



cutting through complexity

Global Transfer Pricing Review

Australia

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TAX



Australia



KPMG observation

The transfer pricing landscape in Australia continues to be one of evolution, if not revolution. Notwithstanding the recent introduction of new and far reaching transfer pricing laws based on self-assessing ‘transfer pricing benefits’ by reference to ‘arm’s length conditions’ (Subdivision 815) and the concurrent introduction of new transfer pricing record keeping rules (Subdivision 284-E), the government has announced further legislative changes aimed at keeping Australia at the forefront of jurisdictions seeking to tackle erosion of their tax base and non-arm’s length profit shifting.

The government has announced a series of measures that would, if enacted, apply to large businesses (i.e. multinational enterprises (MNEs) with global sales of more than 1 billion Australian dollars (AUD)):

- amendments to Australia’s general anti-avoidance rules to apply where the structure put in place is such that a foreign resident connected with a low or no corporate tax jurisdiction avoids income being attributed to an Australian permanent establishment and taxed in Australia
- a doubling of penalties in relation to transfer pricing adjustments and the operation of the proposed anti-avoidance provision where a reasonably arguable position has not been established
- implementation of the Organisation for Economic Co-operation and Development’s (OECD’s) Country-by-Country reporting requirements; and
- implementation of the OECD’s Master File/Local File approach for transfer pricing documentation.

Most of the above measures would apply for years of income commencing on or after 1 January 2016.

Australia continues to be a strong supporter of the OECD/G20 Base Erosion and Profit Shifting (BEPS) initiative and the BEPS project has clearly influenced the above legislative proposals.

Further, the Senate Economics References Committee ‘Corporate Tax Avoidance’ inquiry which began public hearings in April 2015 continues to grab headlines about the tax practices of foreign-based and Australian-based MNEs. The Committee has heard evidence from MNEs operating in a range of industries including information technology, mining, pharmaceutical and oil and gas. The committee was originally due to report by June 2015, however, its reporting date has been extended.

A range of tax transparency measures are designed to provide the Australian public with information about the amount of tax paid in Australia by large companies. Some of these are already on the statute books, and are expected to generate significant public interest. For example, under current law, the Commissioner is required to disclose annually the following information on a public website for companies with turnover greater than AUD100 million: accounting income, taxable income, and tax paid. The first information (relating to the 2013–14 income year) is expected to be released in the final quarter of 2015.

The government has also begun working with businesses to develop a voluntary code on public disclosure of greater tax information by large corporates and has requested the Board of Taxation to lead the development of the new transparency code.

Transfer pricing study snapshot

The purpose of a transfer pricing study

	Applicable	Not applicable	Required to be contemporaneous
Legal requirements		●	
Protection from penalties	●		●
Reduce risk of adjustment	●		
Shifts burden of proof		●	

Basic information

Tax authority name

Australian Taxation Office (ATO).

Citation for transfer pricing rules

Current rules

Subdivisions 815-B to D of the Income Tax Assessment Act 1997 (ITAA 1997).

Subdivision 815-B applies to cross-border dealings between separate legal entities that are not undertaken on an arm's length basis. Subdivision 815-C applies to cross-border dealings within a single legal entity (e.g. between an Australian permanent establishment (PE) of a non-resident entity and its overseas head office, between a foreign PE of an Australian resident entity and the Australian head office). Subdivision 815-D makes Subdivisions 815-B and 815-C applicable to trusts and partnerships.

Previous rules

Division 13 of Part III of the Income Tax Assessment Act 1936 (ITAA 1936).

Subdivision 815-A of the ITAA 1997.

Citation for transfer pricing record keeping rules

Subdivision 284-E of Schedule 1 to the Taxation Administration Act 1953 (Subdivision 284-E).

Effective date of transfer pricing rules

Current rules

Years of income commencing on or after 29 June 2013.

Previous rules

Division 13 applies to assessments in respect of the year of income in which 28 May 1981 occurred and for all subsequent years up to its date of repeal on 29 June 2013.

Subdivision 815-A applies to years of income commencing on or after 1 July 2004 and for all subsequent years up to years of income commencing before 29 June 2013.

