The Parliament of the Commonwealth of Australia

Advisory Report on the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013

House of Representatives
Standing Committee on Economics

March 2013
Canberra

© Commonwealth of Australia 2013

ISBN 978-0-642-79872-5 (printed version)

ISBN 978-0-642-79873-2 (HTML version)

This work is licensed under the Creative Commons Attribution-NonCommercial-NoDerivs 3.0 Australia License.

The details of this licence are available on the Creative Commons website: http://creativecommons.org/licenses/by-nc-nd/3.0/au/.

Chair's foreword

The Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 makes a number of amendments to the tax law. Schedule 1 amends Part IVA of the *Income Tax Assessment Act 1936* with the aim of ensuring that the Act continues to counter schemes that comply with the technical requirements of the tax law but which, when viewed objectively, are conducted in a particular way mainly to avoid tax.

Schedule 2 of the Bill aims to modernise Australia's transfer pricing rules and provide a new, comprehensive and robust transfer pricing regime that is aligned with internationally accepted principles. The objective of these new transfer pricing rules is to ensure that an appropriate return for the contribution of Australian operations of a multinational group is taxable in Australia for the benefit of the broader community.

Both schedules were the subject of prior public consultation by the Treasury.

On 1 March 2012, the Government announced that it would introduce amendments to ensure Part IVA continued to be effective in countering tax avoidance schemes. The Government's announcement was made after reviewing a number of judicial decisions. The Government was concerned that some taxpayers had argued successfully that they did not get a tax benefit because, absent the scheme, they would not have entered into an arrangement that attracted tax, because they would have entered into a different scheme that also avoided tax, because they would have deferred their arrangements indefinitely, or because they would have done nothing at all.

Schedule 1 amends Part IVA to address weaknesses that have come to light as a result of judicial decisions in determining whether there is a tax benefit in connection with a scheme and what that tax benefit is. Schedule 1 provides that the Commissioner of Taxation may use either of two alternative approaches to cancel a tax benefit obtained by a taxpayer in connection with a scheme that was entered into for the sole or dominant purpose, objectively ascertained, of avoiding tax.

These alternative postulates are an annihilation approach, whereby the scheme must be assumed not to have happened but all other events that actually happened must be incorporated; and a reconstruction approach which must represent a reasonable alternative to the scheme but disregard any potential tax costs. The result of either of these postulates will be that the tax effect is less advantageous to the relevant taxpayer than that secured by the taxpayer in connection with the scheme.

It was claimed in some of the submissions that the amendments in Schedule 1 are unnecessary as the court decisions are reasonably unique and of limited application. There are further claims in some submissions that it is not clear how the alternative postulates will operate.

However, it is the Committee's view that the amendments in the Bill are a measured response to exposed weaknesses in the operation of the tax benefit concept.

The Treasury emphasised in its submission to the committee that the annihilation and reconstruction approaches are clearly intended to operate as alternative bases for identifying tax benefits and will not lead to more income tax being payable than results from the ordinary operation of the tax law.

Schedule 2 of the Bill is vital to modernise Australia's transfer pricing rules and bring these into line with accepted international arm's length principles recommended by the OECD. Transfer pricing refers to the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises in different tax jurisdictions.

The arm's length principle is the international standard that OECD member countries have agreed should be used for determining transfer prices for tax purposes. This principle is that each enterprise within a multinational enterprise should be treated as a separate entity and it should be determined what independent entities would have done in the place of the parties. This provides a broad parity of tax treatment for members of multinational groups and independent enterprises.

The committee notes claims in some of the submissions it received that the Bill is not consistent with OECD transfer pricing guidelines and that Schedule 2 goes beyond the exceptional circumstances specified by these guidelines for a tax administration to disregard the structure adopted by a taxpayer for a controlled transaction.

It is also proposed in several submissions that the seven year limit for a transfer pricing adjustment to be made by the Commissioner of Taxation is too long and should be four years only, as applies to general income tax assessments.

However the application and effect of the proposed reconstruction rules are clearly based on the language used in the OECD guidelines and that the Bill also contains a guidance provision that requires the relevant rules to be interpreted consistently with these guidelines. The Treasury also asserts that a four year limit to conduct transfer pricing adjustments would not provide the Commissioner with adequate time to conduct transfer pricing audits.

It is clear that the OECD transfer pricing guidelines are currently the 'best thinking evident in transfer pricing'. The committee considers that reconstruction powers in exceptional circumstances are a core part of modern transfer pricing regimes and that the Bill implements these powers consistently with the OECD guidelines.

In conclusion, the Bill will enable the Commissioner of Taxation to objectively and reasonably enforce tax avoidance measures and collect revenue to which the Commonwealth is entitled under the law. The Bill should pass.

On behalf of the committee, I thank the organisations that assisted the committee during the inquiry through submissions. I also thank my colleagues on the committee for their contribution to the report.

Julie Owens MP
Chair

Contents

Chair's foreword iii
Membership of the Committee x
Terms of reference xi
List of abbreviations xii
Recommendation xiii

REPORT

1 Introduction 1

Referral of the Bill 1

Origins and purpose of the Bill 2

Schedule 1 – General anti-avoidance rules 2

Overview 2
Context of amendments 3
Prior consultation by Government 4
The current anti-avoidance regime 5
The new law 8

Schedule 2 – Modernisation of the transfer pricing rules 14

Overview 14
OECD Guidelines 15
Context of amendments 18
Prior consultation by Government 18
Current transfer pricing rules 20
The new law 21

Date of Effect 28

Objectives and scope of the inquiry **28**
Conduct of the inquiry **28**

2 Issues in the Bill 29

Schedule 1 – General anti-avoidance rules **29**
Overview 29
Response to court decisions **30**
Background 30
Analysis 32
Conclusion 35
Operation of alternative postulates **35**
Background 35
Analysis 36
Conclusion 37
Alternative postulates and commercial decision making **38**
Background 38
Analysis 38
Conclusion 41
Technical issues **41**
Background 41
Analysis 42
Conclusion 43
Schedule 2 – Modernisation of the transfer pricing rules **43**
Overview 43
Consistency with OECD Guidelines and reconstruction of transactions **44**
Background 44
Analysis 46
Conclusion 52
Time limits to amend assessments **53**
Background 53
Analysis 54
Conclusion 55
Record keeping to support a 'reasonably arguable' position **56**
Background 56

Analysis 57
Conclusion 59
Overall conclusion 59

DISSENTING REPORT

Coalition Members' Dissenting Report 61

APPENDICES

Appendix A – List of Submissions 65

Appendix B – List of reports 67

Membership of the Committee

Chair	Ms Julie Owens MP
Deputy Chair	Mr Steven Ciobo MP
Members	Mr Scott Buchholz MP
	Mr Stephen Jones MP
	Hon Joel Fitzgibbon MP
	Dr Andrew Leigh MP
	Ms Kelly O'Dwyer MP
	Mr Craig Thomson MP

Committee Secretariat

Secretary	Mr Stephen Boyd
Inquiry Secretary	Dr Kilian Perrem
Inquiry Staff	Ms Samantha Mannette
Administrative Officers	Ms Natasha Petrović
	Ms Carissa Skinner

Terms of reference

On 14 February 2013 the Selection Committee referred the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 to the committee for inquiry and report.

Under Standing Order 222(e), the House is taken to have adopted the Selection Committee's reports when they are presented.

List of abbreviations

ATO	Australian Taxation Office
CPA	CPA Australia
CTA	Corporate Tax Association
ICAA	Institute of Chartered Accountants Australia
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
MNE	Multinational enterprise
OECD	Organisation for Economic Cooperation and Development
OECD TPGs	*OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*
PE	Permanent establishment
TAA 1953	*Taxation Administration Act 1953*
the Bill	Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013

Recommendation

2 Issues in the Bill

Recommendation 1 (Paragraph 2.133)

The House of Representatives pass the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 as proposed.

1

Introduction

Referral of the Bill

1.1 On 14 February 2013, the Selection Committee referred the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 (the Bill) to the committee for inquiry and report.[1]

1.2 The Bill has two schedules. Broadly, they:

- amend Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) with the aim of ensuring that the Act continues to counter schemes that comply with the technical requirements of the tax law but which, when viewed objectively, are conducted in a particular way mainly to avoid tax (Schedule 1); and
- aim to modernise Australia's transfer pricing rules and provide a new, comprehensive and robust transfer pricing regime that is aligned with internationally accepted principles. The objective of these new transfer pricing rules is to ensure that an appropriate return for the contribution of Australian operations of a multinational group is taxable in Australia for the benefit of the broader community (Schedule 2).

1 House of Representatives Selection Committee, *Report No. 75*, 14 February 2013, p. 3.

Origins and purpose of the Bill

Schedule 1 – General anti-avoidance rules

Overview

1.3 As outlined in the Explanatory Memorandum (EM) 'Schedule 1 to this Bill amends Part IVA of the ITAA 1936 to ensure its effective operation as the income tax general anti-avoidance provision'.[2] The EM states:

> The principal role of Part IVA is to counter arrangements that, objectively viewed, are carried out with the sole or dominant purpose of securing a tax advantage for a taxpayer. Broadly speaking, Part IVA operates to counter such arrangements by exposing the substance or reality of the arrangements to the ordinary operation of the income tax law.[3]

1.4 The EM broadly summarises the purpose of Schedule 1 as follows:

> Part IVA is the income tax law's general anti-avoidance rule that operates to protect the integrity of the tax law from contrived or artificial arrangements designed to obtain a tax advantage. Recent court cases have brought to light some weaknesses in Part IVA that put at risk its capacity to properly perform that operation. The amendments made by this Schedule ensure that Part IVA can continue to protect the integrity of the income tax law.[4]

1.5 The EM describes the legislative history of the anti-avoidance provisions of Part IVA of the ITAA 1936:

> Part IVA was enacted in 1981 to overcome deficiencies that judicial decisions had exposed in the operation of the previous general anti-avoidance provision—section 260 of the ITAA 1936. The explanatory memorandum accompanying Part IVA [in 1981] explained that Part IVA was 'designed to overcome' the difficulties with section 260 and 'provide — with paramount force in the income tax law — an effective general measure against those tax avoidance arrangements that — inexact though the words may be in legal terms — are blatant, artificial or contrived'.[5]

2 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 5.

3 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 5.

4 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 29.

5 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 6.

1.6 The EM further states that these amendments are expected to prevent the loss of over $1 billion a year. The EM maintains that 'this Schedule is compatible with human rights as it does not raise any human rights issues'.[6]

Context of amendments

1.7 The EM comments that 'a number of recent decisions of the Full Federal Court have revealed weaknesses in the way in which the tax benefit concept in section 177C operates'.[7] Section 177C(1) relates to whether a taxpayer obtained a tax benefit in connection with a 'scheme'.

1.8 On 1 March 2012, the Government announced that it would introduce amendments to ensure Part IVA continued to be effective in countering tax avoidance schemes.[8] The context for these amendments is explained in the EM as follows:

> The Government's announcement was made after reviewing a number of judicial decisions, including the decision of the Full Federal Court in *RCI [2011] FCAFC 104*, handed down on 22 August 2011. The High Court dismissed the Commissioner's application for special leave to appeal against that decision on 10 February 2012.
>
> The Government was concerned that some taxpayers had argued successfully that they did not get a 'tax benefit' because, absent the scheme, they would not have entered into an arrangement that attracted tax—for example—because they would have entered into a different scheme that also avoided tax, because they would have deferred their arrangements indefinitely or because they would have done nothing at all.[9]

1.9 The EM further explains that 'the Government was also concerned that Part IVA might not be working effectively in relation to schemes that were steps within broader commercial arrangements'.[10]

---

6 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 3, 30.

7 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 10.

8 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 15.

9 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 15.

10 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 15.

Prior consultation by Government

1.10 The Government established a consultation process to assist with the design of these amendments. The EM states that the process:

> … involved setting up a roundtable of industry representatives, legal academics and tax experts to assist Treasury identify and explore possible approaches to clarifying the law. It also involved the Government seeking advice on different design options from senior members of the bar with particular expertise in Part IVA.[11]

1.11 The EM further states in relation to these consultations:

> The role of the roundtable was not to revisit the policy decisions announced by the Government on 1 March 2012. The roundtable was established because of the unique role that Part IVA plays in the income tax laws, in addition to the normal Treasury consultation processes, to improve the legislative response to the problems that have emerged with Part IVA.
>
> The roundtable process was constructive, and significantly deepened the Government's understanding of the issues with Part IVA that the Government is seeking to address.[12]

1.12 In 2012, meetings were held with the roundtable members in Canberra or by telephone on 16 May, 26 September, 31 October and 6 December. Public consultation on the draft legislation was conducted by the Treasury between 16 November and 19 December 2012. Twenty three submissions were received by the Treasury.[13]

1.13 The Treasury summarises the key issues arising from the public consultation process, entitled *Ensuring the effectiveness of the income tax general anti-avoidance rule*, as follows:

- Many submissions suggested that the approach taken in the exposure draft legislation was overly prescriptive and would introduce new and difficult concepts into the provisions.
- The Bill simplified the expression of the assumptions and removed concepts that were said to be uncertain.

---

11 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 15.

12 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 15–16.

13 Consultation documents and submissions are available from the Treasury website at <http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/General-anti-avoidance-rule>, viewed 21 February 2013.

- Some submissions opposed the requirement that tax costs be disregarded when constructing an alternative postulate to a scheme to work out whether the scheme produced a tax benefit.
- The Bill did not omit that requirement because it would be inconsistent with the policy underlying Part IVA of countering artificial or contrived tax avoidance schemes by exposing their substance or reality to the ordinary operation of the law.
- A number of submissions proposed delaying application of the amendments until the Royal Assent.
- This proposal was not adopted as it would have allowed taxpayers to gain an advantage from artificial or contrived schemes entered into between the release of the exposure draft and the Royal Assent.[14]

1.14 The EM comments in relation to the application of the new provisions in Part IVA that 'the amendments apply from 16 November 2012; that is, from a date before the amendments become law'.[15] The EM asserts that:

> 16 November 2012 was the date on which a draft of the amendments was released for public comment. Applying it from that date is necessary to ensure that taxpayers are not able to benefit from artificial or contrived tax avoidance schemes entered into in the period between that date and the date of Royal Assent.
>
> Application from that date does not affect the operation of any criminal law.[16]

The current anti-avoidance regime

1.15 The current statutory regime that operates under Part IVA is outlined in the EM as follows:

> The Commissioner of Taxation (Commissioner) may cancel a tax benefit obtained by a taxpayer in connection with a scheme 'to which Part IVA applies' (subsection 177F).
>
> Section 177D provides that Part IVA applies to a scheme in respect of which:
>
> - a taxpayer has obtained, or would but for section 177F obtain, a tax benefit in connection with the scheme (paragraph 177D(a)); and

14 *Ensuring the effectiveness of the income tax general anti-avoidance rule* consultation summary available from the Treasury website at <http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/General-anti-avoidance-rule>, viewed 21 February 2013.

