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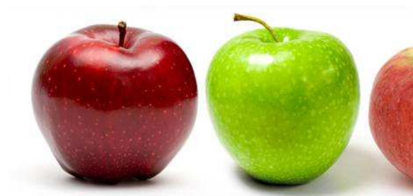

13 April 2012

The Manager
International Tax Integrity Unit
The Treasury
Langlon Crescent
PARKES ACT 2600

By email: transferpricing@treasury.gov.au

Dear Sir/Madam,

Comments on the Exposure Draft – Stage One of Transfer Pricing Reforms

Firstly, we would like to thank you for the opportunity to put forward our views on the exposure draft of the proposed amendments to implement the first stage of the Australian transfer pricing reforms.

In our view, the exposure draft potentially gives rise to several issues specifically related to transfer pricing practices and analyses, and therefore we have prepared this submission aiming to address these issues from a transfer pricing advisor's viewpoint, focused particularly on the practical and international perspectives.

In this regard, the underlying objective of the exposure draft to facilitate international consistency in the application of the arm's length principle to international dealings subject to double taxation agreements based on guidance promulgated by the OECD may become particularly problematic in practice for multinationals, the Australian Taxation Office and Australia's treaty partners. Our views reflect the fact that the current global transfer pricing environment is volatile and evolving, and the OECD precedents can be ambiguous, untimely and unstable. Moreover, the OECD precedents are subject to differing interpretations and levels of acceptance internationally and therefore do not provide the necessary level of international consistency, especially in respect of technical TP issues and analyses.

In addition, the "status" of the OECD Guidelines and the technical positions advocated therein are currently subject to challenge. The current United Nation and OECD "power struggle" over transfer pricing regulation and their adoption of contrary positions in respect of certain technical transfer pricing matters may, in time, reduce international consistency. The coexistence of dissimilar approaches advocated by the OECD, the United Nations and/or any other international organisation or particular jurisdiction(s) may create additional uncertainty and complexity in transfer pricing practice, but may also provide increased flexibility for multinationals. Thus, the Australian legislation should be sufficiently flexible to cover different potential approaches.

As mentioned, we focused our submission on certain practical transfer pricing issues arising from the exposure draft. These issues may be summarised as follows:

a. *Main objectives of the proposed changes – simplify and align the Australian rules to international standards?* Considering the dynamics around TP and the issues surrounding the OECD Guidelines, it seems peculiar to base Australia's domestic rules predominately on these international precedents. Moreover, other international precedents, such as case law in other countries, may be as or more useful and meaningful than OECD precedents. Thus, it would be preferable for the Australian law and courts to simply acknowledge that international precedents (broadly defined) may be relevant in addressing the arm's length principle.

b. *Generalities adopted where bright lines and practical guidance are necessary?* Multinationals confront transfer pricing challenges with decreased corporate budgets and internal resources, increased pressure to reduce taxation expenses, heightened financial accounting and tax-related disclosures and sensitivities, and often in the midst of rapid and significant internal operational changes. Accordingly, to increase compliance, governments must implement clear and practical rules. Linking the Australian domestic legislation to external and changing standards, which are not necessarily definitive nor globally accepted, may not be particularly helpful to taxpayers and does not provide them with clear and timely guidance.

c. *Uncertainty / discrimination – different potential scenarios in respect of similar circumstances?* The legislative changes in the exposure draft could potentially lead to different and perhaps inconsistent results when analysing substantially similar situations based on the location of the counter-party in an international transaction, or whether the analysis relates the allocation of profits to the permanent establishment of an Australian entity, or to a foreign entity's PE in Australia. Different sets of rules and guidance may be applicable to each of these scenarios, as an outcome of the reforms, which increases uncertainty and complexity.

d. *Broadening the basis for similar analyses?* The enactment of new legislation provides to the Australian Tax Office yet another lever for assessment based on the arm's length principle and Australia's double taxation agreements. The exposure draft, which seeks to legislatively adopt OECD precedents, should not alter the Australian Tax Office's position in current disputes, but simply close a "loophole" identified by the Australians courts in respect of Division 13 of the Income Tax Assessment Act 1936, as the arm's length principle has always been and continues to be the standard.

e. *Codification of guidelines and "guidance shopping"?* The OECD Guidelines were not drafted to administer domestic transfer pricing laws, and yet the exposure draft places such significant reliance on those Guidelines. Moreover, it appears that the Australian Tax Office may be able to "pick and choose" which precedents or parts thereof are relevant under the exposure draft. This aspect of the proposed legislation could also be [cynically] associated with the concept of "guidance shopping".

