Consultation Paper 'Income tax: cross border allocation – review of transfer pricing rules' (the Paper) and the related Media Release made by the Assistant Treasurer Mr. Shorten which both issued on 1 November 2011.

CPA Australia believes it is timely to conduct a review of Australia's existing transfer pricing rules given the dynamic manner in which cross border related party transactions have evolved since the enactment of Division 13 of the Income Tax Assessment Act (1936) (the ITAA (1936)) in 1982, and the issue of revised OECD guidance on such dealings over the past 25 years.

However, we believe that any material changes to the Australian transfer pricing regime must be methodically developed and progressively workshopped by Treasury in conjunction will all major stakeholders including transfer pricing practitioners to ensure that robust rules are developed which are compatible with the OECD guidelines whilst ensuring that they do not inhibit Australia's international competitiveness.

In our view the proposed timetable for consultation runs the risk that there will be insufficient time for such issues to be appropriately addressed. This is of paramount importance given the magnitude of intra-firm international dealings which were reported as being over A$270 billion for the 2009 year by the Australian Bureau of Statistics as discussed in paragraph 6 of the Paper.

Moreover, CPA Australia is steadfastly opposed to the proposal in the Assistant Treasurer's Media Release that the Federal Government will retrospectively introduce amendments backdated to 1 July 2004 to clarify that the transfer pricing rules in the double tax treaties operate as an alternative to the rules set out in Division 13 of the ITAA (1936).

If enacted these amendments will provide the Australian Taxation Office (ATO) with an unlimited capacity to reactivate or initiate audit action on cross border related party dealings for up to 7 years on matters that taxpayers may well regard as having been finalised.

As a general principle CPA Australia believes that retrospective tax policy and law changes which are detrimental to taxpayers would only be appropriate in the most exceptional of circumstances and not something that is done as a matter of general practice. In this regard we do not consider the business case has been made as to why such retrospective amendment is necessary, and it is essential that this is done if confidence in Australia's tax system is to be maintained. Where no such clear rationale exists such retrospective changes potentially undermine the confidence of our key foreign trading partners and serve to create negative perceptions of Australia's sovereign risk.

We make the following specific comments in respect of the Paper:

- **Revised profit allocation rules**

We support the proposal that the use of the OECD Guidelines be mandated in any revised transfer pricing legislation as the principles enunciated in the guidelines are generally well understood and applied by multi-national enterprises. Such amendments should apply a high level principles approach rather than be overly prescriptive.

We note that their codification would assist the courts to judicially interpret the law and ensure that future Australian case law is more congruent with that of our international trading partners in terms of applying the arm's length principle. As such profit based methods should not necessarily be regarded as preferable to the traditional transactional methods.

However, we are concerned that there is a misconception in the Paper which asserts that the individual transactional approach set out in Division 13 is in direct contrast to the treaty rules which apply the associated enterprises article of the OECD Model Tax Convention.

Broadly, the application of the associated enterprises article generally requires the selection of the most appropriate arms-length methodology to each individual transaction to cumulatively determine the aggregate cross-border profits derived by related parties.

In practice, any such methodology applied may be any one of the specific OECD approved transactional or profit based methodologies (or a combination thereof) depending on the specific circumstances of each particular transaction.

Hence, any new transfer pricing rules which automatically default to taking a highly aggregated approach in determining arm's length profit outcomes is contrary to the treaty rules.

- **Reconstruction**

The OECD Guidelines clearly state that the restructuring of controlled transactions is generally inappropriate and that a tax administration's examination should be based on the transaction actually undertaken by the associated enterprises.

Specifically, paragraph 1.65 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010 states that a tax administration should not disregard the actual transactions or substitute other transactions for them other than in 'exceptional cases', such as where the economic substance of a transaction is clearly at odds with its form.

In relation to so called 'exceptional cases', Australia already has a comprehensive general anti-avoidance rule (GAAR), being Part IVA of the ITAA (1936), which prevails over Australia's double tax agreements.

Thus, the inclusion of a separate reconstruction provision within Australia's transfer pricing rules canvassed in paragraph 82 of the Paper is not warranted.

- **Self-assessment**

We endorse the modification of Australia's transfer pricing rules so that they apply on a self-assessment basis in accordance with Recommendation 22.12 of the Review of Business Taxation, A Tax System Redesigned, 1999 (the Ralph Review).

As a corollary the Commissioner's discretion to deem an arm's-length consideration under section 136AD(4) of the ITAA (1936) should be fully removed.

Furthermore, Division 13 should be amended so that it does not apply to dealings with unrelated parties as such transactions are either arm's length or potentially subject to the GAAR.

- **Record keeping requirements**

As part of a proposed full self-assessment regime we recognise that it will be incumbent on taxpayers to maintain contemporaneous transfer pricing documentation.

However, we believe that penalties for a failure to take reasonable care should not be imposed provided the taxpayer has made reasonable attempts in good faith to maintain contemporaneous documentation which is commensurate with the relative importance of the transaction to the taxpayer's business.

Moreover, if a legislative requirement to maintain contemporaneous transfer pricing documentation is introduced, a de minimis rule should apply to exclude taxpayers facing compliance costs which are disproportionate to the potential transfer pricing risk involved.

Such a de minimis rule should be structured in such a way as to have regard to the materiality of particular transactions or sets of transactions within the context of a taxpayer's aggregate international related party dealings (IRPDs).

We note that larger taxpayers commonly have a small number of large IRPDs, and a larger number of small, low risk IRPDs. In this regard, where the de minimis rule fails to take matters such as context, materiality and risk into account, larger taxpayers may bear significant compliance costs in documenting transactions of negligible value and little risk.

Thus, in the interest of efficiency and minimising compliance costs, we recommend some form of a 'per transaction' de minimis rule where the de minimis amount is calculated by reference to an objective measure such as the taxpayer's aggregate IRPDs or net income rather than a fixed threshold amount (e.g. gross turnover) that applies to all taxpayers.

- **Time limits on amended assessments**

We welcome the proposal to limit the timeframe in which the Commissioner of Taxation can issue an amended assessment to give effect to transfer pricing adjustments which is similarly consistent with a self-assessment regime.

We recognise that there was a proposal in sub-chapter 2.2.2. of the Treasury Discussion Paper 'Review of Unlimited Amendment Periods in the Income Tax Laws' issued on 22 August 2007 that a period of 8 years from the time the Commissioner gives the taxpayer a notice of assessment may be a more reasonable timeframe in which to issue an amended assessment concerning a transfer pricing adjustment.

However, given the proposed introduction of the Reportable Tax Positions schedule and the International Dealings Schedule it is now likely that the ATO will be able to much more readily identify whether there is any requirement to amend assessments for cross border transactions within the standard amendment periods set out in section 170 of the ITAA (1936).

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

Paul Drum FCPA
Head – Business and Investment Policy

T: +61 3 9606 9701
E: paul.drum@cpaaustralia