5 April 2013

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Senate Standing Committee on Economics
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The Treasury
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Canberra ACT 2600

Dear Sir/Madam

Submission on: Taxation Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013

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.

In view of this fact, we have accordingly provided submissions to both the Federal Treasury and to the House of Representatives Standing Committee on Economics *(copies enclosed)* in respect of the current Bill, and to the Senate Standing Committee on Economics in respect of Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012.

Within this context the FCAI appreciates the opportunity to participate in the consultation process and accordingly provides the following comments on the ***Bill*** which was introduced to Parliament on 13 February 2013.

1. Arm's Length Standard and the OECD Guidelines

Whilst we understand and appreciate that the intention of government is to ensure that Australia's transfer pricing rules better align with the internationally consistent transfer pricing approaches set out by the Organisation for Economic Cooperation and Development (OECD)[1], we believe that the Bill goes beyond this scope.

[1] Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting Bill 2013 Explanatory Memorandum Chapter 2 at 2.1 on page 31.

As mentioned in earlier submissions, the emphasis of the Bill is on allowing the Commissioner a general power to increase the overall "taxable income" of a taxpayer, rather than adjusting the prices of specific underlying transactions. In our view this is not consistent with the intent of the OECD guidelines or ordinary international practice. The OECD Guidelines refer to a range of methodologies that are to be used to determine an "arm's length" price in respect of a transaction[2]. They are not directed to determining an overall taxable income adjustment without regard to specific transactions.

The concern our members have is that the new legislation will allow the Commissioner to take an approach on transfer pricing issues which may be materially different to the approach taken on similar issues by the revenue authorities of other countries. This may result in double taxation without treaty relief as it will make it more difficult to resolve such issues under Mutual Agreement procedures.

Further, unless there is an underlying connection with a "transaction" there is a conflict with the Customs Valuation rules as these rules are levied on a transaction by transaction basis. This inconsistency in approach will make it very difficult for FCAI members to obtain customs duty refunds in instances where the Commissioner of Taxation makes a "transfer pricing adjustment" based on an adjustment to "taxable income". As mentioned in earlier submissions, it is unreasonable to expect FCAI members to be placed in the invidious position of defending transfer pricing processes in respect of the same motor vehicle or motor cycle under two very different valuation rules.

Whilst a suggested solution to this recognised issue is that the Australian Taxation Office "ATO", the Australian Customs and Border Protection Service "ACBPS" and the Treasury liaise to provide a workable solution in practice, our concern is that this may not be effective. There needs to be an amendment to the Bill to ensure that any adjustments to "taxable income" under the operative provisions of Division 815B are referable to an underlying transaction.

Once the law is enacted, the Commissioner of Taxation is only empowered to administer the law as enacted by Parliament[3]. In addition, the ACBPS is also bound by the World Trade Organization (WTO) Valuation Agreement in relation to the treatment of transfer pricing in a customs valuation context.[4]

Accordingly, the FCAI believes that it is important to reiterate that a whole of government approach is required in drafting revenue laws in Australia.

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[2] Refer OECD Guidelines 2010 Glossary at page 28 and the application of the "arm's length principle" to transactions involving an associated enterprise.

[3] The Commissioner's powers of general administration: how far can he go? Paper presented by Bruce Quigley Second Commissioner (Law), Australian Taxation Office to the 24th TIA National Convention - Bright Lights Big City, Sydney, 12 March 2009.

[4] Submission to The Secretary, Senate Economics Legislation Committee 25 July 2012 by Sharon Nyakuengama, Senior Trade Advisor Cargo and Trade Division Australian Customs and Boarder Protection Service.

2. Reconstruction provisions and the OECD Guidelines

As mentioned above, whilst the OECD guidelines focus on transactions and not taxable income, and therefore "reconstruction of transactions" can only be undertaken under "extraordinary circumstances"[5] under the OECD Guidelines, this is not the case under Section 815-130 of the Bill.

Sub section 815-130(4) has no parallel under the OECD Guidelines. As this subsection empowers the Commissioner to disregard the actual conditions connected with the commercial or financial relations between the international parties,[6] it creates undue complications from a customs duty perspective.

As discussed above, Customs duty is levied on transactions, and once goods (including motor vehicles) have been entered into Australia for "home consumption", duty is payable in accordance with Customs valuation rules. Therefore, FCAI members could potentially find themselves in the inequitable position of paying Customs duty on one value for motor cars and yet finding they are unable to obtain a refund for any Customs duty overpaid as a result of a subsequent ATO adjustment.

Accordingly, the FCAI believes that Subsection 815-130(4) should be amended to ensure that actual transactions are not disregarded.

3. Documentation Requirements

The Bill requires that records be prepared before the time by which the entity lodges its income tax return (Refer proposed Section 284-255 of the Taxation Administration Act). This is an unrealistic time frame which will result in potential delays to the lodgement of annual tax returns.

Whilst documentation supporting transfer prices is contemporaneous, the formal compilation in accordance with ATO Ruling TR 98/11 occurs throughout the tax year and is usually finalised after the tax return is lodged so as to not delay lodgement.

