Dear Mr Bryant,

I was recently invited to write a paper for **Television Education Network** (Paper) dealing with the proposed transfer pricing legislation enshrined in Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No.1) 2012 (Bill). I have just had the opportunity to read the "undated" Treasury submission to the Senate Standing Committee on Economics (Committee) and find elements of the Treasury submission inconsistent with other relevant public documents such that it may cause the reader of their submission to arrive at an incorrect conclusion.

I write to comment on some of the matter raised by Treasury and also to provide a copy of my Paper for Committee members to consider.

My Paper was prepared for subscribers to Television Education Network prior to me having the opportunity to read Treasury's submission. My Paper addresses many of the matters raised by Treasury and I believe presents a 'balanced' and alternate view to some of the views expressed by Treasury. For illustrative purposes and having regard to time, I refer to several matters only although in attaching a copy of the Paper I commend it to the Committee in their consideration of the Bill.

- Treasury states that: "...**the ATO has advised that it will not be opening settled cases as a result of the legislative amendments proposed by this bill."** This statement appears incorrect and is arguably an oversimplification of the situation. The **more appropriate** guidance, in any event, is to be sought from the Explanatory Memorandum and not oral non-binding comments that may be made by the ATO. The Explanatory Memorandum states that settled cases "...would **generally** be prevented by the terms of the settlement deed...." from being reopened. The key words here is the word **"generally"** (and 'settlement deed') which, absent protective legislation, leaves this matter wide open for interpretation by the ATO. The ATO comment of which I am aware which perhaps touches on this matter is the statement made by our Commissioner of Taxation, when questioned before the Senate Economics Legislation Committee on 30 May, 2012, whereat he stated:

  > "When we talk about the retrospective application of these laws, we do not see it as if all of a sudden the ATO will be using new laws to go back. It was really a method of maintaining the status quo."

  This statement is equally unhelpful and non-binding on the ATO and was made when Treasury and the Commissioner were questioned as to the financial impact of the Bill (and no quantification of the revenue at stake provided by either party).

- I note that Treasury now advises that: **"The revenue protected by this Bill is substantial."** The document goes on to state that "The ATO has advised that there is $1.9 Billion of tax in dispute related to transfer pricing issues in current audits." Clearly this is the 'financial impact ' of the Bill and, I submit, it is contrary to the statement made in the Explanatory Memorandum that the Bill has "...no revenue impact as it is a revenue protective measure..."

- As to the question of the possible imposition of double taxation suffice it to say that I am aware of some horrendous situations where double taxation has arisen and as my attached Paper notes. I believe that under the proposed law this position will deteriorate further, contrary to Treasury's statement that: **"...these amendments will not change the capacity of the competent authorities to reach a satisfactory solution should double taxation occur."** The Senate must appreciate that many taxpayers do not have the financial capacity

to fight transfer pricing disputes through the courts because of the enormous costs involved and, for some, the fear of the attendant adverse publicity. I submit that it is beholden upon our Government to protect taxpayers from the creation of laws that may be misinterpreted by an overly enthusiastic Revenue authority.

- As a fourth and final comment, and as I say for illustrative purposes only as I find many other 'issues' with the Treasury document, I note that Treasury states that: **"The SNF case is of limited relevance".** This is misleading and arguably 'false'. This is so insofar as the ATO foreshadowed the need for legislative change in the event that it lost the SNF case; this is well documented in the Financial Press; and secondly, the Commissioner's Annual Report for 2010-2011 alludes to the need to change the law given the loss in the SNF case.

I have been practising in the area of transfer pricing for well over two decades and would welcome the opportunity to contribute to further discussion on the Bill.

Yours sincerely,

Stuart Edwards

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***Television Education Network***
***TRANSFER PRICING PRESENTATION***

DATE: 1 July, 2012

SUBJECT: **Transfer Pricing Reform and its Impact on Australian Multinationals**

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## 1.0 Background to Reform of Australia's Transfer Pricing Regime

The pricing of transactions between associated parties in different taxation jurisdictions, referred to as "transfer pricing", is critical for taxpayers and Governments alike as it largely determines the income that falls to tax of both parties to the cross border transaction. In short, related parties may potentially price transactions so that income is shifted (or misallocated) from Australia to more favourable jurisdictions. Accordingly, legislation is necessary to protect a country's tax base and provide investment certainty.

Australia's transfer pricing rules, contained in Division 13 of the *Income Tax Assessment Act 1936 (ITAA1936)* have, for the most part, remained unchanged since their introduction in 1982. These rules were originally cast against a backdrop of OECD transfer pricing guidance[1], since updated several times and now titled: *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Guidelines)[2]. These Guidelines are largely, although not universally, seen as global best practice.[3]

Division 13 was designed to protect Australia's tax base by enabling the Australian Taxation Office ('ATO') to tax Australian businesses on their appropriate share of income generated by Multinational Enterprises applying the concept of the "arm's length principle". Importantly, since introduction in 1982, there is no time-based statute of limitations on the ATO processing adjustments under Division 13.

Until very recently, Australia's transfer pricing landscape has been devoid of litigation as to the meaning of "arm's length"; accordingly, absent legal precedence, the ATO has issued numerous rulings and guidance on the topic. This guidance, historically, has been the primary reference point for taxpayers seeking to ensure that they conduct their international related party dealings in a manner consistent with the ATO view. The ATO view is important as, for the most part, taxpayers are very focussed upon the significant, non-deductible, penalties that may apply, (in excess of 50% of the tax avoided), when the ATO successfully prosecutes a transfer pricing adjustment.

A fundamental issue with the arm's length principle is that many transactions between international **related** parties simply do not take place between independent third parties. OECD Guidelines state that the "...mere fact that a transaction may not be found between independent parties does not of itself mean that it is not arm's length."[4] In such circumstances, one can readily see that the difficulty in finding an arm's length price, or approximation thereof, for both taxpayers and taxation authorities alike.