Additionally, the retrospective nature of the proposed legislation and the lack of time bars on assessments are also particularly problematic considering both legal and practical perspectives, as well as in respect of Australia's double taxation agreements time limits on Competent Authority cases.

In summary, legislative reference to and reliance on the OECD precedents, which are not sufficiently stable, accepted and embedded into jurisdictional laws and regulations around the world to provide the necessary level of international consistency, may create unnecessary complexities and increase the number of disputes. International related party transactions are (and have been) required to comply with the arm's length standard. In the final analysis, demonstrating such compliance depends on the available evidence (i.e., the quality/quantity of the benchmarking analysis and data, information supporting what third party may have done in similar circumstances).

For further discussion of the proposed legislation and related issues covered in this document, please refer to the attached article.

Should you have any questions, or would like to discuss any of the comments included in this submission and/or the attached article, please do not hesitate to contact us.

Yours faithfully,

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CETERIS

Proposed amendments to Australia's transfer pricing rules – Rocking the Casbah?

By Leslie Prescott-Haar and Alejandro Ces
Ceteris

Introduction

On 16 March 2012, the Australian Assistant Treasurer released an Exposure Draft ("ED") of the first tranche of proposed amendments to Australia's transfer pricing ("TP") rules.[1] The ED introduces new legislation intending to facilitate international consistency in the application of the arm's length principle to international dealings subject to a double taxation agreement ("DTA"), based on guidance promulgated by the Organisation for Economic Cooperation and Development ("OECD"). The additional forthcoming reform tranches are expected to cover: (i) new provisions replacing and/or amendments to Division 13 of the Income Tax Assessment Act 1936 ("Division 13") which are expected soon, and may also require the preparation of contemporaneous TP documentation, and (ii) further guidance on dealings undertaken through permanent establishments ("PEs"). In this regard, the Consultation Paper released by the Australian Treasury on 1 November 2011[2] detailed various matters that will likely be covered in the further reforms. These significant legislative developments could, in time, shake the foundations of TP, taxation and legal principles not only in Australia, but also in other jurisdictions, as TP is intrinsically multifaceted.

Much had been said in respect of the legalistic issues related to these proposed changes, particularly the controversial retrospective taxing power that will also be afforded to the Australian Taxation Office ("ATO") under the new proposed rules, which rules essentially codify the position that Australia's DTAs provide additional taxation power to the ATO. In addition, we believe that the ED also raises several issues specifically related to TP practices. The main purpose of this article is to address these TP issues from the practical and international perspectives.

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1 http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2348

2 Income tax: cross border profit allocation / Review of TP rules / Consultation paper 1 November 2011. Refer also to the Ceteris TP Times article: http://www.ceterisgroup.com/index.php/transfer-pricing-times/2011-archives/525-transfer-pricing-times-volume-viii-issue-11.

Current environment and context behind the proposed changes

The ED is a response to and a rejection of the Commissioner's loss in the SNF case,[3] in particular. In the SNF case, the court decided that Division 13 required a transactional/price driven analysis based on the facts and evidence, and thereby disregarded the ATO's position that a more holistic/profit driven analysis was more appropriate based on the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines").[4] In this regard, the court held that such Guidelines are not a valid aid for the construction of Division 13 and Australia's DTAs as domestically enacted.[5] Thus, the main objective of the proposed legislation is to ensure that the arm's length principle is interpreted and applied in a manner consistent with OECD guidance in Australian TP practice, as well as to provide an additional lever to the ATO under which to make assessments. The proposed legislation effectively codifies the Associated Enterprises and Business Profit Articles of the 2010 OECD Model Tax Convention on Income and on Capital ("OECD MTC"), as well as introduces the concept of a 'TP benefit'. Under the ED, a TP benefit must be computed in a manner consistent with the 2010 OECD MTC, the 2010 OECD Guidelines or any other prescribed document, to the extent these documents are considered relevant.

