
Chapter 1

Cross Border Transfer Pricing Rules

Outline of chapter

1.1 Schedule # to this Bill inserts Subdivision 815-A into the *Income Tax Assessment Act 1997* (ITAA 1997). The Subdivision contains amendments that ensure Australia's tax treaty transfer pricing rules operate as intended.

1.2 The amendments ensure the domestic law that references the tax treaty transfer pricing rules are applied in a manner consistent with relevant OECD guidance.

1.3 This Schedule also:

- inserts Subdivision 815-A into the *Income Tax (Transitional Provisions) Act 1997*;
- makes consequential amendments to the *Income Tax Assessment Act 1936* (ITAA 1936).

1.4 All legislative references are to the ITAA 1997 unless otherwise stated.

Context of amendments

1.5 Australia's transfer pricing rules are designed to ensure Australia receives an appropriate share of tax revenue from the international dealings of multinational enterprises, reflecting contributions made by their Australian operations to the overall group.

1.6 Australia's unilateral transfer pricing rules are currently contained in Division 13 of the ITAA 1936 (Division 13) and were introduced in 1982 against the backdrop of the 1979 OECD Transfer Pricing Report. Each of Australia's tax treaties also contains articles that deal with transfer pricing. These articles include the Associated Enterprises Article and the Business Profits Article (although Australia's tax treaties include other articles that deal with transfer pricing issues, references to 'the transfer pricing articles' hereinafter relate to these two articles specifically).

1.7 The transfer pricing articles, interpreted through the framework of the OECD guidance, require profits which relate to cross-border intra group dealings to be calculated in a way that best ensures consistency with the arm's length principle.

1.8 Australia incorporates its income tax treaties into the domestic law of Australia through the *International Tax Agreements Act 1953* (ITAA 1953). Australia's tax treaty transfer pricing rules are also specifically referred to in the ITAA 1936. Over time the Parliament has repeatedly referenced its view that the specific transfer pricing related articles as incorporated into Australia's domestic law provide alternative and independent transfer pricing liability provisions to those contained in Division 13.

1.9 Whether the treaty transfer pricing rules could give rise to a different arm's length outcome than that arrived at through an application of Division 13 is unclear. However, the analysis of Division 13 by the Full Federal Court in the case of *Commissioner of Taxation v SNF (Australia) Pty Ltd* [2011] FCAFC 74 suggests that the articulation of the arm's length principle in the transfer pricing articles is more robust and has remained consistent with international practice.

1.10 These amendments have been introduced to ensure the Parliament's intention is effective, that the Australian revenue is not compromised, and that international consistency is maintained with our tax treaty partners. While this view has been publically expressed consistently since the commencement of Division 13 in 1982, these amendments will apply to income years commencing on or after 1 July 2004. The 2004 income year commenced immediately after the Parliament last demonstrated its intention that the law should operate in this way in the *International Tax Agreements Amendment Act 2003* and its associated explanatory materials.

Summary of new law

1.11 Subdivision 815-A operates on the basis of the Commissioner of Taxation making a determination.

1.12 The provisions of this Subdivision are designed to make certain two aspects of the operation of Australia's transfer pricing rules:

- to ensure that the transfer pricing articles contained in Australia's tax treaties are able to be applied and operate to provide assessment authority independent of Division 13 through explicit incorporation into the ITAA 1997; and

- to require the arm's length principle to be interpreted as consistently as possible with relevant OECD guidance.

1.13 Consistent with the policy underlying current transfer pricing arrangements, the operation of Subdivision 815-A does not require (or imply) a tax avoidance purpose to be present with respect to non-arm's length dealings.

1.14 The Subdivision is designed to protect the integrity of the Australian tax system and as such, its operation is limited to cases where its application would result in a greater amount of taxable income in Australia, a decrease in the tax loss of the entity or a decrease in a net capital loss of the entity relative to what has been returned. These are referred to as bringing an amount of a transfer pricing benefit to tax.

1.15 For an associated entity, a transfer pricing benefit will be determined by comparing the profits that have accrued to that entity with the profits that might have been expected to have accrued had it been independent and dealing wholly independently. This calculation is made consistently with the OECD guidance having regard to the relevant circumstances of the entity and should produce an arm's length outcome.

1.16 For an Australian permanent establishment of a foreign entity, a transfer pricing benefit will be determined by comparing the profits attributed to the permanent establishment with the profits that it might have been expected to make if it were a distinct and separate enterprise. This calculation is made having regard to the relevant circumstances of the permanent establishment and should produce an arm's length outcome having regard to the terms of the relevant tax treaty article.

