

# 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).

**2017:** Establishment of Tax Avoidance Taskforce, Introduction of a diverted profits tax (DPT), increase in penalties for failure to lodge on time and penalties relating to statements and documents to the ATO



## Introduction

In Australia, transfer pricing legislations were enacted in 1982, through Division 13 of Part III of Income Tax Assessment Act (ITAA) applicable to income years commenced prior to 1 July 2013.

In 2012, Subdivision 815-A was enacted with retrospective effect for income years commencing prior to 1 July 2013. These provisions were applicable to taxpayers that transacted with affiliates in countries with which Australia has double tax agreement.

With respect to the transfer pricing for the income years starting on or after 1 July 2013; New Laws were introduced in 2013:

- 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) have in place relevant provisions of double tax treaties and have issued various rulings that assist in the interpretation/application of the existing regulations and issues not covered in the existing statutes.

## 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.

## Arm's length methodologies

Australia's transfer pricing rules do not prescribe any particular methodology or gives preference to arrive at an arm's length outcome rather to adopt a method that is best suited to the circumstances of each case and should be able to provide commercially realistic outcome.

## 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.

In order to have a RAP, it is required that the documentation should:

- be prepared before the time the tax payer lodges its income tax return.
- be prepared in English or readily accessible and convertible into English,
- explain the particular way in which Subdivision 815-B or 815-C of the ITAA 1997 applies (or does not apply)
- explain why the application of Subdivision 815-B or 815-C of the ITAA 1997 to the matter (or matters) in that particular way best achieves the consistency with the prescribed guidance material.

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 and the filing date is within 12 months after the end of the financial year.

### Preparation and submission of documentation

The preparation of documentation is not specified compulsory, however in order to comply with documentation requirements set out in Subdivision 284-E for having a Reasonable Arguable Position and in order to justify the transactions disclosed, documentation needs to be prepared. Further, a comprehensive report need not be prepared each year, if there are no material changes in the nature, quantum of transactions or the operations of the taxpayer.

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 can apply to minimise their record keeping costs. The application of these options shall exempt certain categories of taxpayers:

- Small taxpayers - provided the Australian group turnover is under AUD 25 million
- Distributors - provided the Australian group turnover is under AUD 50 million
- Low-level inbound and outbound loan transactions - provided combined loan balances of \$50 million or less,
- Taxpayers entering into intragroup related party services - provided the services are of the values \$1 million or less
- Taxpayers entering into Management and administration services and Technical technical services provided the income from and expenditure on such services is not more than 50% of total related party dealings
- Taxpayers with a low level of international related-party dealings

However, it shall not be a complete waiver. Further, each such category has a number of very specific access conditions and in order to apply the options the taxpayer must satisfy all the prescribed conditions and are required to notify the ATO by making a disclosure in the annual International Dealings Schedule.

### 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.

### Multiple year data

A valid conclusion as to what constitutes an arm's length outcome for a dealing usually requires examination of several years of dealings for both the controlled and uncontrolled parties.

The number of years that need to be examined depend on the facts and circumstances of the case, but as a starting point the ATO usually considers the year under audit and the preceding four years. Taxpayers may wish to consider the current year and previous four years when setting their prices, subject to the particular facts of their case.

## 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 with international dealings that are more than \$2 million are required to file their International Dealings Schedule (IDS) for transfer pricing arrangements along with its income tax return.

The taxpayer is obliged to disclose information about related party international dealings, including:

- the nature and amount of certain categories of transactions
- details of dealings of a financial nature
- receipts or payments of non-monetary consideration
- details of restructuring events
- details of arm's length methodologies used
- the level of documentation held to support the selection and application of the most appropriate arm's length methodologies
- details of disposals or acquisitions of any interest in a capital asset.

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.

## 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

### Reporting requirements

Australian based groups as well as Australian subsidiaries of foreign groups termed as Significant global entities (SGEs) with an annual global income of more than AUD 1 billion are required to comply with CbC reporting rules with respect to the income years commencing on or after 1 January 2016.

SGEs will be required to lodge with the ATO:

- a **CbCR** which includes the following information for each country that the Multinational operates: revenue, profit (loss) before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, tangible assets, number of employees and main business activity.
- a **master file** which provides an overview of the Multinational's global business, its organizational structure and its transfer pricing policies.
- **and a local file** which contain detailed information about the local taxpayer's operations and intercompany transactions.
- Further, with regards to the local file, the ATO has set out a 'Two Tier' reporting requirement viz: **Short form local list**- Australian Reporting Entity can provide the short form local file to the ATO if it meets at least one of the following criteria:
  - the aggregate value of its international related party dealing is less than \$2 million and it has no international related party dealings on the short form exceptions list, or
  - the Simplified Transfer Pricing Record Keeping criteria for 'small taxpayers' and materiality, and it has no IRPDs on the short form exceptions list.
- Where the reporting entity doesn't meet the criteria for the short form local file, it will be required to complete the **detailed local file**.

