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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX LAWS AMENDMENT (CROSS-BORDER TRANSFER PRICING) BILL (NO. 1) 2012

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP)

Table of contents

Glossary 1

General outline and financial impact.. 3

Chapter 1 Treaty-equivalent cross-border transfer pricing rules 5

Index...45

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	***Definition***
ATO	Australian Taxation Office
Commissioner	Commissioner of Taxation
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1953	*International Tax Agreement Act 1953*
ITAA 1997	*Income Tax Assessment Act 1997*
IT(TP) Act 1997	*Income Tax (Transitional Provisions) Act 1997*
MAP	mutual agreement procedure article
OECD	Organisation for Economic Co-operation and Development
OECD Guidelines	OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
OECD Model	OECD Model Tax Convention on Income and on Capital
SNF	*Commissioner of Taxation v SNF (Australia) Pty Ltd [2011] FCAFC 74*
TAA 1953	*Taxation Administration Act 1953*

General outline and financial impact

Treaty-equivalent cross-border transfer pricing rules

Schedule 1 to this Bill inserts Subdivision 815-A into the *Income Tax Assessment Act 1997* (ITAA 1997) to confirm that the internationally consistent transfer pricing rules contained in Australia's tax treaties and incorporated into Australia's domestic law provide assessment authority to address treaty related transfer pricing. The purpose of these rules is to limit taxable profits being shifted or misallocated offshore.

The amendments also provide direct access to Organisation for Economic Cooperation and Development guidance material and clarify how the Subdivision will interact with Division 820 of the ITAA 1997, which deals with thin capitalisation.

Date of effect: This measure applies for income years commencing on or after 1 July 2004.

The application of the law, as amended by Subdivision 815-A, is consistent with Parliament's view that treaties provided a separate basis for making transfer pricing adjustments. These amendments ensure the law can operate as the Parliament intended.

Although there has been a consistent assumption by Parliament, since at least 1982, that treaties provided a separate basis for making transfer pricing adjustments, the application date for this Bill to income years commencing on or after 1 July 2004 follows the most recent Parliamentary statement to this effect in 2003.

Proposal announced: This measure was announced in the then Assistant Treasurer and Minister for Financial Services and Superannuation's Press Release No. 145 of 1 November 2011.

Financial impact: This measure has no revenue impact as it is a revenue protection measure.

Human rights implications: This Schedule does not raise any human rights issue. See *Statement of Compatibility with Human Rights* — Chapter 1, paragraphs 1.150 to 1.158.

Compliance cost impact: Minimal. These amendments confirm the application of the law as Parliament intended.

Chapter 1
Treaty-equivalent cross-border transfer pricing rules

Outline of chapter

1.1 Schedule 1 to this Bill inserts Subdivision 815-A into the *Income Tax Assessment Act 1997* (ITAA 1997). This Subdivision contains amendments that ensure Australia's tax treaty transfer pricing rules operate as intended.

1.2 The amendments confirm that the internationally consistent transfer pricing rules contained in Australia's tax treaties and incorporated into Australia's domestic law provide assessment authority to address treaty related transfer pricing. The purpose of these rules is to limit taxable profits being shifted or misallocated offshore. The amendments also provide direct access to Organisation for Economic Cooperation and Development (OECD) guidance material in interpreting the rules, and clarify how the Subdivision should interact with Division 820 of the ITAA 1997, which deals with thin capitalisation.

1.3 This Schedule also:

- inserts Subdivision 815-A into the *Income Tax (Transitional Provisions) Act 1997*; and
- makes consequential amendments to the *Income Tax Assessment Act 1936* (ITAA 1936).

1.4 All legislative references are to the ITAA 1997 unless otherwise stated.

Context of amendments

1.5 The introduction of retrospective legislation is not done lightly. It is generally only done where there is a significant risk to revenue that is inconsistent with the Parliament's intention.

1.6 The following sections explain why retrospective application of the amendments in this Bill is appropriate. The evidence that Parliament understood the law to operate consistently with these amendments is set

out in some detail. The current law is then discussed to illustrate that there is a real possibility that the law already applies this way. Finally, this section discusses the nature of possible impacts on taxpayers and how such impacts can be significantly mitigated in the event they actually arise.

1.7 Australia's transfer pricing rules seek to ensure that the appropriate return for the contribution made by Australian operations is taxable in Australia for the benefit of the community. The opportunity to shift profits is most prevalent between related parties who conduct their affairs on a transnational basis. These amendments, consistent with Australia's tax treaties, apply to those cases.

1.8 Transfer pricing rules are critical to the integrity of the tax system. Related party trade was valued at approximately $270 billion in 2009, representing about 50 per cent of Australia's cross-border trade flows. It is therefore important to confirm that the law is fully effective in the way Parliament has clearly assumed it operates. There is no financial impact from these amendments as they protect the existing revenue base.