1.17 The relevant circumstances will generally include a consideration of the activities performed by the business – its functions in relation to the relevant non-arm's length dealings or arrangements, taking into account the assets used and risks assumed.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
A transfer pricing adjustment can be made under Subdivision 815-A, transfer pricing provisions of a tax treaty or Division 13 in certain cases.	A transfer pricing adjustment may be made under either Division 13 or transfer pricing provisions of a tax treaty (there is however some debate as to whether the tax treaty transfer pricing articles are currently effective).

Where the Commissioner makes a determination, the determination will be made based on an amount of a transfer pricing benefit.	The Commissioner may, at any time, amend an assessment to apply the Business Profits and Associated Enterprises articles of a tax treaty, an international tax sharing agreement or Division 13.
A transfer pricing benefit is to be interpreted in a manner that best ensures consistency with the relevant OECD guidance (or other prescribed documents).	OECD guidance or other documents may be used to provide guidance in applying the transfer pricing articles in certain circumstances.
Where relevant, makes certain that this Subdivision applies to establish an arm's length cost of debt capital before Division 820 applies.	No equivalent
In addition to the general Mutual Agreement Procedures in tax treaties, where the Commissioner makes a determination the Commissioner may also make a consequential adjustment to an entity's tax position to relieve any double taxation.	The general Mutual Agreement Procedures in tax treaties provide a procedure for the relief of taxation not in accordance with the treaty. Section 136AF may also apply.
An amount of a transfer pricing benefit that is subject to tax cannot be taken into account under another provision of this Act.	An amendment made under Division 13 or a transfer pricing article of a tax treaty prevents a subsequent amendment being made under those provisions in relation to the same subject matter in an income year.

Detailed explanation of new law

To whom can the measure apply?

1.18 The Subdivision can be applied to an entity where:

- an international tax agreement applies to the entity;
- the agreement contains an Associated Enterprises Article or a Business Profits Article;
- the entity gets a transfer pricing benefit

[Schedule #, item #, subsection 815-20(1)]

1.19 This Subdivision cannot be applied to an entity where these conditions are not met.

When does an international agreement apply?

1.20 An international tax agreement for this purpose is:

- an agreement which is given the force of law by the ITAA 1953.

[Schedule #, item #, subsection 815-20(2)]

1.21 The ITAA 1953 lists Australia's bilateral tax treaties and these agreements set out to whom they apply. Generally, they apply to entities who are residents of one or both of the contracting states to the agreement.

What articles must be contained in the international agreement?

1.22 In order for this Subdivision to apply to an entity for an income year, an agreement that applies to the entity must contain at least one of the following articles.

1.23 A Business Profits Article, being:

- Article 7 of the 2003 United Kingdom convention (within the meaning of the ITAA 1953); or
- a corresponding provision in another agreement (within the meaning of ITAA 1953).

[Schedule #, item #, subsection 815-20(3)]

1.24 An Associated Enterprises Article, being:

- Article 9 of the 2003 United Kingdom convention (within the meaning of the ITAA 1953); or
- a corresponding provision in another agreement (within the meaning of the ITAA 1953).

[Schedule #, item #, subsection 815-20(4)]

When does an entity get a transfer pricing benefit?

1.25 There are two situations in which an entity can get a transfer pricing benefit: where the entity is an Australian resident dealing with related parties; or, where the entity is a foreign resident with an Australian permanent establishment. Different rules apply to determine the transfer pricing benefit in each situation.

Associated entities

1.26 Where the entity is an Australian resident it will receive a transfer pricing benefit where:

- it meets the requirements of the Associated Enterprises Article (each Associated Enterprises Article provides preconditions on participation in the management, capital or control of the enterprise which must be satisfied before the article may apply, that is, the enterprises must be associated); and
- the amount of profits (as described in the Associated Enterprises Article) that might have been expected to accrue to the entity given the circumstances described in the relevant Associated Enterprises Article has not so accrued.

[Schedule #, item #, paragraph 815-22(1)(a)]

1.27 This is a restatement of the arm's length principle and the Subdivision will apply where profits have not accrued to an entity because the conditions which operate between the two enterprises in their commercial or financial relations are not arm's length dealings. This Subdivision will have the effect of ensuring an entity's tax liability in Australia reflects the profits that the entity would have made if it was an independent entity dealing with other entities on a wholly independent basis.

1.28 Subparagraph 815-22(1)(a)(iii) refers to an amount of profits within the meaning of the relevant transfer pricing article. Subsection 3(2) of the ITAA 1953 defines profits in this context to mean taxable income.