All CbC statements must be lodged within 12 months after the end of the reporting period to which they relate. Generally, the the Australian reporting entity will be responsible for providing the Master File and the Local File. The CbC report will need to be lodged separately, usually by the head entity in its jurisdiction.

The preparation and lodgement of CbCR, Master and Local File documentation is separate and distinct to the preparation of Subdivision 815-B documentation for Subdivision 284-E purposes. That is, the new rules simply add an extra layer of reporting, and an additional reporting date (i.e. 12 months after the end of the reporting period).

### Automatic exchange of CbC reports

Australia is currently one of 67 the jurisdictions that have signed the CbC Multilateral Competent Authority Agreement (the MCAA) to facilitate the exchange of CbC reports between tax authorities in different jurisdictions. However, the CbC report can only be exchanged between Australia and another signatory when each jurisdiction has activated exchange with the other.

## Penalties and other consequences of non-compliance

The penalty rates if no RAP can be established are generally 25% to 75% 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.

In addition to the above penalties, effective from 1 July 2017, 'failure to lodge on time (FTL)' penalties and penalties relating to statements and failing to give documents to the ATO, have now been significantly increased and its ranges from AUD 105,000 to AUD 525,000. Further, penalties relating to statements and failing to give documents to the ATO, the base penalty amounts for SGEs in respect of penalties relating to making false or misleading statements or failing to give documents to the ATO ('culpable behaviour' penalties) have been doubled i.e. now it ranges from 50% to 150% of the tax shortfall amount where no RAP can be established.

## Tax Avoidance Task Force

Established in 2016, the taskforce investigates and challenges the most aggressive tax avoidance arrangements, including profit shifting focusing majorly on MNEs. Its role is to ensure that these entities pay the right amount of tax, according to law.

The principal objectives of the Task Force are to:

- detect tax avoidance to protect revenue and maintain the integrity of the tax system
- increase transparency and develop a better understanding of commercial drivers and the industries in which taxpayers operate
- improve our data, analytics, risk, and intelligence capabilities to identify and manage tax avoidance risk
- provide the community with confidence that large public and private groups, and wealthy individuals are paying the right amount of tax, according to law, in Australia.

## Multinational Anti-Avoidance Law (MAAL)

The MAAL was introduced to broadly ensure that MNEs do not use complex, contrived and artificial schemes to avoid a taxable presence in Australia and that multinationals pay their fair share of tax on the profits earned in Australia. MAAL applies to SGE's (namely entities with either annual global income of AUS \$1 billion or more or that is part of a group of entities that have annual global income of AUS \$1 billion or more) and applies to income years commencing on or after 1 January 2016.

Broadly, the MAAL will apply to certain schemes, or in connection with the scheme:

- a foreign entity supplies goods or services to an Australian customer
- an Australian entity, that is an associate of or is commercially dependent on the foreign entity, undertakes activities directly in connection with the supply
- some or all of the income derived by the foreign entity is not attributable to an Australian permanent establishment, and
- the principal purpose, or one of the principal purposes of the scheme, is to obtain an Australian tax benefit or to obtain both an Australian and foreign tax benefit.

SGEs are also subject to increased penalties for tax shortfalls arising from the application of the MAAL.

## Diverted Tax profits (DPT)

Proposed in the 2016-17 Budget, the DPT came into effect on 1 July 2017 and imposes a 40% tax. The DPT aims to prevent the diversion of profits offshore through arrangements involving related parties.

Broadly, DPT would apply where a taxpayer has obtained a tax benefit and it could be concluded that the principal purpose, or one of the principal purposes is to obtain an Australian tax benefit or to obtain both an Australian and foreign tax benefit.

The DPT does not apply to managed investments trusts, certain foreign collective investment vehicles, entities owned by foreign governments, complying superannuation entities and foreign pension funds. Further, DPT would not apply if one of the following exceptions following exceptions apply:

- The \$25 million income test
- The sufficient foreign tax test
- The sufficient economic substance test.



## SUMMARY OF TRANSFER PRICING REQUIREMENTS

**Effective from** 1982

### Compliance requirements

- 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. Filing of CbCR, master file and local file within 12 months from the end of relevant income year (applicable to SGE)

### Penalties

Penalties - 25% to 50% of the shortfall tax amount.

Interest may be levied if payment of penalties is delayed

'Failure to lodge on time (FTL)' penalties- AUD 105,000 to AUD 525,000.

Penalties relating to statements and failing to give documents to the ATO – 50% to 150% of the tax shortfall amount

### 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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Our multi-disciplinary teams serve clients from various geographies and industries ensuring global standards. With over 80% of our client-base being international, we truly understand the needs of global companies and their expectations and our customized global solutions are designed to factor in local nuances. Our commitment is rooted in a passion for solutions, empowering our people and clients to achieve more.

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