1.9 Transfer pricing rules are contained in Division 13 of the ITAA 1936 (Division 13). Division 13 was introduced in 1982 to address results of a court case, emerging concerns about cross-border profit shifting, and against the backdrop of new OECD guidance.

1.10 Each of Australia's tax treaties also contains articles that deal with transfer pricing. These articles include the associated enterprises article and the business profits article. (Other articles in tax treaties may also be relevant to transfer pricing, but references to the 'treaty transfer pricing rules' hereinafter relate to these two articles specifically.) The treaty transfer pricing rules, interpreted through the framework of the OECD guidance, require profits which relate to cross-border intra group dealings to be calculated consistently with the 'arm's length principle'. This internationally accepted principle is set out in the OECD Model Tax Convention on Income and on Capital (OECD Model) and explained in associated guidance material. It forms the basis for Australia's treaty transfer pricing rules.

1.11 Australia incorporates its tax treaties into municipal law through the *International Tax Agreements Act 1953* (ITAA 1953). The Commissioner of Taxation (the Commissioner) has long held and publicly expressed a view that the treaty transfer pricing rules, as enacted, provide an alternate basis to Division 13 for transfer pricing adjustments.

1.12 Transfer pricing cases have been rarely litigated in Australia. In June 2011, the Full Federal Court considered its first substantive transfer pricing case in *Commissioner of Taxation v SNF (Australia) Pty Ltd*

[2011] FCAFC 74 (SNF). This case was argued only on the basis of Division 13; the Court did not have to decide whether the Commissioner could apply the relevant treaty rules as an alternate basis for transfer pricing adjustments. However, the decision in *SNF* highlighted that Division 13 may not adequately reflect the contributions of the Australian operations to multinational groups, and as such in some cases treaty transfer pricing rules may produce a more robust outcome.

1.13 On 1 November 2011, the then Assistant Treasurer and Minister for Financial Services and Superannuation announced a review of Division 13. Additionally, he proposed amendments to confirm that the transfer pricing rules contained in Australia's tax treaties provide a power, through express incorporation into Australia's domestic law, to make transfer pricing adjustments independently of Division 13 for income years commencing on or after 1 July 2004. This measure will give effect to that additional announcement.

1.14 This measure, which is specific to transfer pricing rules contained in Australia's tax treaties, will ensure the Parliament's view as to the way in which treaty transfer pricing rules operate is effective, that the Australian revenue is not compromised, and that international consistency is maintained with our tax treaty partners.

1.15 There are strong arguments (discussed below) for concluding that under the current income tax law, treaty transfer pricing rules apply alternatively to Division 13. If this is the case, these amendments constitute a mere rewrite of those rules. To the extent that some deficiency exists in the current law, these amendments ensure the law can operate as the Parliament intended.

Application of the amendments

1.16 Given the consistent assumption by Parliament since at least 1982 that treaties provided a separate basis for making transfer pricing adjustments, the proposed amendments could apply from the commencement of Division 13 and the accompanying changes to section 170 and former section 226 of the ITAA 1936.

1.17 Subdivision 815-A, however, will only apply to income years commencing on or after 1 July 2004. The 2004 income year commenced immediately after the Parliament's most recent amendment to the income tax laws in 2003 which again evidenced the Parliament's understanding that tax treaties could be used as a separate basis for making transfer pricing adjustments. The 2003 amendments included a modification to the definition of 'relevant provision' contained in subsection 170(14) of the ITAA 1936 and contained explicit statements as to the ability for such provisions to allow for adjustments to the profits of permanent

establishments or associated enterprises on an arm's length basis (see paragraph 3.5 of the Explanatory Memorandum relating to Act No 123 of 2003).

How does Subdivision 815-A interact with Australia's tax treaties more generally?

1.18 A number of provisions in Subdivision 815-A refer to international tax agreements, as well as parts of those agreements, as given effect by the ITAA 1953. These references are important in determining when Subdivision 815-A will apply and ensure that the question of whether an entity gets a 'transfer pricing benefit', and the amount of any such benefit, is consistent with Australia's international tax agreements. Despite drawing upon aspects of the terms and text of Australia's international tax agreements in this manner, the liability to tax that may be imposed under Subdivision 815-A arises under the domestic law rather than the operation of the relevant tax treaty itself.

1.19 Subsection 4(2) of the ITAA 1953 will continue to apply in the (unforeseeable) event of an inconsistency between Australia's international tax agreements and Subdivision 815-A. This Subdivision only allows for upwards adjustments to a taxpayer's Australian tax position. However, nothing in this Subdivision prevents Australia's international tax agreements from applying in circumstances where the outcome under an agreement could result in a lesser adjustment relative to a taxpayer's position under the domestic law provisions.

1.20 Subdivision 815-A will only apply where profits have not accrued to an entity because of non-arm's length conditions and the entity's Australian tax position is negatively affected from the perspective of the revenue as a result.