Effective date of transfer pricing record keeping rules

Years of income commencing on or after 29 June 2013.

What is the relationship threshold for transfer pricing rules to apply between parties?

There is no relationship threshold. The relevant test is whether conditions operate between the entity and another entity in connection with their commercial or financial relations that differ from arm's length conditions (i.e. conditions that might be expected to operate between independent entities dealing wholly independently with one another in comparable circumstances).

What is the statute of limitations on assessment of transfer pricing adjustments?

Current rules

Within seven years of the notice of assessment for a particular year.

Previous rules

No time limit for amendment although cannot be applied prior to effective date.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. An International Dealings Schedule (IDS) needs to be lodged with the income tax return where taxpayers

have international related party dealings of more than two million Australian dollars (AUD) per year or any cross-border intragroup dealings involving foreign branches of Australian entities or Australian branches of foreign entities (i.e. there is no minimum threshold for cross-border intra-group dealings). The IDS is used as a risk assessment tool by the ATO to better target its transfer pricing and other international tax compliance activities.

Under the ATO's Advance Pricing Agreement (APA) program, a taxpayer with an APA is required to prepare and submit an Annual Compliance Report to the ATO disclosing the covered transactions, according to the requirements of Practice Statement Law Administration PS LA 2015/4.

There is no formal requirement for taxpayers to provide their transfer pricing documentation to the ATO with the tax return.

What types of transfer pricing information must be disclosed?

The IDS requires detailed disclosures about international related party dealings including: description and amounts of related party transactions, disclosures related to transactions of special interest to the tax authority (e.g. business restructures), disclosures relating to arm's length transfer pricing methods used and whether transfer pricing documentation has been prepared in relation to the various related party transactions disclosed.

What are the consequences of failure to submit disclosures?

An administrative penalty may apply for failure to prepare or submit the IDS.

Transfer pricing study overview

Can documentation be filed in a language other than the local language? If yes, which ones?

No.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes, for all transactions. To satisfy Subdivision 284-E, the transfer pricing documentation must satisfy each of the matters set out in section 284–255 of the ITAA 1997. In broad terms, the matters to be covered include those that Chapter V of the OECD Guidelines recommends be covered, however, there are nevertheless a number of additional matters from both a technical and a process perspective that need to be covered. For example, from a technical perspective, the records must show whether the reconstruction provisions in section 815–130 apply (the reconstruction provisions apply where the form of the relations between the parties is different to the substance of those arrangements and where independent parties would have entered into different arrangements to those that were entered into). From a process perspective, records must be kept in English or be readily accessible and convertible into English and the records must be prepared prior to lodgment of the annual income tax return.

The ATO has set out its views on the documentation that taxpayers should keep to satisfy Subdivision 284-E in Taxation Ruling TR 2014/8.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

Yes.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 28 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

Historically, ATO practice has been to expect documentation to be supplied within 28 days of request, however, we have seen a number of examples recently where the ATO is requiring documentation to be supplied within a shorter time period.

If an adjustment is proposed by the tax authority, what dispute resolution options are available?

Taxpayers have domestic tax law rights to object and appeal against amended assessments. Objections are dealt with by the ATO. Appeals may go to either the Administrative Appeals Tribunal or to the Federal Court.

With a view to reducing the number of cases that go to objection, the ATO has introduced an internal Independent Review process which involves review of the case by a reviewer who has had no prior involvement in the audit.

The ATO also uses Alternative Dispute Resolution (ADR) conducted by private ADR practitioners (including former Federal and High Court judges) in complex disputes involving large market taxpayers.

For tax treaty countries, taxpayers may invoke the Mutual Agreement Procedure (MAP) provisions in Australia's comprehensive Double Taxation Agreements (DTAs).

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

Yes. Penalties can be applied under both the scheme (transfer pricing) penalty provisions in Subdivision 284-C

of TAA 1953 and under the general penalty provisions in Subdivision 284-B of TAA 1953.

