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The Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

By Email: economics.sen@aph.gov.au

Dear Sir/Madam

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

We refer to the above inquiry and thank-you for the opportunity to provide our comments on the *Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No 1) 2012* and its potential impact on Australian taxpayers, business investment, and our broader international trading relationships.

Australia is a developed nation which is fully integrated with, and exposed to, the global economy. As stated in the initial consultation paper,[1] related party dealings represent approximately 22% of GDP.[2] Australia's transfer pricing policy has a direct and significant impact on the inbound flow of capital, job retention and creation, labour force skills, labour wage levels (through 'capital deepening'), diversification of our economic base and innovation. Australia's transfer pricing policy also has a major role to play in our international trading relationships.

Australia's transfer pricing policy does not exist in an international vacuum; it is currently consistent with and therefore to an extent circumscribed by, internationally accepted norms.

[1] The Treasury, Income Tax: Cross-Border Profit Allocation, Review of Transfer Pricing Rules, Consultation Paper dated 1 November 2011

[2] The Treasury, Income Tax: Cross-Border Profit Allocation, Review of Transfer Pricing Rules, Consultation Paper dated 1 November 2011, page 2. Extracted from ABS data released May 2011; *5352.0 -International Investment Position, Australia: Supplementary Statistics, Calendar year 2010;* http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5352.0Calendaryear2010OpenDocument

Accordingly, any changes to the Australian rules that govern international transactions within multinational groups should be thoughtfully and consensually implemented through the Australian Parliament in a non-partisan manner. It is therefore concerning that the reform process to date can best be characterised as the complete antithesis of this. Reforms have been introduced with haste, legitimate concerns remain unaddressed, and the feeling of many in the taxpaying community is the 'reform package' is a done deal. This undermines confidence in the consultation process; raises significant doubts about the 'quality' of the amendments (and therefore their longevity, which adversely affects long lead time investment certainty); and raises credible concerns of tit-for-tat retaliation from other nations, particularly in respect of the retrospectivity of the amendments.

The avoidance of the double taxation of corporate profits is one of the key objectives of the international taxation framework developed by the OECD, amongst other international organisations. Australia's unilateral changes to its transfer pricing policies, in the manner proposed, simply increases the risk of double taxation of Australian sourced profits for both Australian and non-resident groups operating in Australia.

If we are to remain an investment destination of first choice, (and there are many alternative options open to global companies) we must have an environment where law is known and certain (we allude here to the unacceptable proposal to back-date the legislation to 2004 with no adequate justification), and changes are the outcome of open, *genuine* consultation and debate.

Our comments are solely guided by the Government's stated intention of the review, being to ensure Australia receives its 'fair share' of revenue, while continuing to encourage investment into Australia.[3]

We consider the reforms as they currently stand will not have the desired effect as outlined in the initial consultation paper. They will not encourage or facilitate investment, but instead increase uncertainty and complexity. Ultimately, potential investors will go elsewhere. The Bill, in its current form, should not be enacted without substantial change.

Consultation Process

Firstly, we would like to re-iterate our deep concern that the consultation process to date has been mechanical. The areas highlighted in the submissions of interested parties remain largely unaddressed, and little movement has been made from the original position of the Government, despite overwhelming disagreement as evidenced in the submissions to the consultation process. It would seem the end result of this process was arrived at long ago.[4]

The real and practical concerns of taxpayers including documentation, self-assessment and time limits need to be addressed. The retrospective application of the proposed amendments is unacceptable, and the basis and justification for this "clarification" in complete defiance to the operation of a democratic Government. These concerns have been highlighted in our previous two submissions and those of other parties, however, we highlight them again as it appears there is little resonance.

Summary of Concerns

To summarise our position on the draft legislation, we are concerned by the following technical aspects, discussed at length in our submission dated 13 April 2012:

- The increased complexity of the legislation, with three concurrently operating sets of provisions which will only serve to increase uncertainty and the cost of compliance;

[3] The Treasury, Income Tax: Cross-Border Profit Allocation, Review of Transfer Pricing Rules, Consultation Paper dated 1 November 2011

[4] We note in particular here the Minister's press release of 1 November 2011 regarding the retrospective nature of the legislation and its 'clarification', where this position is highly in doubt.

- The unfairness of provisions that subject entities transacting through treaty countries to the 'double jeopardy' of complying with two sets of transfer pricing rules, while not exposing those operating through non-treaty countries to the same 'double jeopardy';
- The use of new and unclear terminology in the legislation, such as 'transfer pricing benefit';
- The retrospective application of the changes particularly with regard to the transaction reconstruction power. This is totally unnecessary and inequitable, and can only reflect adversely on Australia's perception as a 'rule of law' country;
- Uncertainty in the incorporation of the OECD guidance and the ability to turn components of the guidance 'on and off'; and
- The inappropriate and confusing drafting of the interaction between the transfer pricing and thin capitalisation provisions.

It is our overriding view that the draft legislation has been "rushed through" to deal with perceived weaknesses in the current legislation. It has been formulated with the "broadest possible interpretation" to extend the powers of the ATO, and is to be applied retrospectively. The result of the draft legislation will not be increased tax revenues, but increased disputes both domestically and internationally, coupled with increased litigation. Nor will the draft legislation provide certainty for international investors or trading partners.

In addition to the above, we make the following further comments.

