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

Submission to Federal Treasury
Transfer Pricing Reforms - Stage One

PKF welcomes the opportunity of providing a submission on the Exposure draft for Tax Laws Amendment (2012 Measures No.3) Bill 2012: Cross border transfer pricing ("Exposure Draft").

Retrospective amendments

The Explanatory Material with the Exposure Draft states that proposed amendments are to be applicable from 1 July 2004. We consider this results in inappropriate retrospective application of the amendments.

The Explanatory Materials to the Exposure Draft attempts to justify this retrospective application of the amendments by stating that the Parliament demonstrated its intention that the specific transfer pricing related articles in the double tax agreements provide alternative and independent transfer pricing liability provisions to those contained in Division 13 and this was last demonstrated this in the *International Tax Agreements Amendment Act 2003* and associated Explanatory Materials.

However we don't agree with this proposition. There is nothing in the *International Tax Agreements Amendment Act 2003* or its associated Explanatory Materials that specifically states this proposition.

We understand the Australian double tax conventions do not provide independent taxing mechanisms for transfer pricing adjustments. Taking the Australia UK Convention as an example, the business profits article (article 7) states that Australia **may** tax the profits of an enterprise but only so much of them as is attributable to that permanent establishment. While sub-article 7.2 indicates what profits are to be attributed to that permanent establishment, it does so in the context of what profits the country is limited to taxing. In other words, it is restricting the country's ability to tax only the profits that are attributed to the permanent establishment. The use of the word **'may'** allows the relevant country to tax the relevant entity but it does not prescribe that it is those attributed profits that are to be taxed to the enterprise by that country. The mechanism to tax the permanent establishment is found in the general tax law of the country.

The associated enterprises article (article 9) indicates that where the commercial or relations between two enterprises differ to those which might operate between independent enterprises dealing at arm's length, then profits that might have been expected to accrue to one of those enterprises **may** be included in the profits of that enterprise and taxed accordingly (in Australia). While sub-article 9.1 allows the relevant country to tax profits the entity would have made if the entity had been dealing at arms length with the other entity, it does not provide a mechanism to do so. In the Australian context, the mechanisms for taxing the entity are to be found in the Income Tax Assessment Acts (1936 and 1997) etc, relevantly in relation to transfer pricing, Division 13 ITAA 1936.

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We understand that the Australian Tax office has a different view on this matter but it should be recognised that the view outlined above is at least as valid as the view held by the Australian Taxation Office (ATO).

It is generally inappropriate to enact retrospective law. There may be some situations that warrant the enactment of retrospective law but this should be restricted to situations where there is either a dramatic risk to the revenue or blatant tax evasion. There has been no indication that either of these situations apply in relation to these proposed transfer pricing amendments.

We suggest the application date for the amendments be the date the amending legislation receives Royal Assent or at the earliest, 16 March 2012, the date of the Assistant Treasurer's announcement of the proposed amendments.

Application to Small to Medium enterprises:

Many countries provide a de minimis test before applying the transfer pricing provisions. We suggest that Australian transfer pricing rules be amended to allow small to medium businesses be carved out of the transfer pricing rules on the basis that below a certain threshold it is not worthwhile for both the taxpayers and the ATO to have to deal with the administrative burden of transfer pricing documentation etc.

We also suggest that there be an elimination or restrictions of penalties for small to medium sized business in relation to transfer pricing adjustments, particularly those that have shown a genuine attempt to comply with the transfer pricing law. A number of other countries provide such transfer pricing penalty restrictions for small to medium taxpayers.

In addition consideration of safe harbour transfer pricing methods for small to medium enterprises could be considered. Most Small to medium businesses would be happy to be provided with safe harbour calculations for their transfer pricing. This would eliminate a great deal of the administrative burden and worry for small the medium businesses with international related party transactions and allow the ATO to concentrate on more important issues.

If you have any questions regarding this submission please contact me by phone on 02 9240 9736 or email lance.cunningham@pkf.com.au

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