Scheme (transfer pricing) penalty provisions

The standard shortfall penalty rate is 25 percent of the tax avoided where the sole or dominant purpose was not to avoid tax and the taxpayer does not have a reasonably arguable position (RAP). Where the sole or dominant purpose was to avoid tax, the shortfall penalty amount is 50 percent of the tax avoided where the taxpayer does not have a RAP. Where the taxpayer meets the RAP standard, the shortfall penalty rate is 10 percent of the tax avoided where the sole or dominant purpose was not to avoid tax. Where the sole or dominant purpose was to avoid tax, the shortfall penalty amount is 25 percent of the tax avoided.

General penalty provisions

There are a number of penalties that can be applied under Subdivision 284-B. Of most relevance are those which apply where there is a shortfall amount. In this case, the penalty rate is 25 percent where a taxpayer has not taken reasonable care. Penalties can be remitted to nil where a taxpayer has a RAP. Where a taxpayer does not have a RAP, penalties can be increased to 50 percent due to recklessness on the part of the taxpayer as to the operation of a taxation law and to 75 percent due to intentional disregard on the part of the taxpayer of a taxation law.

The standard rates can be increased or decreased depending on a range of factors. The Commissioner also has the power to remit some or all of the penalties that would otherwise be imposed.

Interest

In addition a Shortfall Interest Charge (SIC) and General Interest Charge (GIC) may also be applied to tax and penalties. For a more detailed description of these charges and the circumstances under which they are levied visit <http://www.ato.gov.au>.

To what extent are transfer pricing penalties enforced?

Often.

What defenses are available with respect to penalties?

Maintaining documentation that satisfies the requirements in Subdivision 284-E; commercial realism analysis; cooperation with the ATO in providing the information requested; and, voluntary disclosure, preferably before the audit notification.

What trends are being observed currently?

In recent years, the ATO has been very active in scrutinizing taxpayers' transfer pricing practices with a view to protecting Australia's revenue base. The ATO has increased its transfer pricing capability through external recruitment and maintains an annual transfer pricing program of risk reviews and audits. In late 2013, the ATO commenced its International Structuring and Profit Shifting (ISAPS) program. This is in addition to its annual compliance activities which includes its existing transfer pricing review work and its Advance Pricing Agreement (APA) program. The areas covered by the ISAPS program are broader than just transfer pricing and include other corporate income tax areas such as permanent establishments, thin capitalization, controlled foreign companies (CFC), particularly focusing on offshore trading hubs and business restructuring.

From a transfer pricing perspective, transactions with respect to related party loans and guarantee arrangements, royalty arrangements, business restructuring, the transfer of intellectual property and the mining, pharmaceutical and motor vehicle industries continue to receive scrutiny by the ATO. Furthermore, periods of prolonged losses or low profitability continue to be a focus of the ATO (regardless of whether there are material related party transactions or not).

Special considerations

Are secret comparables used by tax authorities?

No.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Yes. Although there is no formal requirement to use local comparables

in an Australian benchmarking study, the ATO generally prefers Australian comparable companies during review or audit. Where a regional set is used for Australian purposes, the ATO will focus on the Australian comparables and their relative position in the set. Where necessary, the ATO will conduct its own analysis to identify Australian comparable companies for benchmarking purposes.

Do tax authorities have requirements or preferences regarding databases for comparables?

No.

Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Yes, sometimes.

Does the tax authority have other preferences in benchmarking? If so, please describe.

The ATO has not published detailed guidance on how benchmarking analyses should be undertaken for purposes of Subdivisions 815-B and 815-C (particularly when using the TNMM). Nevertheless, Subdivisions 815-B and 815-C require arm's length conditions to be determined so as best to achieve consistency with amongst other things the OECD Guidelines. It is therefore implicit that benchmarking analyses are undertaken in a way which best achieves consistency with the guidance on benchmarking analyses contained in the OECD Guidelines.

Historically, the ATO has had a general preference for benchmarking analyses to be based on multi-year analyses (ordinarily five years), to use publicly listed companies (rather than private companies) as comparables and for Australian comparables rather than foreign comparables.

What level of interaction do tax authorities have with customs authorities?

High.

Are there limitations on deductibility of management fees beyond the arm's length principle?

Yes, some. Management fees will generally be deductible provided the quantum is consistent with the arm's

length principle and general income tax deductibility requirements are met.

Are management fees subject to withholding?

No.

Are there limitations on the deductibility of royalties beyond the arm's length principle?

