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Manager
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Dear Sir/Madam

Submission on: Exposure Draft Tax Laws (Cross-Border Transfer Pricing) Bill 2013

The Federal Chamber of Automotive Industries (FCAI) is the peak industry organisation representing the automotive industry in Australia. FCAI's membership comprises the three domestic passenger motor vehicle manufacturers and all major international brands which import and market passenger, light commercial and four wheel drive vehicles, and motor cycles in Australia.

As the automotive industry is a significant importer and exporter of goods and services in Australia, it will therefore be directly impacted by the proposed prospective changes to the transfer pricing rules, not only for income tax purposes but also for customs duty purposes.

Whilst we are cognisant and most appreciative of the dialogue between Treasury, the Australian Customs and Border Protection Service and the Australian Taxation office, to seek a workable administrative solution to the problem of inconsistency between taxation and customs legislation, we believe this will be very difficult in practice without legislative support.

Within this context the FCAI appreciates the opportunity to participate in the consultation process and accordingly provide the following comments on the ***Exposure Draft*** which was issued on 22 November 2012.

Operative provisions

"Holistic" approach to profitability *will make it very difficult to reliably price individual transactions.*

Section 815-120 - When an entity gets a transfer pricing benefit

In determining whether an entity receives a transfer pricing benefit in respect of an international dealing, the emphasis is on "an entity's taxable income" and overall profitability and not the pricing of an international transaction. As stated in the Exposure Draft at paragraph 1.20, Subdivision 815-B will apply to ensure that:

> "...The arm's length conditions should be reflective of, and take into account, the totality of the commercial or financial relations between the entities".

This "holistic approach" is reiterated several times throughout the Explanatory Memorandum.[1]

As there is no link to an underlying transaction or specific activity, the concern is that the emphasis on "overall profitability" will leave open the issue of how individual transactions will be priced, and how the actual components of taxable income – namely assessable income and allowable deductions in respect of individual transactions - will be calculated. To complete a tax return under Australian income tax law, taxpayers are required to calculate all items of assessable income and all items of allowable deductions. The structure of the Income Tax Assessment Acts does not permit taxpayers to ignore this requirement and simply insert some profit amount in the tax return in lieu of a proper calculation of taxable income.

Another critical problem with such a very broad construction of the matters which need to be taken into account under the transfer pricing rules, is the significant risk that general economic and commercial factors present in Australia, which have no bearing on the pricing of actual transactions in international dealings, may be incorrectly taken into account under the guise of determining an "overall arm's length outcome".

Further, and of particular importance for FCAI's membership, this approach which concentrates on "overall profitability" and without a reference to an underlying transaction creates a direct conflict with the Customs Valuation rules.

There needs to be a reference in the new provisions to "transactions". In this regard, reference is made to:

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[1] Refer paragraph's 2.36 and 2.38. This holistic approach also encompasses straightforward value chain transactions such as the acquisition of trading stock.

- The UK Transfer Pricing legislation[2], which we understand has been a source of reference for the Exposure Draft; the UK Transfer Pricing rules refer to "transactions" or "series of transactions"; and

- The Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations issued by the Organisation for Economic Cooperation and Development ("OECD Guidelines"); whilst a range of methodologies are discussed in these guideline in order to determine an "arm's length" price, the outcome is converted into the pricing of a transaction.[3]

As mentioned in our earlier submissions on Division 815A, whilst it is generally understood that it is good tax policy to legislate to ensure that international related party dealings result in an "arm's length outcome", it is difficult to understand how such an outcome will be achieved by concentrating on "overall profitability" and in particular the overall profitability of the Australian operations. Unrelated parties dealing at arm's length have no regard for the overall profitability of the party with which they are buying and selling. Further, adopting such an approach will make it very difficult to resolve the potential for double taxation through Mutual Agreement Procedures with Australia's Double Tax Treaty partners.

Interaction between Transfer Pricing Rules and Customs Valuation Rules

As mentioned in earlier submissions on Section 815A, FCAI members are subject not only to the provisions of the Income Tax Assessment Acts of 1936 and 1997, but also the Customs Act 1901 in respect of the importation of motor vehicles, light commercial vehicles and motor cycles.

Under the Customs Act, customs duty is levied on a transaction by transaction basis. There is no reference in the Customs Act to overall profitability of the Australian operations as is proposed under the Exposure Draft.