15 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 29.

16 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 29–30.

- one or more of the persons who participated in the scheme (or part of the scheme) did so for the sole or dominant purpose, objectively ascertained, of enabling the taxpayer to obtain a tax benefit in connection with the scheme (paragraph 177D(b)).[17]

1.16 In relation to the application of this regime, the EM emphasises:

> Although the Commissioner is entitled to put his case in relation to the scheme and the tax benefit in alternative ways, the existence of the Commissioner's discretion to cancel the tax benefit does not depend upon the Commissioner's opinion or satisfaction that there is a tax benefit or that, if there is a tax benefit, it was obtained in connection with a scheme. The existence of a scheme and a tax benefit must be established as matters of objective fact.[18]

1.17 The EM further notes that 'the "bare fact" that a taxpayer can be shown to have obtained a tax benefit in connection with a scheme does not in itself compel the application of Part IVA'.[19] The EM states that:

> The tax benefit must be obtained in connection with a scheme to which Part IVA applies.
>
> In determining whether Part IVA applies to a scheme, the critical question— indeed the fulcrum upon which Part IVA turns— … is whether a person or persons who participated in the scheme did so for the sole or dominant purpose of enabling the taxpayer to obtain a tax benefit that has been so obtained. The relevant purpose must be established objectively based on an analysis of how the scheme was implemented, what the scheme actually achieved as a matter of substance or reality as distinct from legal form (that is, its end effect) and the nature of any connection between the taxpayer and other parties (and each of the other actors in paragraph 177D(b)). A person's subjective motive is irrelevant.[20]

17 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 7–8.

18 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 8.

19 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 8.

20 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 8.

Role of an alternative postulate

1.18 The EM notes that a Part IVA inquiry into a scheme 'requires a comparison between the scheme in question and an alternative postulate'.[21] The EM states:

> A comparison between the scheme and an alternative postulate serves the Part IVA inquiry in two ways:
>
> - first, comparisons between the tax consequences of the scheme and the tax consequences of alternative postulates provide a basis for identifying (and quantifying) any tax advantages (of the relevant kind) that may have been obtained from the scheme; and
> - second, a consideration of alternative postulates may … assist in reaching a conclusion about the purposes of the participants in the scheme … a consideration of whether there were other ways that the participants in the scheme could have achieved their non-tax purposes facilitates a weighing of those purposes against any tax purposes that can be identified.[22]

1.19 The EM further states that 'an alternative postulate could be merely that the scheme did not happen or it could be that the scheme did not happen but that something else did happen'.[23]

Tax benefit

1.20 The EM explains that 'the purpose and function of section 177C is to define the kind of tax outcomes that a participant in the scheme must have had the purpose of securing for the taxpayer, and which must have been secured in connection with the scheme, if Part IVA is to apply'.[24] The EM states:

> The tax outcomes with which section 177C(1) is concerned, and which are labelled 'tax benefits', are:
>
> - an amount not being included in assessable income;
> - a deduction being allowed;
> - a capital loss being incurred; and
> - a foreign income tax offset being allowed.[25]

21 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 9.

22 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 9.

23 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 , p. 9.

24 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 9.

25 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 9–10.

The new law

Overview

1.21 The EM comments that the amendments in Schedule 1 of the Bill aim to 'target deficiencies in section 177C and the way it interacts with other elements of Part IVA, particularly section 177D, as revealed by recent decisions of the Full Federal Court'.[26] The EM asserts that:

> The amendments are not intended to change the operation of Part IVA in any other respect.[27]

1.22 In terms of the Bill's aims, the EM states:

> Consistent with the policy underlying Part IVA, the amendments are intended to have the following effects:
>
> - to put it beyond doubt that the 'would have 'and 'might reasonably be expected to have' limbs of each of the subsection 177C(1) paragraphs represent alternative bases upon which the existence of a tax benefit can be demonstrated;
> - to ensure that, when obtaining a tax benefit depends on the 'would have' limb of one of the paragraphs in subsection 177C(1), that conclusion must be based solely on a postulate that comprises all of the events or circumstances that actually happened or existed other than those forming part of the scheme;
> - to ensure that, when obtaining a tax benefit depends on the 'might reasonably be expected to have' limb of one of the paragraphs in subsection 177C(1), that conclusion must be based on a postulate that is a reasonable alternative to the scheme, having particular regard to the substance of the scheme and its effect for the taxpayer, but disregarding any potential tax costs; and
> - to require the application of Part IVA to start with a consideration of whether a person participated in the scheme for the sole or dominant purpose of securing for the taxpayer a particular tax benefit in connection with the scheme; and so emphasising the dominant purpose test in section 177D as the 'fulcrum' or 'pivot' around which Part IVA operates.[28]

---

26 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 16.

27 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 16.

28 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 16–17.

1.23 A comparison of key features of the new and current law is summarised in the EM as shown below in Table 1.1.

Table 1.1 Key comparisons between new and current anti-avoidance tax law

New law	Current law
It is clear that the 'would have' and 'might reasonably be expected to have' limbs of each of the subsection 177C(1) paragraphs represent alternative bases upon which the existence of a tax benefit can be demonstrated.	It is unclear whether the 'would have' and 'might reasonably be expected to have' limbs of each of the subsection 177C(1) paragraphs represent separate and distinct bases upon which the existence of a tax benefit can be demonstrated.
It is clear that the 'would have' limbs of each of the subsection 177C(1) paragraphs operate on the basis of a postulate that comprises existing facts and circumstances minus the scheme.	The operation of the 'would have' limbs of each paragraph of subsection 177C(1) is uncertain. Recent Federal Court cases appear to have proceeded on the basis that the 'would have' limb involves a prediction about events or circumstances, as opposed to a mere deletion of the scheme.
It is clear that the 'might reasonably be expected to have' limbs of each of the subsection 177C(1) paragraphs operate on the basis of postulates that are reasonable alternatives to the scheme, having particular regard to the substance of the scheme and the non-tax results and consequences achieved by the taxpayer from the scheme, but disregarding potential tax costs.	The operation of the 'might reasonably be expected to have' limbs of each of the subsection 177C(1) paragraphs depends on an inquiry about what other courses of action were reasonably open to the participants in the scheme.
The question whether Part IVA applies to a scheme starts with a consideration of whether any person participated in the scheme for the sole or dominant purpose of securing for the taxpayer a tax benefit in connection with the scheme. This ensures that the examination of the tax benefit happens in the context of examining a participant's purpose.	The question whether Part IVA applies to a scheme starts with a consideration of whether a taxpayer has secured a particular tax benefit in connection with the scheme.

Source *Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 17–18.*

Bases for identifying tax benefits

1.24 The EM emphasises that Schedule 1 'amends Part IVA to address weaknesses that have come to light in how it works out whether there is a tax benefit in connection with a scheme and what that tax benefit is'. The EM explains that:

> A conclusion that one of the paragraphs of subsection 177C(1) [which defines tax benefits in Part IVA] is satisfied requires a conclusion that one of the tax effects specified in that subsection
>
> (for example, the inclusion of an amount of assessable income) 'would have', or 'might reasonably be expected to have', happened, absent a particular scheme.
>
> The new provision puts it beyond doubt that the 'would have' and 'might reasonably be expected to have' limbs of each of the

> paragraphs in subsection 177C operate as alternative bases for identifying relevant tax effects.[29]

Alternative bases

1.25 The EM states that 'Subsection 177C(1) [of Part IVA] contains two bases upon which the existence of a tax benefit can be demonstrated'.[30] The EM goes on to explain these two bases:

> The first is that, absent the scheme, a relevant tax outcome 'would have been' the case. The second is that, absent the scheme, a relevant tax outcome 'might reasonably be expected to have been' the case.[31]

1.26 These two bases are referred to as 'limbs' and are further explained in the EM as follows:

> The first limb requires a comparison of the tax consequences of the scheme with the tax consequences that 'would have' resulted if the scheme had not occurred.
>
> The second limb requires a comparison of the tax consequences of the scheme with the tax consequences that 'might reasonably be expected to have' resulted if the scheme had not occurred.[32]

1.27 The EM elaborates on the first of these two alternatives as follows:

> One approach to the first limb has been to view it as satisfied in cases where a relevant tax advantage is exposed by applying the taxation law to the facts remaining once the statutory postulate has done its work in deleting the scheme. In those cases, a tax benefit exists if it can be demonstrated that the relevant tax advantage flows, as a matter of law, once the scheme is assumed not to have happened. This may be referred to as an 'annihilation approach'. Although this approach involves an alternative postulate, that postulate consists solely of deleting the scheme.[33]

29 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 18.

30 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 10.

31 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 10.

32 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 10.

33 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 11.

1.28 The second limb is described in the following terms by the EM:

> … the second limb is a qualitatively different test that may be satisfied notwithstanding an element of uncertainty in the postulate. For example, it has been applied in cases where the mere deletion of the scheme would not necessarily leave a coherent state of affairs for the tax law to apply to — where a prediction is required about facts not in existence and/or about facts which are in existence not being in existence. In other words, it contemplates a postulate based on a reasonable reconstruction of either the scheme, or of the scheme and things that happened in connection with the scheme. This is sometimes referred to as a 'reconstruction approach'.[34]

1.29 In its description of the manner in which the Commissioner of Taxation may exercise discretion under subsection 177F(1) to cancel a tax benefit the EM states:

> … [the Commissioner] is entitled to put his or her case in alternative ways (including by relying, in the alternative, on the different limbs of the paragraphs in subsection 177C), [however] the tax benefit cancelled must be a tax benefit that has been obtained in connection with a scheme to which Part IVA applies.[35]

1.30 The EM further emphasises in this regard that:

> As such, the question in every case will be whether or not it can be established, as a matter of objective fact, that the tax benefit the Commissioner is purporting to cancel is a tax benefit that was obtained in connection with a scheme that was entered into or carried out with the requisite tax avoidance purpose.[36]

34 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 11.

35 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 18.

36 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 18-19.

Annihilation approach

1.31 In further describing the annihilation approach the EM comments that 'a decision that a tax effect "would have" occurred if the scheme had not been entered into or carried out must be made solely on the basis of a postulate comprising all of the events or circumstances that actually happened or existed, other than those that form part of the scheme'.[37] The EM states:

> This provision makes it clear that, when postulating what would have occurred in the absence of the scheme, the scheme must be assumed not to have happened—that is, it must be 'annihilated', 'deleted' or 'extinguished'. Otherwise, however, the postulate must incorporate all the 'events or circumstances that actually happened or existed'.
>
> In other words, the speculation that is permitted about any other state of affairs that might have come about if the scheme had not been entered into or carried out is limited to the removal of the scheme. A postulate cannot assume the existence of events or circumstances not in existence, nor can it assume the non-existence of events or circumstances that are in existence (other than those that form part of the scheme).[38]

1.32 The EM further explains the operation of the annihilation approach as follows:

> Under this approach, a taxpayer will have obtained a tax benefit in connection with a scheme if it can be demonstrated that a relevant tax effect would have flowed, as a matter of law, from the application of the taxation law to the facts remaining once the scheme is assumed away, that is, a tax effect less advantageous to the taxpayer than the tax effect secured by the taxpayer in connection with the scheme.[39]

37 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 19.

38 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 19.

39 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 19.

Reconstruction approach

1.33 In commenting on the use of the reconstruction approach in assessing the tax benefits of a scheme, the EM asserts that:

> … a decision that a tax effect 'might reasonably be expected to have' occurred if a scheme had not been entered into or carried out must be made on the basis of a postulate that is a reasonable alternative to the scheme, having particular regard to the substance of the scheme and its results and consequences for the taxpayer, and disregarding any potential tax results and consequences.[40]

1.34 The EM comments that 'the amendment makes it clear that when postulating what might reasonably be expected to have occurred in the absence of a scheme, it is not enough to simply assume the non-existence of the scheme - the postulate must represent a reasonable alternative to the scheme, in the sense that it could reasonably take the place of the scheme'.[41] The EM states:

> Such a postulate will necessarily require speculation about the state of affairs that would have existed if the scheme had not been entered into or carried out. This may include speculation about the way in which connected transactions would have been modified if they had had to accommodate the absence of the scheme.
>
> Under this [reconstruction] approach, a taxpayer will obtain a tax benefit in connection with a scheme if it can be demonstrated that a relevant tax effect would have flowed, as a matter of law, from the application of the taxation law to the alternative postulate; again, a tax effect that is less advantageous to the relevant taxpayer than the tax effect secured by the taxpayer in connection with the scheme.[42]

1.35 The EM further notes that 'a reconstruction approach is an effective way to identify a tax benefit in relation to a scheme that achieves substantive non-tax results and consequences'.[43] The EM states:

---

40 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 20.

41 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 21.

42 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 21.

43 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 21.

> In these cases, simply annihilating the scheme would be inconsistent with the non-tax results and consequences sought for the taxpayer by the participants in the scheme.
>
> Typically this will be the case in an income scheme (or a withholding tax scheme) that both produces and shelters economic gains. In such cases an annihilation approach would be an ineffective way to expose the tax avoidance achieved by the tax shelter, since deleting the scheme would destroy both the gain and the shelter. In such cases, a prediction will necessarily be required about other ways in which a comparable gain could have been produced without the tax shelter.[44]

Schedule 2 – Modernisation of the transfer pricing rules

Overview

1.36 Schedule 2 of the Bill aims to modernise Australia's transfer pricing rules and ensure they are aligned with internally accepted principles, of which the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD TPGs) are a crucial component. The EM outlines Schedule 2 of the Bill as follows:

> Schedule 2 inserts Subdivisions 815-B, 815-C and 815-D into the *Income Tax Assessment Act 1997* (ITAA 1997) and Subdivision 284-E into Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953). These Subdivisions contain amendments that modernise the transfer pricing rules contained in Australia's domestic law. They ensure 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).[45]

44 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 21–22.

