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20 December 2012

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

By Email: transferpricing@treasury.gov.au

Dear Sir/Madam

Exposure Draft – Tax Laws Amendment (Cross-Border Transfer Pricing) Bill 2013: Modernisation of transfer pricing rules ("Exposure Draft")

Chevron Australia ("Chevron") welcomes the opportunity to provide comments on the Exposure Draft.

Chevron is currently developing two of Australia's largest resources projects in the North-west of Western Australia. The Chevron-operated Gorgon and Wheatstone Projects represent over $80 billion of investment and will position Australia as a leading liquefied natural gas (LNG) supplier in the Asia-Pacific region.

Gorgon and Wheatstone will create significant benefits for the Australian economy, including substantial revenues to the Australian Government throughout their operations – estimated to be at least forty years.

Resource security continues to underpin Chevron's investment in petroleum exploration and development. Strong investment in petroleum exploration and development in Australia has been facilitated to date by a legislative framework that provides taxpayers with a reasonable degree of certainty as to how the tax laws will apply.

Certainty with regard to the application of the transfer pricing framework is critical to investment in LNG projects and in promoting ongoing exploration.

Chevron is concerned, however, that the reconstruction provisions contained in the Exposure Draft create significant uncertainty for taxpayers, which is inappropriate in a self-assessment context. Chevron is also concerned about elements of the record-keeping requirements including the connection between record-keeping and having a reasonably arguable position. A full submission outlining Chevron's concerns is attached.

Thank you for allowing us to submit our views on what we see as an extremely important matter. We would welcome the opportunity to further work with Treasury on this matter.

In the meantime, please contact Michael Fenner – Tax Manager on (08) 9216 4507 if you would like to discuss any matters raised in the submission.

Yours sincerely

Peter Fairclough
General Manager – Policy, Government and Public Affairs

Submission

Tax Laws Amendment (Cross-Border Transfer Pricing) Bill 2013: Modernisation of transfer pricing rules

Issue Date: 20 December 2012

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1.0 EXECUTIVE SUMMARY

Chevron is currently developing two of Australia's largest resources projects in the North-west of Western Australia. The Chevron-operated Gorgon and Wheatstone Projects represent over $80 billion of investment and will position Australia as a leading liquefied natural gas (LNG) supplier in the Asia-Pacific region.

Gorgon and Wheatstone will create significant benefits for the Australian economy, including substantial revenues to the Australian Government throughout their operations – estimated to be at least forty years.

Chevron's significant investment in petroleum exploration and development in Australia has been facilitated to date by a legislative framework that provides taxpayers with a reasonable degree of certainty as to how the tax laws will apply. Certainty with regard to the application of the transfer pricing framework is critical to investment in LNG projects and in promoting ongoing exploration.

Chevron shares the Government's objective of establishing a transfer pricing framework that encourages capital investment. However, Chevron is concerned that the reconstruction provisions contained in the Exposure Draft create significant uncertainty for taxpayers, which is inappropriate in the proposed self-assessment context.

Chevron is also concerned by the proposed record keeping elements of the Exposure Draft. In particular, the connection between documentation and the ability to attain a reasonably arguable position - and a more favourable penalty outcome - is in Chevron's view inappropriate as the documentation requirements are in practice unreasonably difficult to satisfy. Further, whether the Commissioner considers that those documentation requirements have been satisfied is open to subjective interpretation.

Chevron also submits that, whilst the amendment period of eight years is preferable to the current unlimited period of amendment, a period of four years is both sufficient and consistent with amendments for non-transfer pricing issues.

2.0 ABOUT CHEVRON AUSTRALIA

Chevron has been present in Australia for more than 45 years and is the operator for the Gorgon Project, the Wheatstone Project and the Barrow and Thevenard Island oilfields. The company is a foundation partner in the North West Shelf Venture and is a significant investor in exploration and appraisal activities offshore North-Western Australia.

The $52 billion Gorgon Project is the single largest ever Australian resource investment. The project has been in construction for three years on Barrow Island and will consist of three LNG trains with a total capacity of 15 million tonnes per annum, and a domestic gas plant.

The $29 billion Wheatstone Project has been in construction for a little over one year at Ashburton North, 12 km west of Onslow, and will consist of two LNG trains with a combined capacity of 8.9 million tonnes per year and a domestic gas plant.

The Gorgon and Wheatstone Projects are expected to bring many benefits to Australia including direct and indirect employment, government revenues, economic growth, investment in local goods and services and security of natural gas supply.