Australian permanent establishments of a foreign entity

1.29 Where the entity is a foreign resident with an Australian permanent establishment (within the meaning of the international tax agreement), the entity receives a transfer pricing benefit where:

- the amount of profits attributed to a permanent establishment is less than the amount that the permanent establishment might have been expected to make in the circumstances described in the relevant Business Profits Article. Each agreement also defines when a permanent establishment is taken to exist.

[Schedule #, item #, paragraph 815-22(1)(b)]

1.30 Determining whether a permanent establishment gets a transfer pricing benefit requires an assessment of the profits that permanent establishment might be expected to make if it were a distinct and separate enterprise. *[Schedule #, item #, subparagraph 815-22(1)(b)(ii)]*

1.31 The appropriate attribution of profits to a permanent establishment is to be done in accordance with the terms of the Business Profits article of the relevant Australian tax treaty. For example, the 1988 Australia-China tax treaty includes rules on the deductibility of certain expenses including payments for royalties, fees or other similar payments for the use of patents or other rights, payments for services or for management and interest payments. These rules will be relevant to the application of the separate entity principle and the determination of the expected profits to be attributed to Australian permanent establishments of Chinese entities. Where other tax treaties include specific rules relating to the determination of the profits to be attributed to a permanent establishment, these will also be relevant to the determination of the expected profits of a permanent establishment under this Subdivision.

1.32 At law, an entity cannot transact with itself and thus cannot make a profit from itself. This restricts the attribution exercise to the actual profits (income and expenses) of the entity.

1.33 The attribution of profits to a permanent establishment should be determined by applying by analogy the principles developed for the application of the arm's length principle between associated enterprises (these principles are articulated in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations) by reference to the functions performed, assets used and risk assumed by the enterprise through the permanent establishment relative to the rest of the enterprise.

1.34 Subparagraph 815-22(1)(b)(ii) refers to an amount of profits within the meaning of the relevant article. Subsection 3(2) of the ITAA 1953 defines profits in this context to mean taxable income.

What is the amount of the transfer pricing benefit?

1.35 For an associated entity, the amount of the transfer pricing benefit is the difference between the profits that have accrued to that entity and the profits that might have been expected to have accrued had it been independent and dealing wholly independently of the associated entity and other entities with which it deals. This amount is determined having regard to the relevant circumstances of the entity and should produce an arm's length outcome. *[Schedule #, item #, paragraph 815-22(2)(a)]*

1.36 For an Australian permanent establishment of a foreign entity, the amount of the transfer pricing benefit is the amount of profits that are

attributed to the permanent establishment which fall short of the amount of profits that the permanent establishment might be expected to make if it were a distinct and separate entity engaged and dealing in the manner described in the article. This amount is determined having regard to the relevant circumstances of the permanent establishment and should produce an arm's length outcome in the context of the terms of the relevant tax treaty article. *[Schedule #, item #, paragraph 815-22(2)(b)]*

1.37 In determining the amount of the transfer pricing benefit, regard should also be had to any limitations under the general principles of the law.

How is a transfer pricing benefit calculated when the thin capitalisation rules also apply to an entity for the relevant period?

1.38 Where Division 820 applies to an entity for an income year, additional rules will also apply in working out the amount of the entity's transfer pricing benefit for the income year.

1.39 Consistent with the current administrative approach provided in Taxation Ruling TR 2010/7, additional rules are included to ensure that an adjustment made to an entity's tax position under this Subdivision is used to establish the arm's length cost of debt capital which is applied to the actual debt amount to determine the amount of any debt deductions. This otherwise deductible amount is then subject to the operation of Division 820 (the thin capitalisation rules), which would deny debt deductions to the extent that an entity has excess debt.

1.40 The interaction of this Subdivision with Division 820 operates as follows.

- Firstly, the arm's length cost of debt capital is determined in accordance with this Subdivision. The normal application of this Subdivision would require consideration of the conditions operating between the Australian entity and its foreign associates, and a comparison of the profits which would have accrued to the entity had it been wholly independent. In some exceptional cases, the normal application of this Subdivision will require the cost of debt capital to be determined, in a manner consistent with the relevant material, having regard to an arm's length amount of debt that the entity would have held had it been dealing wholly independently with the other entity, rather than its actual amount of debt. Whether a debt amount meets the safe harbours provided for the purposes of Division 820 is not relevant for this first step. *[Schedule #, item #, paragraph 815-22(4)(a) and subsection 815-22(5)]*

- Secondly, the arm's length cost of debt capital is applied to the entity's actual amount of debt. This ensures that Subdivision 815-A does not defeat the operation of Division 820. The result of this second step would be used by the Commissioner in determining the appropriate adjustment (if any) to the entity's taxable income or tax loss. The Commissioner will also determine the amount of debt deductions which are otherwise allowable under this subdivision, which may be relevant for the purposes of Division 820. *[Schedule #, item #, paragraph 815-20(4)(b)]*
- Finally, and after the consideration of any other part of the Act as may be necessary, Division 820 may reduce the otherwise allowable amounts of debt deductions if the entity's adjusted average debt exceeds its maximum allowable debt.