45 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 31.

1.37 The EM further comments that these amendments will 'ensure greater alignment between outcomes achieved for international arrangements involving Australia and another jurisdiction irrespective of whether the other country forms part of Australia's tax treaty network'.[46] The EM states:

> Subdivisions 815-B, 815-C and 815-D modernise and relocate the transfer pricing provisions into the ITAA 1997 to ensure that consistent rules apply to both tax treaty and non-tax treaty cases.
>
> In addition, Subdivision 284-E of Schedule 1 to the TAA 1953 contains rules related to transfer pricing documentation. Consistent with the approaches under Division 13 [of the ITAA 1936], the new rules in Subdivision 815-B apply the arm's length principle to relevant dealings between both associated and non-associated entities.[47]

OECD Guidelines

1.38 There has been significant growth in multinational enterprises (MNEs) in recent decades, which have led to complex taxation issues where there are a number of entities operating in various countries covered by different national tax regimes. The OECD takes the view that these taxation issues cannot be addressed by separate country rules alone and must be addressed in a broader international context.[48]

1.39 The OECD TPGs provide guidance on the application of the 'arm's length principle', the approach to be taken when evaluating the transfer pricing of associated enterprises, i.e. attributing a value, for tax purposes, of cross-border transactions between associated enterprises.

1.40 The OECD TPGs defines transfer prices as 'the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises'. The OECD TPGs focus on international aspects rather than domestic issues of transfer pricing, maintaining that:

> Transfer prices are significant for both taxpayers and tax administrations because they determine in large part the income and expenses, and therefore taxable profits, of associated enterprises in different tax jurisdictions.

---

46 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 31.

47 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 33.

48 Organisation for Economic Co-operation and Development (OECD), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 22 July 2010, p. 17.

> … These international aspects are more difficult to deal with because they involve more than one tax jurisdiction and therefore any adjustment to the transfer price in one jurisdiction implies that a corresponding change in another jurisdiction is appropriate. However, if the other jurisdiction does not agree to make a corresponding adjustment the MNE group will be taxed twice on this part of its profits. In order to minimise the risk of such double taxation, an international consensus is required on how to establish for tax purposes transfer prices on cross-border transactions.[49]

1.41 The aim of transfer pricing is to ensure that a given country can collect the appropriate amount of tax from the MNEs which reflects that country's contribution to the business transactions. However, determining that is complicated by a range of issues, for example whether the tax is residence based, source based, or both. The OECD member countries agreed that treating each enterprise within an MNE group as a separate entity is 'the most reasonable means for achieving equitable results and minimising the risk of unrelieved double taxation'.[50]

1.42 The OECD TPGs describe the arm's length principle as:

> The international standard that OECD member countries have agreed should be used for determining transfer prices for tax purposes. It is set forth in Article 9 of the OECD Model Tax Convention as follows: where 'conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly'.[51]

1.43 Key aspects of the OECD TPGs include:

- To help tax administrators (in OECD and non-member countries) and MNEs by indicating ways to find mutually satisfactory solutions to transfer pricing cases.

49 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 22 July 2010, p. 19.

50 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 22 July 2010, p. 18.

51 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 22 July 2010, p. 23.

- Analysis of the methods for evaluation whether the conditions of commercial and financial relations within an MNE satisfy the arm's length principle, and discuss practical application of the methods.
- OECD member countries and taxpayers are encouraged to consider the OECD TPGs in their domestic transfer pricing practices.
- To govern the resolution of transfer pricing cases in mutual agreement proceedings between OECD member countries and, where appropriate, arbitration proceedings.[52]

1.44 The OECD TPGs were originally introduced in 1995, and were updated in 2009 and more substantially revised in 2010. The OCED TPGs are widely recognised, but not generally binding on tax administrators, legislators or taxpayers.

1.45 In the Australian context, the Australian Government has considered how to best ensure effective transfer pricing rules. A 2011 Consultation paper on the issue states:

> [T]here is uncertainty over the role of the OECD Guidelines in applying the profit allocation rules. At a formal level, direct resort to the Guidelines has not been endorsed by the courts in Australia, but evidence based on the approach taken in the Guidelines has been accepted. It appears that the OECD Guidelines could be available if it was demonstrated that parties to a relevant treaty would apply the Guidelines in similar circumstances. In practice the OECD Guidelines are extensively used by treaty partner administrations, the ATO and practitioners. Importantly the Guidelines changed in 2010 to give profit based methods equal priority to traditional methods. There is a strong case for reducing uncertainty by mandating the use of the OECD Guidelines in tax legislation. A clearer legal pathway for use of the Guidelines might also reduce the need for legal argument on this point in litigation.[53]

52 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 22 July 2010, pp. 20-21.

53 The Treasury, *Income tax: cross border profit allocation – Review of transfer pricing rules*, Consultation Paper, 1 November 2011, p. 5.

Context of amendments

1.46 The EM comments on the growth of multinational trade over the past decade and that 'growth of this nature underscores the need for modern, robust transfer pricing rules capable of dealing with complex arrangements'.[54] The EM states:

> Australia's transfer pricing rules seek to ensure that an appropriate return for the contribution made by an entity's Australian operations is taxable in Australia for the benefit of the community. The appropriate return is determined through the application of the arm's length principle, which aims to ensure that an entity's tax position is consistent with that of an independent entity dealing wholly independently with others.
>
> The new rules apply the arm's length principle by identifying the conditions that might be expected to operate in comparable circumstances between independent entities dealing wholly independently with one another.[55]

1.47 The EM also asserts that 'the OECD Guidelines are widely recognised as representing international best practice'.[56] The EM states:

> Greater consistency with international standards reduces uncertainty and the risk of double taxation, and assists in minimising compliance and administration costs.[57]

Prior consultation by Government

1.48 On 1 November 2011, the then Assistant Treasurer, the Hon Bill Shorten MP, announced that the Government would 'reform the transfer pricing rules in the income tax law and Australia's future tax treaties to bring them into line with international best practice, improving the integrity and efficiency of the tax system'.[58]

1.49 The then Assistant Treasurer also released a Consultation Paper, *Income tax: cross border profit allocation – Review of transfer pricing rules*. The paper

54 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 32.

55 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 32.

56 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 32.

57 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 32.

58 The Hon Bill Shorten MP, Assistant Treasurer, *Robust transfer pricing rules of multinationals*, Media Release No. 145, 1 November 2011.

outlined the history of the transfer pricing rules, and suggested a number of areas of change, including introducing the arm's length standards and ensuring consistency with the OECD TPGs. The Treasury received 28 submissions to the consultation.[59]

1.50 The Assistant Treasurer, the Hon David Bradbury MP, subsequently released on 22 November 2012 an exposure draft of the proposed amendments to Australia's transfer pricing rules. The Treasury received 24 submissions to the consultation, which closed on 20 December 2012. The Treasury also conducted a consultation meeting with peak-body, industry and corporate representatives on 7 December 2012.

1.51 In its summary of the consultation process, the Treasury states that the Bill 'has greatly benefited from feedback received'. The Treasury indicated that following the consultation substantive changes were made to the draft Bill, and the explanatory material was amended to 'provide further explanation and clarification in response to the specific issues raised in submissions'. [60]

1.52 The Treasury noted that most of the submissions supported the alignment of Australia's domestic transfer pricing rules with the OECD TPGs, and the move towards self-assessment. Concerns raised by submitters to the consultation in relation to documentation rules, the reconstruction power and the time limit for the Commissioner to amend a taxpayer's assessment to give effect to the new rules, led to changes to the draft Bill.

1.53 Other issues raised during the consultation included:

- the extent to which certain concepts are defined in domestic law, as opposed to being left to the OECD TPGs;
- a suggestion that the rules should allow a taxpayer to downward assess a liability;
- that the scope of the documentation rules was too broad, as they require a taxpayer to prepare documentation in respect of all conditions that satisfied the cross-border requirement; and

59 The Treasury, *Income tax: cross border profit allocation – Review of transfer pricing rules*, Consultation Paper, 1 November 2011, available at <http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2011/Transfer-Pricing-Rules>, viewed 21 February 2013.

60 The Treasury, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2012 (Schedule 2) – Modernisation of transfer pricing rules: Summary of consultation process*, p. 2.

- the link between preparing documentation and having a reasonably arguable position in respect of administrative penalties was inappropriate.[61]

Current transfer pricing rules

1.54 Australia's domestic transfer pricing rules are currently set out in Division 13 of the ITAA 1936 and in Subdivision 815-A. Transfer pricing rules are also contained in Australia's bilateral tax treaties.[62] The EM states:

> The rules in Division 13 generally focus on determining the arm's length consideration for the supply or acquisition of property and/or services under an international agreement. By contrast, in determining whether outcomes are consistent with the arm's length principle, Australia's tax treaties and the OECD Guidelines also allow for consideration of the totality of arrangements that would have been expected to operate had the entities been dealing with each other on a wholly independent basis. This focus permits the consideration of a broad range of methods in determining arm's length outcomes. Such methods include, but are not limited to, traditional transaction methods.[63]

1.55 The EM further comments that 'Subdivision 815-A, enacted by the *Tax Laws Amendment (Cross-Border Transfer Pricing) Act (No. 1) 2012*, applies to ensure that Australia's tax treaty transfer pricing rules operate as intended'.[64] The EM states:

> The purpose of Subdivision 815-A is to limit taxable profits being shifted or misallocated offshore.[65]

61 The Treasury, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2012 (Schedule 2) – Modernisation of transfer pricing rules: Summary of consultation process*, pp. 1-2.

62 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 33.

63 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 33.

64 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 33.

65 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 33.

The new law

1.56 The Bill repeals Division 13 of the ITAA 1936 and introduces Subdivisions 815-B, 815-C and 815-D to the ITAA 1997 and Subdivision 284-E into Schedule 1 to the *Taxation Administration Act 1953 (TAA 1953).* The EM comments that 'Subdivision 815-A will no longer have effect when Subdivisions 815-B and 815-C are enacted'.[66] The EM states:

> Subdivisions 815-B, 815-C and 815-D modernise and relocate the transfer pricing provisions into the ITAA 1997 to ensure that consistent rules apply to both tax treaty and non-tax treaty cases…
>
> Unlike the current transfer pricing rules in Division 13 [of the ITAA 1936] and in Subdivision 815-A [of the ITAA 1997], which both rely on the Commissioner of Taxation (Commissioner) making a determination, Subdivisions 815-B and 815-C are self-executing in their operation. This better aligns Australia's domestic transfer pricing rules with the design of Australia's overall tax system which generally operates on a self-assessment basis.[67]

1.57 A comparison of key features of the new and current transfer pricing rules is summarised in the EM as shown below in Table 1.2.

66 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 33.

67 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 33.

Table 1.2 Key comparisons between new and current transfer pricing rules

New law	Current law
Arm's length principle	
Subdivisions 815-B and 815-C and the tax treaty transfer pricing provisions apply the internationally accepted arm's length principle which is to be determined consistently with the relevant OECD Guidance material.	Division 13 operates to ensure that for all purposes of the Act, an arm's length amount of consideration is deemed to be paid or received for a supply or acquisition of property or services under an international agreement. Subdivision 815-A and the tax treaty transfer pricing provisions apply the internationally accepted arm's length principle which is to be determined consistently with the relevant OECD Guidance material.
Transfer pricing adjustments	
A transfer pricing adjustment may be made under Subdivision 815-B, Subdivision 815-C, or the relevant transfer pricing provisions of a tax treaty. Subdivision 815-B applies to certain conditions between entities and Subdivision 815-C applies to the allocation of actual income and expenses of an entity between the entity and its permanent establishment. To the extent they have the same coverage as the equivalent tax treaty rules, an adjustment under Subdivision 815-B or Subdivision 815-C gives the same result as the transfer pricing provisions of a tax treaty.	A transfer pricing adjustment may be made under Division 13, the transfer pricing provisions of a tax treaty, or Subdivision 815-A. Subdivision 815-A, for practical purposes, generally gives the same result as the application of the transfer pricing provisions of a tax treaty by adopting the terms and text of the relevant parts of the transfer pricing articles contained in Australia's tax treaties.
Assessment of transfer pricing adjustments	
Subdivisions 815-B and 815-C apply on a self-assessment basis.	The Commissioner must make a determination under Division 13 or Subdivision 815-A in order to give effect to a transfer pricing adjustment.
Application of the rules to conditions between entities	
Subdivision 815-B applies to conditions that satisfy the cross-border test, irrespective of whether entities are associated or not and/or operating in treaty or non-treaty countries. The transfer pricing provisions of a tax treaty may apply in the event of an inconsistency with Subdivision 815-B.	Division 13 applies to international agreements between both associated and unassociated entities irrespective of tax treaty coverage (although the transfer pricing provisions of a tax treaty may apply in the event of an inconsistency). Subdivision 815-A and the tax treaty transfer pricing provisions apply in treaty cases and in respect of associated entities only.

Allocation of profits between entities and their permanent establishments	
Subdivision 815-C applies to the allocation of actual income and expenses of an entity between the entity and its permanent establishment. Subdivision 815-C applies to a foreign permanent establishment of an Australian resident and to an Australian permanent establishment of a foreign resident entity, irrespective of whether a tax treaty applies. The transfer pricing provisions of a tax treaty may apply in the event of an inconsistency with Subdivision 815-C.	Subdivision 815-A and the relevant tax treaty transfer pricing provisions allocate profits (the income and expenses) to the Australian permanent establishment of a foreign resident entity in treaty cases only. The transfer pricing provisions of a tax treaty may apply in the event of an inconsistency with Subdivision 815-A.
Record keeping	
Subdivision 284-E of Schedule 1 to the TAA 1953 sets out optional record keeping requirements for entities to which Subdivision 815-B or 815-C applies. Records that meet the requirements are necessary, but not sufficient to establish a reasonably arguable position for the purposes of Schedule 1 to the TAA 1953. If the documentation as specified in the Subdivision is not kept in respect of a matter, an entity is not able to demonstrate that it has a reasonably arguable position in relation to that matter for the purposes of Schedule 1 to the TAA 1953.	The general record-keeping provisions of the tax law apply to the transfer pricing provisions.
Administrative penalties	
Administrative penalties may apply if an assessment is amended by the Commissioner for an income year to give effect to Subdivisions 815-B or 815-C and the provisions of section 284-145 of Schedule 1 to the TAA 1953 have been met.	Administrative penalties may apply where a transfer pricing adjustment has been made by the Commissioner under Division 13 or Subdivision 815-A and the provisions of section 284-145 of Schedule 1 to the TAA 1953 have been met. This is subject to the operation of a transitional rule where the Commissioner makes a determination under Subdivision 815-A in respect of income years prior to the first income year starting on or after 1 July 2012.
Amendment period	
An amendment to give effect to Subdivision 815-B or Subdivision 815-C can be made within seven years after the day on which the Commissioner gives notice of the assessment to the entity. Some tax treaties impose specific time limits in relation to transfer pricing adjustments under the tax treaty.	Subject to subsection 170(9C), subsection 170(9B) of the ITAA 1936 provides an unlimited period in which the Commissioner may amend an assessment to give effect to a transfer pricing adjustment under Division 13, the tax treaty transfer pricing provisions, or Subdivision 815-A. Some tax treaties impose specific time limits in relation to transfer pricing adjustments under the tax treaty.

