11 July 2012

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The Chair

Senate Standing Committee on Economics

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Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No.1) 2012

The Federal Chamber of Automotive Industries (FCAI), the peak body representing the interests of the Australian automotive sector, have a keen interest in the Committee considerations of the proposed amendment to the taxation laws outlined in the Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No.1) 2012.

The FCAI has been involved in discussions with a range of Treasury, ATO, and Customs and Border Protection staff along with Parliamentary members over the period of development of this Bill. Copies of a range of our submissions to officials on this subject are attached for your reference (30 November 2011 submission and 13 April 2012 letter). The issues raised in these submissions remain the core matters that must be addressed in the legislation through the Committee.

The industry notes that the public submissions to the Treasury inquiry into this matter, including those from the wider professional legal and taxation community, almost without exception have a common opinion on the various contentious aspects of this proposed law. There is also no doubt that the area of transfer pricing is a highly complex area of taxation and as such the development of good public policy demands that the advice of those who not only understand the law but also its application to day by day commercial operations, represented through the range of submissions to the Stage 1 Transfer Pricing inquiry held by Treasury, be carefully considered. The FCAI submissions are core to this demonstrated wider body of knowledge and experience, all providing the same advice yet to this point, all seemingly ignored.

In short, our concerns are:

1. The retrospective nature of this legislation which is intended to apply from 1 July 2004, creating a great degree of uncertainty surrounding the taxation status between 2004 and 2012.

- The industry believes that this is new law, not clarification of existing law, and therefore would provide the Commissioner with a new retrospective taxing power;
- This will result in potential double taxation as foreign income tax authorities may not provide relief due to:
    - Legal time limits that apply for amendments;
    - The inability to relate any adjustment to an underlying transaction; and/or
    - Simply disagreeing with the ATO position.

- Customs Duty refunds not being available due to the retrospective change as a result of :
    - Legal time limits for refunds will have expired;
    - Potential conflict with the Customs Valuation rules. This will result in Customs Duty being paid on a higher value than is accepted for income tax. (Refer to 3 below. There should be a "whole of government approach" applying to the same transaction)

2. The proposed shift from an assessment of the arms-length nature of the dealings between two parties to an unconfined ability for the Commissioner to determine the profitability of an entity without reference to any underlying commercial transaction. This impacts not only the retrospective uncertainty, but also certainty going forward.

    - This will make it very difficult for our members to determine the relevant transaction necessary to defend pricing policies in relation to international dealings either to the ATO or indeed the Courts
    - Potential double taxation as foreign revenue officials may not provide relief as per the point immediately above (Note, both the OECD Guidelines and the Double Tax Treaties are written in a manner that contemplates adjustment to profits needs to relate to an underlying transaction/activity)
    - Customs Duty refunds not being available as the adjustment must relate to an underlying transaction being the "good" imported to Australia.

3. The inconsistency between the proposed income tax approach in 2 above and the necessary transaction based assessment under the Customs Valuation law.

    - The FCAI is of the view that a consistent whole of Government approach is necessary when addressing the same transaction. This proposed legislation leads to two different tests to determine the commercial value of the same transaction. In our view, it is not reasonable to place FCAI members in the invidious position of having to defend the transfer price in respect of the same motor vehicle under two different transfer pricing rules. This is most inappropriate and aside from the significant commercial and investment uncertainty the proposed amendments would create they would also lead to a significant regulatory burden for our members.

Given the seriousness of this matter and the potential impact on certainty of new and existing investment in the automotive sector we are of the view that the Committee should carefully consider the above and the attached. The amendments also traverse a subject matter which is quite complex and all parties, in our view, would benefit from an opportunity to further discuss this submission and the proposed legislation with the Committee.

We would both welcome and encourage the opportunity to meet with the Committee to as necessary expand upon and clarify the industry views as expressed in this note and the attached. Please contact Tony McDonald at the FCAI on if you would like any clarification or more information.