Australia has a vast network of tax treaties with foreign countries, treaties for the avoidance of double taxation (Treaties). The ATO has long held the view that it has authority under these Treaties to amend a taxpayer's Australian profit allocation under the Associated Enterprises Article (ie separate entities) or the Business Profits Articles (ie branches or permanent establishments) of the relevant Treaty. This view is based upon the premise that the Treaties provide a **separate taxing power** (in addition to Division 13).[5] Conversely, taxpayers and their

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[1] OECD Transfer Pricing and Multinational Enterprises, Report of the OECD Committee of Fiscal Affairs, 1979
[2] The OECD Guidelines referred to herein are the latest, 2010 version unless stated otherwise.
[3] For example, the United Nations Model Convention, whilst endorsing the OECD Guidelines, operates to preserves a greater share of tax revenue to the host country where the economic activity and/or investment take place and thereby favour developing countries. "The OECD Model Tax Convention, on the other hand favours retention of a greater share of taxing rights by the residence country, which is the country of the investor or trader." [Refer UN Newsletter Number 2012/2 March, 2012
[4] OECD Guidelines Paragraph 1.11
[5] It is noteworthy that Justice Downes commented , as obiter dictum, in the Roche Products Case [Roche Products Pty Limited v CofT 2 April, 2008, Paragraph 191] that: "...there is a lot to be said for the proposition that the treaties ...do not...confer power on the Commissioner to assess." In contrast, in SNF (Australia) Pty Ltd v CofT 25 June, 2010 at Paragraph 23 Justice Middleton said: ""...there is a clear legislative intent....that the Commissioner may...rely on either Section 136AD or the relevant associated enterprises article as conferring upon the Commissioner, as a separate power, a power to amend an assessment." In short, whether the Treaties provide a separate taxing power is far from clear.

advisors have long argued that the Treaty provisions are a "shield"; they allocate taxing rights between Treaty countries and thereby seek to avoid the imposition of potential double taxation; in short, they are not a "sword" (or separate and distinct taxing power). The ATO and Treasury do not accept this latter view. Assuming for the moment that the Treasury and ATO view is correct, it is very much counter-intuitive as it means that Treaty country taxpayers have a greater 'arm's length' hurdle to deal with (ie both Division 13 and the Treaty provisions) compared to taxpayers from tax havens.

An inherent problem with relying upon ATO rulings and guidance on transfer pricing is that the ATO 'guidance' has primarily been founded on the principles enshrined in the various OECD Guidelines (as amended over the years). In applying the 'arm's length principle', not unlike Division 13, the Associated Enterprises Article (Article 9) adopts the premise that international related parties should transact with one another as if they were "separate", independent enterprises transacting with independent third parties.

The focus of Article 9 is upon the requirement that an enterprise should derive an arm's length **"profit"** outcome having regard to the functions it undertakes, assets it utilises and the risks it bears (together generally referred to as an entity's 'functional profile') in the conduct of its business. That is, depending on the functional profile of the entity (and other relevant economic factors), a scalable net profit position should theoretically be achieved and this profitability, or balancing of taxing rights between group-company taxpayers located in different jurisdictions, is determined by applying OECD Guidelines.

This apparent 'profit' focus in Treaties is seen to differ to Division 13 albeit both have a common end-game, the application of the arm's length principle and determination of arm's length consideration.

Division 13 is widely recognised as relying on the arm's length nature of a taxpayer's international related party dealings where those dealings are to be determined by reference to the consideration or "price" of a **transaction.** Prima facie, there is no provision in Division 13 for analysis at the bottom line operating "profit" level although, in some circumstances, it may be possible to deconstruct net profit and work backwards to determine arm's length consideration.

To muddy these waters somewhat, over the years (and most recently in July 2010), the OECD released revised and updated versions of these Guidelines reflecting the most current thinking on the OECD approach to application of the arm's length principle.

The most recent version of the OECD Guidelines, the July 2010 version, reinforced the view that taxpayers and tax administrations: "...always aim at finding the '*most appropriate*' (transfer pricing) method for a particular case..."[6] in order to determine an arm's length outcome for international related party dealings. In so doing, the 2010 Guidelines placed greater weight on the so-called 'profit methods' (that is, the **"transactional profit methods"** namely: the Transactional Net Margin Method and Profit Split Method). The OECD Guidelines, however, continue to express not insignificant caution[7] as to the applicability of the profit methods and do not, as the Government maintains, give profit methodologies "equal priority" with the **"traditional transaction methods"** (namely: the Comparable Uncontrolled Price, the Resale Price and the Cost Plus Methods).[8]

The OECD endorsement of the profit methods was seen as a move away from the previous 'hierarchical' nature of the accepted transfer pricing methods set down in the 1995 Guidelines which placed an emphasis on pricing international related party dealings on a 'transactional' basis, before, if ever, viewing the arm's length nature of the dealings by reference to the taxpayer's profit level. Arguably, because of the revised OECD Guidance, some may say that Division 13 became ripe for rewrite in July, 2010. Others may say that Division 13 has long been outdated because the transactional approach to pricing has always been enshrined therein (as against the profit focus in our Treaties) and also having regard to the fact that Division 13, alone, applies to taxpayers from non-Treaty countries.

In light of the above, there has been a great deal of dispute and conjecture around the inherent disparity between Division 13 and the ATO guidance on transfer pricing. The ATO approach has traditionally been to quickly focus on the profitability of an enterprise when conducting a transfer pricing record review or audit. This

[6] OECD Guidelines, 2010 paragraph 2.2

[7] OECD Guidelines at Paragraph 2.149 state that: "In all cases, caution must be used to determine whether a transactional profit method as applied to a particular aspect of a case can produce an arm's length answer." Refer also paragraph 2.49 and 3.2 of the 2010 Guidelines which state, inter alia: that traditional transaction methods (the comparable uncontrolled price, the resale price and the cost plus methods) were 'preferred' to other methods commenting that profit methods should only be used in "....exceptional situations..." where they "....may provide an approximation of transfer pricing in a manner consistent with the arm's length principle." It is also noteworthy that the OECD "Suggested Approach to Transfer Pricing Legislation" published in June, 2011 states that if all methods can be applied "...with equal reliability, the determination of the arm's length conditions shall be made using the comparable uncontrolled price method." [Paragraph 4-3].

[8] 'Consultation Paper-income tax: cross-border profit allocation-Review of transfer pricing rules' November 1, 2011, Paragraph 24

approach has increasingly been 'driven' off the back of the ATO 'economics group'. In my experience, this group appears to believe that the arm's length principle requires a taxpayer, over time, to derive profits. Absent profits, ipso facto, the cause of a taxpayer's losses must be found somewhere in the pricing (or imputed services, ['representative services'], provided to the group by the subsidiary); it matters not a blot that third parties may purchase the same goods at the same prices as those paid to the parent by the Australian subsidiary in like economic circumstances. With respect, this is a misconception of the arm's length principle, evidence for which may be found in the OECD Guidelines which clearly recognize, as one would expect, that an enterprise may make profits lower than the average.

