Minerals Council of Australia

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Senate Standing Committees on Economics
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Committee Secretary

Tax Law Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013

The Minerals Council of Australia (MCA) welcomes the opportunity to comment on the *Tax Law Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013*.

The MCA is the peak industry organisation representing Australia's exploration, mining and minerals processing industry, nationally and internationally. MCA member companies produce more than 85 per cent of the nation's annual minerals output and account for more than 50 per cent of Australia's exports.

The MCA supports the Government's objective to more closely align Australia's transfer pricing legislation with international best practice as set out by the OECD in its Transfer Pricing Guidelines to provide greater certainty for multinational enterprises operating or considering investing in Australia. However, we are concerned that the substantive design of the legislation does not give effect to this objective.

The MCA acknowledges that a number of the issues raised in our submission to Treasury of 20 December 2012 on the *Exposure Draft Tax Laws Amendment (Cross-Border Transfer Pricing) Bill 2013* have been addressed, at least in part, in the current bill and Explanatory Memorandum which is before the committee.

However, there are still a number of areas of concern to the MCA.

In summary, the MCA is concerned that:

- The documentation requirements for a reasonably arguable position (RAP) are opaque, the timeline for completing RAP documentation is unreasonable and there is no clear scope in the bill for the ATO to remit penalties to a rate less than 10%;
- The power to reconstruct commercial transactions is too wide, going well beyond what is provided for in the OECD Transfer Pricing Guidelines;
- The de minimis threshold for imposing the RAP documentation requirements is too low; and
- The 7 year amendment period is excessive and inconsistent with the standard 4 year period.

While these matters have been acknowledged and considered in the House Economics Committee Report, the MCA was disappointed with the absence of any suggested amendment to the legislation in the Committee recommendation.

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The MCA's recommendations in relation to the above issues are outlined below. These recommendations seek to eliminate systemic uncertainty, complexity and compliance costs which hinder, not only the Government's objectives, but also Australia's international competitiveness.

Documentation requirements

Complexity

The bill proposes additional onerous documentation over and above what is currently required for a taxpayer to obtain a RAP. The bill requires taxpayers to hypothesise about what independent entities would have done in place of the actual conditions of a transaction, as well as attempt to document all relevant factors, which in a commercial environment could be impossible to determine. This imposes a significant burden on taxpayers, particularly in the absence of guidance from the ATO on their documentation expectations prior to the new legislation coming into force.

Treasury outlined in its submission to the House of Representatives Economics Committee in February 2013 that "taxpayer's are free to risk-assess their cross-border dealings and prepare documentation only in respect of matters they consider to be at risk of a transfer pricing adjustment by the Commissioner". However, the Commissioner and a taxpayer may have different opinions as to which transactions are considered to be "at risk". The removal of the ability to establish a RAP for transactions a taxpayer considers to not be "at risk" of a transfer pricing adjustment imposes heavy compliance costs on taxpayers and may result in the imposition of penalties by the ATO even though a taxpayer has documentation to show they took a reasonable position.

Recommendation: Documentation requirements should not be linked to the requirement to establish a RAP.

The existing ATO guidance on documentation requirements that allow a taxpayer to demonstrate a reasonable position to the ATO remain applicable and this should be clearly reflected in the legislation (or, at a minimum, clearly stated in the EM). The legislation or explanatory memorandum should capture the ATO's existing practice with respect to documentation as set out in the ATO's taxation rulings on documentation (i.e. TR 98/11).

Timeframe

The current requirement for supporting documentation to be completed at the time of lodging tax returns is unreasonably onerous. Taxpayers would be required to prepare significant additional documentation if seeking a RAP by lodgement of the tax return which is typically 5 or 6 months post the end of the financial year. This is a very short time frame and coincides with year-end financial results, preparation of audited entity financial statements and statutory consolidated statements, preparation of quarter-end reports and preparation of tax returns for many of our member companies and their entities.

Due to the number of financial accounting deadlines in the 5 to 6 months following the end of financial year deadline, the timeframe for supporting documents does not leave sufficient time to prepare detailed formal documentation of all transactions by the tax return lodgement date.

In addition, the documentation requirements outlined in the bill do not take into account the fact that taxpayers can form a reasonable view on the arm's length nature of their dealings and collate relevant data on file to support their dealings without formally preparing the ATO's recommended 4 step transfer pricing documentation (or the yet to be described "arm's length conditions" based documentation) by lodgement date.

Recommendation: The deadline for documentation should be changed from the date of lodgement of tax returns to 12 months after the income year relevant to the matter.

Penalties

Treasury states in its submission to the House of Representatives Economics Committee that "failure to prepare transfer pricing documentation in no way prevents the ATO from exercising a general discretion to remit penalties". However, there is no clear scope in the bill for the ATO to remit penalties to a rate less than 10%.