Source *Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 37-39.*

Subdivision 815-B: Arm's length rule for entities

1.58 The object of Subdivision 815-B is described by the EM as 'to ensure that the amount brought to tax in Australia from cross-border conditions that operate between entities reflects the arm's length contribution made by an entity's Australian operations'.[68] The EM asserts that:

> Subdivision 815-B seeks to achieve this outcome in a way that facilitates trade and investment through alignment with international standards. The international standard that is widely accepted by Australia's trade and investment partners is the arm's length principle, the application of which is set out in the *Organisation for Economic Cooperation and Development* (OECD) *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* … (OECD Guidelines).[69]

1.59 The EM further comments that Subdivision 815-B '…implements this principle by requiring entities that would otherwise get a tax advantage in Australia from non–arm's length conditions, to calculate their Australian tax position as though the arm's length conditions had instead operated'.[70] The EM asserts that:

> Subdivision 815-B takes precedence over other provisions of the … ITAA 1936 and the … ITAA 1997 unless a limitation to its operation is explicitly provided within the Subdivision …
>
> In contrast to the transfer pricing rules that were introduced by Subdivision 815-A (in particular, section 815-30), Subdivision 815-B does not contain an explicit rule requiring individual amounts to be specified. A rule of this kind is not necessary because under Subdivision 815-B an entity is required to *work out* its taxable income, loss of a particular sort, tax offsets or withholding tax payable on the basis that independent conditions operated.[71]

1.60 The EM further explains in relation to the operation of Subdivision 815-B that 'applying the arm's length principle is the internationally accepted approach to dealing with transfer pricing issues'. The EM states:

68 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 41.

69 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 41.

70 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 41.

71 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 41, 43.

> The OECD Guidelines, in particular, expand on the application of the arm's length principle and contain authoritative international know-how on the application of transfer pricing rules. The OECD Guidelines are widely used by both member and non-member tax administrations, and were described by the UK Special Commissioners as 'the best evidence of international thinking on transfer pricing'.[72]

1.61 The EM further elaborates on the principles behind the use of OECD guidance material to determine the arm's length conditions, commenting that 'most of Australia's major trading and investment partners look to the OECD Guidelines to ensure consistent application of transfer pricing rules'.[73] The EM states in this regard that:

> In the event that different standards were used there would be a greater risk that jurisdictions might each tax the same amount under their transfer pricing rules (resulting in double taxation), or not tax an amount at all (leading to double non taxation).
>
> The identification of arm's length conditions under Subdivision 815-B must be done in a way that best achieve consistency with the following material:
>
> - the OECD Guidelines; and
> - any other documents, or part(s) of a document, prescribed by the regulations for this purpose.[74]

1.62 The EM defines the term 'transfer pricing benefit' as the 'shortfall amount of Australian tax that an entity has as the result of its non–arm's length dealings with other entities'.[75] The EM defines the conditions under which this benefit is obtained as follows:

> An entity gets a transfer pricing benefit in an income year from conditions that operate between the entity and another entity in connection with their commercial or financial relations if:
>
> - the actual conditions differ from the arm's length conditions;
> - the actual conditions result in a tax advantage in Australia, relative to the arm's length conditions; and

72 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 44–45.

73 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 45.

74 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 45.

75 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 47.

- the actual conditions satisfy the cross-border test.[76]

Subdivision 815-C: Arm's length rule for permanent establishments

1.63 The object of Subdivision 815-C is described by the EM as follows:

> … to ensure that the amount brought to tax in Australia by entities operating at or through permanent establishments is not less than it would be if the permanent establishment (PE) were a distinct and separate entity engaged in the same or comparable activities under the same or comparable circumstances, but dealing wholly independently with the entity of which it is a part.[77]

1.64 The EM summarises the policy intent of Subdivision 815-C as follows:

> Subdivision 815-C modernises Australia's transfer pricing rules in respect of the attribution of profits between a permanent establishment and the entity of which it is a part …
>
> Broadly, the allocation of profits between a permanent establishment and the entity of which it is a part is determined by analysing the functions performed, the assets used or contributed, and the risks assumed or managed by the various parts of the business. From this analysis, the most appropriate and reliable transfer pricing method or combination of methods should be chosen, having regard to the circumstances of the commercial or financial relations …
>
> Within this framework, applying the most appropriate and reliable transfer pricing method or methods determines the arm's length profits that are attributable to the permanent establishment of an entity.[78]

76 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 47.

77 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 77.

78 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 35.

Subdivision 815-D: Special rules for trusts and partnerships

1.65 The object of Subdivision 815-D as described by the EM is to set out 'special rules about the way Subdivisions 815–B and 815–C apply to trusts and partnerships'.[79] The EM states:

> The rules ensure that the transfer pricing rules apply in relation to the net income of a trust or partnership in the same way they apply to the taxable income of a company. The Subdivisions also apply to the partnership loss of a partnership in the same way they apply to the tax loss of a company.[80]

Amendments to the TAA 1953: Record keeping and penalties

1.66 The EM explains that the introduction of Subdivision 284-E of Schedule 1 to the TAA 1953 'sets out the type of documentation that an entity may prepare and keep in self–assessing its tax position under Subdivision 815-B or 815-C'.[81] The EM asserts that:

> This documentation is referred to as transfer pricing documentation. In order to satisfy the requirements of Subdivision 284-E, transfer pricing documentation must be prepared before the lodgement of the relevant tax return.[82]

1.67 The EM emphasises that 'while the Subdivision does not mandate the preparation or keeping of documentation, failing to do so prevents an entity from establishing a reasonably arguable position'.[83] The EM states:

> Establishing a reasonably arguable position is one avenue through which an entity can lower administrative penalties. However, nothing in these amendments prevents the Commissioner from exercising a general discretion to remit administrative penalties where appropriate (as currently available under the law).[84]

---

79 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 35.

80 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 35–36.

81 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 36.

82 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 36.

83 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 36.

84 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 36.

Date of Effect

1.68 The amendments in Schedule 1 apply to schemes entered into, or commenced to be carried out, on or after 16 November 2012, the day on which draft legislation was released for public comment.

1.69 The transfer pricing rules specified by the amendments in Schedule 2 apply to income years commencing on or after the earlier of:

- 1 July 2013; and
- the day this Bill receives Royal Assent.

Objectives and scope of the inquiry

1.70 The objective of the inquiry is to investigate the adequacy of the Bills in achieving their policy objectives and, where possible, identify any unintended consequences.

1.71 In its report, the Selection Committee gave the following reasons for referral and principal issues for consideration:

> Significant economic impact; and ensure drafting is correct.[85]

Conduct of the inquiry

1.72 Details of the inquiry were placed on the committee's website. On 15 February 2013 the Chair issued a media release announcing the inquiry and seeking submissions.

1.73 Sixteen submissions were received, which are listed in Appendix A.

85 House of Representatives Selection Committee, *Report No. 75*, 14 February 2013, p. 3.

2

Issues in the Bill

2.1 A number of submitters to the inquiry raised concerns about aspects of the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 (the Bill). Many of these issues were previously raised during the Treasury consultation processes on both schedules of the Bill. Selected key issues are discussed below.

Schedule 1 – General anti-avoidance rules

Overview

2.2 Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) covers schemes to reduce income tax. Schedule 1 of the Bill will amend the ITAA 1936 with an aim to ensure that Part IVA continues to counter schemes that comply with the technical requirements but which, when viewed objectively, are conducted in a particular way mainly to avoid tax.

2.3 In his second reading speech on the Bill, the Assistant Treasurer, the Hon David Bradbury MP, comments that without these amendments 'there would be significant scope for taxpayers to plan their way around the law's intended operation and to undermine the revenue base'.[1]

2.4 For Part IVA to apply, three elements must be satisfied:

(1) there is a scheme;

(2) that a tax benefit is obtained in connection with the scheme; and

(3) it must be reasonable to conclude that someone entered into the scheme for the sole or dominant purpose of obtaining a tax benefit in connection with the scheme.

---

1 The Hon David Bradbury MP, Assistant Treasurer, *House of Representatives Hansard*, 13 February 2013, p. 10.

2.5 Submitters to the inquiry raised some concerns about the need for, and technical aspects of, the proposed amendments in Schedule 1. These include the amendments as a response to related court decisions, the clarity of the new law, the effect of changes on commercial decision making, the requirement to disregard tax consequences when considering alternative postulates, and some technical issues. These issues are discussed below.

Response to court decisions

Background

2.6 The Assistant Treasurer's second reading speech on the Bill outlined that:

> Some recent cases have focused on the 'tax benefit' element of part IVA's operation. A tax benefit exists if a scheme produces a tax advantage (for example, reduced assessable income or increased deductions) being an advantage that would not have been obtained, or might reasonably be expected not to have been obtained, if the scheme had not been entered into.[2]

2.7 Section 177C of Part IVA sets out consideration of whether a tax benefit is obtained in connection with a scheme.

2.8 When announcing the Government's plan to introduce amendments to Part IVA, the then Assistant Treasurer, former Senator the Hon Mark Arbib, expressed the Government's concern that the outcome of certain cases —lost by the Australian Tax[ation] Office (ATO) on the basis of the 'do nothing' argument—could 'potentially undermine the overall effectiveness of Part IVA'.[3] The then Assistant Treasurer stated:

> In recent cases, some taxpayers have argued successfully that they did not get a 'tax benefit' because, without the scheme, they would not have entered into an arrangement that attracted tax …
>
> For example, they could have entered into another scheme that also avoided tax, deferred their arrangements indefinitely or done nothing at all. Such an outcome can potentially undermine the overall effectiveness of Part IVA and so the Government will act to ensure such arguments will no longer be successful.

2 The Hon David Bradbury MP, Assistant Treasurer, *House of Representatives Hansard*, 13 February 2013, p. 10.

3 Senator the Hon Mark Arbib, Assistant Treasurer, *Maintaining the effectiveness of the general anti-avoidance rule*, Media Release No. 10, 1 March 2012.

> The Government amendments will confirm that Part IVA always intended to apply to commercial arrangements which have been implemented in a particular way to avoid tax. This also includes steps within broader commercial arrangements.[4]

2.9 The EM comments that 'a number of recent decisions of the Full Federal Court have revealed weaknesses in the way in which the tax benefit concept in section 177C operates'.[5]

2.10 The 'do nothing' argument in question that has succeeded in certain cases is where taxpayers have argued that without the offending tax benefit they would not have proceeded with the relevant transaction.

2.11 One such case (on appeal to the Full Federal Court of Australia) was *RCI Pty Limited v Commissioner of Taxation* [2011] involving whether the Commissioner was correct in determining that the general anti-avoidance provisions applied in the circumstances of a particular transaction entered into by the James Hardie Group. It involved the James Hardie Group transferring its operating companies into a new more tax effective structure headed by James Hardie NV.[6]

2.12 The matter concerned a dividend payment of around $478 million made by James Hardie Holdings (JHH(O)), a US company, to RCI [an Australian subsidiary] which was exempt under s. 23AJ of the ITAA 1936. This reduced the value of the RCI's shares and the subsequent capital gains when they disposed of the shares during an international corporate reorganisation. The Commissioner of Taxation took the view that the dividend payment was a tax avoidance measure taken in anticipation of the restructure, and calculated that if the scheme had not been entered into there would be an additional tax cost of $172 million. Following appeal, the Full Federal Court rejected the Commissioner's conclusion.

2.13 In this appeal case, the Hon Justices Edmonds, Gilmour and Logan found:

> … in our view, if the scheme in either of its manifestations had not been entered into or carried out, the reasonable expectation is that the relevant parties would have either abandoned the proposal, indefinitely deferred it, altered it so that it did not involve the transfer by RCI of its shares in JHH(O) to RCI Malta or pursued one or more of the other alternatives referred to in the Information Memorandum; but they would not have proceeded to have RCI

4 Senator the Hon Mark Arbib, Assistant Treasurer, *Maintaining the effectiveness of the general anti-avoidance rule*, Media Release No. 10, 1 March 2012.

5 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 10.

6 *RCI Pty Limited v Commissioner of Taxation* [2011] FCAFC 104.

> transfer its shares in JHH(O) to RCI Malta at a tax cost of $172 million. On this view, RCI did not obtain the tax benefit it was alleged by the Commissioner to have obtained in connection with the scheme.[7]

2.14 In its Decision Impact Statement in response to the court decision, the ATO acknowledged the Court's findings on dominant purpose 'turned on the facts of the case'. However, the ATO also asserts that:

> The Commissioner will not automatically accept unsubstantiated assertions that a particular commercial transaction would not have been entered into if the tax advantage in question had not been available. The onus of proof remains on the taxpayer to make good such assertions, for example by reference to cogent evidence or compelling commercial logic.[8]

Analysis

2.15 Some submitters claimed that the amendments to Part IVA are an 'over-reaction' to the ATO court loses in these cases. The Corporate Tax Association (CTA) argues that:

> … the proposed changes represent an over-reaction to the Taxation Office losing a number of court decisions that have quite limited application. In addition, they appear to go beyond the scope of the then Assistant Treasurer's policy announcement in March 2012.[9]

2.16 CTA is of the view that 'these losses were not caused by deficiencies in the legislation, but rather by the Taxation Office's case selection and its approach to running the cases it litigates'.[10]

2.17 Similarly, the Law Council of Australia (LCA) argues that these case losses do not signal a design flaw in Part IVA, stating:

> The ATO is concerned that it has lost some recent cases on Part IVA. This does not signal a design flaw in Part IVA. In the 1990's the ATO lost the first case on Part IVA to reach the High Court of Australia. The ATO overcame that loss and over 30 years has found Part IVA to be effective. Part IVA has achieved its purpose.

