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# Justice and International Mission Unit
# Synod of Victoria and Tasmania, Uniting Church in Australia

## Submission to
## Income tax: cross border profit allocation. Review of transfer pricing rules
## Consultation Paper
**December 2011**

The Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church in Australia (the Unit) welcomes this opportunity to make a submission to the "Income tax: cross border profit allocation. Review of transfer pricing rules" consultation paper.

**The Uniting Church's position on Taxation**

The Uniting Church in Australia, Synod of Victoria and Tasmania, is deeply concerned with ensuring tax justice. In 1997 the annual meeting of the Synod of Victoria passed a resolution:

*(a) To affirm the principle that the payment of taxes is a moral responsibility that goes with citizenship;*

*(b) While acknowledging that taxation reform is a complex issue, to recommend to the Federal Government that the following guidelines need to undergird any reform of the Australian Taxation System:*

- *(i) that the taxation system be primarily progressive and just;*
- *(ii) that the taxation system encourage a responsible use of our resources and stewardship of the environment;*
- *(iii) that the taxation system be designed in such a way as to lessen the gap between the rich and the poor;*

*(c) To urge the Federal Government to incorporate within the Tax Reform agenda a resolution of Commonwealth-State taxation issues in such a way as to minimise State Government dependency on gambling taxes; and*

*(d) To inform the Federal and State Government of this resolution.*

In 2008 the annual meeting passed a resolution:

*to become a member of the Tax Justice Network and support its aims to:*

- *(a) promote sustainable finance for development;*
- *(b) promote international co-operation on tax regulation and tax related crimes;*
- *(c) oppose tax havens;*
- *(d) promote progressive and equitable taxation;*

*(e) promote corporate responsibility and accountability; and*
*(f) promote tax compliance and a culture of responsibility*

The Synod of Victoria and Tasmania has seen taxation as playing a vital role in ensuring a just society and a just world. The money lost by developing countries from trade mispricing is vast. Anti-corruption non-government organisation, Global Financial Integrity, estimated collectively developing countries lost US$418 billion from trade mispricing in 2009, much of this money laundered through secrecy jurisdictions. Africa lost US$25 billion in trade mispricing, while the Philippines lost US$8.1 billion, Cambodia US$721 million and Indonesia US$8.5 billion.[1] Globally overseas aid in 2009 was only US$120 billion.

In 2009, Christian Aid commissioned international trade pricing expert, Associate Professor Simon Pak, president of the Trade Research Institute and an academic at Penn State University in the US, to analyse EU and US trade data and estimate the amount of capital shifted from non-EU countries into the EU and the US through bilateral trade mispricing. Professor Pak, who has advised US Congress on this issue, analysed bilateral trade in every product between 2005 and 2007, calculated the parameters of the normal price range for products traded between countries, and estimated the amount of capital shifted by trades that are outside that normal price range. He calculated the flow of capital from non-EU countries to the EU and US through trade mispricing over that period was in the order of US$1.1 trillion, resulting in lost tax revenues to non-EU governments of US$365 billion.

The Christian Aid commissioned calculations also found that Australia lost 1.1 billion euros in tax revenue through trade mispricing to the EU in the period 2005 – 2007 and US$1.5 billion in tax revenue through trade mispricing to the US in the same period.[2]

The Unit notes with concern the significant growth in relation to intra-firm trade with regards to interest and insurance, and service components, both of which have more than doubled over the period 2002 – 2009.[3] It is these areas in which the OECD 'arm's length' pricing principles are most open to failing to deal with tax evasion. The ATO Compliance Plan for 2010-11 notes this concern.[4]

The Unit supports efforts by the Australian Government, including the ATO, to limit tax evasion through trade mispricing. The Unit agrees tax on corporations should be based on their economic contribution in Australia: through functions performed in Australia, the assets used or contributed by Australian entities, and the risks assumed on the Australian side. While the Unit agrees that as far as practicable trade pricing rules should be aligned with and interpreted consistently with international transfer pricing standards, it believes the Australian Government should advocate for those transfer pricing standards to be effective in stemming tax evasion through trade mispricing.

The Unit accepts the OECD Guidelines constitute the transfer pricing standards of many of Australia's major investment partners and therefore applying them to revised laws makes sense at this time.

The rules need to cover non-arm's length dealings of unrelated parties as well as intra-entity dealings.

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[1] Dev Kar and Sarah Freitas, 'Illicit Financial Flows from Developing Countrie Over the Decade Ending 2009', Global Financial Integrity, December 2011, pp. 5, 48-50.
[2] David McNair and Andrew Hogg, 'False profits: robbing the poor to keep the rich tax-free', Christian Aid, March 2009. pp.20, 27.
[3] The Treasury, 'Income tax: cross border profit allocation. Review of transfer pricing rules', Consultation Paper, 1 November 2011, p. 2.
[4] Ibid. p.3.

