

TAX BULLETIN

An update publication for our clients

11 November 2011

Transfer Pricing - the Good, the Bad and the Ugly

Introduction

In a Press Release issued earlier this month the Government announced a review of the current Australian transfer pricing rules.

Whilst there is some good news for the middle market in the Consultation Paper released as part of this review process, the Press Release and the Consultation Paper also contain a number of aspects that could not just be bad news for SMEs but 'downright ugly' for them in terms of their transfer pricing exposures and compliance costs.

Consultation on the Paper is open to 30 November. We expect that further comments will be sought by the Government during the legislative drafting process subsequent to its consideration of the issues raised in submissions on the Paper.

Pitcher Partners will be making a submission on the issues raised by the Press Release and the Consultation Paper and we would encourage you to contact us if you have any concerns that you would like to see included in this submission.

The Press Release announcing the review can be found at this link:

<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/145.htm&pageID=003&min=brs&Year=&DocType=0>

The Consultation Paper relating to the proposed changes can be found by following this link:

<http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2219>

The Good

The 'good news' in the Consultation Paper includes:

- the proposed inclusion of a de minimis rule for documentation in respect of taxpayers that meet the requisite threshold;
- the proposed inclusion of approved transfer pricing methods (along with criteria for selection of such methods);
- the possible removal of the wide discretionary powers currently provided to the ATO to determine an arm's length consideration; and
- removing the currently unlimited time period for transfer pricing amendments under our domestic law - by either aligning it with the amendment period in our tax treaties or introducing an eight year limit from the time that the ATO issues an assessment for the relevant year.



The Bad

Amongst the 'bad news' in the Consultation Paper are proposals to:

- include profit allocation rules which look at the totality of the arrangements between related firms - i.e. not just the prices charged for goods and services;
- require taxpayers to maintain contemporaneous records which fully explain the basis on which the prices charged for goods and services have been established to be on an arm's length terms;
- broaden the situations in which penalties can be imposed on taxpayers under the transfer pricing rules by equating a lack of contemporaneous records with a failure to take reasonable care in the conduct of tax affairs; and
- retrospectively amend the law (back to 1 July 2004) to allow transfer pricing adjustments to be made in accordance with the provisions of a double taxation agreement.

The 'Ugly'

While the review of the transfer pricing rules is a stand-alone matter, it is important to understand that this review is taking place at a time when the ATO is also planning to replace the existing Schedule 25A and Thin Capitalisation schedules, which are a combined 5 pages in length, with a new International Dealings Schedule ("IDS").

The proposed IDS in its current form is 12 pages (i.e. more than double the length of the schedules it replaces) and we believe that requiring the middle market to complete it:

- (a) will impose a compliance burden that is totally out of proportion to any risks to the revenue that might exist; and
- (b) represents a level of disclosure to the ATO that taxpayers would previously only have expected to be needed in an audit situation.

In short, the combined effect of the review of the transfer pricing rules and the new IDS is that compliance costs for the middle market could significantly increase.

We have therefore, communicated our grave concerns with the implications of the proposed IDS on the middle market to the ATO, the Assistant Treasurer and the Inspector-General of Taxation. We have had some success in this regard, being that the ATO have agreed to increase the reporting threshold under the proposed IDS from \$A1 million of related party dealings up to \$A2 million. However, in our view this threshold is still far too low when we compare the revenue risk at this level to the associated compliance costs.



TAX BULLETIN

Next Steps

Pitcher Partners will be making a submission on the issues raised by the Press Release and the Consultation Paper and we would encourage you to contact us if you have any concerns that you would like to see included in this submission.

In particular we plan to focus our submission on the following points:

- retrospective legislation should be avoided unless there is absolutely no alternative - tax compliance for taxpayers is difficult enough without having to anticipate retrospective changes;
- an appropriate de minimis test must be included to ensure that compliance costs for the middle market are not prohibitive;
- safe harbour rules should be included whenever possible to reduce compliance costs for taxpayers;
- clear guidelines for taxpayers to follow must be included under the revised transfer pricing rules; and
- penalties should only be imposed in appropriate cases - in particular, the simple lack of contemporaneous documentation should not be sufficient to impose substantial penalties on taxpayers who have otherwise tried their best to comply with the transfer pricing rules.

Further Information

Please ask either your regular Pitcher Partners tax contact or any of the contacts in the Pitcher Partners firms below for further details on the issues raised in this Tax Bulletin:

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