1.41 The following examples illustrate the interaction of Subdivision 815-A and Division 820.

Example 1.1- thin capitalisation adjustment and no transfer pricing adjustment

Aust Co is an Australian resident subsidiary company of For Co, the parent company that is resident in a country with which Australian has a tax treaty. Being an industrial company and not an Authorised Deposit Taking Institution (ADI), Aus Co is an 'inward investment vehicle (general)' for the purposes of Subdivision 820-C.

For an income year, Aus Co has:

A 'safe harbour debt amount', determined in accordance with section 820-195 of \$375 million;

'adjusted average debt' determined in accordance with subsection 820-185(3) of \$400 million, of which \$200 million is borrowed from For Co and \$200 million from an independent lender, both on the same terms and conditions, and both at an interest rate of 10%; and

equity of \$100 million.

Aus Co's only debt deductions are for the interest incurred at a rate of 10% on its \$400 million debt, meaning that it has \$40 million of debt deductions for the income year.

The Commissioner considers whether Aus Co has received a transfer pricing benefit under section 815-22. In doing so, he has regard to the arm's length rate of return for the debt interest (ie the arm's length interest rate), applied to the actual amount of the related party debt.

Assume that the loan from the independent lender is sufficiently similar to the loan from For Co and the circumstances in which each amount of debt funding was provided do not present material differences that would affect the rate of return for the debt interest or Aus Co's ability to obtain \$400 million in debt funding (that is, the independent loan is directly comparable to the related party loan). A comparable uncontrolled price (CUP) method could be applied in determining the arm's length rate of return for the debt interest from For Co based on an interest rate of 10%, provided that, given the other options realistically available to Aus Co, this makes commercial sense. In this case, no transfer pricing benefit arises to Aus Co and so no adjustment is made under Subdivision 815-A.

However, to the extent that Aus Co has 'excess debt', Division 820 will apply to deny Aus Co's otherwise allowable debt deductions.

Example 1.2- transfer pricing adjustment and thin capitalisation adjustment

Assume the facts and circumstances are the same as in Example 1.1, except that the \$200 million borrowed from For Co is at an interest rate of 15% instead of 10%. Aus Co's debt deductions for the interest incurred on its \$400 million debt total \$50 million for the income year.

On the basis that, as in Example 1.1, a 10% interest rate can be used to determine the arm's length rate of return for the debt interest from For Co, Aus Co gets a transfer pricing benefit of \$10 million (being the difference between an arm's length rate of return for the debt interest of 10% and the actual interest rate of 15% on the actual value of the debt interest (\$200 million) from For Co).

Example 1.3- transfer pricing adjustment and no thin capitalisation adjustment

Assume the facts and circumstances are the same as in Example 1.1, except that Aus Co has \$300 million of debt (\$150 million from For Co and \$150 million from an independent lender) and \$100 million of equity, producing a safe harbour debt amount for Division 820 purposes of \$300 million. The interest rate on Aus Co's debt to For Co is 15%, so that, before applying Subdivision 815-A and Division 820, Aus Co has total debt deductions of \$37.5 million.

On the basis that, as in Example 1.1, a 10% interest rate can be used to determine the arm's length rate of return for the debt interest from For Co, Aus Co gets a transfer pricing benefit of \$7.5 million (being the difference between the arm's length rate of return for the debt interest of 10% and the actual interest rate of 15% on the actual value of the debt interest (\$150 million) from For Co).

Example 1.4- transfer pricing adjustment and no thin capitalisation adjustment

Assume the facts and circumstances are the same as in Example 1.3, except that the entire \$300 million of debt is borrowed from For Co at an interest rate of 15%. Aus Co's debt deductions for the interest incurred on its \$300 million debt total \$45 million for the income year.

Unlike in the previous examples, there is no internal comparable uncontrolled price to benchmark an arm's length rate of return for the debt interest from For Co for the purpose of working out if Aus Co has received a transfer pricing benefit, and if so, in what amount. Given this, available data as to market reference rates for a borrowing of that size, and the credit standing that the capital markets would give Aus Co, might be able to be used in determining a market rate of interest for the loan where Aus Co's credit standing would allow it to borrow \$300 million from independent lenders. This might in turn be used to determine the arm's length rate of return for the debt interest, provided this produces an outcome that makes commercial sense for For Co and Aus Co given the other options realistically available to each of them.