---

7 *RCI Pty Limited v Commissioner of Taxation* [2011] FCAFC 104.

8 Australian Taxation Office (ATO), Decision Impact Statement, *Commissioner of Taxation v RCI Pty Ltd*, <http://law.ato.gov.au/atolaw/view.htm?DocID=LIT/ICD/S324of2011/00001>, viewed 28 February 2012.

9 Corporate Tax Association (CTA), *Submission 7*, p. 3.

10 CTA, *Submission 7*, p. 1.

> An administrator of a statute losing cases occasionally is a healthy sign that the administrator is identifying where the boundaries of the statute lie.[11]

2.18 The Tax Institute also questioned the need for the changes, commenting that:

> The Courts have applied the current rules appropriately to find that a tax benefit exists in only those cases where the taxpayer's actions have resulted in a loss to revenue. Recent cases have not resulted in the effectiveness of Part IVA being compromised and as such the amendments in the Bill are an unnecessary overreaction.[12]

2.19 Further, the Tax Institute argues that the circumstances that lead to a 'do nothing' alternative postulate being successfully put in *RCI Pty Limited v Commissioner of Taxation* were 'reasonably unique'.[13]

2.20 The EM comments that what cases like *RCI Pty Limited v Commissioner of Taxation* highlight was that 'it is permissible to reject an alternative course of action on the basis that the tax costs involved in undertaking that action would have caused the parties to do nothing, including deferring or abandoning a wider transaction of which the scheme was a part'.[14]

2.21 The EM asserts that 'another view of the operation of section 177C has become evident in a number of recent decisions'. The EM states:

> The decision in Futuris is an example. Both at first instance and on appeal, the underlying suggestion seems to be that the reference in subsection 177C(1) to tax consequences that 'would have [occurred], or might reasonably be expected to have [occurred], … if the scheme had not been entered into or carried out' is a composite phrase requiring, in every case, a postulate about what would have or might reasonably be expected to have happened in lieu of the scheme. On this view of the provision, 'would have' or 'might reasonably be expected to have' represent ends of a spectrum of certainty within which acceptable postulates must lie.[15]

---

11 Law Council of Australia (LCA), *Submission 4*, p. [4].

12 The Tax Institute, *Submission 13*, p. 2.

13 The Tax Institute, *Submission 13*, p. 3.

14 Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, *Explanatory Memorandum*, p. 13.

15 Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, *Explanatory Memorandum*, p. 12.

2.22 The EM further comments in relation to this court decision and others that 'it appears to be assumed that all acceptable postulates will involve a prediction about events or circumstances, as opposed to a mere deletion of the scheme'. The EM states:

> The competing constructions of section 177C have yet to be directly considered by a court. To achieve the intended outcome, these amendments include provisions which put it beyond doubt that the 'would have' and 'might reasonably be expected to' limbs of each paragraph of subsection 177C(1) represent separate and distinct bases upon which the existence of a tax benefit can be demonstrated.
>
> From a policy perspective, it is desirable that section 177C(1) should operate in this manner…that reconstruction be permitted in addition to, and not to the exclusion of, voiding an arrangement.[16]

2.23 The Treasury does not accept that these amendments are unnecessary or an over-reaction to court decisions. The Treasury submits the following as key points in this regard:

- The amendments are necessary to ensure the ongoing effective operation of the general anti-avoidance rule known as Part IVA;
- The amendments are a measured response to exposed weaknesses in the operation of the 'tax benefit' concept, not a reaction to whether the Commissioner won or lost a particular case; and
- The amendments protect significant amounts of revenue that would otherwise be at risk.[17]

2.24 The Treasury further states that 'the amendments are wholly directed at addressing problems with the tax benefit test (section 177C) and do not amend the substance of the purpose test (section 177D), which is the main means by which Part IVA distinguishes between legitimate tax planning and impermissible tax avoidance'.[18]

16 Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, *Explanatory Memorandum*, p. 12.

17 The Treasury, *Submission 16*, p. 3.

18 The Treasury, *Submission 16*, p. 3.

Conclusion

2.25 The committee notes that tax cases, and in particular Part IVA cases, will normally depend on their particular facts and circumstances. However, the reasoning used for decisions in a particular case can have implications for the operation of the tax laws more broadly.

2.26 It is expected that Government will fully consider the implications of relevant court decisions, and take action to ensure the effective operation of legislation, with a view to preserving its policy intent.

2.27 This Bill aims to address the issues that recent cases have highlighted to ensure that the legislation continues to provide a more comprehensive framework to counter tax avoidance schemes.

Operation of alternative postulates

Background

2.28 A Part IVA inquiry into a scheme (to which Part IVA applies) 'requires a comparison between the scheme in question and an alternative postulate'.[19] The EM outlines that 'an alternative postulate could be merely that the scheme did not happen or it could be that the scheme did not happen but that something else did happen'.[20]

2.29 The EM states that the amendments in the Bill aim to 'put it beyond doubt that the "would have" and "might reasonably be expected to have" limbs of each of the subsection 177C(1) paragraphs represent alternative bases upon which the existence of a tax benefit can be demonstrated'.[21]

2.30 The EM further asserts with regard to these alternative postulates:

- …when obtaining a tax benefit depends on the 'would have' limb of one of the paragraphs in subsection 177C(1), that conclusion must be based solely on a postulate that comprises all of the events or circumstances that actually happened or existed other than those forming part of the scheme; and
- …when obtaining a tax benefit depends on the 'might reasonably be expected to have' limb of one of the paragraphs in subsection 177C(1), that conclusion must be based on a

19 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 9.

20 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 , p. 9.

21 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 16.

> postulate that is a reasonable alternative to the scheme, having particular regard to the substance of the scheme and its effect for the taxpayer, but disregarding any potential tax costs.[22]

Analysis

2.31 Issues were raised by submitters on the process that will be used to apply the alternative postulates. Cleary Hoare asserts that 'the language used in the EM when detailing the process for having regard to the alternative postulates is uncertain'.[23] Cleary Hoare argues:

> Specifically, paragraph 1.110 [of the EM] details that the non-tax results should simply be 'comparable' which seems to conflict with paragraph 1.102 that outlines that in order to provide a meaningful comparison the alternative postulate should achieve 'substantially the same non-tax results' as those achieved through the arrangement.[24]

2.32 CPA Australia (CPA) contends that:

> More effort needs to be made to align the Bill with the EM. For example, the EM should provide guidance on when subsection 177CB(2) will apply rather than section 177CB(3).[25]

2.33 The Treasury states however that the EM '…makes it clear that the annihilation approach under subsection 177CB(2) and the reconstruction approach under subsection 177CB(3) are intended to operate as alternative bases for identifying tax benefits…'.[26] The Treasury states:

> The Commissioner is entitled to rely on either limb. This will typically depend on the facts of the case.
>
> It is important to note that, under either approach, a tax benefit that the Commissioner purports to cancel must be a tax benefit that exists as a matter of objective fact—it cannot depend upon the Commissioner's opinion or satisfaction that there is a tax benefit.
>
> Moreover, the tax benefit must, viewed objectively, be obtained by a taxpayer in connection with a scheme that was entered into or carried out with the required tax avoidance purpose.[27]

---

22 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 16–17.

23 Cleary Hoare, *Submission 6*, p. 2.

24 Cleary Hoare, *Submission 6*, p. 2.

25 CPA, *Submission 1*, p. 1.

26 The Treasury, *Submission 16*, p. 4.

27 The Treasury, *Submission 16*, p. 4.

2.34 The Treasury responded to specific concerns about the language used to explain alternative postulates:

> At paragraph 1.102, the Explanatory Memorandum explains that, under the reconstruction approach in subsection 177CB(3), the role of an alternative postulate is to provide a meaningful comparison between the tax consequences of the scheme and the tax consequences of 'an alternative that is reasonably capable of achieving for the taxpayer substantially the same non-tax results and consequences as those achieved by the scheme'.
>
> At paragraph 1.110, the Explanatory Memorandum explains that, for a postulate to constitute a reasonable alternative to a scheme it would be expected to 'achieve for the taxpayer non-tax results and consequences that are comparable to those achieved by the scheme itself'.
>
> There is no conflict between the language of paragraphs 1.102 and 1.110. To say that a thing should be 'comparable' to something else is to suggest that it should be 'similar to', 'equivalent to' or 'analogous to'. To say that something should be 'substantially the same' as something else has broadly the same meaning.[28]

Conclusion

2.35 The amendments to Part IVA of the ITAA 1936 make it clear that either the annihilation and reconstruction alternative postulate can be applied by the Commissioner to cancel a tax benefit. It is also clear from these provisions, and from existing law, the Commissioner can only do so where, objectively viewed, the relevant tax avoidance purpose exists (that is, there was a tax benefit in connection with a scheme to which Part IVA applies).

2.36 It is also clear that if a decision to reconstruct a scheme is taken under Part IVA, the Commissioner must have regard to the substance of the arrangements, including the actual non-tax outcomes achieved by the arrangements (ignoring the scheme).

28 The Treasury, *Submission 16*, pp. 4–5.

Alternative postulates and commercial decision making

Background

2.37 When Part IVA was introduced in 1981, the Government indicated that it was not intended to impede normal commercial transactions:

> … the explanatory memorandum made it clear that the 'test for application' of Part IVA was 'intended to have the effect that arrangements of a normal business or family kind, including those of a tax planning nature' would be beyond the scope of Part IVA.
>
> The distinction between tax avoidance and legitimate commercial and family arrangements was emphasised by the then Treasurer in his second reading speech on the Bill. There he stated that Part IVA was not intended to 'cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs'.[29]

2.38 Some submitters to this inquiry express concern however that the changes to Part IVA under Schedule 1 of the Bill will negatively impact on the day to day commercial decision making of businesses. This is further explored below.

Analysis

2.39 CTA expresses its concern in relation to the Part IVA provisions that '…the amended legislation could be administered in a way that would create unexpected tax liabilities in relation to genuine commercial transactions containing no element of contrivance or artificiality'.[30] CTA asserts that:

> The uncertainty that would persist until judicial determination of a number of the new concepts introduced would constrain commercial activity and adversely affect everyday business decision-making.[31]

2.40 In relation to the dominant purpose test, CPA argues that 'contrary to the second reading speech and the EM, the provisions will impact normal commercial transactions'.[32] CPA comments:

---

29 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 6.

30 CTA, *Submission 7*, p. 3.

31 CTA, *Submission 7*, p. 3.

32 CPA, *Submission 1*, p. 2.

> For example, a decision to sell the shares in a company rather than the underlying assets will often be made after taking into account an analysis of costs including tax. Under these proposed amendments tax would be excluded from the analysis, throwing up a tax benefit and, therefore, the need for the taxpayer to demonstrate that there was not a dominant purpose of tax avoidance.[33]

2.41 Similarly, Cleary Hoare argues that the proposed changes disregarded the commercial realities that business must consider when making decisions, stating:

> These proposed changes continue to demonstrate a complete disregard for the commercial reality of decision making that relates to the profitability of an enterprise and the employment of Australians in those enterprises. By seeking to close the door on the 'do nothing' and the 'unreasonable tax burden' alternatives, the legislation will be stepping away from the realities of commercial decision-making. Australian businesses routinely decide to not enter transactions on the basis that an excessive tax burden will make a transaction uncommercial. Preventing this reality from being examined when hypothesising alternative postulates would create an incongruency between regular business decision making and the general anti-avoidance rules.[34]

2.42 Cleary Hoare further argues that 'by preventing consideration of potential tax costs to alternative postulates, the legislation is removing a tool for the judiciary to identify which transactions are tax-avoidant in nature, and which are bona fide transactions meriting no condemnation'.[35]

2.43 CTA expresses further concerns with the proposal to disregard tax costs in alternate postulates (in new subsection 177CB(4)(b)) asserting that 'while such a rule might have some intuitive appeal, it is in fact unnecessary to overcome the "do nothing" argument—the "substance of the scheme" and "result or consequence of the scheme" rules already have that effect'.[36] CTA states:

> There is a risk that a 'disregard tax' rule could potentially be open to abuse by the Commissioner, as it could empower him to construct an alternative postulate that involves what is clearly an excessive amount of tax—for example by taxing the same

33 CPA, *Submission 1*, p. 2.
34 Cleary Hoare, *Submission 6*, pp. 2-3.
35 Cleary Hoare, *Submission 6*, p. 3.
36 CTA, *Submission 7*, p. 4.

> economic gain twice. It has been suggested in the consultation process that such an outcome would be unlikely as the Commissioner would still have to be successful on the 'purpose test' in sec 177D. However, it is far from clear how the purpose test would displace a statutory assumption that tax should be disregarded or how the courts would interpret such a rule.[37]

2.44 The Treasury responded to concerns about disregarding tax when proposing an alternative postulate that '…Part IVA must be capable of exposing the substance or reality of what it is that has been achieved for the taxpayer (tax aside) to the ordinary operation of the taxation laws'.[38] The Treasury states:

> …the focus of the reconstruction approach should be on identifying whether or not there is a reasonable substitute for the scheme. It is not conducive to the effective operation of Part IVA to inquire into whether taxpayers would have pursued an entirely different course of action had they not participated in the scheme.
>
> As the Explanatory Memorandum explains, a tax advantage cannot meaningfully be linked to a scheme by comparing the tax consequences of that scheme to the tax consequences that would have flowed if the parties had chosen to pursue some different objective.[39]

2.45 The Treasury further emphasises that 'having identified a substitute for the scheme, it would undermine the operation of Part IVA to permit the tax consequences of that substitute to be a reason for concluding that the substitute is unreasonable'.[40] The Treasury asserts:

> To do so would be to allow the very tax advantage that Part IVA is seeking to identify and measure to function as a shield against its operation.
>
> The fact that a taxpayer would not have entered into a transaction if it had known in advance that it would be subject to tax should be no answer to Part IVA. To accept such a proposition would be to accept that there are situations in which it is reasonable for a taxpayer to avoid the ordinary operation of the taxation law on the substance or reality of what they have actually done. Applying

37 CTA, *Submission 7*, p. 4.
38 The Treasury, *Submission 16*, p. 6.
39 The Treasury, *Submission 16*, p. 6.
40 The Treasury, *Submission 16*, p. 6.

