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

By email: transferpricing@treasury.gov.au

Dear Sir/Madam

The Federal Chamber of Automotive Industries (FCAI) is the peak industry organisation representing the automotive industry in Australia. FCAI's membership comprises the three domestic passenger motor vehicle manufacturers and all major international brands which import and market passenger, light commercial and four wheel drive vehicles, and motor cycles in Australia.

The FCAI welcomes the opportunity to provide comments on the Consultation Paper which was issued on 1 November 2011.

The automotive industry is a major contributor to Australia's lifestyle, economy and community. The industry is wide-ranging – it incorporates exporters, importers, manufacturers, retailers, servicing, logistics and transport, including activity through Australian ports and transport hubs.

The Australian automotive sector exported $3.6 billion in vehicles and components in 2010 and the turnover in the industry exceeds $160 billion per annum. At present, the industry directly employs around 59,000 people through Australia's three vehicle manufacturers, importers and component manufacturers and more than 400,000 people directly and indirectly throughout Australia.

As the automotive industry is a significant importer and exporter of goods and services in Australia, it will therefore be directly impacted by any changes to the transfer pricing rules, not only for income tax purposes but also for customs duty purposes.

The FCAI has addressed a number of issues raised in the Consultation Paper, focusing on issues of most concern to its members, most importantly ensuring consistency with the arm's length principle and ensuring there is greater convergence of the valuation rules and avoid inconsistencies between the *Customs Act 1901* and *Income Tax Assessment Acts 1936 and 1997*.

Within this context the FCAI appreciates this opportunity to participate in the consultation process and accordingly provide the following comments adopting the headings used in the Consultation Paper.

1. Ensuring consistency with the arm's length principle

Paragraph 23 on page 5 of the Consultation paper states as follows:

> ***Division 13 focuses on pricing individual transaction and as a consequence of the transactional focus of the current rules, there may be judicial reluctance to accept profit based methods.***

FCAI members agree that Division 13 as currently enacted does focus on pricing individual transactions. FCAI members also believe that it is most important that this focus on "transactions" does not change.

As you will no doubt be aware, FCAI members are subject not only to the provisions of the *Income Tax Assessment Acts 1936 and 1997* (as amended) (ITAAs) but also to the *Customs Act 1901 Cth* (Customs Act) regarding the importation of motor vehicles. The valuation rules are contained in sections 159 to 161 of the Customs Act. In addition, section 154 (1) of the Customs Act provides a definition of "price" for the purposes of applying the valuation rules in order to determine customs duty liability. In summary, "price" includes all payments made directly or indirectly to the vendor in accordance with the contract of sale.

Accordingly, customs duty is levied on a transaction basis pursuant to the Customs Act. There is no reference in the Customs Act to overall profitability of the Australian operations. Therefore, to move away from a "transaction" focus to an overall profitability approach will cause tensions between transfer pricing for income tax purposes and transfer pricing for customs purposes. This will have adverse ramifications for FCAI members as follows:

- there may be no recourse to customs duty refunds in instances where the Tax Commissioner has applied an overall profitability measurement to an imported good and reduced the "price", and

- an increased administration burden as there will be two different prices in respect of the same goods together with all the associated supporting documentation under both sets of revenue laws.

Whilst recognising that the statutory schemes under both the Customs Act and the ITAAs are different, FCAI members believe that the overall objective to tax "on an arm's length basis" is similar. Therefore, the aim should be for greater convergence of the valuation rules

of both to ensure a consistent framework in order to ensure that there are no potential problems that would otherwise arise from inconsistencies in the legislative framework. In this regard I refer to a speech by Mr Terry Moran[1], former Secretary of the Department of Prime Minister and Cabinet, concerning the goal for a holistic approach to Government policy as follows:

> "Strategic policy advice must consider the levers available to government across all policy domains and not restrict itself to particular silos."

Further in relation to this holistic approach, the Advisory Group on Reform of Australian Government Administration have recommended that when Government considers changing regulations, care needs to be taken to avoid regulatory burden[2].

2. The objective of the rules is to ensure the overall profits of the parties reflect an arm's length outcome given their respective economic contributions

Whilst it is generally understood that it is good tax policy to legislate to ensure that international related party dealings result in an "arm's length outcome", it is difficult to understand how such an outcome will be achieved by concentrating on "overall profitability" and in particular the overall profitability of the Australian operations. Unrelated parties dealing at "arm's length" have no regard for the overall profitability of the party with which they are buying and selling. It is manifestly unjust and unfair to impute a notional profit when none was derived. The above statement also fails to recognise that in any 10 year business cycle, businesses lose money for a variety of reasons, including factors beyond their control, such as significant fluctuations in currency exchange rates, customer preferences, competitive factors, and as evident in recent years, the global economic crisis. As you will recall, the automotive industry suffered such significant financial losses during the global financial crisis that in a number of countries, including Australia, government financial assistance was made available to prevent closure of operations and the flow on economic ramifications.