With the ongoing global evolution of transfer pricing rules and, arguably, the ATO failings with regard to the arguments that it ran (or failed to run) in the much publicised and scrutinised Roche[9] and SNF [10]cases, it is clear that a significant re-alignment of our legislation is overdue. Indeed, some say that the very reason that the ATO did not run the Treaty taxing power argument in the SNF case was to provide it with the 'trigger' or excuse for a rewrite of our transfer pricing legislation. Certainly, not to have run the Treaty 'taxing power' argument in either or both these cases evidences a strategy much to be desired.

The apparent, but inconclusive, lack of uniformity between Division 13 and the OECD published views (on the Associated Enterprise Article of our Treaties) was highlighted in the Commissioner's Annual Report in 2011.[11] The Government responded announcing on 1 November, 2011[12] that it would address the uncertainty regarding whether tax treaties have the power to enforce transfer pricing adjustments independent of our domestic transfer pricing legislation.

### 2.0 The new taxing powers of Division 815

The Federal Government introduced Taxation Amendment (Cross-Border Transfer Pricing) Bill (no 1) 2012 (Bill) along with the Explanatory Memorandum into Parliament on 24 May, 2012. The Bill contains amendments to Division 815 of the Income Tax Assessment Act, 1997 (ITAA1997). The provisions, the first of a two staged approach to the reform, are contained in Subdivision 815-A titled: "Treaty-equivalent cross-border transfer pricing rules". Further reform is to apply to all taxpayers.[13]

The amendments were designed to provide the ATO with more ready access to the application of profit based transfer pricing methodologies, in so doing they make certain two aspects of the operation of Australia's transfer pricing rules:

i. To ensure that the transfer pricing articles contained in Australia's tax treaties are able to be applied and operate to provide assessment authority **independent** of Division 13 through explicit incorporation into the ITAA1997; and
ii. To require the arm's length principle to be interpreted as consistently as possible with relevant OECD guidance.[14]

In addition, Subdivision 815-A introduces provisions that limit debt deductions, in certain circumstances, before Division 820 (the thin capitalisation provisions) apply.[15] The subdivision operates to potentially modify the pricing of interest, guarantee fees, line fees, discounts etc to an arm's length gearing level, irrespective of the actual level of the taxpayer's gearing, by reference to the profitability of the enterprise.

Most controversially, Division 815 applies retrospectively to taxpayers dealing with **Treaty country** related parties with effect from 1 July, 2004[16].

The object of the Division is to ensure that "profits" which would have accrued to an Australian entity (or permanent establishment)[17] will be brought to tax in Australia if they were less, by reason of non-arm's length conditions, than would have been the case had they been dealing at arm's length.

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[9] Roche Products v CofT, Administrative Appeals Tribunal, 22 July, 2008
[10] CofT v SNF (Australia) Pty Ltd [2011] FCAFC74
[11] Commissioner of Taxation Annual Report 2010-11 The decision of the Full Federal Court in CofT v SNF (Australia) Pty Ltd [2011] was said , in this report, to question "...the alignment of the domestic transfer pricing provisions of Division 13 of the ITAA 1936 and the internationally accepted arm's length principle, as developed by the OECD." Page 112
[12]Media Release 1 November 2011, wherein the Assistant Treasurer, Bill Shorten, states that our transfer pricing rules enshrined in our tax treaties will operate as an alternative to those in our domestic law for income years commencing on or after 1 July, 2004.
[13] Stage two of the reform process is expected to include, inter alia, a time based limitation as to the number of years that the ATO can process transfer pricing adjustments and possibly provision for self-executing adjustments and more prescriptive documentation requirements.
[14] Refer Explanatory Memorandum Paragraph: 1.52
[15] Refer Section 815-20 'Cross-border transfer pricing guidance'
[16] Refer Section 815-1 'Application of Subdivision 815-A of the ITAA 1997'

The provisions operate to 'negate' a **"transfer pricing benefit"**[18] gained by a taxpayer.

A 'transfer pricing benefit' is defined as the amount of the:

- increased taxable income; or
- reduced tax loss; or
- reduced net capital loss; and the
  - entity is an Australian resident or an Australian permanent establishment; and
  - requirements of the "associated enterprises" or "business profits" articles of a relevant Treaty apply in circumstances where taxable income would have been greater or losses less than the actual amount(s) returned because the profits of the enterprise were understated.

In making a "determination" under Subdivision 815-A the ATO is called upon to identify the particular assessable income, deductions or capital gain or loss to which the determination relates **"...unless it is not possible or practicable for the Commissioner so to do."**[19]

The new provisions preserve the primacy of Division 820. This is so as in considering the quantum of a taxpayer's debt deductions one is directed to a phased approach to reviewing its debt; the approach comprises:

- First, determine the arm's length rate[20] applying to the debt;
- Second, apply the rate so determined to the taxpayer's actual debt; and
- Finally, apply Division 820 to reduce, if applicable, the taxpayer's otherwise deductible debt deductions.

Section 815-30 empowers the Commissioner to make one (or more) "determinations" to increase the taxable income or decrease the tax loss or net capital loss of a taxpayer. In making any such determination (on or after 1 July, 2012), the ATO is to have regard, "...to the extent they are relevant..."[21] the following:

- OECD Model Tax Convention dated 22 July 2010;
- OECD Guidelines dated 22 July 2010;
- Documents that may be "...prescribed by the regulations..." or such of the OECD documents as may be prescribed not to apply.[22]

To avoid domestic double taxation, a transfer pricing benefit that is negated as a result of Subdivision 815-A will not be taken into account again under any other provision to increase an entity's assessable income, reduce its deductions or net capital loss.[23]

In relation to years commencing on or after 1 July, 2004, the OECD Guidelines and Convention to apply are those which were last amended before the commencement of the relevant income year subject to scrutiny.[24] Accordingly, generally the OECD Guidelines and Convention approved on 27 June, 1995 will be applicable for the time period up to 30 June 2011 and the 2010 OECD Guidelines and Convention will apply to later years.

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[17] It should be noted that here is a disparity between the 2010 OECD Guidelines and Australia's approach to attribution of profits to a branch operation (or 'permanent establishment'). The OECD adopts a functionally separate entity approach as against an allocation of income and expenses. Assistant Treasurer advised on 24 May, 2012 that he had commissioned the Board of Taxation to investigate the impact of adopting the authorized OECD approach. The Explanatory Memorandum notes at Paragraph 1.98 that none of Australia's existing treaties have adopted the latest OECD Convention and that past OECD Guidelines therefore remain valid.

