

KPMG submission

Consultation Paper

*OECD BEPS Transfer Pricing
Recommendations*

26 February 2016

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Executive Summary

KPMG welcomes the opportunity to comment on the Consultation Paper of *OECD BEPS Transfer Pricing Recommendations*. We support Australia's adoption of the 2015 OECD Report – *Aligning Transfer Pricing Outcomes with Value Creation*.

We believe that while the broad principles of “substance” evaluation on transfer pricing are largely unchanged, they have evolved since the 2013 amendments in a manner that has not been strongly articulated by the ATO. Moreover, the nuanced examples and wording in the 2015 OECD Guidance represent substantive change such that they should not be viewed as a simple continuation of current policy.

Our views on the specific questions raised are as follows:

Unintended consequences. Our view is that the risk of unintended tax technical consequences from adopting the new OECD Guidance is low.

Commencement date. We believe the commencement date be the year of income commencing after 31 December 2016.

Adoption mechanism. Our preference is the regulatory path, so as not to consume parliamentary time that might otherwise be allocated to tax matters.

Required guidance. We consider further ATO guidance in the following areas are required:

- Chapter I – guidance on delineating value creation through day to day control of risks from strategic control of risk, and on the evidence required to support financial capacity to take on risks;
- Chapter II – guidance on how the ATO would support Comparable Uncontrolled Price adjustments, given previous experience of narrow application by the ATO;
- Chapter VI – guidance on value creation related to research and development contracts by associated enterprise, and the role of ex-post analysis to support business propositions;
- Chapter VII – guidance on the benefit test in relation to intra-group services and the ATO's approach to the simplified approach for low-value added services; and
- Chapter VIII – guidance on the ATO's approach to analysing Cost Contribution Agreements.

Detailed comments

1. General

- 1.1 KPMG welcomes the opportunity to comment on the Consultation Paper of *OECD BEPS Transfer Pricing Recommendations* as published by Treasury on 11 February 2016. KPMG supports Australia's adoption of the October 2015 BEPS Action Plan outcomes, including the report on 'Aligning Transfer Pricing Outcomes with Value Creation' (new OECD Guidance).
- 1.2 Our transfer pricing rules and the manner in which transfer pricing is practiced can be viewed at three levels.
- 1.3 Firstly, there is the law including linkages to OECD Guidance. We have seen the "arm's length price" based rules introduced into our taxation law in 1982, which were based on the 1979 OECD Guidance but without a legislative linkage, and changes into "arm's length condition" based on rules in the 2012 and 2013 amendments, which included a legislative linkage to the 2010 OECD Guidance. It is proposed that our arm's length condition rules continue with a linkage to the 2015 OECD Guidance. To the extent that the 2015 OECD Guidance modifies the 2010 OECD Guidance, there is clearly change at this level.
- 1.4 Secondly, there are broad principles or concepts in our transfer pricing rules that are used by the Australian Taxation Office (ATO) and the practitioner community. Indeed, it is thought by some that these principles "overtook" the 1982 legal framework, when profit based methodologies arising from the US came to be adopted more broadly in the OECD countries, including Australia. This level embraces broad international thinking on transfer pricing. Given the 2013 amendments have enabled the ATO to embrace this new, broad international conceptual framework, it is at this level that it can be asserted the new OECD Guidance are "consistent with how the ATO currently applies the transfer pricing rules", particularly in relation to Chapters I and II.
- 1.5 Thirdly, there is a more nuanced and detailed level on which our transfer rules operate. At this level, the particular words and examples adopted by the OECD in the 2015 Guidance are important. The ATO and taxpayers draw upon this new material

to present new and stronger arguments for the various positions of consistency or inconsistency with international norms.

1.6 At the first level, there is clearly change. We had the 2010 OECD Guidance and now we will have the 2015 OECD Guidance embedded in our law. At the third level, it is equally clear that there is change. The guidance is just that – new.

1.7 At the second level, it could be asserted there has been gradual change since the 2013 amendments and the finalisation of the new OECD Guidance. Within this level, most of the change is at the “thinking” and “cultural” level and has not been manifest in the production of material by the ATO.

1.8 This framework has a bearing on our thinking below.

2. Unintended outcomes from implementation

2.1 Our view is that the risk of unintended tax technical outcomes from implementing the new OECD guidance in Australia is low.

3. Commencement date

3.1 The real issue is twofold. Firstly, it is clear that there is change at the third level – nuances, examples and references contained in the 2015 OECD Guidance is clearly different from the 2010 OECD Guidance.