Assume a search for external comparable uncontrolled dealings finds no evidence of similar loans being offered to independent entities similar to Aus Co in similar circumstances. While this in itself is not determinative, further analysis may show that the arrangement involving the loan from For Co, viewed in its totality, might not reasonably be expected to exist between independent parties dealing wholly independently and behaving in a commercially rational manner, for instance because the relatively high cost of the loan produces an outcome for Aus Co, in terms of the profitability, viability or competitiveness of its business, that does not make commercial sense for it, given the options realistically available to it. Assume further that it is not practicable to determine an appropriate arm's length rate of return for the debt interest on the basis of how it has actually been structured.

Assume that the information available to the Commissioner in this case supports a conclusion that the closest arm's length scenario at which a loan might reasonably be expected to exist between independent parties dealing wholly independently with one another is a loan of \$250 million at 10%, provided a further \$50 million of equity is raised.

In this case, a reduced value for the debt interest, being an arm's length value, should be used to determine the amount of transfer pricing benefit Aus Co has received, since that best ensures consistency with the relevant OECD guidance. The fact that Aus Co's debt amount is less than its safe harbour debt amount for Division 820 purposes is not relevant to determining the amount of the transfer pricing benefit.

This information is used to work out the amount of Aus Co's transfer pricing benefit (\$15 million), by applying the 10% interest rate to the

actual debt amount of Aus Co (\$300 million), and comparing this to Aus Co's actual debt deductions of \$45 million.

What documents are relevant to determining when an entity gets a transfer pricing benefit and the amount of that benefit?

1.42 There are two rules for the documents relevant to the interpretation of section 815-22. One rule applies prospectively and a transitional rule applies for income years prior to the 2012-13 income year but beginning on or after 1 July 2004.

1.43 In determining the transfer pricing benefit of an entity for the 2012-13 income year or later income years, section 815-22 should be interpreted so as to best achieve consistency with:

- the 'Model Tax Convention on Income and on Capital' published by the OECD on 22 July 2010;
- the 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration' published by the OECD on 18 August 2010; and
- any other documents prescribed by the regulations for this purpose.

[Schedule #, item #, subsection 815-25(1)]

OECD guidance material

1.44 This Subdivision refers to OECD guidance material, which is the Model Tax Convention on Income and on Capital and the Transfer Pricing Guidelines for Multinational Enterprises referred to above.

1.45 The 2010 OECD guidance material represents the current internationally accepted position in this area and has been adopted by Australia's major trading partners and other developed economies. The utilisation of the OECD standard by different jurisdictions in this way has promoted consistency in the application of transfer pricing rules internationally.

1.46 The phrases 'best achieves consistency' and 'to the extent the documents are relevant' set out the requirements that the OECD material be used in this way, and are intended to provide sufficient flexibility to accommodate any discrepancies between the specific text of a given transfer pricing article and the equivalent OECD Model provision to which the relevant guidance material relates. Where a transfer pricing article deviates in substance from the relevant OECD Model provision, the guidance material in relation to that aspect of the Model would not be

relevant and should not apply in interpreting the transfer pricing article. [Schedule #, item #, subsection 815-22(3)]

Regulation making power in relation to documents

1.47 Section 815-25 provides regulation making powers to prescribe a document, or a part of a document, that may be used for purposes of achieving interpretive consistency as well as the circumstances in which it may be used. [Schedule #, item #, paragraph 815-25(1)(c) and subsection 815-25(3)]

1.48 These regulation powers are included so that additional documents or parts of a document may be prescribed as being relevant for interpreting section 815-22. This ensures sufficient flexibility to prescribe further guidance material that may be published by the OECD or by other organisations that may be relevant for interpretive purposes in the future. Such material might be supplementary in nature or address issues that are not considered by the current OECD material. [Schedule #, item #, paragraph 815-25(1)(c)]

1.49 A regulation making power is also included which permits the OECD material referred to in paragraphs 815-25(1)(a) or (b) to be disqualified as a document relevant to interpreting section 815-22. This regulation making power would allow material to be removed where it is no longer relevant to determining whether an entity receives a transfer pricing benefit, or the amount of that benefit. This might occur where updated material is published by the OECD, or if an alternate model or guidance material is adopted in the future. The regulation making power may also disqualify a part of a document, which may for example be used in situations where Australia makes an observation to that part of the document. [Schedule #, item #, subsection 815-25(2)]

