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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 (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013

We refer to the above inquiry and thank you for the opportunity to provide our comments on the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013* and its potential impact on Australian taxpayers, business investment, and our broader international trading relationships. Our submission will comment only on Schedule 2 of the Bill, those provisions pertaining to the modernisation of the transfer pricing rules.

Australia operates in a global economy where our transfer pricing policies have a direct and significant impact on capital flows, job retention and creation, labour force skills, labour wage levels (through 'capital deepening'), diversification of our economic base, innovation and our international trading relationships.

It is therefore beyond question that *any* legislative changes affecting these relationships be considered deeply and thoroughly and a "consensus position" adopted. Such critical matters should not be subjected to short term political interests, nor that a "one size approach" fit all circumstances. We strongly reiterate here our comments from earlier submissions that the reform process to date has been hastily implemented, legitimate concerns remain unaddressed, new concerns have been raised, and the thoughts and recommendations of many knowledgeable individuals and organisations have been largely ignored. We would implore the Committee to take the time to critically and diligently examine the draft legislation and ensure its deficiencies, many of which have been identified in earlier submissions to this process, and are not further mentioned here, are addressed to prevent excessive and unnecessary angst in the future.

Our comments are, and have been, 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.[1] The reform process to date has in our view singularly failed to meet these objectives.

We consider the reforms as they currently stand represent a rushed attempt at giving the ATO what it wants: put crudely more ammunition to try to increase tax revenue. We do acknowledge there are some positive developments in the draft legislation but these are submerged beneath its negative aspects. The main operative provisions appear to be a concoction of several similar, but technically different concepts, rendering these provisions confusing. These confusions will ultimately be resolved by the courts. The proposals do not take into account the full effect of the proposed changes on investment in Australia, and have paid no regard to the additional burden and cost they will place on business, particularly those in the SME sector.

Summary of Concerns

To summarise our position on the draft legislation, we are concerned by the following particular, discussed further below:

- The attempted reconciliation between international best practice and Australia wishing to maintain its preferred domestic practices and interpretations. The result is clumsy, complex legislation;
- The timing of the consultation and drafting process;
- The potential impact on the investment environment; and
- The impact on small and medium enterprises.

International Best Practice

Australia's objective of aligning its transfer pricing laws with those of international best practice is laudable, and indeed necessary in today's economic climate. Currently, international best practice with regard to transfer pricing is generally viewed as being that espoused by the OECD Transfer Pricing Guidelines. In turn, the draft Legislation attempts to incorporate these Guidelines into our domestic law. It is important to recognise however that the OECD Transfer Pricing Guidelines are premised on a functionally separate entity approach. This is given effect in several ways, including requiring reference to the OECD Model Tax Convention for the interpretation of the arm's length principle. This interpretation is primarily based on the concept of profits not price. The OECD Transfer Pricing Guidelines however, remains largely based on transactions and price. Additionally, the draft legislation is littered with terms and concepts lifted from the transfer pricing Guidelines. The reconciliation between the two is confusing and will be difficult to implement.

As an example of the difficulty in trying to incorporate the two together, Section 815-125 defines 'arm's length conditions' (a model tax convention concept) for the purpose of determining whether an entity gets a transfer pricing benefit under section 815-120. Subsection 815-125(2) stipulates that in identifying the arm's length conditions, taxpayers are to use the method, or combination of methods, that is the most appropriate and reliable (transfer pricing guidelines concept). We assume, given the terminology used, that this is a reference to the OECD Guidelines' five recommended methods for determining compliance with the **arm's length principle (range)**. The OECD Guidelines does not envisage, nor is it possible, to use the five methods to determine the 'arm's length conditions'. Arm's length conditions, and arm's length range, are two entirely different concepts. The former relates to circumstances surrounding the transaction, the latter a numerical range of financial margins. The subsection as drafted, appears to confuse these two concepts and is therefore nonsensical and provides no additional assistance to taxpayers in determining the arm's length conditions.

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

We also add to this the current review underway by the Board of Taxation on the attribution of profits to PE's, and their examination of the OECD's adopted functionally separate entity approach. If the legislation is to align with international best practice, we would consider its implementation should be left until the outcome of this examination is known. This will prevent additional alterations and, most likely, given the current flippancy towards its introduction, retrospective legislation.