3.2 Secondly, there has been developments and modifications at the second level. These modifications have not been strongly articulated by the ATO. Only a few taxpayers at the fore of transfer pricing disputes with the ATO may be aware of the ‘evolving’ ATO position.

3.3 Given the discussions above, we recommend considering a start date being the year of income commencing after 31 December 2016.

4. Mechanism for adoption

4.1 As legislative change uses valuable ‘parliamentary time’ that might otherwise be allocated to taxation matters, we would prefer to see the changes adopted through regulation.

5. Guidance required

5.1 The need for guidance is clear to all. Our priorities and comments are as follows:

- 5.2 *Chapter I – Day to day control vs strategic control of risk.* In evaluating the actual risk assumed in relation to assets, the new OECD Guidance emphasises capabilities and functional performance to determine the ability to control risks. We recommend clear guidance is required (a) to delineate the day to day control of risks from strategic control of risks and (b) on the evidentiary requirement to support the position taken on such risks.
- 5.3 *Chapter I – Risk structuring and valuation of financial capacity.* We believe guidance is required as to (a) the type of evidence and (b) the level of compliance documentation that is reasonably expected to support risk structuring and valuation positions on financial capacity.
- 5.4 *Chapter II – Application of the Comparable Uncontrolled Price ('CUP') method for commodity transactions.* We agree with the use of the CUP method for commodity transactions, as it represents very important market pricing evidence. However, we are concerned of that the CUP method may be applied too strictly when performing the comparability analysis adjustments. This may result in an inappropriate rejection of the CUP method. We note that, in the recent ATO consultation of overseas 'hubs', any CUP analysis was practically rejected by the ATO.
- 5.5 We would recommend (a) clear and broad guidance on the use of CUPs and CUP adjustments for commodities and (b) the level of compliance documentation that would be reasonably expected.
- 5.6 *Chapter VI – Innovation function and R&D contract issues.* In evaluating the value created by associated enterprises for the purposes of allocation of profits, the new OECD Guidance heavily focuses on the functions performed and the risk assumed by associated enterprises. However, issues relating to economic ownership of intellectual property and the performance of R&D function by associated enterprises is important in evaluating value creation. It is our experience there has not been a clear, consistent approach from the ATO in the past.
- 5.7 We recommend clear guidance on the ATO's approach to delineate associated enterprises value creation relating to R&D contract issues for the purposes of profit allocation.
- 5.8 *Chapter VI – Analysing hard to value intangibles.* In analysing 'hard to value' intangibles, our view is that it is necessary to use valuation techniques as presumptive

evidence about the appropriateness of the ex-ante pricing arrangements. We understand that the OECD is expected to provide further guidance on the implementation of this approach during 2016. It is possible that further OECD guidance is not yet ready if Australia applies the new recommendations from 1 July 2016, making a post-31 December 2016 start date more appropriate as mentioned above.

- 5.9 We recommend ATO provide clear guidance on the expected evidentiary support in relation to the use of valuation techniques for ex-ante pricing arrangements. This guidance should cover controversial issues such as the role of ex-post analysis to support business propositions for transfer pricing.
- 5.10 *Chapter VII – Benefit test.* In our view, the new Chapter VII lacks of guidance on how benefits should be analysed in determining whether intra group services have been rendered or not. Given TR 99/1 does not apply to income years subject to subdivisions 815B to 815D. As such, currently there is no ATO guidance on intra group services. We recommend clear ATO guidance on how benefits should be analysed and documented in order to be compliant with the benefits test.
- 5.11 *Chapter VII – Simplified approach for low value-adding intragroup services.* We note that the OECD has recommended an elective moderate mark-up of 5% for low value-adding intragroup services. The ATO has newly introduced a “management and administration services” simplified transfer pricing record keeping option, where one of the eligibility criteria is that a mark-up of 5% or less on relevant services received or 5% or more for services provided is applied.
- 5.12 We recommend clear ATO guidance on the expected approach and whether the same eligibility criteria for the management and administration services simplified transfer pricing record keeping option would be applied.
- 5.13 *Chapter VIII – Cost Contribution Agreements (CCAs).* The revised Chapter VIII provides high level guidance on how CCAs should be analysed and produce outcomes that are consistent with how and where value is created.
- 5.14 However, it is not clear on how value of contributions made by participants and anticipated benefits from the CCA should be measured. These are two critical concepts in applying the arm’s length principle. We recommend clear ATO guidance on what is expected to be included in the analysis to comply with the requirement.