1.50 A regulation that prescribes or disqualifies an additional document, or part thereof, may also prescribe the circumstances under which the document, or part, is to be used or disqualified. This might be used to accommodate circumstances in which the document relates to specific provisions contained in some transfer pricing articles but not in others. Where this is the case it would be appropriate to indicate that the prescribed document is to be considered in applying the relevant transfer pricing articles only. Similarly, a regulation that disqualifies a document under paragraph 815-25(1)(b) or (c) may prescribe the circumstances in which the document is to be disregarded. [Schedule #, item #, subsection 815-25(3)]

Income years prior to the 2012-13 income year

1.51 For income years prior to the 2012-13 income year to which this Subdivision applies, the relevant version of the above OECD documents

are those that were last published before the start of the relevant income year. *[Schedule #, item 20, section 815-25]*

Example 1.5 Documents relevant to an income year

An entity to which the UK Agreement applies has related party dealings in relation to an income year which commenced on 1 July 2007. When determining whether an entity gets a transfer pricing benefit and the amount of that benefit under subparagraph 815-22(1)(a)(iii) section 815-22 should be interpreted so as best to achieve consistency with:

- the OECD Commentary on that article as published on 15 July 2005 (the last update prior to 1 July 2007), insofar as Article 9 of the Australia-UK Agreement accords with the Associated Enterprises Article of the OECD Model, and given that Australia has expressed no observations to it; and
- the version of the Transfer Pricing Guidelines incorporating all changes as adopted by the OECD's Committee on Fiscal Affairs up to 30 June 1999 (the last update prior to 1 July 2007) and approved by the OECD Council on 28 October 1999.

When can the Commissioner make a determination under this Subdivision?

Determinations in relation to an entity's tax position

1.52 Where an entity receives a transfer pricing benefit under subsection 815-22(2), subsection 815-30(1) empowers the Commissioner to make determinations to ensure the entity's liability to tax appropriately reflects the transfer pricing benefit that it receives. Paragraphs 815-30(1)(a) to (c) authorise the Commissioner to make determinations to increase an entity's taxable income, decrease its tax loss, or decrease its net capital losses. Depending on the nature of the transfer pricing benefit received by the entity, the Commissioner may make one or more determinations in order to ensure the adjustments made to alter the entity's tax liability appropriately reflect the transfer pricing benefit. In bringing the transfer pricing benefit to tax, both the nature and the amount of the transfer pricing benefit will be relevant. *[Schedule #, item #, paragraphs 815-30(1)(a) to (c)]*

1.53 A determination made under subsection 815-30(1) will only affect an entity's liability to tax through an overall adjustment to its taxable income, tax loss or net capital losses. Such a determination will not impact upon the way in which the entity is treated by other areas of the tax law because it will not apply to individual items of the entity's

assessable income, particular deductions, particular capital gains, or particular capital losses.

1.54 Where the amount of the transfer pricing benefit relates to more than one component of the entity's income, to more than one income year, or to multiple components over multiple income years, the Commissioner may make a series of determinations to ensure that the necessary adjustments appropriately reflect the transfer pricing benefit.

Determinations in relation to particular items of income

1.55 Subsection 815-30(2) allows the Commissioner to determine that adjustments to an entity's taxable income, tax loss, or net capital losses made under subsection 815-30(1) are attributable to a change in a particular amount of one or more of the following:

- an increase in assessable income for an income year under a particular provision of the Act;
- a decrease of a particular deduction for an income year;
- an increase of a particular capital gain for an income year; and
- a decrease of a particular capital loss for an income year.

[Schedule #, item #, paragraphs 815-30(2)(a) to (d)]

1.56 The Commissioner may make a further determination under subsection 815-30(2). This will not be required except where Division 820 applies for a relevant income year. In other circumstances it will be appropriate for the Commissioner to make a further determination under subsection 815-30(2) to ensure that any adjustments made to the entity's overall tax position interact appropriately with other provisions of the Act (for example, adjustments that relate to capital gains or other expenditure subject to special rules under the Act).

1.57 Unlike a determination made under subsection 815-30(1), a determination made under subsection 815-30(2) has effect for all purposes of the Act. Where an entity's transfer pricing benefit is calculated by reference to specific items, subsection 815-30(2) empowers the Commissioner to make a further determination specifying the extent to which the individual item is affected. A determination that is made under this subsection in relation to a particular amount will impact the way in which it is treated by other provisions of the Act. *[Schedule #, item #, subsection 815-30(2)]*

1.58 Although a further determination under subsection 815-30(2) must relate to a determination made under subsection 815-30(1), it is not necessary for the further determination to specify the relevant increases or decreases to individual amounts to the full extent of the determination under subsection 815-30(1). The Commissioner may determine that a part of the amount which becomes subject to tax under subsection 815-30(1) is attributable to an amount specified under subsection 815-30(2), but make no further determination in relation to the remainder. In this sense, although determination under subsection 815-30(2) might provide further detail in relation to the underlying components of the determination made under subsection 815-30(1), it is not necessary for further detail of this kind to be provided in relation to every component.