[18] Section 815-15 'When an entity gets a transfer pricing benefit'

[19] Section 815-30(3)

[20] "Rate" refers to interest, guarantee fees and other debt related deductions

[21] Refer Section 815-20(1) One can envisage considerable conjecture in interpreting OECD Guidelines and to what"...extent they are relevant."

[22] Refer Section 815-20(2) and (3)

[23] Section 815-40

[24] Refer Section 815-5

### 3.0 How does Division 815 Differ to Division 13?

Interestingly and controversially the Explanatory Memorandum states that Division 815-A has "...no revenue impact as it is a revenue protection measure."[25] The Federal Government budget estimates include revenue as if this new subdivision had always been operational (ie since 1 July, 2004). The Government has stated that the provisions amount to a "clarification of the law". It is noteworthy, however, that in a written explanation of the legislation to the Parliament of Australia the comment is made that: "There is a reasonable expectation that there will be additions to revenue..."[26] arising from the legislation. In addition, it should be noted that the Explanatory Memorandum states: "It is likely that Australia's tax treaties provide access to a greater range of transfer pricing methodologies..."[27] than does Division 13.

The amendments clearly do far more than "clarify" our law. They settle the conjecture as to whether the **Treaties provide a separate head of taxing power.** This is so as Division 815 explicitly provides a taxing authority in addition to Division 13; in so doing, it has a clear focus upon "profits" (defined as 'taxable income') whereas Division 13, as noted above, is very much "price" or transaction focussed. In applying the "Treaty" provisions, the taxpayer's profits will potentially be reduced where the commercial and financial relationship between the associated parties to the transaction differs to that which would exist between third parties. This 'relationship' is explored, not by attacking the 'profit' per se, but by application of the OECD Guidelines. That is the Treaty provision will lead to an examination of the economic circumstances between the parties by applying the OECD Guidelines[28] which clearly endorse the 'transactional profit methods', a perceived but debateable and untested deficiency of Division 13.

It follows that Section 815-20 also resolves the conjecture as to whether the **OECD Guidelines** and Convention are to be applied in interpreting transfer pricing law. This contrasts with the view expressed in the Full Federal Court decision in the SNF case where the statement is made, in relation to the Guidelines: "It is plain from the statement...that the Guidelines are just that-guidelines." The statement was also made that: "The Guidelines then are not a legitimate aid to the construction of the double taxation treaties."[29] Clearly this will not be the case in future and Treaty country related party taxpayers should anticipate that a shortfall in profitability and/or losses for years commencing on or after 1 July, 2004 will be examined by the ATO with renewed vigour.

The provisions dealing with the interaction of the **transfer pricing and thin capitalisation** provisions of the ITAA 1997 were highly controversial and unexpected (albeit they effectively enshrine into law Taxation Ruling 2010/7[30]). Where a "transfer pricing benefit" relates to "...profits or a shortfall of profits referable to costs that are debt deductions..."[31] the ATO may modify that benefit. This will require taxpayers with debt deductions to evaluate what those debt deductions may have been in arm's length circumstances having regard to their profitability and that of comparable businesses irrespective of whether the loans satisfy the thin capitalisation debt to equity requirements. The retrospective nature of this element of the legislation is of great concern to a number of taxpayers particularly given that the ATO only finalized TR 2010/7 on 27 October, 2010 yet the legislation is scheduled to apply from 1 July, 2004!

One fundamental question that arises is: will the new provisions apply from 1 July, 2004?

Division 13 applies to Treaty and non-Treaty countries alike whereas Division 815 presently applies only to Treaty countries.[32] In the absence of further amending legislation (which one expects is imminent) appears not only curious and complex but possibly contrary to Australia's Treaties. Our Treaties include a **non-discrimination** article which provides inter alia that:

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[25] Explanatory Memorandum Page 3
[26] Bills Digest No 160 2011-2012 Page 5
[27] Explanatory Memorandum Paragraph 1.41
[28] A consideration of the economic circumstances between the parties includes a review of the related party transaction with like or similar transactions, if available, between third parties. Attributes that OECD Guidelines say should generally be considered include: (i) the characteristics of the property or services; (ii) the functional profile of the parties; (iii) the contractual terms of the arrangement; (iv) the economic circumstances of the parties (such as similarity of markets etc); and (v) business strategies of the parties (eg market expansion/penetration strategies).
[29] C of T v SNF (Australia) Pty Ltd 2011 Paragraphs 116 and 118
[30] TR 2010/7 "Income tax: the interaction of Division 820 of the ITAA 1997 and the transfer pricing provisions."
[31] Refer Section 815-25
[32] Refer Mansard Senate Economics Legislation Committee of 30 May, 2012 (Page 97) where in response to a question as to the differing tax treatment of Division 815 as between Treaty and non-Treaty countries Treasury responded, rather "cutely": "....parliament clearly intended that the treaty rules would operate to supplement the other rules in domestic law. So in clarifying that the new law operated as intended, that the treaty rules have been incorporated into the domestic law, *is only relevant to treaty countries.*"

> "Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances...are or maybe subjected."[33]

In discussing the draft legislation before a Senate Economics Legislation Committee on 30 May, 2012, Hansard records Senator Cormann as commenting, in response to a comment by a Treasury official:

> "Let me get this right: these new laws, which seek to stop shifting profits offshore, will not apply to trade and investment through tax havens, which will effectively receive **preferential tax treatment** in Australia."[My emphasis]

This begs the question whether the retrospective nature of the legislation will have its desired effect. If it's the case, as Treasury has stated, that Division 815 will apply (in due course) prospectively to taxpayers from non-Treaty countries, the logical finding would appear to be, if and when challenged in the Courts, that the new provisions may **potentially** also only apply prospectively to taxpayers from Treaty countries. Clearly, absent amendments to the draft legislation as it progresses through Parliament, one expects that this aspect of the law can be expected to be challenged before the Courts as some taxpayers argue that the law can only operate from 1 July, 2012 (so that Treaty and non-Treaty country taxpayers are treated alike).

Effective 1 July, 2004, one matter is very clear. Taxpayers with profitability less than industry norms or less than that which the ATO considers "commercially realistic" (or which in the ATO view makes "commercial sense") can expect equal or greater scrutiny than heretobefore.

