

26 February 2016

Manager
Base Erosion and Profit Shifting Unit
Corporate and International Tax Division
The Treasury
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Dear Sir/Madam

Treasury Consultation Paper – Income Tax: cross-border profit allocation – review of transfer pricing rules

The Australian Bankers' Association (**ABA**) appreciates the opportunity to provide comments on Treasury's Consultation Paper *Income Tax: cross-border profit allocation – review of transfer pricing rules (Consultation Paper)*.

With the active participation of its members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

Overview

The Consultation Paper seeks stakeholder views on adopting the new OECD guidance on transfer pricing, *Aligning Transfer Pricing Outcomes with Value Creation*, released in October 2015 (**2015 Report**), in the context of the Australian tax system. Issues to be considered include the timing of implementation of the recommendations, guidance that may be required from the ATO on the uptake of the recommendations, or any unintended consequences that might need to be addressed.

As a general observation the ABA supports the integrity principles that tax paid should reflect the economic activity in the domicile in which it takes place and that excessive related party transactions should not be used to shift profit between domiciles. The ABA also supports, where appropriate, harmonisation of OECD guidelines with Australian transfer pricing legislation in order to ensure cross-border consistency in tax principles and to minimise cross-border compliance and reporting burdens.

The ABA notes that it is intended that Australia's transfer pricing laws be updated to accord with the latest OECD guidelines through the amendment of Australia's transfer pricing legislation in subdivision 815-B of the *Income Tax Assessment Act 1997* to include a reference to the 2015 Report.

The ABA also notes that this Consultation Paper does not propose an update to Subdivision 815-C, Australia's transfer pricing rules in relation to permanent establishments. However, the 2015 Report does reference an earlier 2010 OECD report on the *Attribution of Profits to Permanent Establishments (2010 Report)*. While this area is subject to ongoing OECD and Australian Government work (see below), the incorporation of the earlier 2010 Report into Subdivision 815-C would greatly reduce the uncertainty for financial services businesses.



In addition, many of the revisions and further guidance in the 2015 Report align with the approach in the 2010 Report. Specifically the 2015 Report and 2010 Report focus on ensuring that transfer pricing analysis is based on an accurate delineation of what the associated enterprises actually contribute. The OECD believes guidance in the 2015 Report will reduce BEPS risk and the 2010 Report adopts similar concepts. Therefore it seems reasonable that the 2010 Report should also be adopted and provide a more consistent approach to transfer pricing treatment of permanent establishments and subsidiaries.

This ongoing work includes the OECD work to provide further guidance on the:

- Economically relevant characteristics for determining arm's length conditions for financial transactions involving a fund manager and investor; and
- Attribution of profits as a result of the changes to Article 7 of the Model Treaty.

It also includes the work underway by the Australian Government on responding to the Board of Taxation report on *Tax Arrangements Applying to Permanent Establishments*.

Risk

In relation to the treatment of risk in the 2015 Report, the ABA would make the following points:

- 1) The OECD has already provided considerable bank-specific tax guidance on the subject of risk through its 2010 Report.
- 2) As acknowledged by the OECD report, the guidance provided in the 2010 Report should be taken into account when applying the principles contained in it for financial services entities.
- 3) While there is ongoing work in relation to what constitutes a permanent establishment, the incorporation of the 2010 Report into Subdivision 815-C would greatly reduce the uncertainty for financial services businesses.
- 4) It is important to ensure that there continues to be consistency between the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* and the application of the provisions in Subdivision 815-C.

Further, developing these points, the 2010 Report was a landmark achievement, coming after more than a decade of extensive work by OECD members and involving substantial consultation with the private sector, in particular the banking industry.

As a result of the 2010 Report, a new Article 7 (Business Profits) of the OECD *Model Tax Convention on Income and on Capital*, and related Commentary were approved by the OECD Council on 22 July 2010.