The current global TP environment is volatile in variety of respects, and therefore the legislative approach set forth in the ED may become particularly problematic in practice for multinationals, the ATO and Australia's treaty partners. In this regard, jurisdictional TP regimes are relatively "immature" and TP analytical practices are continually evolving. Whilst the OECD Guidelines facilitate international consensus on TP issues, these Guidelines are complex, changing, and untimely (i.e., TP issues are encountered well before OECD documents are released; which reflects the fact that the OECD processes are extended and numerous voices are heard therein, which is appropriate, but does result in delays). Further, the OECD Guidelines are not black letter law, may be subject to different interpretations and do not provide 'bright lines', which issues hinder adherence to such Guidelines. Moreover, the world is an extremely long way from obtaining international consensus in respect of TP analytical practices.

In addition to the TP practical issues noted above, the "status" of the OECD Guidelines and the technical positions advocated therein are currently subject to challenge. The current United Nation ("UN") and OECD "power struggle" over TP regulation and their adoption of contrary positions in

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[3] Commissioner of Taxation v SNF (Australia) Pty Ltd [2011] FCAFC 74. Refer to the Ceteris TP Times article: http://www.ceterisgroup.com/index.php/transfer-pricing-times/2011-archives/505-transfer-pricing-times-volume-viii-issue-7.

[4] We have regard for the ATO's position in the case as well, given the facts and circumstances of the case, but the benchmarking evidence prevailed. Query whether SNF was well advised of the risks related to their transfer pricing practices and extended duration of operating losses?

[5] Refer paras 115 et. seq of the decision.

respect of certain technical TP matters may reduce international consistency. The coexistence of dissimilar approaches advocated by the OECD, the UN and/or any other international organisation or particular jurisdiction(s) may create additional uncertainty and complexity in TP practice. However, the availability of different accepted approaches may also provide increased flexibility and reduced compliance burden for multinationals; e.g., UN-based safe harbours for low value transactions or limited operations, coupled with the OECD-based arm's length principle for aberrant circumstances, high value and/or complex dealings. Further, Australia's major trading partners generally consider the OECD Guidelines as of limited precedential value, to varying degrees, as discussed further below.

For these reasons, the authors consider that Australia's objective to legislate consistency with international standards, which are inherently incoherent and inconsistent on a global basis, is virtually impossible in practice.

Key issues arising from the ED

The key practical TP issues arising from the ED may be summarised as follows:

a. Main objectives of the proposed changes – simplify and align the Australian rules to international standards?
b. Generalities adopted where bright lines and practical guidance are necessary?
c. Uncertainty / discrimination – different potential scenarios in respect of similar circumstances?
d. Broadening the basis for similar analyses? and
e. Codification of guidelines and "guidance shopping"?

These issues are discussed below. The retrospective nature of this proposed legislation together with the lack of time bars on assessments (under both Division 13 and the ED) are also particularly problematic, from both the legal and practical perspectives; however, we will not elaborate on these issues.

Objectives of the proposed changes

A stated objective of the reforms and the ED is to align Australia's domestic rules with the OECD's international standards and precedents, to provide increased certainty to multinationals. However, for the reasons noted above and discussed below, we question whether these proposed changes would and/or could provide certainty in respect of international related party dealings based principally on OECD guidance. Further, we do not believe that the proposed legislation provides certainty in respect of several relevant technical matters, which we address later in this article.

Even though the OECD Guidelines are internationally recognised as a valuable reference in TP, several jurisdictions such as India, China and Brazil have expressed concerns through the UN in respect of some of the core concepts therein. Moreover, whilst many of Australian major trading partners endorse the OECD Guidelines, these jurisdictions generally do not consider these Guidelines as law nor as substantial precedent, and have not indicated intentions to fundamentally alter the status quo.[6] Instead, their domestic legislation, regulations, case law, rulings, etc. prevail in terms of precedential value for purposes of interpreting and applying their domestic TP provisions. As an example, we refer to the US position, which is based on a memorandum from the Office of Chief Counsel – Internal Revenue Service[7] and states *"...[O]utside of the competent authority process under a treaty, tax administrators, including Appeals, are bound to enforce compliance with section 482 and the regulations without reference to the OECD TP Guidelines"*. This divergence in the precedential value accorded to the OECD Guidelines, as well as differing interpretations and technical application of standards contained in such Guidelines, by Australia's treaty partners leads to uncertainty and incongruities in practice.