Yours sincerely,

Phil Allan

Chief of Staff

Federal Chamber of Automotive Industries

COPY

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30 November 2011

The Principal Adviser
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The Treasury
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By email: transferpricing@treasury.gov.au

Dear Sir/Madam

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.

The FCAI welcomes the opportunity to provide comments on the Consultation Paper which was issued on 1 November 2011.

The automotive industry is a major contributor to Australia's lifestyle, economy and community. The industry is wide-ranging – it incorporates exporters, importers, manufacturers, retailers, servicing, logistics and transport, including activity through Australian ports and transport hubs.

The Australian automotive sector exported $3.6 billion in vehicles and components in 2010 and the turnover in the industry exceeds $160 billion per annum. At present, the industry directly employs around 59,000 people through Australia's three vehicle manufacturers, importers and component manufacturers and more than 400,000 people directly and indirectly throughout Australia.

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

The FCAI has addressed a number of issues raised in the Consultation Paper, focusing on issues of most concern to its members, most importantly ensuring consistency with the arm's length principle and ensuring there is greater convergence of the valuation rules and avoid inconsistencies between the *Customs Act 1901* and *Income Tax Assessment Acts 1936 and 1997*.

Within this context the FCAI appreciates this opportunity to participate in the consultation process and accordingly provide the following comments adopting the headings used in the Consultation Paper.

1. Ensuring consistency with the arm's length principle

Paragraph 23 on page 5 of the Consultation paper states as follows:

> ***Division 13 focuses on pricing individual transaction and as a consequence of the transactional focus of the current rules, there may be judicial reluctance to accept profit based methods.***

FCAI members agree that Division 13 as currently enacted does focus on pricing individual transactions. FCAI members also believe that it is most important that this focus on "transactions" does not change.

As you will no doubt be aware, FCAI members are subject not only to the provisions of the *Income Tax Assessment Acts 1936 and 1997* (as amended) (ITAAs) but also to the *Customs Act 1901 Cth* (Customs Act) regarding the importation of motor vehicles. The valuation rules are contained in sections 159 to 161 of the Customs Act. In addition, section 154 (1) of the Customs Act provides a definition of "price" for the purposes of applying the valuation rules in order to determine customs duty liability. In summary, "price" includes all payments made directly or indirectly to the vendor in accordance with the contract of sale.

Accordingly, customs duty is levied on a transaction basis pursuant to the Customs Act. There is no reference in the Customs Act to overall profitability of the Australian operations. Therefore, to move away from a "transaction" focus to an overall profitability approach will cause tensions between transfer pricing for income tax purposes and transfer pricing for customs purposes. This will have adverse ramifications for FCAI members as follows:

- there may be no recourse to customs duty refunds in instances where the Tax Commissioner has applied an overall profitability measurement to an imported good and reduced the "price", and

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

Whilst recognising that the statutory schemes under both the Customs Act and the ITAAs are different, FCAI members believe that the overall objective to tax "on an arm's length basis" is similar. Therefore, the aim should be for greater convergence of the valuation rules

of both to ensure a consistent framework in order to ensure that there are no potential problems that would otherwise arise from inconsistencies in the legislative framework. In this regard I refer to a speech by Mr Terry Moran[1], former Secretary of the Department of Prime Minister and Cabinet, concerning the goal for a holistic approach to Government policy as follows:

> "Strategic policy advice must consider the levers available to government across all policy domains and not restrict itself to particular silos."

Further in relation to this holistic approach, the Advisory Group on Reform of Australian Government Administration have recommended that when Government considers changing regulations, care needs to be taken to avoid regulatory burden[2].

2. The objective of the rules is to ensure the overall profits of the parties reflect an arm's length outcome given their respective economic contributions

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. It is manifestly unjust and unfair to impute a notional profit when none was derived. The above statement also fails to recognise that in any 10 year business cycle, businesses lose money for a variety of reasons, including factors beyond their control, such as significant fluctuations in currency exchange rates, customer preferences, competitive factors, and as evident in recent years, the global economic crisis. As you will recall, the automotive industry suffered such significant financial losses during the global financial crisis that in a number of countries, including Australia, government financial assistance was made available to prevent closure of operations and the flow on economic ramifications.