### 4.0 Will Division 815 Change the 'Status Quo?'

As the ATO scours the taxpayer landscape for stock-in-trade transfer pricing reviews/audits it will continue, as in the past, to evaluate a taxpayer's profitability (or lack thereof) as a 'bellwether' for potential transfer pricing mischief. The new legislation is designed to endorse the ATO approach and it enshrines within the ITAA1997 the requirement to "...work out..." and "...interpret..." whether a taxpayer has derived a 'transfer pricing benefit' consistently with the Guidelines, Convention and other material that may be 'prescribed'. Accordingly, relevant OECD material, where appropriate and supportive, will be used by the ATO to endorse its audit approach and findings. In this regard, it is also noteworthy that OECD Guidelines clearly provide that there are circumstances where the profit methods are "more appropriate"[34] and ATO transfer pricing audits and reviews will be enlivened by this clarity of 'power' in Division 815.

One concern with the draft legislation is the empowering of the ATO to more aggressively pursue the use of profit methods notwithstanding the comments in both the Roche Products and SNF cases (and, indeed, the OECD Guidelines[35]) that losses do not necessarily mean that profits have been artificially shifted from one jurisdiction to another. I have witnessed many situations, over the past three decades, where long term losses (ie losses over a period of some seven to ten years or so) have been suffered and no transfer pricing 'mischief' was the cause thereof. Indeed, the only reason that these businesses remained operational in Australia was because the parent company continued to support them (for non-tax reasons).

The fundamental question in issue is: does Division 815 provide a greater taxing authority to the ATO than that within Division 13?

Leaving aside for the moment questions in relation to debt and debt deduction transfer pricing benefits, I submit that the ATO armoury at first blush "appears" little changed, initially, at least.

The ATO armoury **"appears"** little changed notwithstanding the incorporation of the OECD Guidelines and Convention into the ITAA1997 because the Guidelines, in my opinion, generally continue to favour traditional transaction methods "....as providing the most **direct means** of establishing whether conditions and financial

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[33] Refer for example to Article 24 of the New Zealand Treaty and Article 26 of the Japan Treaty

[34] OECD Guidelines at Paragraph 2.4 state: "For example, cases where each of the parties makes valuable and unique contributions in relation to the controlled transaction, or where the parties engage in highly integrated activities, may make a transactional profit split more appropriate..."

[35] The OECD Guidelines at paragraph 1.70 states: "Of course, associated enterprises, like independent enterprises, can sustain genuine losses, whether due to heavy start-up costs, unfavourable economic conditions, inefficiencies or other legitimate business reasons."

relations between associated enterprises are arm's length."[36] OECD Guidelines proceed to make cautionary comment and express "concerns" regarding the transactional net margin method stating: "...in particular that it is sometimes applied without adequately taking into account the relevant differences between the controlled and uncontrolled transactions being compared."[37]

Having said that, one anticipates that in future, the Courts will take a very different view of the appropriateness of the profit methods if and when the more 'direct' transactional methods do not justify the pricing outcomes achieved by taxpayers. Thus the Transactional Net Margin and Profit Split methods, having been endorsed by the OECD Guidelines, are effectively enshrined in Division 815 and will remove any doubt as to their efficacy in the ATO transfer pricing armoury.

It follows that taxpayers will be well advised to carefully evaluate the "most appropriate" transfer pricing method and, based upon OECD Guidelines, they may rely upon a method or methods other than a profit method; however, in future taxpayers will be tempting fate if they do not evaluate the commercial factors that have impacted their business and carefully document the evidentiary support for this analysis on a contemporaneous basis. Critically, the ATO can be expected to take a very hard-line view in seeking to apply the profit methods under Division 815. This may even be the case notwithstanding international related party transactions are not the 'source' of the lack of profitability. A consideration of the Roche Products diagnostic division and ATO approach to the audit thereof evidences this point.

The diagnostics division of Roche Products was a long-time, loss-suffering division of the company. Evidence was presented in the proceedings before the Administrative Appeals Tribunal that even if the products bought from overseas related parties had been acquired at **no cost** to the Australian subsidiary, the division would still have suffered a loss. Justice Downes went on to state that the "...totality of the evidence before me (satisfies me) that the prices for the products were arm's length. The bad results flowed from operating expenses not acquisition prices."[38] The fact that the diagnostics division would have suffered a loss even if the products purchased from overseas related parties were provided free of charge did not worry the ATO as it aggressively pursued adjustments in relation to this division of Roche Products despite all the evidence as to the 'commercial reasons' why the losses had been suffered. For my part, I do not believe that the proposed Division 815 would change a Court's view in the Roche Products case insofar as the diagnostic division is concerned.

More generally, considering the Roche Products case, if one contemplates for a moment whether the Administrative Appeals Tribunal may have found differently in relation to the non-diagnostics divisions of the company if Division 815 had been proclaimed as law at that time, I suggest that it would not. Justice Downes raised serious concerns as to the efficacy of the profit method proposed by the ATO and commented: "One of the problems of profit based methodologies is that, when applied to transfer pricing, it inevitably attributes any loss to pricing."[39] Having said that, Justice Downes ultimately relied upon the Resale Price Method, that is a consideration of profitability at the gross rather than the net margin level (but at the profit level nevertheless), when increasing the taxpayer's assessable income in the amount of over 42 million dollars.

As to the SNF case, given the strength of the Federal Court and, in turn, the Full Federal Court's decision in this case, it appears that so long as the facts presented can be substantiated, a like outcome as that decided by the Full Federal Court is probable (notwithstanding that the company paid no income tax for 13 years). Indeed, the Full Federal Court considered the Commissioner's arguments based upon the OECD Guidelines and accepted the taxpayer's position commenting: "It is consistent with the Model Law, the Commentary and, **if it mattered**, the (OECD) Guidelines". [40]This is contrary to the ATO view[41] and that of our Government.[42]

Critical to the taxpayer's 'success' would be:

- presenting substantive **'evidence'** as to the pricing to SNF Australia being on 'all fours' (or better) than the pricing to third parties; and

[36] OECD Guidelines paragraph 2.3. Paragraph continues on to state that where both transactional and profit methods can be applied in an equally reliable manner, "...the traditional transaction method is preferable to the transactional profit method." The CUP method in these circumstances is to be preferred over all other methods.
[37] OECD Guidelines paragraph 2.147
[38] Roche Products 22 July, 2008 Paragraph 188
[39] Roche Products 22 July, 2008 Paragraph 185
[40] SNF Paragraph 122
[41] Decision Impact Statement Cof T v SNF Australia Pty Ltd. The ATO states: "Readers should bear in mind that the **legal position will probably be materially different** if Parliament amends the legislation along the lines proposed."
[42] Speech to the Taxation Institute by the Assistant Treasurer, The Hon David Bradbury titled: 'Tax Reform for an Economy in Transition' 18 May, 2012 wherein at Page 7 he states: "Retrospective legislation is generally only done where the law is operating in a manner inconsistent with the Parliament's intention (this includes but is not limited to examples of egregious tax avoidance and evasion) and there is a **risk of significant revenue loss.**"

- the strength of the **evidence** of the adverse commercial factors that purportedly gave rise to the losses.