A further determination must be made where the thin capitalisation rules apply

1.59 Where the thin capitalisation rules contained in Division 820 apply to an entity for an income year and the Commissioner makes a determination under subsection 815-30(1) in relation to that income year, the Commissioner is required to make a further determination under subsection 815-30(2) in respect of the extent to which the determination is attributable to the debt deductions of the entity. [*Schedule #, item #, subsection 815-30(3)*]

1.60 Subsection 815-30(3) provides an exception to the general position that the Commissioner may exercise discretion in making a further determination under subsection 815-30(2). Because the thin capitalisation rules apply to the whole amount of the entity's otherwise allowable debt deductions, the further adjustment under subsection 815-30(2) is necessary to directly affect the entity's deductions for the purposes of applying Division 820. If this did not occur, the entity would still be liable to tax for the appropriate amount of the transfer pricing benefit calculated under section 815-22 (which takes into account the arm's length rate of return that must be applied to the debt interest), but continue to be subject to Division 820 in relation to the unadjusted debt deductions.

1.61 Given the operation of subsection 815-22(4), the amount of an entity's transfer pricing benefit is limited to an adjustment to the rate of return on the debt interest. It follows therefore that any further determination under subsection 815-30(2) can only apply to the rate of return.

1.62 Where the determination made under subsection 815-30(1) relates to an income year in which Division 820 applies to an entity, but the determination itself does not affect the entity's debt deductions, the Commissioner may state in the further determination under subsection

815-30(2) that none of the entity's debt deductions are affected by the determination.

Example 1.6 Making a further determination where the thin capitalisation rules apply

The facts are the same as in Example 1.2, above. Aus Co gets a transfer pricing benefit of \$10 million and the Commissioner makes a determination to ensure the benefit is subject to tax by increasing the amount of Aus Co's taxable income. As Division 820 applies to Aus Co, the Commissioner further determines that the increase is wholly attributable to a reduction in the amount of debt deductions allowable to Aus Co.

Following these determinations, the amount of Aus Co's debt deductions that are otherwise allowable as a result of the application of Subdivision 815-A is \$40 million. This amount applies for all purposes of the Act. Section 820-220 then operates to deny \$2.5 million of Aus Co's remaining \$40 million of debt deductions because, by reference to the statutory safe harbour debt amount applied by the Aus Co, it has excess debt of \$25 million.

The total debt deductions disallowed to Aus Co are \$12.5 million (\$10 million under Subdivision 815-A and \$2.5 million under Division 820).

Multiple income years and/or determinations

1.63 Where the Commissioner makes a number of determinations that relate to different income years, these determinations may be set out under a single document. Similarly, where determinations are made under both subsection 815-30(1) and (2), or different determinations are made under either of those subsections, the Commissioner may also set these determinations out under a single document. *[Schedule #, item #, paragraphs 815-30(7)(a) to (d)]*

1.64 Subsection 815-30(7) allows the Commissioner to deal with the amount of the transfer pricing benefit as a whole and avoids the need to issue multiple documents in respect of individual income years or the determinations to which the transfer pricing benefit relates.

Actions by the Commissioner

1.65 In giving effect to a determination under subsections 815-30(1) or (2), the Commissioner may take any action that is considered necessary. Such action could include, for example, amending an assessment to ensure the transfer pricing benefit is subject to tax. *[Schedule #, item #, subsection 815-30(4)]*

1.66 Subsection 815-30(5) imposes a positive obligation upon the Commissioner to provide a copy of any determination that is made under subsections 815-30(1) or (2) to the entity to which they relate. Although there is a statutory obligation upon the Commissioner in this regard, the failure to provide a copy of the determination is not of itself sufficient to invalidate the determination. [*Schedule #, item #, subsection 815-30(5) and (6)*]

Consequential adjustments

What is the purpose of a consequential adjustment?

1.67 Where there is an adjustment to the Australian tax position of an entity under subsection 815-30(1), there are rules that provide for consequential adjustments which ensure taxpayers are not subject to double taxation within Australia. The taxpayer can be either the entity subject to the section 815-30 determination, or any other entity. [*Schedule #, item #, paragraph 815-45(1)(b)*]

When would this provision apply?

