Law Council
OF AUSTRALIA

Professor (Emeritus) Sally Walker
Secretary-General

11 July 2012

Mr Tim Bryant
The Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Mr Bryant

Submission
Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No 1) 2012

1. The Taxation Committee of the Business Law Section, Law Council of Australia (the Committee), welcomes the opportunity to make a submission to assist the Senate Economics Legislation Committee (SELC) in its consideration of the *Tax Laws Amendment (Cross Border Transfer Pricing) Bill (No 1) 2012* (the Bill).

Retrospective nature of the law

2. At the outset, the Committee observes that one of the Law Council's key objectives is to maintain and promote the rule of law. One of the ways in which that is done is through the analysis of federal legislation and federal executive action based on compliance with its "Rule of Law Principles".[1] Among the principles is a requirement that the law must be readily known and available and certain and clear. In circumstances where this principle is threatened, representations are made to that effect.

3. In this context, and recognising that under the proposed measures penalties will apply as if only the existing transfer pricing rules applied, the Committee believes there is no justification for the retrospective application of the amendments. The Committee disagrees that either the 2003 amendments (as referred to in paragraph 1.17 of the

[1] http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=4858D679-AA9B-27F0-219A-40A47E586C70&siteName=lca.

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Explanatory Memorandum to the Bill (EM)), or the explanatory memorandum relating to those amendments, evidenced a prior understanding that the transfer pricing rules would operate in the manner proposed by the Bill. While the Commissioner of Taxation (Commissioner) may well have "long held" the view that the treaty transfer pricing rules provided an alternative basis for transfer pricing adjustments (see paragraph 1.11 of the EM), his view does not necessarily equate with Parliament's intention. Moreover, as indicated in a speech given by Mr Jim Killaly in 2008,[2] the Commissioner was well aware of the differing views on this point.

4. The Committee notes that there has been no attempt by the Parliament to clarify the law in the eight years since the 2003 amendments, despite questions being raised by the Courts.[3] While the Committee accepts that the retrospective application of the law can be justified in some exceptional cases, this is not such a case, particularly in circumstances where there is no evidence of avoidance behaviour.

5. More fundamentally, the proposed amendments cannot be regarded as merely 'clarifying' the law. To the contrary, the Bill introduces a new test for interpretation. This test requires taxpayers and the Court to read relevant provisions of the tax treaties "consistently" with OECD guidance, fundamentally changing the interpretation and application of the law.

6. In the Committee's view, a significant burden on taxpayers would be imposed as a result of this unannounced and unanticipated regime operating on a retrospective basis. The Committee considers that it is incumbent on the SELC to ensure that the rule of law is maintained, and commends the changes which were proposed in the House of Representatives to ensure that the amendments operated only prospectively.

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[2] "Distinguishing between business driven and tax driven restructuring." Tax Institute Victorian State Convention, 9 October 2008.

[3] See, for example, *GE Capital Finance Pty Ltd v Commissioner of Taxation* [2007] FCA 558 at [36] per Middleton J, *Roche Products Pty Ltd v Commissioner of Taxation*, [2008] AATA 639 at [191] per Downes J (President AAT), *Undershaft (No 1) Limited v Commissioner of Taxation* [2009] FCA 41, at [45] – [46] per Lindgren J.

The burden of proof

7. The Committee is also concerned that taxpayers retain the burden of proof even though the proposed amendments significantly increase the Commissioner's powers. This is inconsistent with international practice where tax administrations generally have the burden to prove a taxpayer's pricing is not consistent with the arm's length principle.[4]

8. The amendment provided for in the Bill gives the Commissioner an independent and additional taxing power and increases the scope for application of profit based analysis using information more readily available to the Commissioner than taxpayers. As already observed, the burden of compliance with the proposed new laws, as well as the existing domestic transfer pricing regime which will continue to apply, will be significant for taxpayers. Accordingly, the Committee considers that the burden of proof in relation to the new measures should properly lie with the Commissioner. In the alternative, either the taxpayer should bear no legal or evidential onus to prove that the assessment is excessive or, upon leading evidence in support of positions taken, it should be expressly incumbent on the Commissioner to demonstrate that the taxpayer's position is manifestly wrong.

Uncertain time limit

9. Even if the case for retrospectivity were to be accepted by the SELC, it is unclear to the Committee why it is necessary to allow the Commissioner an unlimited amendment period. The Commissioner is already equipped with substantial resources to identify transfer pricing issues and make amendments within a normal four year period, or longer with taxpayer consent or on application to a Court made following commencement of an audit and within the statutory limitation period. The Committee considers a short period of two or, at most, four years for the Commissioner to make adjustments from the time the measures are introduced would be more appropriate.

Characterisation of Arm's Length Test

10. The Bill characterises the arm's length test as applicable to the allocation of profits generally, rather than being applied to the profits resulting from specific transactions.

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4 See paragraph 18 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2010 (2010 OECD Guidelines).

This is not consistent with the OECD guidelines[5] or model OECD transfer pricing legislation[6] and will not ensure effective, equitable and transparent tax administration. Taxpayers do not have the broad coercive information gathering powers enjoyed by the Commissioner and are often unable to obtain required data.

11. The Committee submits that the legislation needs to be modified to make it clear that there is no general discretion for the Commissioner to apply a transfer pricing method to reconstruct transactions or to tax an enterprise on profits that it does not earn, merely on the basis that the group overall is in a profitable position, where this does not otherwise reflect the adoption of arm's length pricing for transactions which have actually occurred between those parties.

Further Contact

12. The Law Council would welcome the opportunity to expand on this submission at the SELC's hearings in relation to the Bill.

13. In the meantime, should you wish to discuss any aspect of this matter, please do not hesitate to contact Reynah Tang, a member of the Committee, on should you require any further information.

Yours sincerely

Professor Sally Walker
Secretary-General

[5] See paragraph 2.7 of the 2010 OECD guidelines.

[6] See OECD Suggested Transfer Pricing legislation, section 1, paragraph 1.