Having said that, in the SNF case, the Full Federal Court noted that the Commissioner "...suggested that the taxpayer's motive was to make losses in Australia and to make profits in France by transfer pricing."[43] In response to this proposition, the Court explained that the focus of the transfer pricing rules is to establish whether arm's length consideration has been paid/received and it "...cannot include the requirement of investigation or consideration...of motive and purpose" of the taxpayer.[44]

Having regard to this, the Court questioned the utility and significance of the debate as to why SNF incurred sustained losses. In this regard, it would appear that there would be prospect of some significant change in process if the SNF case were to be run under Division 815. This is so as in examining the "profitability" of an enterprise, under Division 815, one would anticipate questions around how and why the losses arose and a thorough examination of the economic circumstances between the parties to the transactions can be expected to be both important and relevant to the outcome.

In future 'look-alike' cases, similar to SNF, the Courts can be expected to seek to better understand why it is that sustained losses were suffered which will lead to a consideration of budgets and forecasts and not just the actual operating results of an entity. In the final analysis, provided one of the more "direct" transfer pricing methods (namely, the Comparable Uncontrolled Price method, Resale Price or Cost Plus Methods) and attendant functional and economic analysis supports the pricing outcomes achieved, there appears little prospect of a different outcome in the SNF case to that which the Full Federal Court found. Having said that, in circumstances where the comparable transactional data does not comprehensively support the pricing of all the 'material' related party transactions of a taxpayer (or is inconclusive in respect of some or all transactions), contemporaneous evidence defining the commercial drivers and explaining the taxpayer's poor economic performance may be critical to preventing the possible application of the profit methods under Division 815.

One issue of real substance, for both the ATO and taxpayers alike in seeking to apply the profit methods, is the dearth of a robust sample of potentially comparable independent companies against which one may 'benchmark' the financial performance or profitability of a taxpayer. Historically, in some circumstances, this has lead the ATO to using inappropriate comparables, such as private companies (where results may be materially distorted) and 'divisions' of public companies (where the allocation of costs and revenue may, equally, be materially distorted). Perhaps instructively, in the SNF case, independent economists were consulted by the ATO to complete a benchmarking study of companies 'comparable' to SNF for purposes of the ATO applying the Transactional Net Margin Method. The independent economists downgraded, materially (to 1.7%),[45] the proposed operating net profit to sales margin compared to that initially proposed by the ATO.

It is noteworthy that the ATO Decision Impact Statement[46] on the SNF case stated, inter alia:
"...the ATO accepts that the mere fact that the consideration a taxpayer actually paid for property would leave a hypothetical independent party in the exact same circumstances as the actual taxpayer in a commercially unsustainable position does not by itself entail that the consideration actually paid was more than the arm's length consideration."[47] Whilst tortuous language, it is a valuable acknowledgement, that taxpayers do make losses for valid reasons; a controversial area about which taxpayers and transfer pricing professionals have often been in conflict with the ATO. One wonders how the ATO will factor this 'thinking' into their future transfer pricing audits; hopefully, in a case such as the Roche Products diagnostics division, the ATO would walk-away without seeking any adjustment; somehow I am not convinced that it would.

As to whether the ATO may succeed in prosecuting a 'representative services'[48] argument in the SNF case under Division 815 (or Division 13) as alluded to in the ATO Decision Impact Statement on SNF, I remain very sceptical. Under Division 815 the question at issue would be what benefit has SNF Australia really provided to its overseas related parties? It appears to me that under Division 815, any such argument would have to be run in relation to each of the three relevant Treaties, China, France and the United States (the source country suppliers to Australia of the products in question); each requiring quantification of the "transfer pricing benefit", each with a somewhat different Treaty, each requiring a separate "determination" under Section 815-30 and so on.

The ATO has long-held the view that some intangible "representative services" are provided to parent companies by under-performing Australian subsidiaries. It appears to me, from a 'commercial perspective' that it would be

[43] SNF Paragraph 6
[44] SNF Paragraph 7
[45] SNF Federal Court of Australia Paragraph 130
[46] Decision Impact Statement Cof T v SNF Australia Pty Ltd
[47] SNF Decision Impact Statement Page 3
[48] That is whether the French parent company derived a 'benefit' from the Australian subsidiary company's market penetration and marketing strategy.

impossible for independent parties to 'charge' for such "services"; rather, they could be expected to take account of the forecast time period to business profitability and reflect this in the quantum of their capital or borrowing arrangements. I see little prospect of the ATO running such a case and even less prospect of it succeeding in any such argument.

A significant concern in all of this is how our treaty partners will react to adjustments made under Division 815.

The Explanatory Memorandum accompanying Division 815 states that:

> "To the extent that Subdivision 815-A provides as alternative taxation power, that power is *limited to the international consensus*. Any increased Australian taxation will generally be capable of being offset to some extent by compensating reductions in foreign taxation through mutual agreement procedures...[49] [My emphasis.]

A number of writers on the subject of Division 815 have foreshadowed an expectation of an increase in situations of double or multiple taxation arising; this can be expected to be the case, particularly if the ATO successfully applies the profit methods in circumstances in which the Treaty country of the counterparty does not accept the methodology or adjustments. The failure in the legislation to "require" the ATO to identify the counterparty and the specific transactions in relation to each and every 'determination' made by the Commissioner under Division 815 is a grave error in legislative design and, if determinations are made in the manner contemplated, unquestionably, multiple country taxation of the same income can be expected to occur. The legislative design, I submit, is contrary to OECD Guidelines.[50] I also submit that the Explanatory Memorandum is incorrect in its assertion that: "To date, the ATO has been successful in reaching agreements with other jurisdictions through mutual agreement procedures..."[51] for, I am familiar with some horrendous situations where double taxation has arisen. Remember, absent an appropriate arbitration provision in our Treaties, there is no requirement on the part of the Australian and relevant overseas revenue authorities to come to an 'agreement' in relation to transfer pricing adjustments. They can merely agree to disagree and double tax will apply.[52]

It is also noteworthy that the mutual agreement procedure process is long and arduous. The taxpayer is largely left-out of this process not being privy to the Revenue to Revenue negotiations wherein the ATO "seeks" to reach agreement with the Treaty partner Revenue authority. It is also an expensive process and the outcome uncertain.