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3.0 RECONSTRUCTION

Chevron understands that the intention underlying the proposed amendments is to ensure Australia's domestic transfer pricing rules are consistent with the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* ('OECD Guidelines').

The Assistant Treasurer's media release of 22 November 2012 accompanying the Exposure Draft states that the reformed Australian transfer pricing rules would *"ensure that Australia's domestic laws are applied in a manner that is consistent with international best practice as set out by OECD Guidelines"* and provide "*direct access to the OECD guidelines...to help interpret transfer pricing issues"*. Further, the Explanatory Memorandum states that the rules *"better align with the internationally consistent transfer pricing approaches set out by the Organisation for Economic Cooperation and Development (OECD)*[1]*"*.

Chevron supports the aims stated, and in particular, aligning Australia's domestic transfer pricing laws with the OECD Guidelines. However, in Chevron's view, the way in which the proposed amendments are drafted in respect of when it is appropriate to reconstruct transactions goes significantly further than the OECD Guidelines. In particular, whilst the OECD Guidelines contemplate reconstruction of transactions in only exceptional circumstances, the proposed amendments contemplate reconstruction in much broader circumstances.

At Chapter I Part D.2 of the OECD Guidelines it states: *"In other than* ***exceptional cases****, the tax administration should not disregard the actual transactions or substitute other transactions for them"* (emphasis added). The OECD goes on to state that there are two particular circumstance in which it may, **exceptionally**, be appropriate for a tax administration to consider disregarding the structure adopted by a taxpayer. The first is where the economic substance of a transaction differs from its form. The second is where, while the form and substance of the transaction are the same, the arrangements viewed in their totality differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner **and** the actual structure practically impedes the tax administration from determining an appropriate transfer price.

Chevron's interpretation is that the proposed amendments contemplate reconstruction of a transaction in broader circumstances than those outlined by the OECD. In particular, subsections 815-125(6) and 815-125(7) provide for reconstruction in a manner that does not recognise the "exceptional cases" element contained in the OECD Guidelines. Subsection 815-125(6) provides that in identifying the arm's length conditions, whilst regard is given to the economic substance of what the taxpayer actually did, it is not a requirement that this is the same as the economic substance of what another hypothetical taxpayer might have done. Further, subsection 815-125(7) provides for the actual transaction to be disregarded completely in certain circumstances.

There is no limitation in either sub-section to cases that are "exceptional". Rather, those subsections appear to require a taxpayer to consider, for **any** international related party dealing, what other hypothetical taxpayers might have done in lieu of what was actually done. The Explanatory Memorandum[2] also appears to have no regard to the OECD Guidelines' limitation of reconstruction to exceptional cases. The difficulty with this approach, particularly in a self-assessment context, is that the taxpayer is expected to consider for all of its international related party dealings, the various different ways in

[1] At paragraph 1.1
[2] At paragraphs 2.82 to 2.91

which a hypothetical taxpayer might alternatively have structured its dealings, and select which of those options might align with what the Commissioner may consider the 'best' option. Clearly, this creates significant uncertainty for the taxpayer.

Chevron contends that there are a number of ways in which an entity might legitimately structure its arrangements. The structure ultimately implemented depends on a number of commercial factors and is influenced by human decision-making which may, in hindsight, not have produced the 'best' commercial outcome. That another hypothetical taxpayer might, in hindsight, have selected a different structure should not in Chevron's view warrant a transaction being reconstructed in other than the exceptional circumstances outlined in the OECD Guidelines. Further, the OECD Guidelines acknowledge that transactions between associated enterprises might legitimately differ to those between independent enterprises because they face different commercial circumstances. At Chapter I Part B.1 the OECD Guidelines state: *"The mere fact that a transaction may not be found between independent parties does not of itself mean that it is not arm's length"*[3].

Chevron does acknowledge that subsection 815-130(1) requires interpretation of Subdivision 815-B so as to best achieve consistency with the OECD Guidelines. However, that is limited by the phrase *"except where the contrary intention appears"*. To best achieve consistency with the OECD Guidelines, an intention to import the "exceptional circumstances" requirement into the legislation should be clearly expressed.

[3] At paragraph 1.11

4.0 SELF-ASSESSMENT

In addition to the difficulties of self-assessment in relation to reconstruction as outlined in Section 3.0 above, Chevron is concerned more broadly at the proposed self-assessment aspect of the Exposure Draft.

Specifically, there is an inherent difficulty in establishing that a transaction is consistent with the arm's length principle. It requires a taxpayer to not only consider how other entities might hypothetically have negotiated a transaction, but also to obtain data to support the proposition that the transaction is consistent with the arm's length principle. Accordingly, the taxpayer faces significant uncertainty in transfer pricing matters.