> Part IVA will not lead to more income tax being payable than results from that ordinary operation.
>
> Furthermore, the Commissioner has the power under existing subsection 177F(3) to provide compensating adjustments where it 'is fair and reasonable' to do so.[41]

Conclusion

2.46 It is appropriate that alternative postulates under Part IVA can be objectively and fairly applied to business transactions in order that they be subject to the ordinary operation of taxation law. The committee acknowledges that permitting businesses to avoid tax on commercial operations on the basis that they would not have conducted these activities if they had been subject to tax is an unacceptable proposition.

2.47 The amendments provide a judicious basis for the Commissioner of Taxation to protect revenue that may otherwise be at risk and will not subject businesses to higher tax than is required under the ordinary operation of the law compared to what they did in substance.

Technical issues

Background

2.48 Some technical issues were raised in the submissions with the operation of proposed sections 177C(1)(bc), 177C(1)(g) and 177CB(3). Section 177C(1)(bc) provides that non-payment of withholding tax shall be considered a tax benefit to which Part IVA can apply. Section 177C(1)(g) is consequential to section 177C(1)(bc) and provides that where paragraph (bc) applies, the amount of the tax benefit shall be taken to be the amount referred to in that paragraph.

2.49 Section 177CB(3) is a new provision introduced by the Bill and provides that:

> A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.[42]

---

41 The Treasury, *Submission 16*, p. 6.

42 Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, s. 177CB(3).

Analysis

2.50 In relation to proposed section 177C(1)(bc) CTA asserts that:

> …there is a technical deficiency in the drafting of proposed sec[tion] 177C(1)(g). In its interaction with proposed sec[tion] 177C(1)(bc), it appears to define the tax benefit in a withholding tax scenario as being the gross amount on which tax would be withheld, rather than the quantum of the withholding tax benefit itself.[43]

2.51 The Treasury states that '…proposed paragraph 177C(1)(g) is a consequential amendment designed to bring the avoidance of withholding tax within the same list as the other tax benefits set out in section 177C'.[44] The Treasury states:

> Proposed paragraphs 177C(1)(bc) and 177C(1)(g) replace, and are consistent with, existing section 177CA of the 1936 Act, which provides that a taxpayer who avoids paying withholding tax on an amount on which it would have, or could reasonably be expected to have, paid withholding tax is taken to have obtained a tax benefit equal to the amount on which withholding tax is avoided.
>
> In a similar way, where Part IVA applies to an amount of assessable income, the cancelled tax benefit is the amount of assessable income, not the tax payable on that assessable income. (The amount of tax payable on that assessable income could then be reduced by other factors such as losses.)[45]

2.52 In relation to concerns regarding most likely alternative postulates, CTA states that '…the use of the test "a reasonable alternative" in proposed sec[tion] 177CB(3) introduces a degree of uncertainty for taxpayers in assessing alternative postulates as "a reasonable alternative" may not always be the most likely alternative'.[46]

43 CTA, *Submission 7*, p. 5.
44 The Treasury, *Submission 16*, p. 7.
45 The Treasury, *Submission 16*, p. 7.
46 CTA, *Submission 7*, p. 3.

2.53 The Treasury asserts that 'Subsection 177CB(3) builds on existing subsection 177C(1), which itself tests the reasonableness of alternative postulates'.[47] The Treasury states:

> Proposed subsection 177CB(3)…will introduce no greater uncertainty than currently exists in Part IVA.[48]

Conclusion

2.54 These amendments are appropriate and necessary and reflect the existing provisions of Part IVA regarding the reasonableness of alternative postulates. It is also appropriate that Part IVA can apply to withholding tax liabilities which would have been incurred but for the operation of a tax avoidance scheme. These amendments are consistent with other sections of the ITAA 1936.

Schedule 2 – Modernisation of the transfer pricing rules

Overview

2.55 Schedule 2 of the Bill aims to modernise Australia's transfer pricing rules and ensure they are aligned with internally accepted principles, of which the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD TPGs) are a crucial component.

2.56 On 1 November 2011, the then Assistant Treasurer, the Hon Bill Shorten MP, announced that the Government would 'reform the transfer pricing rules in the income tax law and Australia's future tax treaties to bring them into line with international best practice, improving the integrity and efficiency of the tax system'.[49]

2.57 The Treasury indicated that following the consultation substantive changes were made to the draft Bill, and the explanatory material was amended to 'provide further explanation and clarification in response to specific issues raised in submissions'. [50]

2.58 Treasury notes that specific issues raised during the consultation included:

- the extent to which certain concepts are defined in domestic law, as opposed to being left to the OECD TPGs;

47 The Treasury, *Submission 16*, p. 7.

48 The Treasury, *Submission 16*, p. 7.

49 The Hon Bill Shorten MP, Assistant Treasurer, *Robust transfer pricing rules of multinationals*, Media Release No. 145, 1 November 2011.

50 The Treasury, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2012 (Schedule 2) – Modernisation of transfer pricing rules: Summary of consultation process*, p. 2.

- a suggestion that the rules should allow a taxpayer to downward assess a liability;
- that the scope of the documentation rules was too broad, as they require a taxpayer to prepare documentation in respect of all conditions that satisfied the cross-border requirement; and
- the link between preparing documentation and having a reasonably arguable position in respect of administrative penalties was inappropriate.[51]

2.59 The Bill repeals Division 13 of the ITAA 1936 and introduces Subdivisions 815-B, 815-C and 815-D to the ITAA 1997 and Subdivision 284-E into Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953). The EM states that these provisions 'modernise and relocate the transfer pricing provisions into the ITAA 1997 to ensure that consistent rules apply to both tax treaty and non-tax treaty cases'.[52]

2.60 Submitters to the inquiry raised concerns in relation to Schedule 2 of the Bill about its consistency with OECD guidelines, the reconstruction of transactions, the time limits to amend assessments, and record-keeping requirements. These issues are explored further below.

Consistency with OECD Guidelines and reconstruction of transactions

Background

2.61 The arm's length principle is central to transfer pricing regimes. It is the international standard that OECD member countries have agreed should be used for determining transfer prices for tax purposes. The arm's length principle is set out in Article 9 of the OECD Model Tax Convention, and is integral to tax considerations for multinational groups and tax administrations. It provides a broad parity of tax treatment for members of multinational groups and independent enterprises, and has been found to work effectively in the vast majority of cases.[53]

---

51 The Treasury, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2012 (Schedule 2) – Modernisation of transfer pricing rules :Summary of consultation process*, pp. 1-2.

52 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 33.

53 Organisation for Economic Co-operation and Development (OECD), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 22 July 2010, p. 34.

2.62 The *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD TPGs) provide guidance on the application of the 'arm's length principle', the approach to be taken when evaluating the transfer pricing of associated enterprises, i.e. attributing a value, for tax purposes, of cross-border transactions between associated enterprises.

2.63 The OECD TPGs defines transfer prices as 'the prices which an enterprise transfers physical goods and intangible property or provides services to associated enterprises'.[54]

2.64 The OECD TPGs are widely recognised and used. The EM acknowledged that:

> The OECD Guidelines are widely used by both member and non-member tax administrations, and were described by the UK Special Commissioners as 'the best evidence of international thinking on transfer pricing'.[55]

2.65 The amendments proposed in Schedule 2 aim to ensure that Australia's transfer pricing rules in relation to multinational groups align with the OECD TPGs.

2.66 In its summary of the consultation process on Schedule 2 of the Bill, the Treasury noted that most of the submissions supported the alignment of Australia's domestic transfer pricing rules with the OECD TPGs.[56]

2.67 Section 815-130 in the Bill deals with the relevance of actual commercial or financial relations. Paragraph (1) provides the following basic rule:

> (1) The identification of the arm's length conditions must:
>
> (a) be based on the commercial or financial relations in connection with which the actual conditions operate; and
>
> (b) have regard to both the form and substance of those relations.

2.68 Paragraphs (2) to (5) of 815-130 provide for exceptions to the basic rule.

2.69 In its chapter on the arm's length principle the OECD TPGs provide for the recognition of the actual transactions undertaken, specifying that:

> A tax administration's examination of a controlled transaction ordinarily should be based on the transaction actually undertaken

54 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 22 July 2010, p. 19.

55 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, pp. 44-45.

56 The Treasury, *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2012 (Schedule 2) – Modernisation of transfer pricing rules: Summary of consultation process*, p. 1.

> by the associated enterprises as it has been structured by them, using the methods applied by the taxpayer insofar as these are consistent with the methods described in Chapter II. In other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them. Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.[57]

2.70 The OECD TPGs then go on to outline two exceptional circumstances where it may be both appropriate and legitimate for a tax administration to consider disregarding the structure adopted by a taxpayer in entering into a controlled transaction. These are where:

- the economic substance of a transaction differs from its form; and
- while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price.[58]

Analysis

General consistency with OECD Guidelines

2.71 A number of submitters to the inquiry comment on the approach taken in Schedule 2 to aligning Australia's transfer pricing rules with the OECD TPGs.

2.72 GE questioned whether it was necessary to introduce the sections proposed, and suggested that 'the policy intent of the legislation could be achieved by incorporating the OECD Guidelines directly into the legislation rather than drafting unique stand-alone provisions'.[59]

---

57 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 22 July 2010, p. 51.

58 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 22 July 2010, p. 52.

59 GE, *Submission 2*, p. 1.

2.73 Further, GE argue that some provisions in Schedule 2 of the Bill actually create uncertainty as to whether Australia's transfer pricing rules are consistent with the OECD TPGs. It states:

> Using language in the Bill that is not the same as the language in the OECD Guidelines could lead to differences in interpretation, despite the intention that the new transfer pricing measures be consistent with the OECD Guidelines.[60]

2.74 The committee raised this issue with the Treasury, who reiterated that it is the 'clear policy intent of the Government in relation to these amendments … to better align the rules with international best practice as currently set out by the OECD'.[61]

2.75 The Treasury maintains that the alignment of the rules with the OECD TPGs 'has been achieved through drawing heavily on the language of the relevant treaty provisions and the Guidelines in the construction of the provisions'.[62]

2.76 Proposed subsection 815-135 provides for guidance material which should be referred to when considering the application of the arm's length principle to a given situation. The EM states that:

> The identification of arm's length conditions under Subdivision 815-B must be done in a way that best achieve consistency with the following material:
>
> - the OECD Guidelines; and
> - any other documents, or part(s) of a document, prescribed by the regulations for this purpose.[63]

2.77 The Treasury argues that making provision for guidance material in the Bill, including the OECD TPGs is 'a mechanism that a number of countries have introduced in various forms into their legislation or subordinate rules to assist in the interpretation of what are frequently complex cross-jurisdictional issues'. The Treasury outlined that:

> In addition to using language drawn from the relevant treaty articles and the OECD guidelines, a specific legal pathway is provided to require regard to be had to the OECD material for interpretive purposes. The provision requires that the identification of arm's length conditions be undertaken in a way

60 GE, *Submission 2*, p. 1.

61 The Treasury, *Submission 16*, p. 8.

62 The Treasury, *Submission 16*, p. 8.

63 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 45.

> that best ensures consistency with prescribed materials, currently the OECD guidelines.[64]

2.78 While the language used in the Bill significantly draws from the OECD TPGs, the provision in the Bill also allow for the inclusion or refocusing on other reference sources, if in the future there are developments in international best practice on transfer pricing methodology that may diverge from, or substantially add to, the OCED TPGs. The Treasury submitted:

> The Explanatory Memorandum explains that the provisions are constructed to provide a mechanism to prescribe interpretive materials (or remove them, for example, if they cease to represent international best practice or are overtaken by more relevant alternative materials). The provision of a regulation making power ensures the Australian Parliament will always retain control over what materials are referred to in the laws of Australia.[65]

Reconstruction of transactions

2.79 GE acknowledged that 'the Bill more closely aligns with OECD principles than the previous exposure draft of the provisions'.[66] However, in its submission it highlights that certain concerns remained. In particular, that proposed section 815-130(4) does not appear to have an equivalent in the OECD Guidelines.[67]

2.80 Subsection 815-130(4) of the Bill provides for one of the exceptions to the basic rule:

> (4) Despite subsection (1), if independent entities dealing wholly independently with one another in comparable circumstances would not have entered into commercial or financial relations, the identification of the arm's length conditions is to be based on that absence of commercial or financial relations.