Interestingly, when questioned on the implications of Division 815 before the Senate Economics Legislation Committee our Commissioner, Mr D'Ascenzo, said:

> "When we talk about the retrospective application of these laws, we do not see it as if all of a sudden the ATO will be using new laws to go back. **It was really a method of maintaining the status quo.**"[53] (My emphasis)

If one accepts the Commissioner's statement why did the ATO not argue that Article 9 was a 'separate taxing power' in the SNF case and/or clarify the law in an open and transparent manner by litigating the matter in one of the several transfer pricing cases that are presently on foot? It is apparent that the ATO sees the retrospective law as endorsing its historical focus upon the profitability of an enterprise and based on its comments before the Senate Economics Committee, clearly the retrospective law is directed at several taxpayers presently under audit (no doubt, including SNF for the period 1 July 2004 to 30 June 2012 along with a number of taxpayers with perceived high rates of interest and/or guarantee fees on intercompany loans).

An increasingly common transfer pricing "risk management" approach adopted by many taxpayers is to enter into Advance Pricing Arrangements (APAs). Most APAs have historically been agreed by application of a profit

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[49] Explanatory Memorandum paragraph 1.42 The mutual agreement procedures within Australia's various Treaties generally provide that where taxation falls due, taxation that is not in accordance with the Treaty, that is the same income is taxed in both countries ('double taxation') the respective 'Competent Authorities' of each country will seek to reach agreement so as to avoid that double taxation. The fact is that generally there is no requirement that the competent authorities reach agreement. Historically, double taxation has occurred and can be expected to occur in the future. Generally there is little in our Treaties to "prevent" this horrendous situation occurring. Having said that, our New Zealand Treaty now includes an arbitration clause[49] and our Government should actively pursue such articles in all our Treaties as this is the only sure way to avoid the imposition of double taxation.

[50] OECD Guidelines provide, at Paragraph 2.148: "As with any method, it is important that it is possible to calculate appropriate corresponding adjustments when traditional profit methods are used..." so that Treaty relief from double taxation may be sought by the overseas related party.

[51] Explanatory Memorandum Paragraph 1.50

[52] Refer footnote 45

[53] Hansard Senate Economics Legislation Committee 30 May, 2012 page 90

based methodology[54]; accordingly, there is likely to be little change on this front in future except insofar as any debt deduction component thereof can be expected to be subject to greater scrutiny.

It appears to me that the retrospective nature of the legislation will have an indubitable adverse impact on the reputational standing of the ATO. The ATO has long argued that it is a stakeholder in the operation of an efficient tax system, a system that provides"...practical certainty and in promoting a level playing field..."[55] Deputy Commissioner of Taxation, Mr Mark Konza [56]recently stated: "Transparency is what makes our self-assessment system work..."

My concern is that taxpayers, many harbouring some suspicions of the ATO albeit around its lack of commercial understanding and 'blind' focus on profitability, are likely to see it as not 'walking the talk', that is, insincere in some of its public statements. Whilst arguably Treasury and the Government must take responsibility for the amending legislation, it is unlikely to change this unhealthy outcome, an outcome some suggest, raises questions of trust in the ATO and sovereign investment risk. Unquestionably the retrospective nature of the legislation raises the prospect of increased uncertainty as to the application of the law with attendant increased tax risk ... with a number of taxpayers clearly in the legislative firing-line.

**5.0 The Interaction between the Thin Capitalisation and Transfer Pricing Rules.**

In relation to the impact of the proposed debt, debt deductions and thin capitalisation provisions within Division 815 there is a very real and substantive change to the status quo as historically there has been "...no legislative provision specifically addressing the relationship between transfer pricing and thin capitalisation rules."[57]

The argument run by the ATO in TR 2010/7 is that, as an alternative to the more traditional transfer pricing methods, it is authorized to consider the profitability of taxpayers, by applying the 'profit methods' "....to achieve a commercially realistic arm's length profit outcome"[58]. Division 815 appears directed at mischief the ATO perceives where a foreign parent entity under-funds its subsidiary and then demands: "... a high interest rate, guarantee fee or other credit support charge because the debt was unsecured and the subsidiary had a weak debt to equity ratio and consequent low standalone credit rating."[59] As background to this element of the legislation, the ATO has become increasingly concerned, in recent years, at the significant growth in that related party corporate debt in Australia.

Some argue that the provisions dealing with thin capitalisation and debt deductions provide greater 'certainty' as to how the provisions interact; however, on the other hand they appear to create substantial uncertainty. For example, taxpayers with related party debt or debt guaranteed by a related party will need to evaluate whether or not the ATO may consider their "profitability" makes "commercial sense" having regard to the comparable profits of similar arm's length enterprises.[60] One wonders whether we may see a hiatus of situations where the ATO concludes that a taxpayer's profitability is less than 'commercially realistic', having regard to a taxpayer's debt deductions, and adjust the interest rate so that profits comply with the ATO view of commercial realism. This may potentially be despite the fact that debt may be within the Division 820 safe harbour amount. If this understanding is correct, it appears that the approach conflicts with the OECD suggested approach. For example, the OECD Guidelines provide that generally when determining "net profit" of an enterprise:

> "Non-operating items such as interest income and expenses and income taxes should be excluded..."[61]

That is, profit is generally evaluated in practice and according to OECD Guidelines at the pre-interest level.

It appears that Subdivision 815-20, by enabling the reconstruction of actual transactions, is likely to lead to substantive litigation as taxpayers explore the extent of the ATO powers and seek to overturn its subjective view as to what profits the entity should have derived. It is noteworthy that OECD Guidelines provide: "In other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them."[62] The reconstruction of business transactions is, however, contemplated by OECD Guidelines and the example that the Guidelines provides relates to the recharacterisation of interest-bearing

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[54] The ATO 'Advance Pricing Arrangement Program 2010-11' report notes that over 73% of the 53 APAs completed in the year ended 30 June, 2011 were based upon a profit methodology, by far the majority applying the Transactional Net Margin Method (TNMM). In the 2010 year the application of profit methods in completed APAs was slightly higher at nearly 77% of the 39 APAs completed in that year. In 2011, four, (or 7.5%) of completed APAs applied the Comparable Uncontrolled Price method and nearly 19 % the Cost Plus method.

