



THE TAX INSTITUTE

THE MARK OF EXPERTISE

16 December 2016

Mr John Nicols
Australian Taxation Office
GPO Box 9977
SYDNEY NSW 2001

By email: TPsafeharbours@ato.gov.au

Dear Mr Nicols,

Simplified Transfer Pricing Record Keeping Options Draft Practical Compliance Guideline

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office in relation to the *Simplified Transfer Pricing Record Keeping Options Draft Practical Compliance Guideline (Draft PCG)*.

1. General comments

- Our members are of the view that simplified transfer pricing record keeping options (**TP Simplification Options**) are important from the perspective of providing guidance to taxpayers, influencing taxpayer behaviour and focusing scarce ATO resources on significant risks.
- Members with clients that advise privately held groups or groups with significantly less than \$1 billion turnover had expected to be able to make use of the simplification requirements. However, in practice they have had very few clients who have been able to satisfy all of the very strict requirements.
- Members welcome the introduction of the outbound loan measure and would anticipate that this will have a positive impact for many clients.
- However, the 'bright line' restrictions regarding specified countries and royalty transactions continue to be a significant barrier to taxpayers wishing to access these measures. Many affected taxpayers have minimal specified country and/or royalty dealings and as such it seems unfair that such transactions should completely exclude them from these measures. Members would strongly urge the ATO to consider whether there is some de minimis level of such transactions that would be acceptable from a risk management perspective. This could perhaps be coupled with a global turnover restriction (i.e. \$1 billion) to manage potential revenue leakage. Since this matter was last raised with the ATO, the list of specified countries has increased and therefore

now is an appropriate time for the ATO to reconsider this aspect of the simplification measures.

- We refer to the 'Consultation Executive Summary' document for the consultation and note that the ATO is currently completing a report into the effectiveness of the simplification measures (see heading 'Effectiveness Report'). There is also reference to a proposed review of the measures in September 2017. We would like our comments to be considered as part of the implementation of the PCG and also in the context of the effectiveness review.
- The PCG should focus on offering safe harbours to ensure low dollar value and low risk transactions are excluded from the compliance burden associated with the transfer pricing rules and that the simplification measures can be effectively applied. Where relevant, we have suggested a number of options for the ATO to consider to make the simplifications measures effective including some caveats to minimise any perceived risk of revenue leakage.

2. Specified countries

- The list of specified countries is extensive and includes 38 countries. We note that this does not include the additional 6 countries now included in the 2016 International Dealings Schedule instructions¹. We welcome the ATO's position not to further extend the list.
- Having said this, the simplification measures are not working as effectively as they could, given that many taxpayers will not be permitted to use the simplification measures simply because they have small transactions with entities in the specified countries.
- Based on previous discussions, we understand this reflects the ATO's view on the overall risk profile of taxpayers that have dealings with related parties in specified countries. In this respect, we note that the TP Simplification Options are for transfer pricing only and do not restrict the ATO in reviewing taxpayers that have such transactions.
- Therefore, we would welcome a further narrowing of the specified countries list (for the purposes of the simplification measures) and the introduction of a threshold test for dealings with specified countries. For example, a test involving one or more of the following may be appropriate:
 - 10% of turnover;
 - 25% of International related-party dealings (IRDP); or
 - Total IRDPs with specified countries are less than \$500,000.

3. Royalties

- Many SME taxpayers are excluded from the simplification measures where they have minor intellectual property dealings with international related parties. For example, one taxpayer was precluded from using the distribution option because it had a \$2,000 royalty payment to a high tax jurisdiction.

¹ The additional 6 countries are Hong Kong, Ireland, Luxembourg, Netherlands, Singapore and Switzerland.

- The ATO should consider the introduction of specific maximum thresholds for intellectual property dealings, such as an amount of royalties of less than \$500,000 paid to entities in the specified countries, similar to the test recommended in Item 2 above.
- Another alternative would be to loosen the rules around royalty transactions but only where global turnover for the relevant group is below a certain threshold (i.e. \$1 billion) to align with other administrative measures.
- It is also possible to limit the absolute threshold for expense amounts if the ATO would be concerned about royalty expenses being underreported.