Furthermore, an increasing lack of sufficient and reliable benchmarking data resulting from various factors such as relaxed financial reporting standards in a number of jurisdictions and increased globalisation, coupled with more robust comparability standards (as per Chapter III of the 2010 OECD Guidelines) means that substantiating compliance with the arm's length principle is increasingly difficult. Moreover, under the arm's length principle, various equally valid outcomes can potentially arise for one particular international dealing. Thus, the arm's length principle provides flexibility in terms of the approach to benchmarking and through the application of arm's length ranges, which may not be obtained through global formulary apportionment nor safe harbours. This is appropriate given that different multinationals do, in fact, operate differently, and derive different financial outcomes. However, the TP authorities around the world (collectively and/or individually) may adopt one or more of these fundamental approaches – i.e., the arm's length principle and/or safe harbours. Hence, the Australian domestic law and related guidance should be sufficiently flexible to address any of these approaches, as well as the practical and technical issues encountered in corroborating compliance with the arm's length principle in Australia and from the ATO's perspective.

Considering the dynamics around TP and the issues surrounding the OECD Guidelines, it seems inappropriate to depend *predominately* on the OECD guidance for international dealings covered by

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[6] It is noted, however, that Japan has implemented measures to align more closely with the OECD Guidelines.

[7] Office of Chief Counsel Internal Revenue Service - Memorandum [Release number: AM-2007-007 / Release date: 3/23/07]

Australia's DTAs, as Australia does not have the requisite level of comfort that its treaty partners maintain indistinguishable positions. This issue places both multinationals and the ATO in uncertain positions in respect of technical and practical TP matters, and will no doubt lead to more Competent Authority and litigation cases, which can be risky, costly and time consuming for multinationals. Moreover, other international precedents, such as case law in other countries, may be as or more useful and meaningful than OECD precedents. Thus, it would be preferable for the Australian law and courts to simply acknowledge that international precedents (broadly defined) may be relevant in addressing the arm's length principle in respect of international related party dealings governed by domestic legislation and DTAs. In addition, Australian rulings or regulations should provide clear and effective examples illustrating the "boundaries", as well as the ATO's views in respect of technical issues, as discussed further below.

Generalities adopted where practical guidance and bright lines are necessary

The velocity and significance of recent TP developments around the world has been remarkable. Moreover, countless factors related to the recent and current economic environment such as the global financial crisis, economic uncertainty surrounding specific regions and countries, the necessity for increased taxation collections in both developed countries and emerging markets, etc. have complicated TP. As a result, multinationals are facing the most challenging TP environment in history. Multinationals confront these TP challenges with decreased corporate budgets and internal resources, increased pressure to reduce taxation expenses, heightened financial accounting and tax-related disclosures and sensitivities, and often in the midst of rapid and significant internal operational changes. Thus, to improve compliance, governments must implement clear, timely and practical guidance. Linking the Australian domestic legislation to external and changing standards, which are not necessarily definitive nor globally accepted, may be ineffective.

We note that Advance Pricing Agreements ("APAs") may provide a practical solution for the TP issues faced by multinationals, but these agreements can take significant time and cost to implement, and various revenue authorities around the world, at present, cannot effectively and efficiently process their existing APA cases. Moreover, revenue authorities tend to move significantly more slowly than multinationals, and APAs do not effectively handle the operational changes implemented frequently by multinationals. Additionally, multinationals should not be placed into the position of having to have their transactions 'blessed' by revenue authorities to avoid disputes and related risks.

Inconsistency / Discrimination

The legislative changes in the ED could potentially lead to different and perhaps inconsistent results when analysing substantially similar situations based on the jurisdiction of the counter-party in an

international transaction, or whether the analysis relates the allocation of profits to the PE of an Australian entity abroad, or to a foreign entity's PE in Australia, as different sets of rules and guidance may be applicable to each of these scenarios, as an outcome of the reforms.[8] There is also a temporal aspect to this issue of inconsistency, as discussed below.

