

Telephone: 6216 3111
Facsimile: 6216 1784

Our Reference: LBI/ITD
Contact Officer: Paul McBride **Extn:** 61049
Your Reference:

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House of Representatives
Standing Committee on Economics, Finance and
Public Administration
Parliament House
CANBERRA ACT 2600

Attention: Tas Luttrell, Principal Research Officer

**INQUIRY INTO INTERNATIONAL FINANCIAL MARKET EFFECTS
ON GOVERNMENT POLICY**

I refer to your recent letter to Mr Bruce Paine, Treasury, seeking corrections to the transcript of the Committee's public hearing on 13 April 2000 and any additional documents or information requested or offered during the hearing. With regard to the latter, I have included below information requested by Committee members from Mr David Grecian of the ATO.

In particular, Mr Latham sought an updated analysis of the revenue that could be lost through transfer pricing practices. Mr Hawker (Chair) and Mr Burke, in considering the work being done in the OECD, sought evidence that the ATO was actually collecting the revenue and a quantification of the revenue base. Mr Grecian undertook to get some figures on specific results and wider trend analysis and modelling of what could be involved.

The ATO shares the view that transfer pricing is a strategic issue of continuing significance. Companies that engage in international transactions are required to lodge a schedule with their tax returns providing certain information about their international dealings. The level of international dealings between related parties reported in this schedule for the 1997/98 income year was \$138 billion. This comprises sales/revenue of \$31 billion, expenditure/purchases of \$45 billion and loans of \$62 billion.

By way of background, 8,330 companies lodged an international schedule for the 1997/98 income year. This group comprises about 1.44% of all companies, they report 45.5% of all company income and pay 45.6% of company tax. The amount of tax paid by this group of companies has over the last 3 years increased above the growth in GDP.

For many years the ATO has conducted transfer pricing audits. In just one industry transfer pricing audit adjustments and penalties made during the 1997-99 years

amounted to \$75.5 million. The ATO has in recent years put in place a more integrated approach to transfer pricing that is making a real difference. This approach included a round of record keeping reviews of 190 companies that reported very low taxable incomes in relation to their turnover during a 4 year period.

This review found that:

- (a) 84% of the companies had documentation that was inadequate to verify or explain the application of the arm's length test to related party dealings;
- (b) 56% of the companies were found to be in a medium high to very high risk category of a transfer pricing audit.

The tax paid in the returns lodged by this group of companies nearly doubled to some \$166 million in the year following the reviews.

While this level of voluntary compliance was encouraging, the performance of the worst of those reviewed required more detailed analysis and transfer pricing audits of 46 of the companies have now commenced.

This brings the number of companies currently under audit in respect to their transfer pricing practices to over 70. Audit adjustments are expected to amount to several hundred million dollars of income.

The ATO has also moved from a position of having had 18 Advance Pricing Arrangements (APAs) concluded in the previous eight years, to one where eight have been completed in the last nine months. A further 36 applications have been received or foreshadowed. In addition there are another 28 companies talking about entering the program.

The move to APAs as part of the more integrated approach to compliance is significant because it involves agreement on future pricing strategies that ensure Australia is getting its fair share of revenue from international transactions (worth over \$4 billion for APAs currently in place). It is a significant real time approach in that it locks in appropriate pricing for what is typically a five year period. Some of Australia's largest payers of company tax are now in the program.

The ATO objective is to address its concerns with transfer pricing through a mix of assistance and enforcement. The audit results we have achieved indicate that the program the ATO has in place is effectively dealing with non-compliance. The large increase in APA applications suggests that more taxpayers are wanting to resolve their transfer pricing issues and are prepared to work with the ATO to achieve that result.

Yours sincerely

Stephanie Martin
Acting ASSISTANT DEPUTY COMMISSIONER
(International)
Large Business & International