Yes. Royalties will generally be deductible provided the quantum is consistent with the arm's length principle and general income tax deductibility requirements are met.

Are royalties subject to withholding?

Yes.

Are taxpayers allowed to file tax return numbers that differ from book numbers?

Yes.

For Australian subsidiaries of foreign-based multinational enterprises (MNEs)

Year-end adjustments are generally allowed where a written agreement exists between the parties which crystallizes the obligation on the part of one party to make a year-end adjustment to the other party, where a benchmarking study has been undertaken, and where the year-end adjustment is required in order to achieve arm's length conditions between the foreign parent and its Australian subsidiary. However, year-end adjustments have the potential to increase risk especially where there is an unclear transfer pricing policy, the adjustments are applied inconsistently or the characterization of the adjustment is unclear.

For foreign subsidiaries of Australian-based MNEs

The same as above, with the following additional requirement. A year-end adjustment made by an Australian parent to its foreign subsidiary may not be deductible to the Australian parent (i.e. the payment will be considered to be a capital payment) unless it is possible to identify assets or services which have a price and which are being re-priced TD 2014/4.

Other unique attributes?

The new transfer pricing rules are self-assessed

The new transfer pricing legislation is aligned with the more general policy intent of self-assessment. Consequently the new rules are self-executing and therefore place a higher burden on taxpayers, and particularly on public officers, who must form a view prior to the time of lodgment of the income tax return that cross-border related party transactions have been structured and priced on an arm's length basis for tax purposes, for which they may be held accountable.

Apply to independent parties as well as to related parties

As with Australia's previous transfer pricing rules, the new provisions capture non-arm's length dealings between both related and unrelated parties.

Include specific reconstruction provisions

The new transfer pricing rules contain a specific provision that enables transactions to be reconstructed for tax purposes (Section 815–130) in situations where there is (i) inconsistency between the form and substance of a particular arrangement; or (ii) situations where the arrangement is not one that would have been entered into by independent parties acting at arm's length. While section 815–130 was intended to be consistent with the reconstruction provisions described in paragraph 1.65 of the OECD's transfer pricing Guidelines, section 815–130 does not include an 'exceptional circumstances' requirement, and the ATO has confirmed that the potential application of the reconstruction provisions needs to be considered in all cases. The ATO intends to use the reconstruction provisions in section 815–130 to pursue its BEPS agenda and implement the ISAPS program.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Extensive.

If extensive, is the competent authority effective in obtaining double tax relief?

Almost always.

When may a taxpayer submit an adjustment to competent authority?

After an adjustment is proposed to the taxpayer. This will usually be in the form of a position paper.

May a taxpayer go to competent authority before paying tax?

Yes.

Advance pricing agreements

What APA options are available, if any?

Unilateral, bilateral, multilateral.

Is there a filing fee for APAs?

No.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

Yes.

Are there any difficulties or limitations on the availability or effectiveness of APAs?

No. Following a further review of its APA program, the ATO recently issued PS LA 2015/4 setting out its revised practice and procedures in dealing with requests from taxpayers to enter into an APA.

Amongst other things, PS LA 2015/4 formalizes use of the ATO's new 'triage' process in its APA program. Triage assists

the ATO's new APA/MAP and Competent Authority Practice Management Unit (PMU) in determining whether an APA request can and should proceed further. Triage identifies whether there are material impediments to the ATO entering into an APA with the taxpayer by examining the information supplied by the taxpayer and the APA team.

PS LA 2015/4 states that the ATO is less likely to enter into an APA where one or more of the following indicators are present:

- where the arrangements that are the subject of the proposed APA appear to lack commerciality or be primarily tax driven; or
- collateral issues affect the ATO's ability to enter into the proposed APA (collateral issues include carried forward losses being available to a taxpayer and the possible application of Australia's general anti-avoidance provision in relation to the cross-border dealings to be covered by the proposed APA).

Notwithstanding the change in approach in PS LA 2015/4, in practice, APAs are still able to be concluded with the ATO where documentation submitted to the ATO during the APA process shows that profit outcomes in Australia reflect the true economic contribution made by the Australian-based enterprise.

KPMG in Australia

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