To illustrate the above, if an Australian entity is involved in an international transaction which is not subject to a DTA, the transaction should be analysed under the existing Australian domestic legislation (i.e., Division 13). However, if the same Australian taxpayer undertakes a substantially similar international related party transactions under analogous terms and conditions, but these transactions are subject to DTAs, then these transactions and the potential TP benefit arising therefrom should be analysed in accordance to the legislation proposed in the ED (i.e., Subdivision 815-A ITAA 1997) and the appropriate OECD guidance at the point in time that these transactions were undertaken. In the authors' view, the creation and maintenance of separate domestic provisions is overly-complicated and potentially discriminatory.

Further, the dynamics of and developments in TP practices, coupled with the recent changes in the OECD guidance, means an analysis of the same or substantially similar transactions over time could potentially result in differing outcomes under the ED. In the period between 1 July 2004 and the date of this article, there have been several different versions of the OECD Guidelines and the OECD MTC. The evolution of these precedents is shown in Table 1 below:

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8 It is noted that this situation may already exist in Australia.

Table 1: Different versions of the OECD Guidelines and OECD MTC from 1 July 2004 to Present

OECD TP Guidelines	OECD Model Tax Convention
1999 update[9]	28 January 2003[10] update
	15 July 2005[11] update
2009 update[12]	17 July 2008[13] update
2010 update[14]	22 July 2010[15] update

As could be inferred from Table 1, a particular recurring transaction may be analysed under 6 different combinations of precedential OECD documents based on the proposed effective date of the ED. In addition, if the proposed amendments are enacted into law, based on the subsection 815-25, new prescribed guidance may be incorporated into the law, aggravating issues around uncertainty and instability in precedents. Accordingly, changes to Australia's TP rules should be prospective.

In addition, based on the language of the ED, it could be assumed that the attribution of profits to an Australian PE of a foreign entity should be aligned (wholly, partially or selectively) to the authorised OECD approach ("AOA"), which approach considers PEs as distinct and separate entities to some extent. This is a significant development which may not be completely consistent with the current approach for attributing profits and costs to outbound PEs, and therefore, the legislators should provide clarification in this regard once the third tranche of proposed reforms is released. In addition, not only should the Australian perspective be considered in respect of these matters, but the views of Australia's major trading partners should also be taken into account, as certain of Australia's treaty partners may have different positions in respect of the AOA, which could result in potential conflicts when allocating profits and costs to PEs.

Another significant matter covered in the ED is the interaction between the thin capitalisation rule and TP (as considered in the ATO's TR 2010/7). The particularly contentious concept of an "arm's length

[9] OECD (1999), *SET TP Guidelines for Multinational Enterprises and Tax Administrations - Binder+1999 Update*, OECD Publishing.

[10] OECD (2003), *Model Tax Convention on Income and on Capital: Condensed Version 2003*, OECD Publishing.

[11] OECD (2005), *Model Tax Convention on Income and on Capital: Condensed Version 2005*, OECD Publishing.

[12] OECD (2009), *OECD TP Guidelines for Multinational Enterprises and Tax Administrations 2009*, OECD Publishing.

[13] OECD (2008), *Model Tax Convention on Income and on Capital: Condensed Version 2008*, OECD Publishing.

[14] OECD (2010), *OECD TP Guidelines for Multinational Enterprises and Tax Administrations 2010*, OECD Publishing.

[15] OECD (2010), *Model Tax Convention on Income and on Capital: Condensed Version 2010*, OECD Publishing.

amount of debt" requires significantly more practical guidance, especially in respect of quantification and benchmarking of this amount. Further, based on the ED and the examples provided in the explanatory notes, it appears that if the actual liabilities under analysis exceed the "arm's length amount of debt", the deduction of interest charges may be disallowed under domestic provisions, therefore limiting competent authority relief. Whilst this may be a commonly adopted position in other jurisdictions such as the US, Korea and Japan, this position is not desirable. Moreover, the proposed legislation is to be applied retrospectively to fiscal years commencing in 2004, whereas the ATO's ruling and the landmark GE Capital Canada case which address key issues were not released until 2010, and there has been limited guidance in respect of the issues provided by the OECD thus far. This exposes the contentious and undeveloped nature of this technical issue in global TP practice.

