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The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Our ref Submission to Senate Economics Committee

Contact Anthony Seve

11 July 2012

Dear Secretary

Tax Laws Amendment (Cross-border Transfer Pricing) Bill (No.1) 2012

We appreciate the opportunity to comment on *Tax Laws Amendment (Cross-border Transfer Pricing) Bill (No.1) 2012* (the Bill) which proposes to insert a new Subdivision 815-A into the tax law.

KPMG has played a significant role in drafting submissions to the Senate Standing Committee on Economics (the Committee) for both the Institute of Chartered Accountants in Australia and The Tax Institute and supports the issues raised in these submissions. Our intention in providing this submission is to highlight our key areas of concern with the Bill.

Key areas of concern

Our key areas of concern with the Bill and accompanying Explanatory Memorandum (the EM) are the following:

Retrospective application

- The proposal to make Subdivision 815-A retrospective to years of income commencing on or after 1 July 2004 in circumstances which could materially disadvantage taxpayers.
- We believe the effect of the proposed amendments goes beyond a simple clarification of the law, but provides the Commissioner of Taxation (Commissioner) with additional taxing powers.
- Contrary to paragraph 1.8 of the EM, which states that "There is no financial impact from these amendments as they protect the existing revenue base", passage of the Bill could result in a significant additional tax burden for many taxpayers. The financial impact of the Bill will only be nil if the transfer pricing rules in Australia's tax treaties currently provide a separate and independent power to Division 13 of Part III of the *Income Tax Assessment Act 1936* (Division 13). As noted in paragraph 1.35 of the EM, the courts have not directly considered this issue and views differ on what the answer might be under existing law.

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Reconstruction power

- In general terms, the provision of a retrospective reconstruction power being provided to the Commissioner under Subdivision 815-A. More specifically:
  - Any retrospective reconstruction powers should apply to the most exceptional of circumstances such that these powers would be largely inoperative. As such, given the limited potential application, this power should be excluded in full from Subdivision 815-A to avoid confusion for taxpayers and the Australian Taxation Office ("ATO");
  - To the extent that retrospective reconstruction powers are not excluded in totality, we are of the view that Subdivision 815-A should not be modified by way of partial amendments in relation to this matter, as there is a real risk that such amendments could inadvertently alter the law in favour of the ATO, rather than clarifying the existing law (in line with the stated objectives of Treasury);
  - In contrast, the Commissioner's ability to amend assessments on a prospective basis in reliance on a new reconstruction power should be strictly and expressly limited in the "phase two" prospective amendments as foreshadowed in the November 2011 Treasury Discussion Paper.

Potential double taxation and Mutual Agreement Procedure (MAP) implications

- The retrospective aspect of the Bill has the potential to lead to significant unresolved double taxation for which positive resolution using the MAP in Australia's tax treaties would be unlikely. This in turn would have a negative impact on the profile of Australia as an OECD member country and raise issues of sovereign risk for prospective future investment decisions.

Thin capitalisation

- As stated in paragraph 1.105 of the EM, the Bill proposes to introduce a special rule (contained in section 815-25) which is intended to align Subdivision 815-A with the current administrative practice provided in Taxation Ruling TR 2010/7.
- It is of particular concern that the retrospective application of Subdivision 815-A will have the effect of giving legislative backing to an interpretative approach which the ATO had not finally developed until TR 2010/7 issued on 27 October 2010, i.e. more than 6 years after 1 July 2004.
- Throughout the proposed retrospective period of application (and also for many years before), many taxpayers arranged their tax affairs on the basis the safe harbour limits in Division 820 operated as a true safe harbour, contrary to the approach ultimately developed by the ATO in TR 2010/7. That is, a significant number of taxpayers have adopted an alternative view whereby gearing levels were kept below the safe harbour limits in Division 820 and then any related party debt was priced, having regard to ATO guidance available at the time (e.g. Taxation Ruling TR 92/11), on the basis of the actual amount of debt the taxpayer had and not on the basis of a notional 'arm's length' amount of debt.

- Notwithstanding the ATO does not agree with this alternative view, taxpayers that have reasonably adopted this alternative view will be significantly disadvantaged by the retrospective nature of the Bill.

Discrimination against countries with which Australia has concluded a tax treaty

- The proposed Subdivision 815-A discriminates against taxpayers that trade with related parties resident in countries with which Australia has a tax treaty. For example, the proposed amendments have the potential to lead to tax outcomes whereby taxpayers who transact with associated enterprises in non-tax treaty countries (e.g. Bermuda, Caymans) will only be subject to transfer pricing adjustments based on Division 13, whereas taxpayers who transact with associated enterprises in tax treaty countries (e.g. United States, United Kingdom, Japan) could be subject to transfer pricing adjustments under Subdivision 815-A and also Division 13.
- Such an outcome is counter-intuitive as the impact of the retrospective and reconstruction power aspects of the Bill will only affect taxpayers who transact with associated enterprises in tax treaty countries.

Penalties

- Without resiling in any way from our primary concern about the proposed retrospective application of Subdivision 815-A,we nevertheless broadly support the manner in which penalties may be applied under the Bill in respect of past periods where the taxpayer's primary tax liability is greater under Subdivision 815-A than would have been the case under Division 13. However, the Bill only allows for penalties to be limited where the penalty is levied under Subdivision 284-C of Schedule 1 to the *Tax Administration Act 1953* (ITAA 1953). Notably, the same treatment does not apply to penalties levied under Subdivision 284-B of the same Act.
- We recommend the Bill be amended to also limit potential penalties under Subdivision 284-B in respect of the application of penalties to past periods.

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We would appreciate discussing these and any other issues relevant to the Bill and the EM with the Committee. In this regard please feel free to call us at any time.

Yours sincerely	Yours sincerely
Anthony Seve Partner	Damian Preshaw Director