It is unreasonable to place FCAI members in the invidious position of defending transfer prices in respect of the same motor vehicle under two very different valuation rules. Whilst it should be acknowledged that this inconsistency of approach to the valuation rules has been the subject of much international debate, the focus has now changed completely from the examination of transactions to a holistic "overall profit outcome."[4]

This inconsistency in approach may have adverse ramifications for FCAI members as follows:

- There may be no recourse to customs duty refunds in instances where the Commissioner has applied an overall profitability approach to an imported good to reduce the price.

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[2] Taxation (International and other Provisions) Act 2010 UK Chapter 1 Basic Transfer - Pricing Rule at Section 147 and Chapter2 Key Interpretive Provisions at section 150

[3] Refer OECD Guidelines 2010 Glossary at page 28 and the application of the "arm's length principle" to transactions involving an associated enterprise.

[4] Refer Chapter 2 of the Exposure Draft at paragraphs 2.31 to 2.36 and in particular paragraph 2.34 at page 17.

- Increased administration burden as there will be two different prices in respect of the same goods together with the associated supporting documentation under both sets of revenue laws.

Whilst we refer to our earlier submission which provides further details, it is important to reiterate that a whole of government approach is required in drafting revenue laws in Australia.

Whilst we welcome dialogue between Treasury, the Australian Customs and Border Protection Service and the Australian Taxation Office, on a workable administrative solution to this problem, unless this is supported by legislative intent our members are exposed.

No Requirement by the Commissioner to Provide a Determination and the "Self Assessment System"

The draft provisions are silent on the issue of the requirement by the ATO or Commissioner of Taxation to provide a Determination. Reference is made to paragraph 1.22 of the Explanatory Memorandum to the Exposure Draft as follows:

> *"Unlike the current transfer pricing rules in Division 13 and in Subdivision 815-A, which both rely on the Commissioner of Taxation making a determination, these provisions will be self-executing in their operation. This will bring these rules in line with the design of Australia's taxation system which generally operates on a self – assessment basis".*

Whilst the lack of a requirement to furnish a determination will enable the Commissioner of Taxation to have a great deal of flexibility in stating grounds of response in litigation matters before the Courts, taxpayers will be adversely impacted, not least by the uncertainty.

Unless the Commissioner provides a Determination which contains full details of an adjustment to taxable income, including full details of the relevant transactions whose pricing is being adjusted, and full details of items of assessable income which are being increased and the items of allowable deductions which are being reduced, taxpayers will be disadvantaged as they will be unable to provide a considered response or defence of the pricing of their international dealings. Further, they will have no defendable grounds upon which to claim a Customs Duty refund in respect of the goods the subject of the international dealings.

It should also be mentioned that the "Self Assessment" system was introduced with the full support of the Australian Taxation Office as the aim was to become more efficient in its compliance and revenue raising activities.

Reference is made to a Paper released by the Treasurer in 2004 as follows:[5]

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[5] Review of Aspects of Income Tax Self Assessment Discussion Paper March 2004 by Peter Costello Treasurer at page 3.

> *"Self assessment relieved the Tax Office of the obligation to examine returns lodged by taxpayers in the process of assessment ..... returns were generally taken at face value, subject to post–assessment audit and other verification checks."*

Therefore, the "self assessment" refers to and relates to taxpayers initial lodgement obligations and does not extend to subsequent adjustments by the Commissioner as a result of audit activities. These adjustments need to be fully documented in a formal manner to ensure that taxpayers clearly understand the basis for these adjustments and that their rights of objection and review are fully protected at law.

Amendment of Assessments

Whilst we welcome the time limit for amendment of an assessment in Proposed Section 815 -145, we recommend a shorter period in keeping with other provisions of the Income Tax Assessment Act particularly in view of subsection 170(7) which enables the Commissioner to obtain additional time in which to complete his enquiries of a taxpayer's affairs and:

- To mitigate the potential for double taxation in instances where the time limits for amendment in other jurisdictions such as the United Kingdom are much shorter.
- To meet the time limits for obtaining a Customs Duty refund if applicable.

Record Keeping Requirements

Whilst it is recognised that records need to be kept and are being kept, the requirement that they must be prepared before the time of lodging the annual income tax return provides an undue administrative burden on our members. It should be mentioned that the final documentation in practice represents the formal compilation of contemporaneous documents which are summarised and assembled after the tax return has been lodged and before year end so as not to delay lodgement of the tax return.

In Summary

We request a whole of government approach to transfer pricing, not only from an income tax perspective, but also in relation to Customs Duty. As mentioned in earlier submissions, the government has previously committed to a whole of government approach to legislation and this approach needs to be reflected in the modernisation of the transfer pricing rules.

Yours faithfully

Tony Weber

Tony Weber
Chief Executive