

13 April 2012

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

By email: transferpricing@treasury.gov.au

Dear International Tax Integrity Unit Manager,

Inquiry: Exposure Draft – Stage One Transfer Pricing Reforms

The Rule of Law Institute of Australia (RoLIA) thanks Treasury for the opportunity to submit on the exposure draft of the Tax Laws Amendment (2012 Measures No. 3) Bill 2012: Cross-border transfer pricing (the draft bill).

About RoLIA

RoLIA is an independent non-profit entity formed to uphold the rule of law in Australia.

The Institute's objectives are:

- To foster the rule of law in Australia.
- To promote good governance in Australia by the rule of law.
- To encourage truth and transparency in Australian Federal and State governments, and government departments and agencies.
- To reduce the complexity, arbitrariness and uncertainty of Australian laws.
- To reduce the complexity, arbitrariness and uncertainty of the administrative application of Australian laws.

Introduction

RoLIA congratulates Treasury and the Minister on the review of the transfer pricing rules to minimise the illegitimate transfer of profits from the Australian tax system. Our only concern is with the proposed retrospectivity of the rules, back to 1 July 2004.

The rule of law comprises a number of fundamental principles by which laws (and executive and judicial decision making) are measured to see if they fulfil those principles.

The principles include that laws should be capable of being complied with and therefore not operate retrospectively.¹

It is however a reality of the law making process in Australia with our voluminous and complex tax laws, that it takes time for Bills to be drafted, to be properly scrutinised by Committees and passed by the House and Senate.

A practice has developed that laws are made retrospective to the date of the Minister's media release. This minimises the possibility of taxpayers organising their affairs between when proposed changes to the law are announced, and their coming into force. In these circumstances taxpayers are given fair warning of changes to the law at the time of the media release. Although not ideal as a matter of principle, it is a practical solution where matters of revenue are concerned.

Tax Laws Amendment (2012 Measures No 3) Bill 2012: Cross-border transfer pricing

The basis for the retrospective amendment to 1 July 2004 is said to be:

“The 2004 income year commenced immediately after Parliament last demonstrated its intention that the law should operate in this way in the *International Tax Agreements Act 2003* and its associated explanatory material.”²

The *International Tax Agreements Act 2003* gave the force of law in Australia to two Double Tax Agreements (DTA's), one with the United Kingdom and the other with Mexico.

The two DTAs were as their name suggests enacted to prevent the double taxation of entities who are residents of both Australia and either Great Britain or Mexico. In most countries the amount of tax payable is dependent on whether an entity is a resident of a country. A person or company etc may be a resident of more than one country. To avoid double taxation DTAs have been entered into by Australia with 42 other countries.

DTAs cover such matter as residence, permanent establishments, income from real property, business profits, profits from the operation of ships and aircraft, dividends etc. The DTA's referred to each have around 30 Articles. Article 9 deals with transfer pricing.

Article 9 in both DTA's did not however adopt the OECD model. Indeed the EM to the International Tax Agreements Bill 2003 states:

“This reflects Australia's reservation to Article 9 (Associated enterprises) of the OECD model.”³

Clearly Australia was not adopting the OECD model with respect to transfer pricing in the *International Tax Agreements Amendment Act 2003*. The proposed new transfer pricing rules are not based on Parliament's intention in 2003.

In the media release of 1 November 2011 the Minister is quoted as saying:

¹ Dominic De Cogan 'The Delicate Balance - Tax, Discretion and the Rule of Law' Pg 6 eds Chris Evans, Judith Freedman, Richard Krever and G.D.Q Walker 'The Rule of Law: Foundation of Constitutional Democracy' 1988 (Melbourne University Press).

² EM to the 2012 Bill [1.10]

³ EM to International Tax Agreements Amendment Bill 2003 [1.104]

“Last year [2010], for example, the OECD substantially updated its Transferring Pricing Guidelines, which are used by Governments and business alike. Further, recent court decisions suggest our existing transfer pricing rules may be interpreted in a way that is out-of-kilter with international norms.”

It is clear that what has motivated the proposed changes are the 2010 OECD update of its Transferring Pricing Guidelines and the recent court decisions. One of those decisions is *Commissioner of Taxation v SNF Australia Pty Limited* [2011] FCAFC 74. These are of course recent developments and no justification or making the amendments retrospective to 1 July 2004.

How retrospective should the new rules be?

The most appropriate date for the retrospective operation of these rules should be the date of the Minister’s press release, 1 November 2011. However there is some justification for extending the date to 1 July 2011 so the amendments apply for the entirety of this income year. This will save some expense in businesses having two sets of calculations and should minimise the need for transitional provisions. This would give those subject to the new rules ample time to calculate their tax obligations under the new rules. In most circumstances the last payment for tax for the 2011/2012 income year is on 1 December 2012 with tax returns to be lodged in early January 2013.

Recommendation

RoLIA recommends that proposed s815-10 of the Bill be amended to delete “1 July 2004” and replaced with “1 July 2011”.

Should you need any further information please contact RoLIA Research Officer, Ms Laura Hicks

Yours Sincerely



Mr Malcolm Stewart
Rule of Law Institute of Australia
Vice President