The Unit supports the arm's length principle applying to the profits of the associated enterprises, not being limited to prices of particular transactions.

In trying to make the arm's length principle work, the Unit supports listing comparability as a factor that should be taken into account in deciding which method is most appropriate and in applying that method. The 2010 OECD Guidelines provide for selection of methodology taking into account comparability. However, the arm's length principle is put under severe strain when truly comparable transactions are not available.

The Unit is supportive of the ATO's powers under section 167 to make an assessment or amend an assessment of taxable income when not satisfied with the return furnished by the taxpayer, particularly where the taxpayer has failed to cooperate.

The Unit is supportive of requirements to ensure taxpayers maintain contemporaneous transfer pricing documentation to ensure they are paying their legal tax obligations. The Unit also supports linking the proposed requirement to keep contemporaneous documentation to the penalty rules of revised profit allocation rules.

The Unit is supportive of Division 284 being extended to allow for the base penalty amount to be increased by 20% where a taxpayer does not provide reasonable cooperation in the course of an examination of the taxpayer's affairs.

The Unit agrees that penalties should be linked to the level of cooperation and good faith efforts made by the taxpayer to comply with their legal obligations. Higher penalties should apply where the tax shortfall is due to the taxpayer's recklessness or intentional disregard of the requirements of the profit allocation rules.

The Unit supports that any time limit for amendment in a transfer pricing case should allow for additional time where delays are created by taxpayers due to lack of reasonable cooperation or hindrance or obstruction prevent the ATO from finalising a profit allocation examination within the statutory time limit. Further, additional time should be allowed where a secrecy jurisdiction fails to provide the information needed to the ATO. The Unit is supportive of the formulation on time limits for adjustments as outlined in Australia's recent tax treaties, as outlined in page 26 of the Consultation Paper.

While supporting the efforts to combat tax evasion through transfer mispricing outlined in the Consultation Paper, the Unit is concerned about the limitations of the 'arm's length' principle and would urge supporting other methods at a multilateral level to combat tax evasion through transfer mispricing. There is great scope for misunderstanding or deliberate mispricing in areas around intellectual property such as patents, trademarks and other proprietary information within the arm's length principle. Multinational enterprises arise in large part due to organisational and internalisation advantages relative to the efforts of unrelated, separate companies that seek to do business with one another. Such advantages mean that within multinational enterprises, profit is generated in part by internalising transactions within the firm. Thus, for companies that are truly integrated across borders, holding related entities within the commonly controlled group to an 'arm's length' standard for pricing of intracompany transactions does not make sense, nor does allocating income and expenses on a country-by-country basis.[5] Reuvan Avi-Yonah (2009) argues the arm's length transfer pricing rules have spawned a huge industry of lawyers, accountants and economists whose professional role is to assist multinational companies in their transfer pricing planning and compliance. He concludes that no matter how assiduously one performs "functional

[5] Reuven S. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation', University of Michigan Law School, Paper 102, 2009.

analyses" designed to identify "uncontrolled comparables" that are reasonably similar to members of multinational groups, one is rarely going to find them. He argues such comparables have not been found with sufficient regularity to serve as the basis for a workable transfer pricing system.

The Unit believes the Australian Government should support the development of a new international norm to eventually replace the OECD arm's length principle using combined reporting, with formulary apportionment and Unitary Taxation.[6] This would prioritise the economic substance of a multinational and its transactions, instead of prioritising the legal form in which a multinational organises itself and its transactions.

Unitary taxation originated in the US over a century ago, as a response to the difficulties US states were having in taxing railroads. Over 20 states inside the US, notably California, have set up a system where they treat a corporate group as a unit, then the corporate group's income is "apportioned" out to the different states according to an agreed formula. Then each state can apply its own state income tax rate to whatever portion of the overall unit's income was apportioned to it. Such a formula allocates profits to a jurisdiction based upon real factors such as total third-party sales; total employment (either calculated by headcount or by salaries) and the value of physical assets actually located in each territory where the multinational operates. The Unit recognises there are technical and political complexities involved in designing such an "apportionment" formula. However, limited forms of unitary taxation have been shown to work well in practice.

The aim of unitary taxation is to tax portions of a multinational company's income without reference to how that enterprise is organised internally. Multinational companies would have far less need to set themselves up as highly complex, tax-driven multi-jurisdictional structures and are likely to simplify their corporate structures, creating efficiencies. The bid losers are those consultants who derive substantial income from setting up and servicing complex tax-driven corporate structures.

Hybrid versions of the arm's length and unitary taxation system are possible as interim steps.[7]

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[6] Tax Justice Network, 'Transfer Pricing', http://www.taxjustice.net/cms/front_content.php?idcat=139; and The Hamilton Project, 'Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment', The Brookings Institute, Policy Brief No. 2007-08, June 2007.
[7] Reuven S. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation', University of Michigan Law School, Paper 102, 2009.