Minerals Council of Australia

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RESPONSE TO EXPOSURE DRAFT TAX LAWS AMENDMENT (CROSS-BORDER TRANSFER PRICING) BILL 2013: MODERNISATION OF TRANSFER PRICING RULES

The Minerals Council of Australia (MCA) welcomes the opportunity to comment on the exposure draft of the *Tax Laws Amendment (Cross-Border Transfer Pricing) Bill 2013: Modernisation of Transfer Pricing Rules*.

The MCA represents Australia's exploration, mining and minerals processing industry, nationally and internationally, in its contribution to sustainable development and society. MCA member companies produce more than 85 per cent of Australia's annual minerals output and account for more than 50 per cent of Australia's exports.

The MCA welcomes the decision to align Australia's transfer pricing legislation more closely with international best practice as set out by the OECD in its *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* and the *OECD Model Tax Convention on Income and on Capital*. This will help to provide greater certainty for multinational enterprises operating or considering investing in Australia.

However, the MCA has serious concerns about the way the Bill is currently drafted. In a number of aspects, we do not believe it reflects the Government's stated intent and we are concerned that, as currently worded, it would enact tax rules which are unclear, complex and difficult to uphold in practice. Further time and discussion is required to ensure the proposed legislation is workable and that the supporting Explanatory Memorandum (EM) is clear and informative. Without additional consultation and amendment, the Exposure Draft (ED) would significantly increase the compliance burden for Australian taxpayers with little value to the administration of the law.

The issues of most concern to the MCA are itemised below together with recommendations to improve the clarity, efficiency and effectiveness of the proposed changes and their application.

1. SECTIONS 815-115, 120, 125

These subsections are unnecessarily prescriptive. The OECD Guidelines thoroughly and adequately describe the arm's length principle and its operation. By introducing an interpretation of the OECD Guidelines, the ED creates parallel definitions and introduces the potential for conflict with recognised and understood international best practice.

There appears to be a mismatch between the OECD Guidelines, which primarily address the application of the arm's length principle, and the ED's focus on identifying the arm's length conditions. In applying the arm's length principle, the OECD recognises "it is important not to lose sight of the objective to find a reasonable estimate of an arm's length outcome based on reliable information" (paragraph 1.13). In contrast, in defining meanings of "transfer pricing benefit" and "the arm's length conditions", the ED appears focussed on identifying a single set of arm's length conditions. The nature of transfer pricing makes this unrealistic. If the intention is to align with international best practice, the OECD Guidelines should be sufficient.

Specific examples of issues arising with 815-125 are provided below.

MCA recommendation:

- That the definition of "the arm's length conditions" be removed, including as part of the definition of the "transfer pricing benefit".
- That a less prescriptive approach be adopted - a clearer reliance on OECD Guidelines would affirm the intent of the legislation and improve the efficiency of its application for both taxpayers and the revenue authority.

2. SUBSECTION 815-115

The substitution of "the arm's length conditions" in all cases where there is deemed to be a transfer pricing benefit affords the Commissioner a very broad power of reconstruction. This appears to apply irrespective of the magnitude of any benefit. It does not differentiate between instances where an adjustment to pricing is contemplated and those where the Commissioner might seek to recharacterise the transaction.

With any individual transaction there may be many variables found between arms-length parties. The fact that another arms-length condition is possible should not give rise to the reconstruction of an actual transaction that is also observed in a similar arms-length transaction. This will create an uncertainty for both taxpayer and tax administrator that is unworkable in practise.

This issue is fundamental to the application of the transfer pricing rules and to allowing taxpayers transparent guidance in complying with their obligations.

MCA recommendation:

- That it is clearly stated that a recharacterisation should only be considered in the two exceptional circumstances set out in the OECD Guidelines at paragraph 1.65. If the position of the Australian Taxation Office (ATO) differs from that of the OECD on this point, this should be clearly identified in the proposed legislation, and the ATO's preferred position set out in detail in the EM.
- That in arriving at a position regarding recharacterisation, the ATO should consider the wider implications of recharacterising transactions under broader circumstances (rather than re-pricing the actual transaction as entered into). These implications could include, for example, a reputational risk to the taxpayer and consequent potential to impact on earnings and profitability; or undue influence on an investor's choice of business model - for example, doing business *with* instead of *in* Australia.

3. SUBSECTION 815-120

As noted above, the MCA regards 815-120(1)(a) to be unnecessarily prescriptive. The requirement to identify "the arm's length conditions" and compare with the actual conditions is particularly onerous. The focus should instead be on applying the arm's length principle.

The operation of Subsection 815-120(2), and in particular (2)(b), is not clear. Paragraph 2.26 of the EM adds little. It is difficult to envisage how this subsection might be applied in practice, unless a specific condition can be shown to be *always* present between independent parties, but absent in the actual conditions; or can be shown to be *always* absent between independent parties but present in the actual conditions. However, this level of proof is unlikely to be available in many cases and the need for such proof would be contrary to paragraph 2.88 of the EM.

MCA recommendation:

- That the requirement to identify "the arm's length conditions" and compare with the actual conditions be removed.
- That how subsection 815-120(2) is intended to operate in practice be clarified.