Broadening the basis for similar analysis

The arm's length standard is, by its very nature, subject to subjective interpretation, as well as factual and economic circumstances, and therefore, courts must render decisions based on their understanding of the relevant facts, circumstances, and evidence provided. Hence, the enactment of new legislation in order to provide to the ATO yet another lever for assessment based on the arm's length principle (which is also the basis of Division 13, the DTAs and OECD Guidelines) is legislatively excessive. Further, expanded domestic law which legislatively adopts OECD precedents should not be allowed to 'improve' the ATO's substantive position in current disputes, but should simply close a perceived "loophole" identified by the Australians courts, as the arm's length principle has always been the fundamental standard.

The ATO has had a long standing emphasis on commercially realistic outcomes (i.e., profits and profit TP methods), and multinationals have also extensively applied the profit TP methods. As a result of the 2010 update to the OECD Guidelines, international acceptance of the profit TP methods has been advanced. In this regard, the OECD Guidelines now incorporate a best method rule, but the traditional transactional methods continue to have some priority therein.[16] Thus, the proposed legislation must not be interpreted nor applied as a preference for the profit methods in practice and in the courts. Our concern in the regard stems from the language of ED and, in particular, the frequent references therein to profits in the ED which could potentially be given more regard than the OECD Guidelines in the courts.

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[16] Chapter II, Paragraph 2.3 of the 2010 OECD Guidelines provides: "[w]here . . . a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferable to the transactional profit method. Moreover, where . . . the comparable uncontrolled price method (CUP) and another transfer pricing method can be applied in an equally reliable manner, the CUP method is to be preferred."

The simple fact that a taxpayer does not continually achieve a taxable income does not necessary mean that their transfer prices are not in accordance with the arm's length standard. There are numerous factors that must be considered in determining arm's length profits and/or a "TP benefit" in the context of the ED. Some of these variables are enumerated as follows:

- Information available at the time of entering into the transactions;
- Projections or budgets at the time of entering into the transactions (audits occur *ex-post* while prices are set *ex-ante*);
- Market conditions;
- Relevance and consequences of the "local" or "non-related" costs such as local labour, supplies, etc.;
- Internal parameters of comparison (either prices or transactions);
- Economies of scales; or
- Existence of similar transactions undertaken between third parties.

In practice, multinationals often do not have specific regard for net operating profits when establishing the transfer prices for specific transactions (e.g., a royalty based on a percentage of sales, a guarantee fee based on outstanding guaranteed debts, or a set gross margin established for product pricing purposes, etc.). This approach to price setting is normally consistent with the arrangements of third parties in uncontrolled dealings; in these cases, the third parties would, in time, seek to re-negotiate those arrangements in case it is considered that the arrangements are not commercially viable/profitable in the long term, seek to reduce their operational costs, and/or a combination of both.

When an economic contraction occurs or market share declines, such market risks can result in losses or reduced profits in the short to mid-term, not because of the transfer prices, but rather because of market conditions, and in an uncontrolled dealing, the supplier/s generally would not 'cover' the purchaser's losses or reduced profits during the contraction unless contractually obligated to provide such support and/or such support would [in the longer term] benefit to the supplier/s. Moreover, arrangements may appear commercially realistic upon initial execution, but as time passes and conditions change, such arrangements may become an issue, which may trigger re-negotiation or other solutions. Hence, application of the proposed legislation to bolster profit approaches is not consistent with the OECD Guidelines' best method' rule, as well as the arrangements normally entered into between third parties. And the application of hindsight in the assessment of profits is inappropriate to some extent. To address this risk [of a potential assessment based solely on profit outcomes], multinationals may be forced to apply both the transactional and profit TP methods, both

upon initial execution of a transaction/s and subsequent to that transaction/s, which would be excessively cumbersome and costly to multinationals.

Hence, even though the Commissioner may rely, to a greater extent, on profit-based analyses under on the new legislation and the revised OECD Guidelines, the ATO should not be permitted to target certain "expected" or "accepted" profit levels across industries and/or transactions, and simply attribute any potential shortfall to the transfer prices. Some legislative limitations should be enacted in this regard, particularly in respect of "reconstruction". Further, even after implementing the proposed legislation, the Commissioner will still have to live with and defend against cases like SNF.

