

AUSTRALIA

TRANSFER PRICING LANDSCAPE

1982: Division 13 of Part III of the Income Tax Assessment Act (ITAA), 1936 applies to income years commenced prior to 1 July 2013.

2012: Subdivision 815-A of the ITAA, 1997 was introduced with retrospective effect from 1 July 2004 to 30 June 2013.

2013: Subdivision 815-B, 815-C and 815-D of the ITAA, 1997 and subdivision 284-E of Schedule 1 of the Tax Administration Act (TAA), 1953 were made applicable to income years starting on or after 1 July 2013. This year also witnessed the start of the new self-assessment based regime.

2016: Australian government announces the implementation of the Organisation for Economic Co-operation and Development's (OECD's) new transfer pricing documentation standards (Country by Country Report, master file and local file).



Introduction

The new legislations with respect to transfer pricing for income years starting on or after 1 July 2013 are contained in:

- Subdivision 815-B - Arm's length principle for cross-border arrangements between entities;
- Subdivision 815-C - Arm's length principle for permanent establishments; and
- Subdivision 815-D - Special rules for trusts and partnerships

Furthermore, subdivision 284-E of the TAA, 1953 outlines transfer pricing documentation requirements for having a Reasonable Arguable Position (RAP).

Apart from the above regulations, the Australian Tax Office (ATO) has issued various rulings that assist in the interpretation/application of the existing regulations and issues not covered in the existing statutes.

Related party transactions

The parties involved in transfer pricing arrangements do not need to be related to each other. The transfer pricing rules are applicable if an Australian entity gets a tax benefit in Australia from cross-border conditions that are inconsistent with the arm's length principle.

Arm's length conditions

Arm's length conditions are the conditions that might be expected to operate between independent entities dealing wholly independently with one another in comparable circumstances.

Transfer pricing documentation

Contemporaneous documentation

Although the preparation of transfer pricing documentation is not a legal requirement, the failure to prepare transfer pricing documentation by the time the relevant tax return is filed would mean that a RAP does not exist. The penalty risk will be reduced by preparing and maintaining contemporaneous transfer pricing documentation that meets the RAP standard.

The ATO recommends that 'five key questions' be considered by taxpayers while preparing transfer pricing documentation. The five key questions are as follows:

1. What are the actual conditions that are relevant to the matter(s)?
2. What are the comparable circumstances relevant to identifying the arm's length conditions?
3. What are the particulars of the methods used to identify the arm's length conditions?

4. What are the arm's length conditions and is/was the transfer pricing treatment appropriate?
5. Have any material changes or updates been identified and documented?

Apart from the above, for large companies that operate in Australia (entities with an annual global income of AUD 1 billion or more), as per the new requirements, the ATO shall receive the Country by Country (CbC) Report, a master file and a local file. These extensive reporting requirements apply for income tax years beginning on or after 1 January 2016.

Submission of documentation

In the case of an enquiry from the ATO, documentation needs to be submitted within 21-28 days of the request.

Simplified documentation

The ATO developed simplified transfer pricing record keeping options that eligible businesses (mainly small businesses) can apply to minimise their record keeping costs. The application of these options shall exempt certain categories of taxpayers and transactions from preparing detailed transfer pricing documentation. However, it shall not be a complete waiver.

In case an entity has elected to apply this option, the ATO provides assurance that compliance action would not be undertaken to examine the transfer pricing records relevant to that option for a period of three years.

Selection of method

The transfer pricing methods are similar to the five methods specified in the OECD's transfer pricing guidelines.

Selection of comparables

Comparables may be selected from internal as well as external sources. In the absence of internal transactions being undertaken in similar circumstances, external comparables would be preferred.

The ATO recommends local comparables. However, in the absence of such local comparables, foreign comparables from similar markets may be accepted by the ATO. Secret comparables are not considered for the purpose of transfer pricing analyses.

Certain specific provisions

Reconstruction provision

Reconstruction provisions are unique to the Australian law and are wide enough to empower the ATO to redefine the actual transactions based on how independent entities in comparable circumstances would have dealt with these transactions.

Commerciality test

Under this test, taxpayers must replace the actual commercial or financial relations if independent parties would not have entered into the actual arrangement or would not have entered into an arrangement altogether. Accordingly, Australian taxpayers should support the commerciality of their overall outcomes in addition to justifying the arm's length nature of the individual transaction.

Reporting and compliance

Related party disclosures along with filing of annual corporate tax return

Taxpayers are required to file their International Dealings Schedule (IDS) for transfer pricing arrangements along with its income tax return.

The date for filing the income tax return is due on 15th day of seventh month after the close of the income period.

Statute of limitations for transfer pricing audits

Under the new laws, the statute of limitations on assessment of transfer pricing is seven years. However, the tax legislation applicable for income years starting before 1 July 2013 does not provide any time limitations and therefore can be challenged indefinitely.

The risk areas that can trigger transfer pricing queries during general tax audits are:

- Payment of royalties/management fees;
- Financial arrangements;
- Persistent losses, inconsistent profit/loss patterns;
- Business restructurings; and
- Dealings with tax heaven jurisdictions, etc.

Penalties and other consequences of non-compliance

The penalty rates if no RAP can be established are generally 25% to 50% of the tax shortfall amount. These penalties may be reduced if the taxpayer can demonstrate that it has a RAP through the transfer pricing documentation finalised at the time of lodgement of the tax return.

In the case of delayed payments of the aforesaid penalties, the ATO may levy a shortfall interest charge and general interest charge.

APA and MAP procedures

Taxpayers may opt for unilateral, bilateral and multilateral Advance Pricing Agreements (APAs) for a period of three to five years. A rollback mechanism is provided under the APA regulations. Rollback provisions will be appropriate if

there are no material changes to the covered dealings or the conditions that operate between the parties in the rollback period as compared to the APA period.

Taxpayer may also apply for Mutual Agreement Procedures (MAPs).

BEPS/CbC applicability

Australia has formally accepted the recommendations of the OECD and G20 Base Erosion and Profit Shifting (BEPS) Project in connection with transfer pricing documentation. CbC reporting shall apply to income years starting on or after 1 January 2016 for multinationals operating with an annual global income of more than AUD 1 billion.



SUMMARY OF TRANSFER PRICING REQUIREMENTS

Effective from	1982
Compliance requirements	<ul style="list-style-type: none">• IDS is to be filed for disclosing transfer pricing transactions along with the income tax return.• Contemporaneous documentation establishing a RAP must be in existence at the date of lodgement of the tax return to gain penalty protection.
Penalties	Penalties - 25% to 50% of the shortfall tax amount. Interest may be levied if payment of penalties is delayed.
Method and preference for comparable	Five methods as defined by the OECD. Preference for local comparables.
Peculiar features	Reconstruction provisions and commerciality test.
APA	Available
BEPS/CbC applicability	Applicable

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Key contact

Maulik P. Doshi

Partner, Transfer Pricing

E: maulik.doshi@skpgroup.com

T: +91 22 6617 8041

M: +91 98205 40027

skpgroup.com



[linkedin.com/company/skp-group](https://www.linkedin.com/company/skp-group)



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