BIAC
The Voice of OECD Business

Paris, 10 July 2012

Dear Sir,

Inquiry into the Tax Laws Amendment (Cross Border Transfer Pricing) Bill (No. 1) 2012

Business and Industry Advisory Committee to the OECD (BIAC) welcomes the opportunity to comment on the Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No.1) 2012.

The global business community is concerned about recent developments in the tax field in Australia. BIAC founded in 1962 as an independent organisation, is the officially recognised representative of the OECD business community. BIAC's members are the major business organisations in the OECD member countries and an increasing number of OECD observer countries. Australia has been a member of OECD since 1971 and has agreed to abide by OECD guidelines in the field of taxation.

Our key concerns are as follows:

- The retrospective effect of the proposed legislation.
- The use of double tax agreements (DTA) to invoke a taxing power to discriminate against entities in treaty partners countries.
- The application of a broad profit concept, without any necessity to reference specific underlying transactions as set out by OECD.

These are set out in more detail below:

1. Retrospectivity

The retrospective nature of the proposed legislation back to 1 July 2004 is explained as a clarification of existing legislation through the use of double tax agreements. However there is strong support for the alternative view that double tax agreements do not provide the power to make a transfer pricing adjustment independently of the domestic transfer pricing provisions. This alternative view has been clearly expressed in a number of recent court cases; Undershaft (No 1) Limited v Commissioner of Taxation [2009], Chong v Commissioner of Taxation [2000], GE Capital Finance Pty Ltd v Commissioner of Taxation [2007] and Roche Products Pty Ltd v Commissioner of Taxation, 2008.

Therefore business consider that taxpayers could legitimately have adopted a contrary view of the operation of the law, namely that the tax treaty rules do not operate independently of, and do not provide a separate taxing power from the domestic law.

Business does not agree with retrospective legislation as we need to know how the law operates when we enter into transactions. Doing business around the world or even between two countries means a potential conflict between different domestic tax systems. We recognise that countries are sovereign and their legislators sometimes do not take into account effects outside their jurisdiction. With accelerating globalization this should be reviewed to allow continuation of global growth and welfare.

We are concerned that retroactivity is not only unwelcome for the future of Australia's investment climate, it will also send a signal to other countries that retroactivity is an acceptable route, including those countries with which Australia trades and in whom Australian business invests . Currently, many countries have rules that forbid such retroactivity or have through other means indicated that retroactivity is not a course that will be used by their legislator. Retroactive rules will serve to cause a downturn in global economic activities. After all, how can an investor be certain of the legislative environment when it comes to the return on its investment made many years prior? Business has a responsibility under the Multi National Guidelines to comply with "the letter and the spirit of the law". How can a business do this where a government introduces retrospective legislation? BIAC considers retrospective legislation 'bad for business'.

2. Double Tax Agreements

In addition to the comments made above in relation to the lack of taxing powers invoked by double tax agreements in the Australian context, it is also important to bring to the attention of Parliament that this is out of line with international practice. None of Australia's major trading partners treat double tax agreements as giving a separate taxing power, such trading partners include China, Japan, USA, UK, New Zealand, Germany, Canada, France, Ireland and Italy.

The proposed sub-division 815-A will only apply to transactions with countries that Australia has a double tax agreement. There is a question as to whether such treatment is in breach of the non-discrimination article included in such treaties. Also perversely this would treat countries where the Australian Government has seen it fit to agree double taxation agreements in recognition of the trading relationship with such countries but then tax such relationships in an adverse way, while treating the likes of tax havens, where Australia has no double tax agreements, in a preferential way.

If Parliament, as the EM suggests, had intended double tax agreements to provide a taxing power wouldn't they have ensured, through changes to domestic legislation, that whatever mischief may have been occurring would also be caught in relation to non-treaty partners as well?

The EM makes reference to mutual agreement procedures articles (MAP) will ensure that no double taxation will occur as the Commissioner has an unlimited period of time in which to make transfer pricing amendments. Adjustments under sub-division 815-A will require adjustments in the non-Australian jurisdiction to remove double taxation, however in a number of jurisdictions there is a statutory time limit (e.g. 6 years in the UK) for adjustments, therefore there is a real risk of double taxation in a number of instances.

3. The application of a broad profit concept without reference to a specific underlying transaction

Sub-division 815-A refers to the arm's length profit accruing to an entity, and does not necessarily require that this profit be referenced to a specific underlying transaction. This is not in alignment with OECD which looks to transactions rather than a broader profit concept. This will lead to significant practical difficulties and may preclude the ability to contemporaneously set prices as arm's length parties would. In the not uncommon circumstance where an entity has dealings with multiple associates in multiple countries or with a mixture of 3rd party and connected party dealings, it will not be practical to determine a broad profit outcome. This is a common problem with multinationals setting up global service centres or global hub operations to services multiple local operations to maximise value add, efficiency, standardisation and control. To overcome this issue the legislation needs to refer to the profit in relation to a transaction or set of similar transactions. The UK has recently changed its transfer pricing rules (2010) and they have effectively brought in the concept of profit in relation to a transaction or series.

Yours sincerely,

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