It should also be emphasised that Associated Enterprises Article "Article 9" in most of Australia's tax treaties only permits Australia to tax those profits which may have reasonably accrued if the parties were dealing in a wholly independent manner.[3] This Article does not grant authority to revenue officials of either jurisdiction to tax profits on an overall bench mark basis.

3. Profit methods are frequently relied upon by taxpayers and administrators alike

FCAI members do not agree that profit methods are frequently relied upon, nor do FCAI members agree with the statement in paragraph 24 on page 5 of the Consultation Paper

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[1] Speech by Mr Terry Moran AO Secretary, Department of the Prime Minister and Cabinet to the Institute of Public Administration Australia Public Lecture Reform of Government Administration: From Blueprint to Outcomes 18 May 2010 at page 3.

[2] Ahead of the Game Blue Print For the Reform Of Australian Government Administration March 2010 Recommendation 1.4: Reduce unnecessary Business Regulation Burden - advisory Group on Reform of Australian Government Administration.

[3] The United States Convention Article 9 Associated Enterprises.

that the OECD Guidelines give profit based methods equal priority to traditional methods. The OECD Guidelines tend to focus less on the results of transfer pricing and more on whether transfer prices were established in an arm's length manner substantially similar to the manner in which uncontrolled parties would negotiate prices.[4] In addition, the OECD Guidelines express a higher level of preference for the use of traditional transaction methods for testing the "arm's length character of transfer prices for transfers of tangible property.

Furthermore, the OECD Guidelines[5] state that:

> "Methods that are based on profits can be accepted only insofar that they are compatible with Article 9 of the OECD Model tax Convention, especially with regard to comparability."

4. Retrospectivity

FCAI members do not believe it is good tax policy to empower the Commissioner of Taxation to apply the new rules retrospectively to 2004, as advised in the Assistant Treasurer's Press Release. FCAI members have complied with tax legislation in accordance with the tax laws as enacted at the time. Applying the proposed changes retrospectively may result in some members being placed in unfavourable tax positions through no fault of their own. In practice, revenue officials in the foreign jurisdiction may not agree to amend prior year assessments or those assessments may be out of time for amendment. This will result in double taxation without treaty relief.

In addition, Customs officials may not agree to provide duty refunds due to either time limits for refunds expiring or technical valuation methodology reasons. I refer to the Recommendation of the Senate Estimates Committee[6] in respect of legislating retrospectively as follows:

> "The Committee is firmly of the view that legislating retrospectively should not be an approach that is frequently used, nor one pursued without careful consideration. Retrospective legislation can lead to potential uncertainty and has the ability to significantly impact the rights of those affected. In the sphere of tax laws, retrospective changes can pose practical difficulties for those affected in managing their tax affairs."

Further, to enact retrospective changes as a result of recent litigation (refer clause 22 of the Consultation Paper) which has produced a favourable outcome to the taxpayers, is not within the spirit of co-operative and collaborative compliance in a self assessment regime. FCAI members believe that it is not appropriate for the Government to retrospectively change the law merely as a result of failed legal proceedings.

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[4] OECD Review of Comparability of Profit Methods: Revision of Chapters I –III of the Transfer Pricing Guidelines 22 July 2010 at page 21 at paras 2.3 to 2.10.

[5] Refer footnote 4 above at para 2.6.

[6] Senate Economics Legislative Committee Tax Laws Amendment (2011 Measures No. 8) Bill 2011 (Provisions) November 2011 at page 16 paragraph 2.41.

5. Time limits

Time limit for amendments regarding transfer pricing afforded to the Commissioner of Taxation pursuant to subsection 170(10) should be consistent with subsection 170(1). Prescribing different time limits for transfer pricing adjustments will continue to burden taxpayers with uncertainty of tax assessments. Subsection 170(1) Item 5 and Part IVA provides the Commissioner of Taxation the legislative authority to redress any genuine tax evasion without a time limit.

