



Law Council
OF AUSTRALIA

Business Law Section

The Manager
Base Erosion and Profit Shifting Unit
Corporate and International Division
The Treasury
Langton Crescent
PARKES ACT 2600
Via email:

25 February 2016

Dear Sir/Madam

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

We refer to the Consultation Paper in relation to the above matter issued on 11 February 2016 and inviting submissions by 26 February 2016.

As you are aware, the Law Council of Australia is the peak body for the Australian legal profession and through the Taxation Committee of its Business Law Section (**Taxation Committee**) has been an active participant in Treasury consultations regarding the development of Australia's new transfer pricing regime and, more recently, the administrative aspects of the regime through the Division 815 Working Group established by the Australian Taxation Office (**ATO**), albeit now disbanded.

The Consultation Paper invites feedback on the following 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?
- 2 Are there any significant challenges with commencing the new Guidance for income years starting on or after 1 July 2016?
- 3 It is envisaged in section 815-135 of the ITAA 1997 that documents to be relied upon in applying Australia's transfer 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.
- 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 OECD Report are adopted?

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We address each of these matters below.

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?

The Taxation Committee is concerned that, although ‘Aligning Transfer Pricing Outcomes with Value Creation’ (Actions 8-10 : 2015 Final Reports) (**OECD Paper**) has been approved by the Council of the OECD, the 2010 Transfer Pricing Guidelines have yet to be formally updated to reflect the changes proposed in the OECD Paper. Further, as noted at page 5 of the Consultation Paper, there is a proposal to conduct further work and issue additional guidance in 2017. Accordingly, it seems to the Taxation Committee that there is a risk that in the process of doing so, the OECD may make further changes to the wording of the relevant section of the guidelines and that it would therefore be premature to adopt the guidance from the OECD Paper at this stage. Further, even if the OECD Council were to amend the 2010 Transfer Pricing Guidelines precisely in the manner proposed in the OECD Paper, there remains an issue with Australia adopting that guidance in advance of its counterparts as it gives rise to the potential for double taxation. For instance, this could arise where Australia considers that “exceptional circumstances” exist based on the new guidance, but its foreign counterpart does not consider the circumstances fit within the current examples in the 2010 Transfer Pricing Guidelines. We consider this would be a significant and unintended consequence of incorporating the relevant guidance at this time.

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

A key challenge which we foresee concerning the new guidance for income years starting on or after 1 July 2016 is that appropriate administrative guidance (see point 4 below) needs to be in place well in advance to enable affected taxpayers to be confident that they are appropriately addressing the issue in their transfer pricing documentation. We note, in this regard, that the ATO is yet to finalise all of the guidance on Subdivision 815-B, some 2 1/2 years after its commencement, including critical guidance on “consequential adjustments” and a range of financing related transfer pricing issues.

3 It is envisaged in section 815-135 of the ITAA 1997 that documents to be relied upon in applying Australia’s transfer 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.

The Taxation Committee understands that the proposed regulations would operate as a disallowable instrument and, accordingly, will be subject to a level of Parliamentary oversight.¹ On that basis, the Taxation Committee has no objections to the proposed method for incorporating the recommendations.

¹ See discussions at paragraph 3.30 of the Explanatory Memorandum to the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*.

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 OECD Report are adopted?**

As noted above, a critical issue is for appropriate administrative material to be made available to taxpayers to enable their documentation to address the implications of the new guidance.

For example, we consider there is a need to address the interaction between section 815-130 of the *Income Tax Assessment Act 1997* and paragraphs 1.119 to 1.128 of the redrafted Chapter I of the Transfer Pricing Guidelines as proposed in the new guidance. There is currently a discussion of this point (in so far as it relates to the 2010 Transfer Pricing Guidelines) at paragraphs 31, 39, 92, 124 and 175 of Taxation Ruling TR 2014/6. The Taxation Committee considers that it would be beneficial for taxpayers if the ATO more clearly delineated those aspects of the guidance which it considers are relevant to the application of the section, and those that are not. For instance, the ATO appears to take the view that the 2010 Transfer Pricing Guidelines provide the support for defining “substance” (as used in section 815-130) as “economic substance” (see paragraph 92 of TR 2014/16 and also page 5 of the Consultation Paper), but the phrase “exceptional circumstances” (as defined for the purposes of the 2010 Transfer Pricing Guidelines) does not operate to constrain section 815-130.

Should you have any questions regarding this submission or require any further information, in the first instance, please contact the Chair of the Taxation Committee, Adrian Varrasso on 03 8608 2483 or via email at adrian.varrasso@minterellison.com.

Yours faithfully,



Teresa Dyson, Chair
Business Law Section