Recommendation: The bill should clearly provide clear scope and discretion that the ATO can remit penalties to a rate less than 10% where adequate documentation is kept.

ATO's power to reconstruct

The bill retains the ability for the arm's length conditions to replace the actual conditions in all cases where a taxpayer obtains a transfer pricing benefit. Therefore, the potential for the ATO to reconstruct transactions is not limited to 'exceptional circumstances' as required by the OECD and this creates significant uncertainty.

In addition, the inconsistency with paragraphs 1.64 and 1.65 of the OECD Transfer Pricing Guidelines increases the risk of disagreement between tax authorities and could result in double taxation if the ATO reconstructs transactions other than in the exceptional circumstances outlined in the OECD Guidelines.

The MCA believes that any power to override a business transaction needs to be restricted in order to ensure that legitimate commercial transactions are protected. Determination of the arm's length conditions is a complex area and requires a certain degree of knowledge about the transaction including the industry, contract terms, function and risk analysis, etc. The numerous transactions which our members undertake cover an array of different businesses, functions, risk profiles, markets, industries and market pricing mechanisms.

As currently drafted, there is a risk that the ATO could disregard legitimate commercial transitions because the threshold for reconstruction is too low and is not flexible enough to allow for the complex nature of transactions. There should be a significant hurdle before the ATO can disregard a commercial transaction.

Recommendation: The ATO's power to reconstruct should be amended to ensure it applies only in exceptional circumstances, consistent with paragraph 1.64 and 1.65 of the OECD Guidelines.

De minimis threshold

The MCA has concerns about linking the ability to rely on a RAP with documentation requirements for the reasons set out above. However, if this link is to remain, the de minimis threshold should be more practical.

While the 1% of income tax payable de minimis threshold is a workable and acceptable threshold, the fixed amount of de minimis threshold will be irrelevant for most companies. Due to the cyclical nature of the mining industry, companies may go into a low profit position or even a loss position for a period. Under the proposed legislation a threshold of only $10,000 of income tax payable creates a potential obligation to prepare full documentation for a related party cross border transaction just over $33,000 in order to obtain a RAP. This threshold is far too low for all entities including small to medium organisations and there is no rationale provided for this apparently arbitrary threshold. The compliance costs associated with record keeping are likely to be significant and would constitute an unreasonable administrative burden on our member companies – and indeed on the ATO – for the limited revenue return on dealings below this threshold.

Recommendation: Documentation requirements should not be linked to the requirement to establish a RAP. However, if this link is to remain, in the interests of maintaining a reasonable balance between compliance costs and revenue gained, the de minimis threshold should be the greater of $10 million or 1% of income tax payable. This threshold would achieve the desired outcome of carving out low risk transactions while keeping compliance costs to a minimum.

Time Limit for amended assessment

The seven year time limit for transfer pricing adjustments imposed by the Bill as excessively onerous and inconsistent with time limits relating to other areas of the taxation legislation.

With the recent introduction of the International Dealings Schedule (IDS), considerably more information is now available to the ATO at the date of filing the income tax return which should allow more timely identification of issues.

The MCA maintains that a four year limit would be more consistent with other areas of equal complexity such as Capital Gains Tax; would be more in line with other major economies; and would therefore be a more practical means by which to achieve the Government's objectives.

Further, in cases of fraud or evasion, the ATO already has the ability to extend the time limit under ITAA 1936 s 170(7). It is therefore not clear why an extended time-frame is required.

In addition, in order to provide greater certainty to taxpayers, the time limit for the ATO to amend an assessment should also apply to all open years, which are currently without time limit.

Recommendation: The time limit at 815-150(1)(a) should be 4 years in line with the standard amendment period; and the time limit should apply to all years of assessment that remain open at the date of enactment of the proposed legislation (i.e. all earlier years would be closed, unless under dispute, after 4 years).

Financial impact of compliance

The financial impact on member companies will include not only additional compliance costs (both internal resourcing and external consultants), but also significant costs pursuing Mutual Agreement Procedure (MAP) activities.

Some of our members have a number of current matters which may be affected by the proposed legislation's inconsistency with OECD guidelines.

Conclusion

MCA members are of the strong view that changes as outlined in this submission should be made to the bill to ensure it adequately reflects the Government's objective. In the absence of substantive changes, at the very least, there is an urgent need for the Commissioner of Taxation to provide clear guidance on the RAP and reconstruction requirements, given the complexity of the provisions and lack of clarity in the legislation.

The MCA is grateful for the opportunity to provide these comments to the Senate Committee and MCA would welcome the opportunity to contribute to further discussions on this subject.

Should you require further explanation of any issues raised in this submission, please contact me in the first instance

Yours sincerely,

James Sorahan
Director - Taxation