SUBMISSION 9

Tax
10 Shelley Street
Sydney NSW 2000

P O Box H67
Australia Square 1213
Australia

ABN: 51 194 660 183
Telephone: +61 2 9335 7000
Facsimile: +61 2 9335 7001
DX: 1056 Sydney
www.kpmg.com.au

The Secretary
Standing Committee on Economics
House of Representatives
PO Box 6021
Parliament House
Canberra ACT 2600

Our ref KPMG submission

Contact Anthony Seve
(02) 9335 8728

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Dear Sir/Madam,

Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013: Schedule 2 - Modernisation of transfer pricing rules

We appreciate the opportunity to make a submission on *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013* (the Bill) and accompanying Explanatory Memorandum (the EM) which was referred to the House of Representatives Economics Committee on 14 February 2013. Our submission only addresses Schedule 2 to the Bill (Modernisation of the transfer pricing rules).

KPMG has also played a significant role in drafting the submission for The Tax Institute and supports the issues raised in that submission.

Our intention in providing this submission is to highlight our key areas of concern and also key concerns raised with us by our clients.

Introduction

Following consultation held with Treasury on 7 December 2012, we understood the Government's underlying policy objectives with respect to the Bill could be broadly expressed in the following terms:

- To align Australia's transfer pricing rules with international best practice as expressed in the 2010 OECD Transfer Pricing Guidelines (OECD guidelines);
- To maintain the 'single entity' approach with respect to the attribution of profits to permanent establishments (PEs);
- To give legislative effect to the current administrative practices set out in ATO transfer pricing rulings in relation to record keeping and penalties (in particular TR 98/11 and TR 98/16); and

- To ensure that the rules are "sufficiently robust to protect the Australian tax base – but they also need to be balanced so as not to overreach or impose transaction costs which may inhibit Australian's international competitiveness[1]".

We base the key comments outlined in our submission on the above understanding. Unless otherwise indicated, all section references are to sections of the Bill.

Key areas of concern

We are concerned that the Bill could be seen not to strike an appropriate balance between protecting the revenue and the additional compliance burden and uncertainty that will arise for taxpayers if the Bill is enacted in its current form. In this respect, we urge the Committee to recommend that Treasury be asked to undertake further consultation with relevant stakeholders with a view to having the Bill amended to achieve a more appropriate balance between these competing objectives.

Our key areas of concern with the Bill and accompanying EM, having regard to the Government's underlying policy objectives and also more generally, are:

Reconstruction of transactions

Subsections 815-130(2)-(4) are not consistent with OECD guidelines

The potential for the Commissioner to reconstruct actual transactions for tax purposes as set out in the Bill is not in keeping with the policy objective of aligning Australia's transfer pricing rules with international best practice as expressed in the OECD guidelines. This is because under subsections 815-130(2)-(4), the arm's length conditions replace the actual conditions in all cases where a taxpayer obtains a transfer pricing benefit. As a result, these provisions do not limit the potential for the ATO to reconstruct transactions. This position can be contrasted with the OECD guidelines which focus on actual transactions conducted and only countenance reconstructing actual transactions in limited 'exceptional' circumstances (paragraphs 1.64 and 1.65 of the OECD guidelines).

In our view, recourse to section 815-135 (Guidance) together with certain comments made in the EM, does not provide sufficient certainty that the principle stated in paragraphs 1.64 and 1.65 of the OECD guidelines, that the reconstruction of actual transactions should only occur in exceptional cases, has been imported into subsections 815-130(2)-(4).

Recommendation

The Committee should recommend that subsections 815-130(2)-(4) be amended to ensure that they can only be applied in limited exceptional cases, consistent with the OECD guidelines.

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[1] Statement from 1 November 2011 Consultation Paper.

Subsection 815-130(4) is likely to result in harsh or potentially oppressive outcomes in some cases

The annihilation provision in subsection 815-130(4), which seeks to calculate the transfer pricing benefit by disregarding the actual arrangement between the parties, is likely to result in harsh or potentially oppressive outcomes in cases where real activities are being undertaken by the Australian taxpayer. Paragraphs 3.105 and 3.106 of the EM confirm that the actual arrangement is to be disregarded.

Notwithstanding section 815-135, subsection 815-130(4) is inconsistent with paragraphs 1.11, 1.67 and 9.172 of the OECD guidelines which recognise that multinational enterprises may engage in transactions that independent enterprises would not undertake and does not automatically regard such transactions as being non-arm's length nor commercially rational. Furthermore, disregarding transactions where real activities are undertaken in Australia is inconsistent with the Objects clause in paragraph 815-105(1)(a) of the Bill and with paragraph 3.1 of the EM.