4. Services

- At present, within the Draft PCG, for different types of intra-group services there are three available simplification measures each referencing different mark-ups, being:
 - o Management and administration services: 5%
 - o Intra-group services: 7.5%
 - o Technical services: 10%
- We would welcome further simplification of these measures and would propose alignment with the recently updated OECD guidance. For example, in the first instance it would be worthwhile if the simplification measures aligned where possible to the recent OECD guidance on low value adding intra-group services (potentially looking at combining how intra-group services and management and administrative services could be simplified within one simplification measure).

5. Materiality

- The materiality simplification measure only applies where IRPDs are less than or equal to 2.5% of total turnover. These measures have been in operation for the past 2 years and as yet, in practice, members have yet to report any instance of this measure being applied in any client situation.
- This threshold test is too low and should be revisited to provide a more meaningful measure. For example, an alternative test may be to provide that the threshold limit be the higher of 2.5% of total turnover or IRPDs less than \$500,000.

6. Low-level outbound loans

- We welcome the addition of an outbound loan simplification option that addresses an obvious gap in the current simplification measures.
- We also welcome the provision of rates.
- In relation to the eligibility criteria and the dot point “the funds actually provided by you under the loan are Australian dollar funds and this is reflected in your loan agreements”, it is not clear whether the currency of the loan can only be in

AUD or whether the loan can be in any currency but the funds can only be drawn down in AUD. It would be appreciated if this could be clarified.

- If the current option is proposed to only apply to Australian dollar based loans, we believe this is unnecessarily restrictive and it is recommended to allow the option to apply to loans in foreign currency as well and to provide guidance on rates in these currencies. From an administrative perspective, this extended option could be applied to core global currencies only, e.g. USD, Euro, GBP, Japanese Yen.
- We are mindful of the ATO's current concerns in relation to non-AUD denominated loans and cross-currency interest rate swaps (see Taxpayer Alert TA 2016/3). We do not see a material risk in this regard in relation to outbound loans, but if the ATO has remaining concerns in relation to this point, a carve out could be added where cross currency swaps are used.

7. Low-level inbound loans

- This simplification measure, as currently drafted, only applies where the funds actually provided to the taxpayer under the loan are Australian dollar funds. Inbound loans are also likely to be denominated in currencies other than AUD, therefore it would be beneficial if this measure was expanded to provide some guidance for loans denominated in other foreign currencies (i.e. the currencies noted above in relation to outbound loans).
- In members' experience, the policy of many smaller multi-national groups is to denominate loans in the currency of the lender, or that the Australian entity is such a small part of the overall global group that it has to accept the currency specified by the overseas lender. Therefore, there would be real value (for taxpayers and the ATO) in allowing some simplification measures for non-AUD inbound loans. This would be of more value than taking similar steps in the context of outbound loans.
- If the ATO has concerns about non-AUD loans in the context of other related activities (i.e. cross currency swaps), taxpayers with such instruments could be carved out of the measure.

8. Errors/observations through the examples

- Example 1 - Final paragraph, *'Australco meets the eligibility criteria for the small taxpayers' record-keeping option and can elect to apply it to its purchases from Kenspire.'* The only related party transaction in the example provided is administrative support services **NOT** purchases from Kenspire. The example will need to be updated appropriately.
- Example 14:
 - Holdal's dealings consist of \$8 million in management and administration services and \$1 million in training. The example states that Holdal has no other related-party dealings.

- The example has calculated Holdal's management and administration services as 25% of its total international related party dealings. This is incorrect – it is actually closer to 88.89% of its international related party dealings. The example will need to be updated appropriately.
- General comments on examples
 - There is some general inconsistency with the level of analysis undertaken in the examples contained in the PCG. Some of the examples contain a full analysis of the eligibility criteria for the simplification option while other examples only consider some of the eligibility criteria.
 - For example, in example 13 it is stated that Darco neither meets the 2.5% materiality threshold nor the specific international related-party dealings criteria.
 - In contrast, example 15 states that Richoil fails the mark-up criterion for management and administration services. It does not state that Richoil also fails the requirement that its management and administration services dealings are more than 50% of its total IRPDs.
- Branch operations
 - The Draft PCG does not include any reference to whether the simplification measures can apply to branch operations. However, the ATO have stated in the '*Simplifying transfer pricing record-keeping – frequently asked questions*' that simplification measures can apply to branch operations.
 - We suggest the ATO clarify through the PCG that the TP Simplification Options apply to branches as reflected in the '*Simplifying transfer pricing record-keeping – frequently asked questions*' including foreign branches of Australian-based multinational enterprises and Australian branches of foreign-based multinational enterprises.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely



Arthur Athanasiou
President