Timing and haste of consultation and drafting process

Upon release of the second tranche of the draft legislation, it became evident that the first tranche was now largely redundant. This is symptomatic of the whole process whereby consultation and legislation has been rushed, leading to inappropriate and overly complex outcomes. As alluded to above, and in many of the submissions to both tranche 1 and tranche 2 of the rewrite project, the legislation as drafted is sloppy and relies on a 'vibe of the law' principles approach, which invariably leads to the type of result that has instituted this whole process in the first place – costly litigation and the legislation being labelled as 'inadequate' and 'not achieving the intended effect of Parliament' to use a few terms recently thrown up.

If adequate time is allocated for consultation and drafting, and the feedback received during the consultation process is noted and duly acted on, the Legislation will operate as intended and there will be little or immaterial consequences. Professionals, taxpayers and industry bodies have an incredible depth of both theoretical and practical knowledge of the operation of Australia's tax regime and their opinions should not be ignored without rationale due cause. They understand the costs of compliance, the impact on investment and the practical implications of changing our tax laws. They are not 'fringe groups' with vested interests. Instead they seek simplicity and predictability, which should be cornerstones for all proposed legislation. It is regrettable that they remain largely ignored.

Unintended consequences are not fixed by rushing through changes that will result in more unintended consequences. This point cannot be emphasised enough and, regrettably, transfer pricing is not the only aspect of Australia's tax regime which is currently suffering from this haste and ill-advised changed.

Investment Environment

We have highlighted in earlier submissions to this rewrite project, the proposed changes in the context of the investment climate facing Australian taxpayers. We can now add to an already considerable list (which includes the carbon tax and industrial relations regime) the uncertainty surrounding 457 Visas, and an upcoming election.

An important aspect of any investment decision is the stability and predictability of its tax regime. To this extent, two aspects of the draft legislation concern us greatly. The first is the Commissioners powers to reconstruct transactions. Almost no limit is placed on this power, and very little guidance is given for its use. The OECD guidance has clear directions on the use of such a power, being only in *exceptiona*l circumstances. To prevent this power being used incorrectly and thereby possibly eroding confidence in our tax system, the OECD wording should be incorporated into any such power.

The second is the lack of retrospective protection in the Bill. Nothing in the draft offers protection to taxpayers from the Commissioner reconstructing transactions under this new power entered into in periods commencing before its enactment.

Small Medium Enterprises

RSM Bird Cameron is proud to act on behalf of many small-medium sized enterprises and understands the resource pressures they are under – not only from a cost perspective but often, more importantly, from a time perspective. Businesses in the growth stage wishing to expand their operations locally and internationally do not

have the appropriate resources to prepare compliant documentation themselves, nor can they easily afford to pay others to do it for them. Nor is it a priority for most small business owners who are concerned with obtaining and training staff, investing in new markets, and complying with the proliferation of red tape already in existence. These entities are collectively attempting to grow and drive our economy, not engage in tax avoidance or profit shifting.

A simple reflection on the ownership structure of these entities will also reveal many as Australian owned. It is therefore logical, under Australia's current international tax system to bring to account in Australia as much profit as possible as this allows dividends to be franked, and reduces tax leakage whereby a credit for foreign tax paid is not provided. These enterprises should not be caught up in the current changes which are increasingly becoming a political game. The current drafting which includes them is ignorant of their situation, and indeed the reality of Australia's international tax regime.

The lack of an adequate *de minimus* threshold within the legislation amounts to a significant burden being placed on the SME sector, particularly given these enterprises do not engage in the supposed profit shifting of multi-national enterprises which these legislative changes have been sold on. It is very unfortunate, and indeed concerning, that the smaller end of town will once again suffer from changes brought on by the actions of larger enterprises.

We would strongly advocate the committee consider the lack of protection offered to small and medium enterprises by these proposed changes and the cost to their growth and resource allocation. We recommend that a threshold aligned to the IDS $2m should be adopted as an appropriate threshold level at which the legislation has effect.

Conclusion

In summary, these are our concerns in regards to the draft legislation. It stands as a clumsy attempt at reconciling international best practice and Australian preferred practice. References to OECD terms and concepts are reframed and reinterpreted and ultimately produce a complicated and confusing draft. The timing and rushed consultation/drafting process merely accentuates these issues, producing a disordered and vague draft. Additionally the legislation will produce considerable impact on the investment environment, which is reliant on the stability and predictability of the relevant tax regime. Within the circumstances outlined by the draft legislation this is largely unachievable. Finally, the drafted legislation would invariably cause an undue and disproportionate and prohibitive burden upon small and medium enterprises that get caught by a reform aimed at large multi-national enterprises.

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 should you wish to further discuss any of the above.

Yours faithfully

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