Recommendation

The Committee should recommend that subsection 815-130(4) be amended to enable real activities undertaken by Australian taxpayers to be taken into account in determining whether a taxpayer has obtained a transfer pricing benefit.

Record keeping and penalty requirements

The Bill as currently drafted is not consistent with the current administrative practices of the ATO in relation to record keeping and penalties in a number of key respects and therefore does not accurately reflect the policy intention to give legislative effect to the current administrative practices set out in ATO transfer pricing rulings in relation to record keeping and penalties (in particular TR 98/11 and TR 98/16). For example, Subdivision 284-E of Schedule 1 to the *Taxation Administration Act 1953* ("Subdivision 284-E"):

- has not been drafted having regard to prudent business management principles as endorsed by the ATO in paragraphs 1.5-1.10 of TR 98/11;
- does not distinguish between the quantum, proportion or complexity of a taxpayer's cross-border dealings contrary to the ATO's current administrative approach set out in, in particular, paragraph 1.9 of TR 98/11; and
- has not been drafted having regard to reducing documentation requirements for small businesses contrary to the approach taken in Chapter 6 of TR 98/11.

Further, Subdivision 284-E does not leave any meaningful scope for the ATO to remit penalties under section 298-20 of the *Taxation Administration Act 1953* (TAA 1953) to a rate less than 10% and therefore does not encourage voluntary compliance.

More particularly, the Bill as currently drafted does not accurately reflect the policy intention in relation to record keeping as set out in paragraphs 6.25 and 6.26 of the EM with potentially adverse consequences for taxpayers. Paragraphs 6.25 and 6.26 of the EM state the policy intention to be that "an entity only maintain and prepare documentation in respect of those conditions that are both material and relevant to the application of Subdivision 815-B and 815-C to them." However, there is nothing on the face of the text of proposed subsections 284-250 or 284-255 of Schedule 1 to the TAA 1953 that enables taxpayers or the Commissioner to have regard to issues of materiality or relevance of conditions for purposes of determining the records that need to be kept.

The key concern here is that taxpayers cannot point to the EM with a view to obtaining a more favourable interpretation of the law in cases where the meaning of the text of the law is clear and results in a different and less favourable outcome for them. As reiterated in recent High Court cases, the task of statutory construction must begin with a consideration of the statutory text itself considered in its context. Legislative history and extrinsic materials cannot displace the meaning of the statutory text (*Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* [2009] HCA 41 at paragraph 47; *Commissioner of Taxation v Consolidated Media Holdings* Ltd [2012] HCA 55 at paragraph 39). Section 15AB of the *Acts Interpretation Act 1901* (use of extrinsic material) does not assist where the meaning of the statutory text is clear on its face.

Recommendation

The Committee should recommend that Subdivision 284-E be amended to:

- more closely align with the current administrative practices set out in ATO transfer pricing rulings in relation to record keeping and penalties (in particular TR 98/11 and TR 98/16);
- ensure that the statutory text clearly and accurately reflects the policy intention set out in paragraphs 6.25 and 6.26 of the EM; and
- leave meaningful scope for the ATO to remit penalties under section 298-20 of the TAA 1953 to a rate less than 10% with the aim of encouraging voluntary compliance.

Time limits for amending assessments

A compelling case has not been made as to why the Commissioner should be given a 7-year time limit for amending assessments under paragraphs 815-150(1)(a) and 815-240(a) rather than applying the normal time limits for amending assessments under section 170 of the *Income Tax Assessment Act 1936* (ITAA 1936). In this respect, it is particularly important to note that subsection 170(7) of the ITAA 1936 provides the Commissioner with the ability to obtain additional time in which to complete an examination of a taxpayer's affairs.

Recommendation

The Committee should recommend that the normal time limits for amending assessments under section 170 of the ITAA 1936 should apply in transfer pricing cases.

Interaction between the transfer pricing rules and customs duty rules

The Bill does not address the interaction between the transfer pricing rules and customs duty rules. Transfer pricing adjustments involving the importation of goods, particularly adjustments resulting from the use of profit methods, can cause customs duty problems, because a separate adjustment needs to be sought from Customs in order to obtain a refund of any overpaid customs duty. Obtaining such customs duty adjustments is not straightforward. A whole-of-government approach is needed with the aim of creating a simple legislative mechanism by which taxpayers can obtain refunds of any overpaid customs duty following the making of a transfer pricing adjustment by the ATO.

Recommendation

The Committee should recommend that a whole-of-government approach be instituted with the aim of creating a simple legislative mechanism by which taxpayers can obtain refunds of any overpaid customs duty following the making of a transfer pricing adjustment by the ATO.

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

Yours faithfully

Anthony Seve
Partner

Yours faithfully

Damian Preshaw
Director