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

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

Dear Sir,

Thank you for the invitation to make a submission to the inquiry.

Consistent with our earlier submissions to the Treasury, we fundamentally oppose the introduction of the proposed retrospective transfer pricing legislation given that it is inherently unfair, technically flawed and potentially damaging to Australia's trade and direct investment. Even though we do not agree with a number of aspects of the new legislation, it would be more appropriate if the new law operated on a purely prospective basis. This would allow taxpayers to consider and take stock of their transfer pricing positions and arrangements in light of the new law and potentially look to change them on a prospective basis, if it is considered necessary.

Having said this, the objective of our submission is not to restate the concerns detailed in our previous submissions, which we have attached for your further information and consideration. The objective of this submission is to identify areas for further consideration which, if addressed appropriately, should mitigate a number of the negative aspects arising from the introduction of this legislation. These areas for further consideration are set out in Attachment 1.

If you have any comments or questions regarding any of the matters discussed in our submission, please do not hesitate to contact either of the undersigned. If it would facilitate your review of this important issue, we would be happy to discuss such matters in person.

Yours sincerely

Paul Balkus

Jesper Solgaard

Copy: Mr David Bradbury, Assistant Treasurer

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ATTACHMENT 1

Submission

The primary areas for further consideration include the following:

1. Application of penalty provisions
2. Treatment of transfer pricing matters previously agreed under an audit settlement agreement ("Audits"), Advance Pricing Agreement ("APA's") or Mutual Agreement Procedures ("MAP")
3. Selection of future transfer pricing reviews and audits
4. Introduction of a transition period

Each of these areas of concern is discussed below.

1. Application of penalty provisions

The proposed legislation provides that where a determination is made under subsection 815-30(1) for income years before 1 July 2012, the penalty would be determined on the basis that Subdivision 815-A had not been enacted. This approach introduces a number of issues as to how this would apply in practice. In particular, this approach would seem to require at least two layers of analyses that would address the following questions:

- What part of the determination relates to an adjustment under Division 13?
- What part of the determination relates to an adjustment under Subdivision 815-A?
- What part of the determination potentially relates to either Division 13 or 815-A?

To address these questions in a transfer pricing audit would seem to require the taxpayer to run the gauntlet of two different transfer pricing rules. Given the time and resources required to arrive at a determination under existing Division 13, attempting to consider potential adjustments under both having regard to the potential for an overlap of these different rules would suggest that this approach is fundamentally flawed.

Further, it is also somewhat concerning where a taxpayer is able to demonstrate that the transfer pricing position adopted would not have resulted in an adjustment under Division 13 (i.e. that the position adopted is consistent with the current legislation) that the best such taxpayer can hope for is an elimination of any penalties arising from the application of a new set of rules.

Therefore, to help mitigate adverse consequences arising from the introduction of this retrospective legislation, the following clarifications should be made to the application of penalties:

- Taxpayers do not need to prove that there would not have been a determination under Division 13 or what portion of the determination is subject to Division 13 and/or 815-A.
- Where the Commissioner makes a determination that relies in whole or in part on 815-A such determination would not be subject to penalties or general interest charge.

2. **Treatment of transfer pricing matters previously agreed under Audits, APA's or MAP**

Although there have been recent comments by the Commissioner and Second Commissioner (Bruce Quigley) that suggest that it is "unlikely" that transfer pricing matters previously agreed under Audits, APA's or MAPs would be re-opened, these comments provide insufficient comfort to taxpayers and little in the way of defence should such adjustments be suggested. We also raise the issue of cases that are currently in an advanced stage of completion, based on the current legislation.

These cases were completed or have been substantially completed on the basis of the previously enacted legislation and it would grossly unfair and inappropriate to introduce this level of taxpayer uncertainty. Once again, it is ironic that taxpayers that have not been previously audited may find that their determination could be materially different from a taxpayer that was previously audited with a similar fact pattern.

Therefore, to help mitigate adverse consequences arising from the introduction of this retrospective legislation, there should be an explicit statement from the Commissioner that Subdivision 815-A will not be used to re-open, amend or in any way modify transfer pricing positions that have been previously agreed (or are currently at an advanced stage of completion) under Audits, APA's or MAP.

3. **Selection of future transfer pricing reviews and audits**

There have been repeated assertions by the Treasury/ATO that the proposed legislation simply clarifies how the law operated in the past and that it is "business as usual" for the ATO. That is, the introduction of this legislation will not change the way in which the ATO has been seeking to apply the transfer pricing provisions. Therefore, taxpayers would be rightly concerned if the ATO was to now embark on a major transfer pricing risk review and/or audit program initiative with the express intent of retrospectively applying Subdivision 815-A.

We accept that the ATO should have the right the right to examine the affairs of taxpayers and that there will be taxpayers that may have been selected by the ATO for review prior to the announcement of the new legislation. However, we think it reasonable that the Commissioner agree in principle that any taxpayer who has been previously internally risk screened by the ATO and not selected for review or audit, would not now be selected for review or audit purely on the basis of Subdivision 815-A.

Therefore, to help mitigate adverse consequences arising from the introduction of this retrospective legislation, there should be an explicit statement from the Commissioner that a taxpayer will not be selected purely on the basis of Subdivision 815-A being enacted.

4. **Introduction of a transition period**

The introduction of retrospective legislation that introduces an alternative application of the transfer pricing rules that may be inconsistent with the current legislation creates a significant impediment for taxpayers wishing to modify existing transfer pricing practices.

That is, where a taxpayer makes a change in existing transfer pricing practices as a result of 815-A this change could be seen as an admission by the taxpayer that the prior position was incorrect.. We would suggest that taxpayers would then be concerned that such an admission could be used by the ATO to support a position that the prior transfer pricing position should be adjusted. To avoid potentially undermining earlier transfer pricing positions, taxpayers may be motivated to maintain existing positions and to develop audit defence strategies that take into account the new rules. This will only lead to more audits and lower rates of change in taxpayer behaviour.

Therefore, to help mitigate adverse consequences arising from the introduction of this retrospective legislation and to encourage a change in taxpayer behaviour, some form of transition period should be introduced. These transition rules should be structured such that taxpayers can reasonably modify their future transfer pricing positions without undermining earlier transfer pricing positions or risk having such change used against them. For example, taxpayers not currently subject to audit or review, could be given a 12 month period from the introduction of the new legislation in which to modify their transfer pricing arrangements to more closely align with 815-A with the assurance that earlier transfer pricing positions would not be adjusted and penalised.