

Taxation Law Committee

Submission on cross-border profit allocation and income tax - review of transfer pricing rules

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NSW Young Lawyers

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The NSW Young Lawyers Taxation Law Committee (**Committee**) consists of young practitioners from NSW who share an interest in and passion for taxation law. The Committee represents a group of emerging legal practitioners who will be at the forefront of tax planning advice and tax disputes over the coming years.

The Committee thanks Treasury for the invitation to make submissions on the Treasury's "Income Tax: cross-border profit allocation – review of transfer pricing rules" consultation paper. This consultation paper is seeking comment on Australia adopting the 2015 OECD Report "Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10: 2015 Final Reports" (**2015 OECD Report**) in domestic transfer pricing legislation

Summary of Recommendations

The Committee submits that Australia should defer adopting paragraphs 6.186 to 6.212 of the 2015 OECD Report (as that term is defined in the consultation paper) in relation to the valuation of 'hard to value intangibles' on an *ex-ante* basis until further guidance is issued by the OECD on this matter. The Committee submits that this will provide taxpayers with greater certainty in relation to this matter.

The Committee recommends that minor changes should be made to three Australian Taxation Office (**ATO**) taxation rulings.

Question 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 Committee makes no submission in relation to Question 1.

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

The summary section of the part of the 2015 OECD Report amending Chapter VI of the 2010 OECD Guidelines (as that term is defined in the consultation paper) (**Guidelines**) relating to 'hard to value intangibles' states that further guidelines will be issued in this matter during 2016.

The Committee submits that the part of the 2015 OECD Report amending the Guidelines in relation to 'hard to value intangibles' (paragraphs 6.186 to 6.212 of the 2015 OECD Report) should not take effect until this further guidance is issued. Taxpayers will not be able to comply with these Guidelines unless they know, at the time of the sale of an intangible asset, the *ex-ante* criteria that they must assess and ultimately document, in order to have a defensible legal position from a transfer pricing point of view at the time the asset is sold. Further, caution should be exercised in considering *ex-post* criteria (once the further Guidelines have been issued) as this may mean factors can be taken into account (which may occur years after the intangible was sold) that were not foreseeable by a taxpayer at the time of sale, making it difficult (if not impossible) for taxpayers to defend their position or have certainty that the position reached at the time of sale was appropriate.

The Committee recommends that the regulation adopting the 2015 OECD Report ensures that paragraphs 6.168 to 6.212 of the 2015 OECD Report will not take effect until the OECD issues further relevant guidelines on how to value hard-to-value intangibles on an *ex-ante* basis.

Question 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 Committee submits that regulation is the most appropriate method for incorporating the 2015 OECD Report into domestic legislation. This would have two benefits.

Firstly, the regulations could be made subject to the *Legislative Instruments Act 2003* (Cth) to ensure that they are reviewed at least once every 10 years.

Secondly, it would provide increased flexibility as any updates to the OECD guidelines could be able to be enacted more easily and efficiently as they will not be required to pass both Houses of Parliament.

Question 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?

(a) Re-charging of service fees in relation to intra-group services

The Committee submits that the revisions to Part VII of the Guidelines in relation to 'low value-adding intra-group services' may provide considerable benefits to both taxpayers and the ATO. By simplifying the process for determining whether intra-group services are deductible this will give taxpayers the option of certainty and savings in time and expense in relation to planning their affairs. Likewise, where companies opt-in to this regime, it should similarly result in the saving of time for the ATO in relation to auditing the relevant taxpayer's intra-group service arrangements.

However, in order to give companies the best opportunity to opt-in to this regime, the ATO will need to issue guidance as to what they consider to be 'low value-added services' and to ensure that taxpayers do not allocate services which are not 'low value-added services' to the 'low value-added' cost pool or vice versa (for instance, there may be some cross-over between management services that are supportive in nature and those which occur in the course of producing the ultimate goods or services which the business provides to the market). Further, it is noted that the new 'low value-added services' regime may not be entirely consistent with the current guidance that the ATO has issued on the recharge of intra-group services in Taxation Ruling TR 1999/1 (see

particularly paragraphs 77 to 85 of this ruling). In light of the changes to the OECD guidelines, the Committee submits that the ATO will need to clarify its guidance in due course.

**(b) Minor updates need to be made to Taxation Ruling TR 97/20
Income Tax: arm's length transfer pricing methodologies for
international dealings ("TR 97/20")**

The Committee submits that TR 97/20, and particularly paragraph 3.52 of this ruling, needs to be further updated to take account of further guidance at pages 59 and 60 of the 2015 OECD Report. Essentially, the 2015 OECD Report considers that selecting the most appropriate method where inexact comparables are available for a particular method (essentially the other four main methods specified in the Guidelines), is the preferred method over the use of a profit split method.

The 2015 OECD Report suggests that the transactional profit split method may generally be appropriate where the activities in a value chain operate on a parallel basis or where a party makes "unique and valuable" contributions. It should be noted that the 2015 OECD Report says that it will issue further guidance in relation to both these matters (in the case of the latter scenario, further guidance will be issued both in relation to "unique and valuable" contributions involving intangibles and also those not involving intangibles). The Committee submits that the ATO may need to consider further changes to TR 97/20 or issuing a further taxation ruling in light of these further proposed changes to the OECD's transfer pricing guidelines. Also, the ATO may need to be mindful of the way it administers the 2015 OECD report in light of the fact that further guidance is pending.

**(c) Minor updates need to be made to Taxation Ruling TR 2004/1
Income Tax: international transfer pricing – cost contribution
arrangements ("TR 2004/1")**

The Committee recommends that minor updates be made to TR 2004/1.

First, TR 2004/1 could be updated to reflect that buy-in payments for a cost contribution arrangement in respect of 'hard to value intangibles' should be based on the valuation methodology discussed at question 2 above. Essentially, this methodology should take account of reasonably foreseeable events (see particularly paragraphs 6.193 and 8.26 of the 2015 OECD Report). As stated at question 2 above, the OECD is to issue further guidance in relation to the valuation of 'hard to value intangibles' and any update to the ruling may have to be delayed to take account of this.

Second, TR 2004/1 could be updated to reflect the more explicit guidance in the 2015 OECD Report that a party entering in to a cost contribution arrangement should exercise appropriate control over the risk that it assumes and has financial capacity to assume that risk.

Concluding Comments

NSW Young Lawyers and the Committee thank you for the opportunity to make this submission. If you have any queries or require further submissions please contact the undersigned at your convenience.

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