The 2010 Report is far more detailed than the Commentary on Article 7, however the 2010 Report is essentially incorporated by reference, with paragraph 9 of the Commentary stating: "The current version of the Article therefore reflects the approach developed in the [2010] Report and must be interpreted in light of the guidance contained in it".

The 2010 Report contains four parts (and an Appendix and Addendum), including relevantly for current purposes:

- Part II: Special considerations for applying the authorised OECD approach to permanent establishments of banks.
- Part III: Special considerations for applying the authorised OECD approach to permanent establishments of enterprises carrying on global trading of financial instruments.

It is most important to note that Part III of the 2010 Report is not limited in scope and application only to permanent establishments. It will have relevance to the interpretation and application of Article 9 (Associated Enterprises) as well as Article 7.



The nature of all manner of risk within banks, and the resulting tax implications, is canvassed at great length in both Parts II and III of the 240 page 2010 Report.

That is, the OECD has already provided extensive, and relatively recent, transfer pricing guidance on the treatment of risk within banks and other financial services organisations in the 2010 Report. As noted above, critical parts of that Report also apply to separate entities and not just permanent establishments/branches.

Treasury Questions

The Consultation Paper poses four questions.

1) Would there be any significant unintended consequences for Australia if these recommendations are incorporated as relevant Guidance for the purposes of applying Division 815 of the ITAA 1997?

Referencing a point made earlier, the ABA observes that the 2015 Report is not specific to any particular industry sector. What is of particular relevance to banks, the 2015 Report acknowledges and makes specific reference to the 2010 Report. Footnote 2 acknowledges the importance of the regulatory approach to risk allocation for regulated sectors (including banks) and transfer pricing guidance specific to financial services business in the 2010 Report. This report not only provides guidance on Article 7 Permanent Establishments but also Article 9 Associated Enterprises of the OECD Model Tax Convention.

While this area is subject to ongoing OECD and Australian Government work, the incorporation of the earlier 2010 Report into Subdivision 815-C would greatly reduce the uncertainty for financial services businesses.

In addition, many of the revisions and further guidance in the 2015 Report align with the approach in the 2010 Report. Specifically, the 2015 Report and 2010 Report focus on ensuring that transfer pricing analysis is based on an accurate delineation of what the associated enterprises actually contribute. The OECD believes guidance in the 2015 Report will reduce BEPS risk and the 2010 Report adopts similar concepts. Therefore it seems reasonable that the 2010 Report should also be adopted and provide a more consistent approach to transfer pricing treatment of permanent establishments and subsidiaries.

2) Are there any significant challenges with commencing the new Guidance for income years starting on or after 1 July 2016?

The significant increase in the amount of transfer pricing documents required to be prepared by taxpayers through the other OECD BEPS Action items (i.e. Transfer Pricing master file, detailed Transfer Pricing local file, Country-by-Country Reporting, Common Reporting Standard etc.) that have been implemented within the same time period will constrain internal resources. Further consultation on implementation timeframes would be welcome.

The other significant challenge is the level of adoption of the proposed Guidance by other countries that do not follow the Guidelines or delay incorporation into their local law.

3) It is envisaged in section 815-135 of the ITAA that documents to be relied upon in applying Australia's pricing rules can be prescribed by way of regulation. Are there any reasons why regulation (as opposed to legislative amendment) is not the appropriate method for incorporating the recommendations contained within the 2015 OECD report.

Adopting the 2015 Report is a good idea. We are not aware of any significant issues associated with the Guidance being implemented by regulation versus legislation.



Strong banks – strong Australia

4) What new ATO guidance/explanatory materials do you think the ATO will need to prepare (and what existing ATO guidance/explanatory materials will need to be updated) if the changes by the 2015 Report are adopted?

As mentioned for question 1, the 2015 Report is not specific to any particular industry sector. Specific guidance will be required for the regulated sectors such as financial institutions where risk is a significant part of their business operations.

Thank you again for the opportunity to comment on this Consultation Paper.

Yours sincerely

A handwritten signature in black ink that reads 'Tony Pearson'. The signature is written in a cursive, flowing style.

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