The incorporation of the OECD Guidelines into domestic transfer pricing law does not alleviate that uncertainty. In fact, the OECD Guidelines are themselves not prescriptive and are open to interpretation by the taxpayer and taxing authorities. As such, they cannot be applied with any certainty or precision by a taxpayer in a self-assessment environment.

Chevron considers that, in light of the above uncertainty, any proposed amendments to the domestic transfer pricing law should not include the introduction of self-assessment. Rather, the Commissioner should be required to make a determination in relation to transfer pricing matters as is currently the case.

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5.0 RECORD KEEPING & PENALTIES

Whilst acknowledging that the record keeping requirements in the draft Subdivision 815-D are not mandatory, Chevron is concerned at the manner in which record keeping has been linked to whether a taxpayer has reasonably arguable position ('RAP') for the purposes of determining administrative penalties.

Chevron notes that as per current ATO guidance contained in *Taxation Ruling TR 98/11*, where a taxpayer is found to have transfer pricing documentation of at least a medium-high quality, that taxpayer would generally not be subject to penalties[4]. However, under the proposed new rules, a taxpayer's best outcome is to attain a RAP, in which case penalties still apply.

In addition, satisfying the record keeping requirements may not be achievable in practice in many cases. In particular, subsection 815-305(4) requires the taxpayer to document, for **all conditions** operating in the income year meeting the cross-border requirement, a number of matters. "Conditions" are described in the note to section 815-115(1) as including, but not being limited to, *"such things as price, gross margin, net profit, and the division of profit between the entities".* Accordingly, in order to satisfy the record keeping requirements the taxpayer must document **all** of those listed conditions in respect of the matters outlined at subsection 815-305(4) and, because that list of conditions is not exhaustive, any other conditions that might operate in that income year.

Chevron has two concerns with this approach. Firstly, that **all** conditions operating must be addressed irrespective of whether they are relevant or material. Secondly, that conditions which are not prescribed must be identified. In the event that a taxpayer does not address a condition, whether in the first part because it is irrelevant or immaterial, or in the second part because it is simply not in the range of unprescribed conditions considered by the taxpayer, if the Commissioner had an alternate view of what **all** the conditions were, the taxpayer would have failed to satisfy the record keeping requirements and be unable to attain a RAP. Chevron also notes that, in the case of a comparable uncontrolled price ('CUP'), where a comparable transaction can be identified and any differences appropriately adjusted for, the documentation requirements in Subdivision 815-D should be deemed to have been met. As the proposed amendments are currently drafted, those requirements would not be met because the taxpayer has not documented all the other conditions including gross margin and net profit.

Chevron also considers that taxpayers attempting to satisfy the record keeping requirements are faced with an extremely onerous compliance burden. This arises not only from the requirement to address all conditions, but also from the reconstruction provisions contained in Subdivision 815-B. Specifically, if a taxpayer is required to consider all possible ways in which a hypothetical taxpayer might structure an arrangement, the record keeping requirement in subsection 815-305(2)(a) requires the taxpayer to adequately explain the way in which that was considered. Given the myriad of hypothetical alternatives, it is clear that the compliance burden would be significant. Further, as the proposed amendments apply to cross-border dealings between both associated and non-associated entities, the record-keeping requirements potentially extend to all overseas transactions entered into by the taxpayer. The related compliance burden would be both significant and disproportionate to the transfer pricing risk.

Chevron also notes that, given the significant compliance burden outlined above, it is difficult to conceive of how a taxpayer could complete documentation by the time the income tax return is lodged as required by subsection 815-305(5).

[4] At paragraphs 4.19 and 4.21

Finally, Chevron also considers that the proposed threshold for penalties is too low to provide meaningful de minimis relief for large business taxpayers.

6.0 OTHER ISSUES

6.1 Time Limits

Chevron welcomes introduction of a time limit to amend assessments for the purpose of giving effect to the proposed new transfer pricing rules. However, in Chevron's view an amendment period of four years rather than eight years is both sufficient and consistent with amendments under other areas of taxation law. Chevron notes that in the event a four year amendment period is validly insufficient in a particular case, the Commissioner may request an extension from the taxpayer or via the court system.

6.2 Repealing legacy law

The Explanatory Memorandum states that Division 13 will be repealed when the new subdivisions are enacted.[5] In Chevron's view, Subdivision 815-A should also be repealed at the same time to provide certainty for taxpayers in determining which relevant subdivision applies at any one time.

[5] See paragraph 1.18

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