It should also be emphasised that Associated Enterprises Article "Article 9" in most of Australia's tax treaties only permits Australia to tax those profits which may have reasonably accrued if the parties were dealing in a wholly independent manner.[3] This Article does not grant authority to revenue officials of either jurisdiction to tax profits on an overall bench mark basis.

3. Profit methods are frequently relied upon by taxpayers and administrators alike

FCAI members do not agree that profit methods are frequently relied upon, nor do FCAI members agree with the statement in paragraph 24 on page 5 of the Consultation Paper

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[1] Speech by Mr Terry Moran AO Secretary, Department of the Prime Minister and Cabinet to the Institute of Public Administration Australia Public Lecture Reform of Government Administration: From Blueprint to Outcomes 18 May 2010 at page 3.

[2] Ahead of the Game Blue Print For the Reform Of Australian Government Administration March 2010 Recommendation 1.4: Reduce unnecessary Business Regulation Burden - advisory Group on Reform of Australian Government Administration.

[3] The United States Convention Article 9 Associated Enterprises.

that the OECD Guidelines give profit based methods equal priority to traditional methods. The OECD Guidelines tend to focus less on the results of transfer pricing and more on whether transfer prices were established in an arm's length manner substantially similar to the manner in which uncontrolled parties would negotiate prices.[4] In addition, the OECD Guidelines express a higher level of preference for the use of traditional transaction methods for testing the "arm's length character of transfer prices for transfers of tangible property.

Furthermore, the OECD Guidelines[5] state that:

> "Methods that are based on profits can be accepted only insofar that they are compatible with Article 9 of the OECD Model tax Convention, especially with regard to comparability."

4. Retrospectivity

FCAI members do not believe it is good tax policy to empower the Commissioner of Taxation to apply the new rules retrospectively to 2004, as advised in the Assistant Treasurer's Press Release. FCAI members have complied with tax legislation in accordance with the tax laws as enacted at the time. Applying the proposed changes retrospectively may result in some members being placed in unfavourable tax positions through no fault of their own. In practice, revenue officials in the foreign jurisdiction may not agree to amend prior year assessments or those assessments may be out of time for amendment. This will result in double taxation without treaty relief.

In addition, Customs officials may not agree to provide duty refunds due to either time limits for refunds expiring or technical valuation methodology reasons. I refer to the Recommendation of the Senate Estimates Committee[6] in respect of legislating retrospectively as follows:

> "The Committee is firmly of the view that legislating retrospectively should not be an approach that is frequently used, nor one pursued without careful consideration. Retrospective legislation can lead to potential uncertainty and has the ability to significantly impact the rights of those affected. In the sphere of tax laws, retrospective changes can pose practical difficulties for those affected in managing their tax affairs."

Further, to enact retrospective changes as a result of recent litigation (refer clause 22 of the Consultation Paper) which has produced a favourable outcome to the taxpayers, is not within the spirit of co-operative and collaborative compliance in a self assessment regime. FCAI members believe that it is not appropriate for the Government to retrospectively change the law merely as a result of failed legal proceedings.

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[4] OECD Review of Comparability of Profit Methods: Revision of Chapters I –III of the Transfer Pricing Guidelines 22 July 2010 at page 21 at paras 2.3 to 2.10.

[5] Refer footnote 4 above at para 2.6.

[6] Senate Economics Legislative Committee Tax Laws Amendment (2011 Measures No. 8) Bill 2011 (Provisions) November 2011 at page 16 paragraph 2.41.

5. Time limits

Time limit for amendments regarding transfer pricing afforded to the Commissioner of Taxation pursuant to subsection 170(10) should be consistent with subsection 170(1). Prescribing different time limits for transfer pricing adjustments will continue to burden taxpayers with uncertainty of tax assessments. Subsection 170(1) Item 5 and Part IVA provides the Commissioner of Taxation the legislative authority to redress any genuine tax evasion without a time limit.

Summary

FCAI accordingly request that the Treasury consider its members concerns and the potential ramifications for FCAI members, not only from an income tax perspective, but also in relation to Customs Duty. This is particularly relevant as both Income Tax and Customs are ultimately the responsibility of the Federal Treasurer and the Treasury. As mentioned in this submission, the Government has previously committed to a whole of Government approach to legislation.

The FCAI would welcome the opportunity to discuss this submission with you in further detail and will be in contact in the near future to arrange a meeting.

Yours sincerely

Ian Chalmers
Chief Executive