1.68 This provision would only apply to authorise the Commissioner to make a consequential adjustment in favour of the entity or another entity where:

- the Commissioner makes a determination under subsection 815-30(1) to increase the taxable income (or reduce its taxable losses or capital losses) of an entity or a permanent establishment of an entity;
- the entity, or another entity might have been expected to have a smaller taxable income, a greater tax loss, a greater amount of net capital losses, or a smaller amount of withholding tax payable in respect of interest or royalties, had there been no transfer pricing benefit; and
- the Commissioner is satisfied that it would be fair and reasonable in the circumstances to make the consequential adjustment.

1.69 In order for the Commissioner to make a consequential adjustment, the Commissioner must form an opinion that it is fair and reasonable to do so, both from the point of view of the taxpayer and the revenue.

How would a consequential adjustment be made?

1.70 The Commissioner may make one or more determinations to reflect the consequential adjustments by:

- decreasing the taxable income of an entity for an income year;
- increasing the tax loss of an entity for an income year;
- increasing the net capital losses of the entity for an income year;
- decreasing the withholding tax payable by the entity in respect of interest or royalties

[Schedule #, item #, paragraphs 815-45(2)(a) to (d)]

1.71 In such case, a copy of the determination must be provided to the taxpayer. A failure by the Commissioner to provide a copy of the determination will not, however, affect its validity. Determinations relating to different income years may be included in the same document. *[Schedule #, item #, subsections 815-45(5) and (6)]*

1.72 The Commissioner may also take necessary actions to give effect to the determination. An example of such actions is the remission of the relevant tax paid by the entity subject to the determination under this section, notwithstanding the absence of a specific provision in the law to that effect. *[Schedule #, item #, subsection 815-45(3)]*

Can an entity request a determination be made under this section?

1.73 A taxpayer may give the Commissioner a written request to make a determination under this section, and the Commissioner must decide whether or not to grant the request and give notice of the decision. *[Schedule #, item #, subsection 815-45(4)]*

1.74 If an entity is dissatisfied with the Commissioner's decision, the entity may object against the decision in accordance with Part IVC of the *Taxation Administration Act 1953*. This is designed to extend the benefit of the ordinary objection and appeal provisions to a taxpayer dissatisfied with any decision of the Commissioner not to make a consequential adjustment in favour of the taxpayer. *[Schedule #, item #, subsection 815-45(8)]*

Example 1.7

An Australian resident company has paid interest on a loan to a foreign resident associated entity. In accordance with the arm's length

principle, the Commissioner determines that the interest is excessive and makes a determination under subsection 815-30(1) to increase the taxable income of the Australian entity.

The payment to the non-resident company is subject to interest withholding tax. In these circumstances, the Commissioner determines that it is reasonable and fair to make a consequential adjustment in respect of the interest paid to the foreign company in excess of the arm's length amount that was subject to interest withholding tax.

To give effect to the determination the Commissioner remits the relevant amount of interest withholding tax to the foreign resident.

How does this Subdivision ensure that a transfer pricing benefit is not subject to double tax?

1.75 To avoid double taxation, a transfer pricing benefit that is subject to tax as the result of the application of this Subdivision will not be subject to tax again under any other provision of this Act. *[Schedule #, item #, subsection 815-50(1)]*

1.76 This rule over-rides section 136AB, which ordinarily provides that nothing in the Act would limit the operation of Division 13. *[Schedule #, item #, subsection 815-50(2)]*

1.77 In some cases both Division 13 and Subdivision 815-A may apply to an entity in an income year, but in doing so apply discretely to separate amounts. Where this is the case, subsection 815-50(1) does not prevent the application of Division 13 to amounts not subject to tax under this Subdivision. *[Schedule #, item #, subsection 815-50(1)]*

1.78 Nothing in this Subdivision limits Division 820 in its application to further reduce the debt deductions of an entity. An adjustment under Division 820 itself does not give rise to double tax as the Commissioner is required to make a further determination under subsection 815-30(2) in relation to the debt deductions of the entity. This is consistent with the current administrative approach provided in Taxation Ruling TR 2010/7.

1.79

Consequential amendments

1.80 Subsections 170(9B) and 170(9C) provide that the Commissioner is able to make adjustments for the purposes of giving effect to either Division 13, tax treaties or international tax sharing agreements at any time. These amendments make certain that the same

conditions apply to give effect to determinations made under Subdivision 815-A applies. *[Schedule #, items 1 and 4, subsection 170(9B) and paragraph 170(9C)(b)]*

1.81 An item updates the checklist in section 10-5 to include a reference to distributions of cross-border transfer pricing. *[Schedule #, item 5, section 10-5]*