Summary

FCAI accordingly request that the Treasury consider its members concerns and the potential ramifications for FCAI members, not only from an income tax perspective, but also in relation to Customs Duty. This is particularly relevant as both Income Tax and Customs are ultimately the responsibility of the Federal Treasurer and the Treasury. As mentioned in this submission, the Government has previously committed to a whole of Government approach to legislation.

The FCAI would welcome the opportunity to discuss this submission with you in further detail and will be in contact in the near future to arrange a meeting.

Yours sincerely

Ian Chalmers
Chief Executive

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13 April 2012

The Manager
International Tax Integrity Unit
The Treasury
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Dear Sir/Madam

Submission on: Exposure Draft Tax Laws Amendment (2012 Measures No. 3) Bill 2012 Cross- Border Transfer Pricing

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 changes to the transfer pricing rules, not only for income tax purposes but also for customs duty purposes.

As the FCAI has already provided detailed comments in our submission dated 30 November 2011 in relation to the Consultation paper – Income Tax Cross Border Profit Allocation – Review of Transfer Pricing Rules, (copy enclosed) - we advise that those comments also form part of our current submission.

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 16 March 2012 in addition to those raised in the Consultation document :

Operative provisions

Section 815-10 Object

As stated in the Exposure Draft the object of Subdivision 815-A is to ensure that ***"profits"*** are appropriately brought to tax in Australia , consistent with the arm's length principle. The objects clause fails to link the concept of dealing at arms length with either a specific person or persons, or a specific transaction or transactions. As there is no link to an underlying transaction or specific activity, the concern is that the term "profits", used in this context, may be construed very broadly to include a consideration of overall profitability, and to permit the imposition of additional income tax without reference to any specific dealing or dealings of the taxpayer.

As mentioned in our earlier submission, 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.

Section 815-22 When an entity gets a transfer pricing benefit and Section 815-30 Commissioner may ensure transfer pricing benefit is taxed

In keeping with the Objects clause, section 815-22 refers to "an amount of profit" that an entity might have accrued as being a "transfer pricing benefit." Also in keeping with the Objects clause, section 815-30 authorises the Commissioner to ensure such a "transfer pricing benefit" is subject to tax by simply making a determination to increase the taxable income of an entity in one or more income years. There is no link to an underlying transaction. There is no requirement that the Commissioner identify an actual taxable dealing or transaction as giving rise to the increase in taxable income. While sub-section 815-30(2) permits the Commissioner to do this at the Commissioner's discretion, there is no requirement that this occur before a tax assessment is made.

Reference is made to the UK Transfer Pricing legislation[1], 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". In our submission, this is the correct and preferred approach.

It is submitted that both section 815-22 and 815-30 are inconsistent with the general structure of the Income Tax Assessment Acts, which do not impose income tax on a taxpayer's net "profit" – but rather, impose tax on taxable income calculated under the Acts as arising from individual amounts of assessable income and allowable deductions, as derived or incurred from specific transactions and dealings.

It is further submitted that both sections are also inconsistent with section 3(2) of the International Tax Agreements Act 1953, and, in particular, the interpretation of that provision advanced by the Commissioner, and accepted by the Full Federal Court, in *Russell v CT*

[1] 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

[2011] FCAFC 10. As the Commissioner submitted, and as that case makes clear, a reference to profits of an enterprise in a treaty is to be construed as meaning those profits which are, according to the meaning of the Income Tax Assessment Acts, taxable income in the hands of an identifiable taxpayer. It follows that, before a transfer pricing adjustment can be made under the associated enterprises article, there must first be an identification of an actual transaction of an actual taxpayer which would otherwise give rise to taxable income within the meaning of the Income Tax Assessment Acts. The associated enterprises article cannot be used to manufacture taxable income where there is no specific underlying transaction of an actual taxpayer to which the taxable income can be attributed.