2.81 CTA shares GE's concern about the perceived inconsistency of proposed section 815-130(4) with the OECD TPGs, stating:

> … proposed sec 815-130(4), which deals with instances where independent entities dealing with each other at arm's length would not have entered into any transactions with each other at all, has no equivalent rule in the OECD Guidelines. It is not

64 The Treasury, *Submission 16*, p. 8.

65 The Treasury, *Submission 16*, p. 8.

66 GE, *Submission 2*, p. 1.

67 GE, *Submission 2*, p. 1.

> entirely clear what this provision is attempting to achieve but if, as we have been assured, the aim of Schedule 2 of the Bill is no more than to import the OECD Guidelines into the Australian domestic law, then it should not include provisions that are not to be found in the OECD Guidelines.[68]

2.82 The Institute of Chartered Accountants Australia (ICAA) argues that the Bill 'appears to provide for a broader application for the reconstruction of transactions than was intended' by the OECD TPGs.[69]

2.83 Some submitters argue that the Bill may enable the Commissioner of Taxation to make changes to transactions in a wider range of circumstances than the 'exceptional circumstances' envisage in the OECD TPGs. They argue that these provisions should be removed or at least qualified.[70] CTA asserts that:

> The scope of the Commissioner's power to reconstruct actual transactions appears to be very broad and to go beyond what is contemplated by the OECD Guidelines. Heavy reliance is placed on the Explanatory Memoranda and guidance material to read down the words in the Bill so as to align the Bill to OECD principles. However, the Courts have recently down played the role of Explanatory Memoranda in statutory interpretation, and there is a significant risk that the Commissioner will use this power routinely in circumstances other than the 'exceptional circumstances' the OECD contemplates.[71]

2.84 Similarly, Deloitte argues that any reconstruction rule in the legislation 'should be explicitly limited to the exceptional circumstances prescribed in the OECD Guidelines'. Deloitte acknowledged that the Government has amended the EM to include reference in paragraph 3.94 to the exceptional circumstances 'discussed in the OECD Guidelines in the context of non-recognition and alternative characterisation of certain arrangements or transactions'. However, Deloitte remains concerned that no corresponding amendments were made to the Bill, and recommends that 'explicit rules be incorporated Subdivision 815-B to reflect the positions stated in paragraphs 3.94 … to allow for clear interpretation of the law'.[72]

---

68 CTA, *Submission 7*, p. 2.

69 Institute of Chartered Accountants Australia (ICAA), *Submission 8*, p. 1.

70 For example, see KPMG, *Submission 9*, pp. 2-3; PricewaterhouseCoopers, *Submission 10*, p. 2;

71 CTA, *Submission 7*, p. 2.

72 Deloitte, *Submission 12*, p. 1.

2.85 The LCA also did not support the Commissioner having wider powers in relation to reconstruction, arguing that:

> Reconstruction of transactions is an arbitrary exercise liable to result in double taxation. The LCA considers that in certain cases it may be necessary to go beyond the contractual terms and examine the functions, assets and risks to identify the real transaction. However, that should be no warrant for substituting some allegedly more commercially realistic arrangement for that agreed by the parties.[73]

2.86 The ICAA maintains that the relevant paragraphs in the OECD TPGs 'are clearly directed at tax administrations seeking to review transfer prices and make it clear that the review should be of the "actual transactions undertaken". The ICAA does not believe that they were drafted with a view for inclusion in domestic legislation.[74] It submitted that:

> Where reconstruction is considered necessary in line with the OECD TPGs, our members are of the view that the ability to reconstruct should only be relevant on determination by the Commissioner where the basis for the determination is clearly set out. The current drafting of the Bill requires taxpayers to self assess a reconstruction of a transaction which is an overly complex and unnecessary exercise.[75]

2.87 The ICAA cautions that uncertainty surrounding this provision could 'heighten the risk of double taxation and increase the compliance burden…', which could negatively affect international perceptions of Australia's desirability as a location for capital investment.[76]

2.88 In addressing concerns raised by submitters on this matter, the Treasury emphasises that the concept of the arm's length principle is at the core of the OECD material, stating:

> The internationally accepted articulation of this principle is in paragraph 1 of Article 9 of the OECD Model Tax Convention on Income and Capital and is replicated in all of Australia's treaties. This reference is replicated in the Explanatory Memorandum at 2.19 and the OECD guidelines at paragraph 1.6.[77]

73 LCA, *Submission 4*, pp. [6]-[7].

74 ICAA, *Submission 8*, p. 3.

75 ICAA, *Submission 8*, p. 4.

76 ICAA, *Submission 8*, p. 4.

77 The Treasury, *Submission 16*, p. 9.

2.89 In its submission, the Treasury explained that the reconstruction of actual dealings is a 'key feature of all modern transfer pricing regimes'. It states:

> The non-recognition and substitution (commonly referred to as 'reconstruction') of actual dealings or arrangements is one way of achieving an arm's length outcome consistent with the arm's length principle.[78]

2.90 The Treasury maintains that the Bill does not introduce a broad reconstruction power. It argues that the proposed rules on reconstruction 'draw directly upon the language used in the OECD guidelines'. It further noted that proposed subsection 815-130 has a subheading 'exceptions' to cover a number of possible interpretations of the rules.[79] The Treasury states:

> Rather, the ability to reconstruct dealings or arrangements under the proposed rules is entirely consistent with the OECD guidelines, which only permit reconstruction in 'exceptional circumstances'. Examples of 'exceptional circumstances' are described by the OECD as instances where:
>
> - the economic substance of the arrangements does not match the legal form; and
> - where the arrangements, viewed in their totality, differ from those which would have been entered into by independent enterprises acting in a commercially rational manner.[80]

2.91 The Treasury noted other submitters' contentions that the OECD TPGs 'only contemplate non-recognition of arrangements where other arrangements are substituted in their place'. However, the Treasury emphasises that:

> … the clear focus of the arm's length principle is on determining what independent entities would have done in the place of the parties. As such, if independent entities simply would not have entered into any arrangements at all, non-recognition (and substitution with *no* arrangements) is entirely consistent with the OECD guidelines.
>
> It is important to note that this rule only has application where it can be demonstrated that independent entities would not have done anything. This imposes a high threshold because in any

78 The Treasury, *Submission 16*, p. 9.

79 The Treasury, *Submission 16*, p. 9.

80 The Treasury, *Submission 16*, p. 9.

instance where an alternative set of arrangements or dealings can be postulated, subsection 815-130(4) cannot apply.[81]

Conclusion

2.92 The significant growth in MNEs operating across a number of countries—and consequently different tax jurisdictions—has necessitated the development of methodologies to assist countries to ensure that an appropriate amount of tax is being received by a given country to reflect that country's contribution to the relevant commercial transactions. There is a risk that if multinational groups operating various associated enterprises are only subject to domestic law, their operations could be arranged in such a way that mean they could avoid paying appropriate amounts of tax, or could be subject to double taxation. Consequently, countries enter into tax treaties and international guidelines are developed.

2.93 The OECD takes the view that this issue cannot be effectively dealt with by a single country and that a broader international approach must be taken. Accordingly, the group developed the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD TPGs).[82]

2.94 The OCED TPGs provide guidance on the application of the 'arm's length principle', the approach to be taken when evaluating the transfer pricing of associated enterprises, i.e. attributing a value, for tax purposes, of cross-border transactions between associated enterprises. The arm's length principle aims to treat the parties to a transaction as if they were independent, and to assess what the tax outcomes would have been in that case.

2.95 The OECD TPGs are widely recognised as providing international best practice on transfer pricing and application of the arm's length principle. The Australian Government aims to align Australia's transfer pricing rules in the *Income Tax Assessment Act 1997* (ITAA 1997) with international best practice through Schedule 2 of the Bill.

2.96 The committee agrees that rather than a simple wholesale incorporation of the OECD TPGs it is appropriate to consider and apply them to the Australian context. While it is clear that the OECD TPGs are currently the best thinking on transfer pricing, the provision for guidance material also

81 The Treasury, *Submission 16*, p. 10.

82 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 22 July 2010.

allows for reference to other material as international developments are made in relation to transfer pricing methodologies.

2.97 The Committee considers that 'reconstruction' powers are a necessary part of all modern transfer pricing regimes. These amendments incorporate reconstruction powers under the heading 'Exceptions', consistent with the OECD TPGs and the overall objective of determining the most appropriate arm's length outcome.

2.98 The language in the Bill and the EM draws significantly on the OECD TPGs. Furthermore, the Bill includes a specific requirement that the core principle of 'arm's length conditions' be determined to ensure consistency with the OECD TPGs.

2.99 The committee notes the Treasury's advice that that it has drawn significantly from the OECD TPGs in the language used in the Bill, and have created a 'direct legal pathway' by requiring that the central concept of the arm's length principle is determined consistently with the OECD TPGs.

2.100 It is clear that the OECD TPGs, and the core principle of applying arm's length conditions to associated enterprises in respect of financial transactions, are reflected in the Schedule 2 amendments in the Bill and expanded on in the EM.

Time limits to amend assessments

Background

2.101 Under the current tax laws, the Commissioner has an unlimited period to amend an assessment to give effect to a transfer pricing adjustment under Division 13 of the ITAA 1936, the tax treaty transfer pricing provisions, or Subdivision 815-A of the ITAA 1997. Specific time limits in relation to transfer pricing adjustments are also provided for in some tax treaties.

2.102 The proposed sections 815-150 and 815-240 in the ITAA 1997 provide that the Commissioner can amend assessments in relation to transfer pricing calculations, for a seven year time period after the day on which the Commissioner gives notice of the assessment to the entity. As is currently the case, some tax treaties will continue to impose specific time limits in relation to transfer pricing adjustments.

2.103 The Assistant Treasurer, in the second reading speech, outlined the introduction of the seven year time limit, stating:

> The new rules also introduce a time limit in which the commissioner may amend a taxpayer's assessment to give effect to

> a transfer pricing adjustment. Under the previous rules, the commissioner had an unlimited period in which to amend an assessment. These rules reduce this period to seven years.[83]

Analysis

2.104 GE commended the introduction of a time limit for the Commissioner of Taxation to make transfer pricing adjustments.[84] However, GE and other submitters felt that the seven years was not justified, and argue that the time limit should align with the four year period applicable to general income tax assessments.[85]

2.105 The American Chamber of Commerce in Australia comments that the transfer pricing adjustment period in many jurisdictions 'is considerably shorter than seven years'.[86]

2.106 Similarly, PricewaterhouseCoopers supports a four year limit, referring in its submission to a survey performed by the OECD's Forum on Tax Administration that revealed that 'the average resolution of transfer pricing cases (amongst 43 OECD and non-OECD countries) was 540 days'.[87]

2.107 PricewaterhouseCoopers comments that their view was supported by the Inspector General of Taxation's findings in the *Review into improving the self assessment system*, which recommended:

> To improve the certainty in relation to the review of transfer pricing matters, the Government should consider providing the same period of review for these matters as exists for the general period of review. [Recommendation 3.10][88]

2.108 In its response to the Inspector-General's recommendation, the ATO indicated that that was a matter for the Government.[89]

2.109 CTA argues that the proposed seven year limit was too long, and for a four year limit for transfer pricing adjustments, 'the same as other tax

83 The Hon David Bradbury MP, Assistant Treasurer, *House of Representatives Hansard*, 13 February 2013, p. 11.

84 GE, *Submission 2*, p. 2.

85 See for example: ICAA, *Submission 8*, p. 1; KPMG, *Submission 9*, p. 4; PricewaterhouseCoopers, *Submission 10*, p. 2; and Deloitte, *Submission* 12, Appendix A, p. 1.

86 American Chamber of Commerce in Australia, *Submission 15*, p. 1.

87 PricewaterhouseCoopers, *Submission 10*, pp. 2-3.

88 Inspector-General of Taxation, *Review into improving the self assessment system*, August 2012, p. 89.

89 Inspector-General of Taxation, *Review into improving the self assessment system*, August 2012, p. 89.

matters, some of which can be at least as complex as transfer pricing matters'.[90]

2.110 However, the Treasury indicated that due to their cross-jurisdictional nature, the review of transfer pricing assessments may take considerably longer than a standard adjustment. It set out the reasons for this as follows:

- Transfer pricing audits are typically highly complex in nature and often require substantial time and resources in order to be properly conducted.
- In contrast to many audits that consider individual income years, transfer pricing audits often require the examination of dealings that take place over a number of income years. The general amendment period does not provide sufficient time to conduct multi-period analysis.
- The ATO has advised that obtaining the information required to conduct transfer pricing audits is typically more difficult and time consuming than for other matters. This issue is exacerbated by the cross-jurisdictional nature of transfer pricing because the ability to acquire information can be impeded by resource constraints of tax administrations in other jurisdictions.[91]

Conclusion

2.111 It is important to provide taxpayers with certainty that ATO adjustments to their assessments can only be made within a fixed number of years. The committee notes the Treasury's advice that it can take a number of years to obtain relevant information from some jurisdictions when the ATO is reviewing a transfer pricing assessment for possible adjustment.

2.112 The proposed seven year limit provides greater certainty than the current unlimited period. It strikes an appropriate balance between providing taxpayers with certainty, and allowing the ATO enough time to conduct transfer pricing audits and make an adjustment to a taxpayer's assessment.

90 CTA, *Submission 7*, p. 2.

91 The Treasury, *Submission 16*, p. 11.

Record keeping to support a 'reasonably arguable' position

Background

2.113 General record keeping provisions of tax law currently apply to the transfer pricing provisions.

2.114 The current section 284-15 of Schedule 1 of the *Taxation Administration Act 1953* (TAA 1953) provides for when a matter is 'reasonably arguable':

> A matter is reasonably arguable if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect.[92]

2.115 The proposed changes in Schedule 2 of the Bill will link the record keeping requirements for establishing a reasonably arguable position to administrative penalties if a transfer pricing adjustment is made to a taxpayer's assessment.

2.116 In Schedule 2, proposed subdivision 284-E in Schedule 1 of the TAA 1953 will cover the special rules about unarguable positions for cross-border transfer pricing, including covering the documents required to be kept for the application of subdivisions 815-B and 815-C of the ITAA 1997. In effect, it 'sets out optional record keeping requirements'. The EM outlined that:

> Records that meet the requirements are necessary, but not sufficient to establish a reasonably arguable position for the purposes of Schedule 1 to the TAA 1953.
>
> If the documentation as specified in the Subdivision is not kept in respect of a matter, an entity is not able to demonstrate that it has a reasonably arguable position in relation to that matter for the purposes of Schedule 1 to the TAA 1953.[93]

2.117 To satisfy the requirements of Subdivision 284-E, transfer pricing documentation must be prepared before the lodgement of the relevant tax return. Establishing a reasonably arguable position is one way in which a taxpayer can seek to lower administrative penalties they may incur if their assessable tax is other than that lodged in their tax return, i.e. following an adjustment made by the Commissioner.

92 Subsection 284-15(1), *Taxation Administration Act 1953*.

93 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 39.

