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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).

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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]

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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:

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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.

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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.

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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]

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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:

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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]

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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]

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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.