Codification of guidelines and "guidance shopping"

Another issue to highlight is that the OECD Guidelines were not drafted to enforce domestic TP legislation, and therefore it is arguably inappropriate to adopt these Guidelines in domestic legislation nor to place such heavy reliance on them. Instead, the OECD Guidelines provide guidance and therefore are broad and general in nature, which are adjectives that should not be associated with law.

Further, these are complex documents subject to continual scrutiny and evolution. For example, at the same time that the current versions of the OECD documents may be incorporated into the Australian law, the OECD Secretary-General has pledged his organisation to simplify the OECD guidance, stating that "the time has come to simplify the [TP] rules and alleviate the compliance burden for both tax authorities and taxpayers."[17] Hence, query whether the law should be associated with varying doctrines and principles.

Moreover, the OECD Guidelines can be ambiguous given that the Guidelines provide key lineaments to analyse diverse scenarios and views. These Guidelines are a highly valuable resource in TP practice, however, it would be utopian to assume that the Guidelines cover all of the different possibilities and positions that could arise. Therefore, it is important to apply the broad concepts covered in these Guidelines, together with specific criterion (as well as common scene), when analysing each particular issue that may arise.

Furthermore, not only does the proposed legislation reference the OECD Guidelines and OECD MTC for guidance in respect of TP, but the draft legislation also states that it would be possible that parts of these documents may not be relevant in the future and/or other documents (or part of future documents) may be considered as relevant at some stage. This aspect of the proposed legislation does

[17] OECD Secretary-General pledges group to simplify TP provisions – Bloomberg BNA TP Report March 2012

significantly increase uncertainty, and this issue would be exasperated through further retrospective legislation and/or pronouncements in the future. This aspect of the proposed legislation could also be [cynically] associated with the concept of 'guidance shopping' – i.e., the Commissioner's legislative entitlement to decide the most convenient rule or precedent when necessary.

Finally, we also note that even though the OECD publications and documents are generally considered as international standards, there are considerable exceptions to the OECD suggested approaches (such as safe harbours, small business concessions, special regimes (i.e., maquilas in Mexico), etc.) and also relevant jurisdictions (Brazil is an example) that do not adhere to the OECD's standards. Therefore, these situations should be addressed to avoid uncertainty and incremental administrative burden.

Conclusions

The objective of this article is to provide a practical and international analysis of the potential implications arising from the ED. We would like to close this article with a succinct conclusion focused on these practical issues.

We agree that international consistency is an appropriate initiative aiming to minimise uncertainty in international TP practice, however, the OECD precedents are not the only material that should be considered relevant and, at this stage, these OECD precedents are not sufficiently stable, accepted and embedded into jurisdictional laws and regulations around the world to provide the necessary level of international consistency, especially in respect of technical TP issues and analyses. Therefore, for Australia to take this leap of faith may be questionable and may also create unnecessary complexities.

Further, the OECD precedents are very useful, but the OECD Guidelines were conceived as basis for reference and not as black letter law. Moreover, these Guidelines do not necessarily provide bright lines. Because TP, by its very nature, is subjective, multinationals, advisors and revenue authorities need bright lines, at the right time (i.e., when setting their transfer prices for transactions or when auditing such transactions). In this regard, setting out the grounds rules clearly and upon commencement of the game would avoid significant disputes.

International related party transactions are (and have been) required to comply with the arm's length standard. In the final analysis, demonstrating such compliance depends on the available evidence (i.e., the quality/quantity of the benchmarking analysis and data, and/or information supporting what third party may have done in similar circumstances). Given that the arm's length principle has consistently been the standard followed by multinationals and the ATO for some time, the retrospective nature of

the proposed legislation contained in the ED should not serve to improve the Commissioner's position with respect to disputes currently en route. Instead, the evidence should be the deciding factor in these and future cases.

Finally, we believe that when drafting law covering a significant portion of Australia's international trade, it is essential that the proposed changes are not only focused on setting the basis for future judgments, *ex-post approach*, but also on providing guidance and certainty at the time international transactions are agreed, *ex-ante approach.* The OECD Guidelines often do not sufficiently satisfy this necessity.

The views and opinions experessed in this article are those of the authors, and not necessarily shared by Ceteris.