International Best Practice

Australia is a growing component of an integrated global economy, and the corporations that transact across our borders do so mainly by choice. We are heavily reliant on foreign investment, both monetary and human, to develop and maintain our position as an economy of strength in a global environment. It follows from this that Australia is entitled to tax the multinational entities that transact across its borders.

Equitable cross-border taxation has historically been a difficult task; with the OECD committing extensive resources over the past decades to assist global economies achieve this task. This has included the development of tax treaties and the transfer pricing guidelines. Not every jurisdiction necessarily agrees with all aspects of the OECD's guidance; however it is a model which allows global corporations to have a degree of certainty in operating across borders and is broadly fair in its allocation of taxing rights. Such models only work where all participants agree in the substantive main to conform to its requirements.

We are greatly concerned that the direction the Government is seeking to head with regard to its review of Australia's cross-border taxation policies represents a departure from this internationally accepted model, and an erosion of international consensus. The focus of consultation thus far appears to be on ensuring Australia taxes its "fair share of profits" (as opposed to receiving arm's length consideration). What is Australia's "fair share of profits" (based on relative economic contribution) in any given transaction or circumstance is a highly subjective question and will receive a different answer from every Revenue authority worldwide. As does the reciprocal question of any international authority's "fair share" when asked of the ATO. For this reason, the move in Australia to taxing based on a "fair share of profits based on relative economic contribution" is unworkable. What is proposed appears to be a form of 'free for all'. The impact of this will be, in our view, business uncertainty and concern over the Australian political process. It will result in increased disputes, double taxation and reduced international investment. If Australia wishes to be highly involved in the global economy, it must conform to global interpretations or risk losing investment.

The current proposed legislation represents a significant departure from the internationally accepted arm's length principle. The wording of the legislation refers to a difference in profits, rather than focusing on arm's length pricing of transactions. The current arm's length principle is well understood, adopted internationally and importantly, is applied by our major trading partners. There should be no departure from this principle. Judicial decisions which are adverse to the ATO are not a justifiable reason to warrant rushed responses such as that made to date; 'Chicken Little' is not an appropriate role model for the Australian Government in seeking to modify domestic transfer pricing policy and rules.

Investment Environment

These reforms should be viewed in the context of the current changes underfoot facing Australian taxpayers. We highlight here, for example, the mining industry. In the past year, there has been the introduction of the MRRT (of which considerable effort was expended in ensuring double taxation **within** Australia did not occur), the carbon tax, discussion of alterations to the thin capitalisation provisions, changes to LAFHA which impact on the availability of skills, all compounded by the current industrial relations environment.

Increasing the tax uncertainty through the proposed transfer pricing changes (with retrospective application) will compound these issues in the competitive task of attracting foreign capital. It would be foolish to think that international investors will continue to invest here when the returns available in other jurisdictions are superior. We note here, for example, the increasing number of announcements deferring mineral and petroleum investment decisions in Australia and do not see evidence of this trend in other resource-reliant countries. Australia is a participant in the global market place and capital is a highly mobile commodity. Given the choice, investors will direct capital away from uncertain political, economic and legislative environments.

Documentation

While we acknowledge the current Division 13 requires amendment to allow the use of profit-split methods, the focus of the transfer pricing review should be on implementing clear guidance as to what are and are not appropriate comparables and what constitutes adequate contemporaneous documentation. A proper review of the decisions in *SNF* and *Roche* will reveal this as the major short-coming in the ATO's argument, not the legislation. The overall OECD framework which upholds allocating taxing rights on an arm's length basis should not be interfered with in any way.

Conclusion

The Bill proposed to date needs a fundamental rethink. As an absolute minimum the retrospective elements of the Bill should be removed, and if not, adequately justified. Transactions through treaty countries should not be treated differently than those through non-treaty countries, and certainly not treated with greater scrutiny. Finally a commitment to the arm's length principle and international best practice should be made to ensure the ATO does not take extended liberty in its interpretations.

Going forward, the review of the transfer pricing legislation should be focused on ensuring taxpayers have clear guidelines on how to comply with the arm's length principle. It will follow from meeting this obligation, that the correct transfer prices will be arrived at and paid. This will ensure a more stable environment to attract foreign investment, will facilitate prompt and accurate payments of tax, and maximise the potential for correct collation of supporting documentation.

In closing, we consider the reform process has been unsatisfactory. The current Bill falls well short of achieving the stated goals and makes Australia a much more difficult investment destination for multinational companies. We can ill afford to push such opportunities away.

RSM Bird Cameron

RSM Bird Cameron is the Australian member firm of the RSM International network of accountants and business advisors. Within Australia, RSM Bird Cameron boasts a national network of 26 offices which, combined with our 90 year Australian heritage, has helped us develop an extensive understanding of Australian business trends and conditions. RSM International is a global accounting and business advisory network, spanning 83 countries, and ranks 6th on the table of international accounting groups. RSM International targets internationally active businesses, and transfer pricing is a 'hot topic' within this community of clients. RSM's specialist transfer pricing teams are extensively engaged in assisting multinational enterprises comply with their transfer pricing obligations in Australia, and globally, and the uncertainty and cost associated with these Australian proposals is a matter of vocal concern in discussions with those clients with Australian operations.

Please contact Anthony Hayley on or should you wish to further discuss any of the above.

Yours faithfully

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