



Insights: Transfer Pricing

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ATO's Exposure Draft proposes retrospective amendments, signals first stage of Australian transfer pricing reform

By Brian Vincent



On March 16, 2012, the Australian Taxation Office (ATO) released an Exposure Draft of proposed retrospective amendments that will likely implement the country's first stage of transfer pricing reform. The most significant provisions presented in the Exposure Draft confirm that Australia's transfer pricing rules function differently than prior provisions that were set forth in the country's various bilateral income tax treaties.

The release of the Exposure Draft follows an announcement that was issued by the ATO on November 1, 2011 in which the ATO cited its desire to reform Australia's transfer pricing rules to "bring them into line with international best practice," citing recent substantial revisions to the OECD Transfer Pricing Guidelines as the impetus for bringing about such needed change. The prior so-called domestic rules were initially introduced in 1982 and are found in Division 13 of the Income Tax Assessment Act of 1936 as well as in various Articles of Australia's bilateral tax treaties. The rules have not been materially amended or refined since their introduction. As proposed, the amendments presented in the Exposure Draft would apply retroactively to income years commencing on or after July 1, 2004. The "backdating" provisions set forth in the Exposure Draft are expected to draw significant attention during the period of public comment on the pending legislation.

At its core, the Exposure Draft emphasizes the interaction between Australia's treaty network and the domestic transfer pricing rules contained within Division 13. The Exposure Draft effectively confirms that where a treaty exists, the treaty will apply and operate independently of domestic rules. The Exposure Draft calls for the introduction of a new subdivision (815-A) within the Income Tax Assessment Act of 1997, the spirit of which is twofold—first, to ensure that relevant aspects of the treaties can provide assessment authority independently of the rules promulgated under Division 13, and, secondly, to require that the arm's length principle be interpreted as consistently as possible, pursuant to OECD guidance. Given the spirit of the proposed regulations, it will indeed be important that the new rules are drafted using OECD guidance as a starting point and that the rules are ultimately enforced in a manner that conforms to the OECD Guidelines as much as possible.

In addition to examining the degree of interaction between treaty provisions and domestic rules, the Exposure Draft also introduces the concept of a "transfer pricing benefit." The proposed legislation states that the amount of the "transfer pricing benefit" is the difference between the profits accrued (or attributed) and the profits that might have been expected to have accrued (or had been

attributed) had the affiliated parties operated independently of each other. In instances where a transfer pricing benefit has been identified and quantified by the ATO, the proposed rules set forth in the Exposure Draft empower the Commissioner to make appropriate determinations as a means of ensuring that the domestic taxpayer's tax liability appropriately reflects the transfer pricing benefit received. This may include, for example, increases to taxable income and/or reductions of tax or capital losses for the relevant income year(s). In summary, the transfer pricing benefit is simply the amount that a taxpayer understates Australian income in the view of the ATO.

The Exposure Draft also includes a proposed rule that refers to sources of guidance that can be relied on and referred to in determining whether a transfer pricing benefit exists. As described in a Consultation Paper issued on November 1, 2011, the government noted that while practitioners, the ATO, and treaty partners have "extensively" relied on the OECD Guidelines in interpreting transfer pricing profit allocations impacting Australian taxpayers, the Australian courts have not endorsed the use of the OECD Guidelines in such a robust manner. As a manner of remedying this disconnect, the Exposure Draft cites that, for income years commencing on or after July 1, 2012, both the OECD Transfer Pricing Guidelines and the OECD's Model Tax Convention on Income and on Capital can be relied upon in determining income derived from transactions with related parties. For years prior to income year 2012 (but beginning on or after July 1, 2004), the relevant OECD guidance is from the versions of the Guidelines and the Model Tax Convention that were last published before the start of the relevant income year.

Public comments on the Exposure Draft close on April 13. While the government has not yet announced whether further Exposure Draft legislation will be issued on separate transfer pricing issues, it appears that the first Exposure Draft represents the first stage of forthcoming reform efforts.

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