In addition, the detailed records to be kept as part of the documentation requirements as per proposed Section 284-255 are overly onerous and without reference to materiality. This will result in additional compliance costs for our members with no discernible benefit for any party.

In view of this additional administration burden, the FCAI recommends that the section be amended to permit a more realistic time frame for formal completion, within a reasonable time after lodgement of the tax return (for example 6 months) and the documentation requirements be amended to more appropriately reflect materiality and relevance of international dealings.

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[5] See paragraphs 1.64 and 1.65 of the OECD Guidelines

[6] See paragraphs 3.104 and 3.105 of the accompanying EM to the Bill

Thank you for this opportunity to comment on the Bill. Please feel free to contact Tony McDonald at FCAI on if you require any further information.

Yours sincerely

Tony Weber
Chief Executive

Attachments:

- *Submission to Federal Treasury*
- *Submission to House of Representatives Standing Committee on Economics*

Ms Julie Owens MP
Committee Chair
House of Representatives Standing Committee on Economics
Parliament House
CANBERRA ACT 2600

Dear Ms Owens

Review of Legislation – Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013

The Federal Chamber of Automotive Industries is the peak industry body representing the interests of Australia's manufacturers and importers of passenger motor vehicles, four wheel drives, light commercials and motor cycles. Our members are the main representatives of major international companies in these areas and all are involved in significant international trade.

We have a keen interest in the Committees consideration of the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 which has been referred to the Committee. We have previously engaged with the Treasury and Australian Tax Office on the issues addressed in the Bill. However, on examination of the Bill, while a range of improvements have been made our major concerns have not been addressed.

FCAI are concerned that as the legislation proposed in the Bill has no link to an underlying commercial transaction or specific activity, and the emphasis is on overall profitability and taxable income, this creates a number of concerns/issues as follows:

1. Direct conflict with the customs valuation rules as under the Customs Act, customs duty is levied on a transaction by transaction basis; and

2. Such a broad based approach with emphasis on taxable income may lead to a significant risk that general economic and commercial factors present in Australia, which have no bearing on the price of actual transactions in international dealings, may be incorrectly taken into account under the guise of determining an "overall arm's length outcome". Adopting such an approach will make it very difficult to resolve the potential for double taxation through mutual agreement procedures with Australia's Double Tax Treaty partners.

FCAI has expanded on these points in the attached copy of our submission to the Treasury during the consultation phase of preparing the legislation.

Thank you for the opportunity to comment on the Bill. Please feel free to contact Tony McDonald at FCAI on 02 6229 8217 if you require any further information.

Yours sincerely

Tony Weber
Chief Executive

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20 December 2012

Manager
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Email: transferpricing@treasury.gov.au

Dear Sir/Madam

Submission on: Exposure Draft Tax Laws (Cross-Border Transfer Pricing) Bill 2013

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

Whilst we are cognisant and most appreciative of the dialogue between Treasury, the Australian Customs and Border Protection Service and the Australian Taxation office, to seek a workable administrative solution to the problem of inconsistency between taxation and customs legislation, we believe this will be very difficult in practice without legislative support.

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 22 November 2012.

Operative provisions

***"Holistic" approach to profitability** will make it very difficult to reliably price individual transactions.*

Section 815-120 - When an entity gets a transfer pricing benefit

In determining whether an entity receives a transfer pricing benefit in respect of an international dealing, the emphasis is on "an entity's taxable income" and overall profitability and not the pricing of an international transaction. As stated in the Exposure Draft at paragraph 1.20, Subdivision 815-B will apply to ensure that:

> "...The arm's length conditions should be reflective of, and take into account, the totality of the commercial or financial relations between the entities".

This "holistic approach" is reiterated several times throughout the Explanatory Memorandum.[1]

As there is no link to an underlying transaction or specific activity, the concern is that the emphasis on "overall profitability" will leave open the issue of how individual transactions will be priced, and how the actual components of taxable income – namely assessable income and allowable deductions in respect of individual transactions - will be calculated. To complete a tax return under Australian income tax law, taxpayers are required to calculate all items of assessable income and all items of allowable deductions. The structure of the Income Tax Assessment Acts does not permit taxpayers to ignore this requirement and simply insert some profit amount in the tax return in lieu of a proper calculation of taxable income.

Another critical problem with such a very broad construction of the matters which need to be taken into account under the transfer pricing rules, is the significant risk that general economic and commercial factors present in Australia, which have no bearing on the pricing of actual transactions in international dealings, may be incorrectly taken into account under the guise of determining an "overall arm's length outcome".

Further, and of particular importance for FCAI's membership, this approach which concentrates on "overall profitability" and without a reference to an underlying transaction creates a direct conflict with the Customs Valuation rules.

There needs to be a reference in the new provisions to "transactions". In this regard, reference is made to:

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[1] Refer paragraph's 2.36 and 2.38. This holistic approach also encompasses straightforward value chain transactions such as the acquisition of trading stock.