2.118 In the second reading speech on the Bill, the Assistant Treasurer emphasises that the new rules operate on a self-assessment basis, enabling taxpayers to self-assess their Australian tax position in accordance with the arm's length principle. This self-assessment approach is in keeping with the overall design of the Australian tax system. The Assistant Treasurer states that:

> Specific rules linking voluntary documentation with a reduction in administrative penalties are included under the new rules. This approach balances compliance costs for taxpayers with incentives to adequately document issues relevant to transfer pricing matters. It allows taxpayers to risk assess matters that could be the subject of administrative penalties and prepare documentation accordingly.[94]

Analysis

2.119 The LCA agreed with linking base document obligations to the level of penalties, but was strongly opposed to having document obligations as a 'pre-condition to demonstrating a reasonably arguable position', stating:

> The assessment of whether a taxpayer has a 'RAP' [reasonably arguable position] is an objective inquiry that ought not be pre-judged by reference to the level of documentation …[95]

2.120 CTA described the documentation requirements as 'quite onerous', submitting that:

> The standard and scope of the documentation required to meet the requirements of the Bill is very high. Given the significant adverse consequences of having documentation that does not meet these strict requirements, the time frame allowed for document preparation is extremely limited and should be extended.[96]

2.121 PricewaterhouseCoopers took the view that while taxpayers may have made an assessment of their 'reasonably arguable' position, they may not have prepared formal transfer pricing documentation by the time of lodging their tax return. They made two suggestions to improve the operation of the record keeping requirements in relation to a taxpayer establishing a reasonably arguable position:

- to allow for documentation to be provided within 90 days of a requestion from the ATO; and

94 The Hon David Bradbury MP, Assistant Treasurer, *House of Representatives Hansard*, 13 February 2013, p. 11.

95 LCA, *Submission 4*, p. [8].

96 CTA, *Submission 7*, p. 2.

- the ATO to provide guidance, as a matter of priority, on how they will assess whether a taxpayer's transfer pricing documents meets the requirements of proposed subsection 284-255 of the TAA 1953, to ensure taxpayers have a clear understanding of what will be required to establish a reasonably arguable positions in relation to the transfer pricing arrangements.[97]

2.122 The EM states that 'while the Subdivision does not mandate the preparation or keeping of documentation, failing to do so prevents an entity from establishing a reasonably arguable position'.[98] However, this point is qualified in the EM:

> Establishing a reasonably arguable position is one avenue through which an entity can lower administrative penalties. However, nothing in these amendments prevents the Commissioner from exercising a general discretion to remit administrative penalties where appropriate (as currently available under the law).[99]

2.123 The Treasury outlined that under current administrative practice, the Commissioner will generally reduce administrative penalties in cases where a taxpayer has prepared documentation in accordance with ATO Tax Ruling 98/16. The Treasury comments that 'the proposed record keeping rules, including the nature of the documentation, are consistent with the approach taken in that ruling and therefore should be familiar to taxpayers'.[100]

2.124 In its submission, the Treasury states that linking the preparation of transfer pricing documentation to establishing a reasonably arguable position leaves it at the taxpayer's discretion to prepare documentation for transactions for which they believe there is a higher risk of a transfer pricing adjustment being made by the Commissioner of Taxation. The Treasury states:

> This approach provides an incentive for taxpayers to evaluate their cross-border dealings and prepare documentation in respect of matters that they consider to be at risk of transfer pricing adjustments. Allowing taxpayers to determine which matters, if any, should be documented provides appropriate flexibility for smaller taxpayers and taxpayers with low-risk dealings to self-

97 PricewaterhouseCoopers, *Submission 10*, p. 2.

98 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 36.

99 Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, p. 36.

100 The Treasury, *Submission 16*, p. 12.

> assess whether transfer pricing documentation is needed to support their cross-border dealings.[101]

2.125 The Treasury also noted that special *de minimis* rules will also apply to exempt transfer pricing adjustments under certain thresholds from administrative penalties. It submitted:

> These thresholds provide additional protection to smaller taxpayers. The transfer pricing thresholds are directly linked to the general thresholds under the law, ensuring that they will be automatically updated by any changes to the general thresholds.[102]

Conclusion

2.126 The reporting requirements will not be mandatory. Linking the preparation of transfer pricing documentation to establishing a reasonably arguable position leaves it at the taxpayer's discretion to prepare documentation for transactions for which they believe there is a higher risk of a transfer pricing adjustment being made by the Commissioner of Taxation.

2.127 The Commissioner of Taxation will continue to have 'broad discretion to remit penalties where tax payers have not prepared documentation', and that further protection for taxpayers is afforded to exempt transfer pricing adjustments under certain thresholds.

Overall conclusion

2.128 Schedule 1 of the Bill aims to ensure that Part IVA of the ITAA 1936 can continue to counter schemes that comply with the technical requirements of the law, but upon objective examination are clearly engineered to avoid tax. It is appropriate for Government to legislate for weaknesses in existing taxation legislation that have been revealed by recent decisions of the courts against the Commissioner of Taxation. The amendments in Schedule 1 are an appropriate, reasoned and measured response to these identified weaknesses in the legislation.

2.129 Schedule 1 provides that the Commissioner may use either the annihilation or reconstruction approach to cancel a tax benefit. This is appropriate as it will enable the Commissioner to protect legitimate revenues that may otherwise be at risk. The committee does not accept that there is any lack of clarity in how these provisions will operate, or that

101 The Treasury, *Submission 16*, p. 12.
102 The Treasury, *Submission 16*, p. 12.

they will require businesses to pay more tax than is fair or negatively affect commercial activities. These provisions will enable the Commissioner to objectively and reasonably enforce tax avoidance measures and collect revenue to which the Commonwealth is entitled under the law.

2.130 Schedule 2 of the Bill is vital to modernise Australia's transfer pricing rules and bring these into line with accepted international arm's length principles recommended by the OECD. The committee agrees that rather than a simple wholesale incorporation of the OECD TPGs, it is appropriate to consider and apply them to the Australian context.

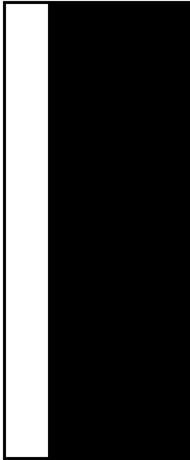
2.131 It is clear that the OECD TPGs are currently the 'best thinking evident in transfer pricing' and the committee notes the advice from the Treasury that it has drawn significantly from the OECD TPGs in the language used in the Bill.

2.132 The committee considers that 'reconstruction' powers in exceptional circumstances are a core part of modern transfer pricing regimes. The Bill implements these powers consistently with the OECD TPGs.

Recommendation 1

2.133 **The House of Representatives pass the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 as proposed.**

Julie Owens MP
Chair
8 March 2013



Coalition Members' Dissenting Report

Recommendation: That the Bill not be passed.

Liberal Members of the House Standing Committee on Economics were not afforded the opportunity to have a public hearing into this legislation. This was a Committee decision that Coalition committee members disagreed with.

15 submissions were received by the inquiry into this legislation, with many critical of the content of this Bill. Most notably absent from these was that of Treasury.

However, we note that today (12 March 2013), an undated electronic submission had been uploaded from Treasury and has subsequently been published on the Committee's website, apparently in response to enquiries from the Committee.

Coalition members of the Committee view this to be highly unsatisfactory.

Coalition Members of the Committee find it difficult to support the passage of this Bill without having been afforded the opportunity to question the assumptions underlying the Government's policy intent and to address many of the issues raised from submissions to the Committee. These issues include but are not limited to:

- Questions around the financial impact of this Bill and specifically how it applies to Schedule 1, Part IVA of the *Income Tax Assessment Act 1936*. The Explanatory Memorandum to the Bill states that schedule 1 is expected "to prevent the loss of over a $1 billion a year" but little detail has been provided as to how this amount has been quantified. Also, it would have been prudent to confirm whether there was any financial impact from the changes put forward in Schedule 2 of the Bill relating to the modernisation of the transfer pricing rules , despite the EM stating that the impact would be nil.

Schedule 1 Part IVA:

- There are legitimate concerns that the drafting of the schedule may have been an over-reaction and would have greatly benefited from a public hearing.
- In responding to a number of court cases the Commissioner of Taxation has lost when applying Part IVA in recent times, there is a real risk that the Government, via these amendments, has over-reacted and given the Commissioner too much power to raise tax and penalties in the context of alleged income tax avoidance. This is a position held by several submissions including from The Tax Institute, the Corporate Tax Association (CTA), and the Law Council of Australia (LCA) – that the failures of the current GAAR or Part IVA may have been more to do with the ATO's poor case selection or management, or extending it to situations where the rule was not intended to apply.
- It is important to be certain that an over- reach has not occurred and that these proposed amendments do not have give the ATO Part IVA unintended powers that could cause unintended consequences such as excessive compliance costs and uncertainty which would be damaging to investor confidence.
- The amendments as introduced risk tipping the balance the other way. They are worthy of further consultation and testing, in order to avoid circumstances where either:
  - ⇒ Part IVA should not apply and it does as a result of the amendments; or
  - ⇒ when it does apply, that the ATO reconstruction (of a reasonable alternative postulate) may not be fair and realistic, leading to excessive additional tax and penalties.
- If the ATO's reconstructed alternative is not what a taxpayer focused after tax return would ever have undertaken or even contemplated – as it lacks common sense or commercial reality/judgment – then the tax difference which arises is arguably excessive and unfair.
- The amendments apply to schemes entered into, or commenced to be carried out, on or after 16 November 2012, the day on which draft legislation was released for public comment. Given that the legislative amendments as introduced are significantly different to those proposed by the Minister at the time, it is reasonable to argue that this Bill will have a retrospective effect from 16 November 2012, as taxpayers could not have known the proposed legislative landscape at the time.

Modernisation of Transfer Pricing:

Australia's transfer pricing legislation has rarely been amended, and largely stood the test of time.

Given the Government's moves to block hearings by the House Standing Committee on Economics into this Bill, we are concerned that the design and drafting of the schedule may have been rushed and requires further testing (ie consultation and scrutiny) before it is passed to ensure that it is both robust and workable, and will stand the test of time. This is a position held by many submissions including from the Corporate Tax Association (CTA), PricewaterhouseCoopers (PwC), KPMG and The Tax Institute of Australia (TIA).

For example, on page 7 of its submission to the House Standing Committee on Economics's inquiry into the Bill, the TIA said that:

> "*… we are concerned that the Bill as currently drafted will not yield many of the lauded simplicity and certainty benefits and will increase the compliance burden especially and disproportionately on small to medium enterprises*."

The schedule could benefit from further consultation and scrutiny in the following key areas:

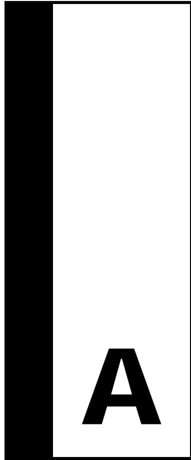
- The de minimis or threshold at which entities need not apply these complex and compliance-costly rules, nor suffer penalties where tax errors exceed the threshold, appears to be too low relative to the revenue at risk – as submissions argue, the tax-error de minimis/threshold could be raised significantly without much of an increase in revenue risk, but with a likely large saving in complexity and compliance costs, especially at the smaller end of business.
- The documentation requirements for penalty leniency appear onerous in terms of timeframes and extent, especially for SMEs – with a greater de minimis/threshold, these concerns could be significantly and acceptably reduced.
- Retaining the time limit of 7 years (from notice of initial assessment) that the Commissioner of Taxation has to make a transfer pricing adjustment appears excessive – the Inspector General of Taxation recently recommended 4 years (see further details below), which would also align with the standard amendment period.
- The OECD guidelines/provisions have been reworded a little, rather than simply referred to, in the new legislation – as submissions argue, this rewording or use of new language could give rise to unnecessary risks, confusion and possible inconsistencies at law.

- The scope of the ATO's power to reconstruct (or annihilate) unlikely, uncommercial, transactions to arrive at the right level of tax may be excessive – it may be broader, and more commonly used, than appropriate and intended, and not used "only in exceptional circumstances" (as the OCED commentary contemplates).
- Financial impact – it is difficult to fathom how the impact of this schedule is estimated at zero extra tax dollars per year whereas the impact of Schedule 1 is expected to prevent the loss of over $1 billion per year – discussed further in Schedule 1.

Mr Steven Ciobo MP
Deputy Chair

Ms Kelly O'Dwyer MP

Mr Scott Buchholz MP



Appendix A – List of Submissions

Submissions

No.

1. CPA Australia Ltd
2. General Electric (GE)
3. Australian Bankers' Association Inc.
4. Law Council of Australia
5. Federal Chamber of Automotive Industries
6. Cleary Hoare Solicitors
7. Corporate Tax Association
8. The Institute of Chartered Accountants Australia
9. KPMG
10. PricewaterhouseCoopers (PwC)
11. Confidential
12. Deloitte
13. The Tax Institute
14. The Tax Justice Network Australia
15. The American Chamber of Commerce
16. The Treasury

Appendix B – List of reports

Below is a list of reports tabled by the House of Representatives Standing Committee on Economics in the 43rd Parliament.

No.

1. Inquiry into the Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011, and the Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011
2. Inquiry into Indigenous economic development in Queensland and advisory report on the Wild Rivers (Environmental Management) Bill 2010
3. Advisory report on the Taxation of Alternative Fuels Bills 2011
4. Advisory report on the National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011
5. Advisory report on the Competition and Consumer (Price Signalling) Amendment Bill 2010, and the Competition and Consumer Amendment Bill (No. 1) 2011
6. Advisory report on the Food Standards Amendment (Truth in Labelling - Palm Oil) Bill 2011
7. Advisory report on the Corporations (Fees) Amendment Bill 2011
8. Advisory report on the Tax Laws Amendment (2011 Measures No. 8) Bill 2011, and the Pay As You Go Withholding Non-compliance Tax Bill 2011
9. Advisory report on the Minerals Resource Rent Tax Bill 2011 and related bills
10. Review of the Tax Laws Amendment (2011 No. 9 Measures) Bill 2011
11. Review of the Insurance Contracts Amendment Bill 2011

12. Advisory report on the Tax and Superannuation Laws Amendment (2012 Measures No. 1) Bill 2012
13. Advisory report on the Clean Energy Finance Corporation, Clean Energy Legislation Amendment Bill 2012, Clean Energy (Customs Tariff Amendment) Bill 2012, and Clean Energy (Excise Tariff Legislation Amendment) Bill 2012
14. Advisory Report on the Tax Laws Amendment (2012 Measures No. 2) Bill 2012, Pay As You Go Withholding Non-compliance Tax Bill 2012, Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, and Passenger Movement Charge Amendment Bill 2012
15. Advisory Report on the Tax Laws Amendment (Managed Investment Trust Withholding Tax) Bill 2012
16. Advisory Report on the Tax Laws Amendment (2012 Measures No. 4) Bill 2012
17. Report on the Exposure Draft of the Australian Charities and Not-for-profits Commission Bills 2012
18. Advisory Report on the Clean Energy Amendment (International Emissions Trading and Other Measures) Bill 2012, Clean Energy (Charges—Excise) Amendment Bill 2012, Clean Energy (Charges—Customs) Amendment Bill 2012, Excise Tariff Amendment (Per-Tonne Carbon Price Equivalent) Bill 2012, Ozone Protection and Synthetic Greenhouse Gas (Import Levy) Amendment (Per-Tonne Carbon Price Equivalent) Bill 2012, Ozone Protection and Synthetic Greenhouse Gas (Manufacture Levy) Amendment (Per-Tonne Carbon Price Equivalent) Bill 2012, and Clean Energy (Unit Issue Charge—Auctions) Amendment Bill 2012
19. Report on Australia's Oil Refinery Industry
20. Advisory Report on the Tax Laws Amendment (2012 Measures No. 6) Bill 2012