Thus the proposed amendments go far beyond "clarifying" the previous operation of the transfer pricing rules. They provide the Commissioner a new, unprecedented, power to impose additional income tax by direct determination, without any requirement to bring the adjustment to tax liabilities within the specific assessing provisions of the Income Tax Assessment Acts.

Section 815-25 Cross Border transfer pricing guidance

Both subsection 1(c) and (3) are problematic in that they provide no guidance as to what additional documents will be used by the Commissioner for the purposes of achieving interpretive consistency in the application of the Division. Whilst it creates maximum flexibility for the Commissioner, it will create uncertainty for taxpayers in understanding and complying with the law.

Section 815-30 Commissioner may ensure transfer pricing benefit is taxed

Whilst this section empowers the Commissioner to make a determination giving effect to a transfer pricing adjustment, it does not require him to provide a copy of the determination to the taxpayer. Therefore, the situation could arise whereby an FCAI member receives a transfer pricing adjustment to overall taxable income with no underlying explanation as to how the adjustment was calculated and whether it related to a particular transaction, or amount of assessable income or deduction. This will create uncertainty for our members and make it very difficult to object, litigate or obtain a Customs Duty refund if applicable. This will also have potential double tax implications for FCAI members considering a MAP process as they will have insufficient information.

Principles Based Legislation

As the Exposure Draft has been draft according to "principles based legislation" reference is made to a University of Oxford research paper by Judith Freedman [2] as follows:

"It raises fundamental questions about the interpretation of legislation, the separation of powers as between the legislature, the courts and the administration, and the level of detailed guidance required to satisfy basic requirements of the rule of law".

[2] University of Oxford Legal Research Paper Series paper No 26/2011 April 2011 - " Improving (Not Perfecting) Tax Legislation; Rules and Principles Revisited by Judith Freedman Reprinted from British Tax Review Issue 6, 2010 Sweet & Maxwell at page 718.

Whilst "principles based legislation" has advantages and is much easier to comprehend, unless it provides clear detailed guidance it will lead to greater uncertainty for taxpayers. As written, the Exposure draft provides the Commissioner with far greater discretion to amend taxable income without the obligation to provide taxpayers with background supporting details, or to link the adjustment to specific transactions or dealings. It will be very difficult for a taxpayer to mount a legal challenge in a Court of law due to this uncertainty, or for the judiciary to interpret the law as placing any limit on the Commissioner's discretion to impose additional income tax as he or she sees fit. Provisions which have the practical effect of making the exercise of taxing power immune to judicial oversight are not consistent with the rule of law.

Interaction between Transfer Pricing Rules and Customs Valuation Rules

As you will be aware, FCAI members are subject not only to the provisions of the Income tax Assessment Acts of 1936 (as amended) and 1997, but also the Customs Act 1901 "Customs Act" 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, under the existing Division 13 of the Income Tax Assessment Act the focus is on "transactions". This focus will change completely under the new rules envisaged in the Exposure Draft.

This inconsistency in approach may have adverse ramifications for FCAI members. 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.

Retrospective Legislation

As stated in our earlier submission, we do not believe it is good tax policy to empower the Commissioner of Taxation to apply the new rules retrospectively to 2004. Members have complied with tax legislation in accordance with the tax laws as enacted at the time. Applying the proposed changes retrospectively may result in some members being placed in unfavourable tax positions through no fault of their own. In practice, revenue officials in the foreign jurisdiction may not agree to amend prior year assessments or those assessments may be out of time for amendment. This will result in double taxation without treaty relief. In addition, Customs officials may not agree to provide duty refunds due to either time limits for refunds expiring or technical valuation methodology reasons.

In Summary

We accordingly request that the Treasury consider our concerns and the potential ramifications for our members, not only from an income tax perspective, but also in relation

to Customs Duty. This is particularly relevant as both Income Tax and Customs are ultimately the responsibility of the Federal Treasurer and the Treasury. As mentioned in our earlier submission, the government has previously committed to a whole of government approach to legislation.

Yours faithfully

Ian Chalmers
Chief Executive