- The UK Transfer Pricing legislation[2], 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"; and

- The Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations issued by the Organisation for Economic Cooperation and Development ("OECD Guidelines"); whilst a range of methodologies are discussed in these guideline in order to determine an "arm's length" price, the outcome is converted into the pricing of a transaction.[3]

As mentioned in our earlier submissions on Division 815A, 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. Further, adopting such an approach will make it very difficult to resolve the potential for double taxation through Mutual Agreement Procedures with Australia's Double Tax Treaty partners.

Interaction between Transfer Pricing Rules and Customs Valuation Rules

As mentioned in earlier submissions on Section 815A, FCAI members are subject not only to the provisions of the Income Tax Assessment Acts of 1936 and 1997, but also the Customs Act 1901 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, the focus has now changed completely from the examination of transactions to a holistic "overall profit outcome."[4]

This inconsistency in approach may have adverse ramifications for FCAI members as follows:

- There may be no recourse to customs duty refunds in instances where the Commissioner has applied an overall profitability approach to an imported good to reduce the price.

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[2] 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

[3] Refer OECD Guidelines 2010 Glossary at page 28 and the application of the "arm's length principle" to transactions involving an associated enterprise.

[4] Refer Chapter 2 of the Exposure Draft at paragraphs 2.31 to 2.36 and in particular paragraph 2.34 at page 17.

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

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.

Whilst we welcome dialogue between Treasury, the Australian Customs and Border Protection Service and the Australian Taxation Office, on a workable administrative solution to this problem, unless this is supported by legislative intent our members are exposed.

No Requirement by the Commissioner to Provide a Determination and the "Self Assessment System"

The draft provisions are silent on the issue of the requirement by the ATO or Commissioner of Taxation to provide a Determination. Reference is made to paragraph 1.22 of the Explanatory Memorandum to the Exposure Draft as follows:

> *"Unlike the current transfer pricing rules in Division 13 and in Subdivision 815-A, which both rely on the Commissioner of Taxation making a determination, these provisions will be self-executing in their operation. This will bring these rules in line with the design of Australia's taxation system which generally operates on a self – assessment basis".*

Whilst the lack of a requirement to furnish a determination will enable the Commissioner of Taxation to have a great deal of flexibility in stating grounds of response in litigation matters before the Courts, taxpayers will be adversely impacted, not least by the uncertainty.

Unless the Commissioner provides a Determination which contains full details of an adjustment to taxable income, including full details of the relevant transactions whose pricing is being adjusted, and full details of items of assessable income which are being increased and the items of allowable deductions which are being reduced, taxpayers will be disadvantaged as they will be unable to provide a considered response or defence of the pricing of their international dealings. Further, they will have no defendable grounds upon which to claim a Customs Duty refund in respect of the goods the subject of the international dealings.

It should also be mentioned that the "Self Assessment" system was introduced with the full support of the Australian Taxation Office as the aim was to become more efficient in its compliance and revenue raising activities.

Reference is made to a Paper released by the Treasurer in 2004 as follows:[5]

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[5] Review of Aspects of Income Tax Self Assessment Discussion Paper March 2004 by Peter Costello Treasurer at page 3.

> *"Self assessment relieved the Tax Office of the obligation to examine returns lodged by taxpayers in the process of assessment ..... returns were generally taken at face value, subject to post–assessment audit and other verification checks."*

Therefore, the "self assessment" refers to and relates to taxpayers initial lodgement obligations and does not extend to subsequent adjustments by the Commissioner as a result of audit activities. These adjustments need to be fully documented in a formal manner to ensure that taxpayers clearly understand the basis for these adjustments and that their rights of objection and review are fully protected at law.

Amendment of Assessments

Whilst we welcome the time limit for amendment of an assessment in Proposed Section 815 -145, we recommend a shorter period in keeping with other provisions of the Income Tax Assessment Act particularly in view of subsection 170(7) which enables the Commissioner to obtain additional time in which to complete his enquiries of a taxpayer's affairs and:

- To mitigate the potential for double taxation in instances where the time limits for amendment in other jurisdictions such as the United Kingdom are much shorter.
- To meet the time limits for obtaining a Customs Duty refund if applicable.

Record Keeping Requirements

Whilst it is recognised that records need to be kept and are being kept, the requirement that they must be prepared before the time of lodging the annual income tax return provides an undue administrative burden on our members. It should be mentioned that the final documentation in practice represents the formal compilation of contemporaneous documents which are summarised and assembled after the tax return has been lodged and before year end so as not to delay lodgement of the tax return.

In Summary

We request a whole of government approach to transfer pricing, not only from an income tax perspective, but also in relation to Customs Duty. As mentioned in earlier submissions, the government has previously committed to a whole of government approach to legislation and this approach needs to be reflected in the modernisation of the transfer pricing rules.

Yours faithfully

Tony Weber
Chief Executive

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11 July 2012

The Chair

Senate Standing Committee on Economics

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CANBERRA ACT 2600

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
International Tax and Treaties Division
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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
Langton Crescent
PARKES ACT 2600

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