

Group Tax



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20 December 2012

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

Sent by email: transferpricing@treasury.gov.au

Dear Sir / Madam,

**Tax Laws Amendment (Cross Border Transfer Pricing) Bill 2013
Modernisation of Transfer Pricing Rules**

Overview

BHP Billiton is the largest taxpayer in Australia and operates in multiple jurisdictions. Cross border transactions are a fundamental part of our business.

We are keen to ensure that any changes to Australia's tax rules maintain the competitiveness of Australian multinational companies and the attractiveness of Australia as a destination for foreign direct investment. Accordingly, we appreciate the opportunity to comment on the *Tax Laws Amendment (Cross Border Transfer Pricing) Bill 2013 Exposure Draft (ED)*.

We consider that any tax legislative reform should respect key principles. In particular, the proposed legislation should not create unnecessary uncertainty or additional complexity, and should ensure Australia continues to be internationally competitive. In addition, we believe legislation should apply prospectively, be general in application and that there be transparency in terms of the purpose of the reforms. Our review of the ED has been undertaken with these principles in mind.

We support Government's policy objective of ensuring Australia's transfer pricing rules are aligned and interpreted consistently with international transfer pricing standards, especially those of our major investment and trading partners. We see this policy as consistent with the principle of maintaining Australia's international competitiveness and appreciate Treasury's transparency in relation to Government's policy objectives through the consultation process.

Our submission seeks to promote a substantive design of the legislation that best gives effect to the Government's policy objectives and reduces the risk of double taxation. Our submission also seeks to eliminate additional systemic uncertainty, complexity and compliance costs, which risks hindering Australia's international competitiveness.

Our concerns are most evident in relation to three aspects of the proposed legislation:

- Approach to incorporation of OECD Guidelines;
- Reconstruction power; and
- Documentation requirements.

These topics are discussed below.

Approach to incorporation of OECD Guidelines

The OECD principles should be incorporated into Australian legislation by reference rather than the ED approach of codification.

The ED attempts to codify certain elements of the OECD Guidelines, but uses different language and concepts. This causes the ED to diverge from the OECD principles. As a consequence, there is a heightened risk of double taxation (and double deductions) arising when the OECD principles are applied inconsistently between countries. Inconsistent application creates additional uncertainty for Australian taxpayers and increases the compliance and administrative burden for companies with Australian transactions.

We recommend that the OECD Guidelines should be incorporated into Australian legislation by reference, consistent with the approach adopted in the UK's domestic legislation and recently adopted by Australia in Subdivision 815-A. We recommend that Subdivision 815-A should be used as the starting point for the new legislation.

We acknowledge that subdivision 815-A only applies to treaty countries. However, this could be addressed by incorporating by reference Articles 7 and 9 of the Model Tax Convention where a treaty does not otherwise apply.

Reconstruction power

Codification of a reconstruction power in the ED goes well beyond the directive of the OECD Guidelines. The OECD Guidelines direct tax administrations to only disregard the actual transactions or substitute other transactions for them in 'exceptional cases.' The 'exceptional circumstances' limitation expressed in the OECD Guidelines is notably absent from the ED.

The reconstruction power in the ED is broad and self executing which is inconsistent with the OECD Guidelines which state at Paragraph 1.64 that:

"Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured."

As noted above, inconsistency with the OECD Guidelines leads to heightened risk of double taxation. Although Mutual Agreement Procedures are available to address this, they involve significant time and cost to taxpayers and the Revenue and provide no guarantee of resolution.

Inconsistency also increases the administrative burden on taxpayers to second guess the tax administration's approach to reconstruction. Under the ED, taxpayers would be required to provide transfer pricing documentation for not just the actual business transaction in question, but also for

one or more hypothetical transactions that were not contemplated in order to ensure penalties do not apply.

Accordingly, we recommend that Treasury:

- adopt a drafting approach consistent with that adopted in respect of Subdivision 815-A; and
- maintain consistency with paragraph 1.65 of the OECD Guidelines by ensuring the legislation and explanatory material is absolutely clear that reconstruction of a transaction should only be allowed in truly 'exceptional circumstances'.

Documentation requirements

The drafting of the rules relating to documentation needs to be revisited to ensure that the provisions give effect to Treasury policy objectives without causing practical hardship for taxpayers. In addition, a fair and reasonable balance needs to be achieved between compliance costs imposed and revenue earned.

We understand that documentation is not strictly mandatory. However, where documentation is required, the ED sets an obligation to create non-standard business reports within significantly constrained timeframes to support transfer prices that go far beyond other countries' domestic requirements (e.g. US, UK, France and Ireland). The impact of this obligation goes beyond what is reasonably required by a taxpayer to support the transfer prices adopted for related party transactions and extends to imposing significant financial penalties for failing to do so.

By way of example, paragraph (b) of sub-section 815-305(2) requires that the documentation explain why the application of Subdivision 815-B "*best achieves consistency*" with the OECD Guidelines. In addition, sub-section 815-305(4) outlines the various elements of information that "must" be included in transfer pricing documentation in respect of "all conditions." Conclusively meeting these requirements will be nearly impossible and would involve significant cost and effort in the attempt.

The proposed new documentation requirements go well beyond what is currently required to qualify for remission of penalties under *Taxation Ruling TR 94/7*. We understand that Treasury's intention is to go no further than the current documentation requirements. In our view, the ED as currently drafted does not reflect this intent.

Accordingly, we recommend that the rules be drafted based on the following key parameters:

- The documentation requirements should not increase the compliance burden for Australian taxpayers when compared to the current requirements.
- Documentation requirements should not be linked to the requirement to establish a reasonably arguable position.
- Penalties should only apply to the extent documentation is inadequate.
- Taxpayers should be allowed adequate time to prepare documentation.
- Compulsory documentation requirements should only apply to material transactions.
- A "carve out" of documentary requirements should be accommodated if a taxpayer has entered into an Advanced Pricing Agreement.

Further contact

We support what the Government is trying to achieve and would welcome an opportunity to work together with Treasury to ensure the modernisation of the transfer pricing rules provides certainty, simplicity and international competitiveness to Australian taxpayers.

When you have had a chance to consider our submission, please contact me on +61 3 9609 3201 if you would like to discuss these matters further.

Yours faithfully



Tony Merlo
Head of Group Tax