[55] Commissioner of Taxation Mr Michael D'Ascenzo Speech to the Institute of Company Directors 16 February, 2010

[56]DCT Mr Mark Konza in speech titled: A world without audits" 17 October, 2011

[57] Explanatory Memorandum Page 17

[58] TR 2010/7 Paragraph 53

[59] Refer TR 2010/7 Paragraph 78

[60] Refer TR 2010/7 Paragraphs 17, 50 et al

[61] OECD Guidelines Paragraph: 2.80 See also Secton B3.3 generally

[62] OECD Guidelines Paragraph 1.64

debt to equity where "...having regard to the economic circumstances of the borrowing company, the investment would not be expected to be structured in this way."[63]

Taxpayers with hybrid type debt arrangements, such as redeemable preference shares, where those shares are treated as debt[64] for domestic taxation purposes but equity by the shareholder, may be particularly challenged by the new provisions. One can contemplate difficult mutual agreement procedure negotiations where this type of financing arises for consideration. One is left wondering whether a question arises: What is an arm's length amount of redeemable preference shares?

Overlaying these more specific concerns, as a more general comment, it is noteworthy that there is presently no OECD guidance as to how one should construct an arm's length return on debt (least of all how taxpayers should address the deemed interest on equity that is deemed to be debt).

Clearly, we are going to see significant litigation in this area of transfer pricing in the near term if the legislation is enacted as drafted.

## 6.0 Limitations, if any, on the Making of Retrospective Adjustments

As has already been highlighted, the amendments apply to income years commencing on or after 1 July, 2004.

The Explanatory Memorandum states that settled cases that may otherwise be affected by the new law "would generally be prevented by the terms of the settlement deed..."[65] from being reopened. As noted above, the Commissioner has also advised that the ATO will not be using the new laws to go back. Having said that, there are presently no restrictions, (except, perhaps, the Treaty non-discrimination clauses), that would prevent the ATO seeking to apply the retrospective law to taxpayers that have not reached a settlement agreement with the ATO in relation to their transfer pricing affairs.

## 7.0 Application of Penalties and Interest to Division 815 Retrospective Adjustments

Division 815 includes a transitional rule that provides that the administrative penalty provisions will apply as if the new rules were never enacted and penalties in relation to income years commencing prior to 1 July 2012 will be limited to amounts that can be substantiated under Division 13.

This provision was designed to protect taxpayers from penalties where Subdivision 815-A is applied and but for the new provisions no retrospective transfer pricing adjustment would have applied under Division 13. Having regard to the ATO view that the Treaty provisions have always provided a separate taxing power (albeit the Full Federal Court in SNF suggested otherwise) I anticipate that where transfer pricing adjustments are processed in respect of years 1 July, 2005 to 30 June, 2012 taxpayers are likely to become embroiled in extensive debate, argument and negotiations with the ATO as to whether or not penalties apply. Indeed, I envisage that the ATO, in an endeavour to get taxpayers to "settle" disputes in relation to retrospective amendments, will hold out penalties as both a 'carrot and stick' in seeking to bring taxpayers to accept settlements they may not otherwise be inclined to do

## 8.0 Unfinished Symphony[66]

Subdivision 815-A goes further than merely 'clarifying' the existing law. The new provisions cast an obligation on taxpayers dealing with Treaty countries to address the specific provisions of the relevant Treaty(ies) and OECD Guidelines, Conventions and 'prescribed' material when interpreting those treaties. Whilst for most taxpayers this is likely to simply mean maintaining the status quo, clearly there will be some taxpayers that have additional obligations notwithstanding their income tax returns, when lodged, complied in all respects with the then existing law. Taxpayers are well advised to ensure that they have given serious consideration to their 'profitability' (for the period commencing 1 July, 2004) and, where appropriate, they should ensure that they have contemporaneous evidence not only justifying their pricing but also outlining why their profits may be less than some may see as 'commercial'. As was found in both the Roche Products and SNF cases, a lack of profitability in the face of commercial reasons therefore will not be determinative that a taxpayer has shifted profits from Australia.

[63] OECD Guidelines Paragraph 1.65
[64] Refer Division 974 Debt and equity interests
[65] Explanatory Memorandum Paragraph: 1.44
[66] With apologies to Franz Schubert, Symphony No 8 in B Minor

In short, the ATO can be expected to maintain the status quo of reviewing a taxpayer's profitability as a 'risk identifier' and it is likely to be emboldened to more strongly argue that unsatisfactory profits translates into transfer pricing mischief.

Ultimately, one can expect that the proposed new provisions will be challenged before the Courts and, absent one or other of the more "direct" traditional transactional transfer pricing methods supporting a taxpayer's pricing arrangements, the alchemy of transfer pricing can be expected to embrace the profit methods as a valid means of dealing with transfer pricing disputes (just as they have gained currency in bilateral APA matters).

The reforms should also be considered in concert with taxpayers' annual reporting obligations, in particular, the new International Dealings Schedule and, for some, the Reportable Tax Positions Schedule, both of which significantly increase the non-productive, administrative documentation requirements for affected taxpayers.

In some respects backdating the reform provisions bears the hallmarks of a desperate minority Government exhibiting characteristics not unlike those of the desperate European Governments seeking 'bail-out' financial assistance only to require further assistance a short time later. In some respects too, some say that the arm's length principle has all but run its race. Simplistically, Division 815 may be merely 'kicking the can down the road' for it is a partial fix of the problem with further Australian legislative reform foreshadowed. More importantly, it is noteworthy that the United Nations, comprising over 192 countries (there are 34 member countries in the OECD), is presently drafting its own transfer pricing rules, rules that differ in some important respects to OECD Guidelines.

One wonders whether it is time to move-on from the arm's length principle and perhaps consider a more pure economic approach to the allocation of the global profits of our multinationals. An allocation based upon assets, sales, employees and other key 'economic' drivers of a business has been proposed by some. For the time being, the OECD says this is not to be. It is instructive to note, however, that an independent Task Force[67] recently encouraged member countries to require all multinational corporations to report sales, profits and taxes paid in all jurisdictions in their audited financial statements and income tax returns. If implemented, this information may hasten the view of some that we have moved-on from yesterday's solution to the transfer pricing dilemma.

Transfer pricing practitioners can look forward to a bright and busy future.

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**POSTSCRIPT:**
The ***Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No 1) 2012*** was passed by the House of Representatives on 19 June, 2012 (by73 votes to 71). No amendments were made notwithstanding several were proposed by the Federal Opposition. The Bill has now been referred to the Senate Economics Legislation Committee for inquiry and it is presently seeking submissions to this enquiry. Submissions are required by11 July, 2012. The Committee is due to report to the Senate by 14 August 2012.

[67] The Task Force on Financial Integrity and Economic Development