Parliament understood the treaty transfer pricing rules provide separate assessment authority

Treaty rules were intended to be alternatives to Division 13

1.21 The design of income tax laws has long provided for the application of treaty transfer pricing rules as an alternative to the rules in Division 13. Explanatory material circulated by various Treasury Ministers strongly confirms this. A contrary argument relies on a general view that tax treaty rules cannot be used to extend taxing rights beyond the limits of domestic law. However this general argument does not address the specific context of the transfer pricing rules in Australia's income tax laws.

Legislative context

1.22 Since 1982, the income tax law has made specific provision for transfer pricing amendments based on treaty rules. The Parliament not only assumed that the treaty transfer pricing rules could be applied to increase a taxpayer's liability, but intended this outcome be both facilitated and clarified through further amendments to the income tax laws (notably through the enactment of section 170 and former section 226 of the ITAA 1936).

1.23 The plain words of subsections 170(9B), 170(9C) and 170(14) of the ITAA 1936, introduced in 1982 (with Division 13), assume the treaty transfer pricing rules provide a power to amend assessments. Likewise, associated amendments to the penalty provisions in 1984 to former subsections 226(2B) to (2F) of the ITAA 1936 assumed that the treaty transfer pricing rules and Division 13 each established a basis for liability.

1.24 This position is also supported by the Explanatory Memorandum to the 1982 changes, circulated by the authority of the then Treasurer. See for example pages 6, 63-64, 79, and 81-83 of the Explanatory Memorandum relating to Act No. 29 of 1982.

1.25 The following extract from that Explanatory Memorandum makes it clear that a treaty power to make a transfer pricing adjustment could apply if inconsistent with Division 13:

> In their practical effect, proposed sub-sections 170(9B) and (9C) will clarify the powers of the Commissioner to amend an assessment where a provision of a double taxation agreement that deals with profit shifting may be applicable. Subsection 4(2) of the *Income Tax (International Agreements) Act 1953* provides that the provisions of that Act are to have effect notwithstanding anything inconsistent with those provisions contained in the Principal Act. Technically, therefore, **the provisions of a double taxation agreement that deal with profit shifting**, either under a "business profits" article (e.g., Article 5 of the Australia/U.K. agreement), or an "associated enterprises" article (e.g., Article 7 of that agreement), **may have to be applied instead of Division 13**. Where the profit shifting provisions of a double taxation agreement are to apply in these circumstances, sub-sections 170(9B) and (9C) confer the same specific powers of amendment of an assessment as are to be provided in relation to revised Division 13.[1] (emphasis supplied)

1.26 Subsequent legislation and explanatory material further confirm that treaty rules have separate application to Division 13. This material reveals a remarkable consistency of approach by the Parliament over the decades. See for example:

1 Explanatory Memorandum — Act No. 29 of 1982, page 79.

- 1984 amendments to penalty rules in section 225 of the ITAA 1936 (see also Explanatory Memorandum Part A, Act 123 of 1984, page 12);

- 1995 explanation of franking credit changes (Explanatory Memorandum, Act No 172 of 1995, paragraph 4.2);

- 2000 consolidation of penalty rules in section 284-145 of the *Taxation Administration Act 1953* (TAA 1953) (see also Explanatory Memorandum, Act 91 of 2000 paragraphs 1.3, 1.90, 1.96 and 1.97);

- 2001 explanation of new thin capitalisation rules (Explanatory Memorandum, Act 162 of 2001, paragraph 1.79); and

- 2003 amendments to the definition of 'relevant provision' in section 170(14) of the ITAA 1936.

1.27 In light of this evidence of the Parliament's intention, if the law does not currently provide for treaty rules to have separate application to Division 13, this reflects inadequacy or errors in the drafting rather than the intention of the Parliament.

Sword and shield analogy

1.28 It has been alternatively argued that any such view of the law is misguided as the treaty transfer pricing rules cannot extend taxing rights. This alternative argument is based on the view that tax treaties can only be used to *relieve* non-residents from Australian tax. This limited role of tax treaties is explained by reference to a 'sword and shield' analogy: the idea that a tax treaty can only be used as a 'shield' to limit Australian taxation; as opposed to a 'sword' to extend taxation.

1.29 However, while the 'sword and shield' analogy may be useful as a shorthand description of the way many articles in tax treaties generally operate, in any broader sense it is a philosophical argument rather than a legal argument. There is no principle under international law that tax treaties are to be applied in an exclusively relieving manner. The issue is a matter for the constitutional arrangements of a given country.

1.30 Having regard to Australia's constitutional framework and municipal laws, a Commonwealth law may adopt its terms or text from another source. This source can be an international agreement. There is no legal basis to support the proposition that a power to make or amend an assessment based on the provisions of a tax treaty can only operate in an exclusively relieving manner.

1.31 During consultation on these amendments, some submissions argued that the purpose of a tax treaty 'is for the relief of double taxation' and that this purpose cannot be reconciled with an argument that tax treaties can operate in a way that is not exclusively relieving in nature. However, clearly all of Australia's tax treaties have a dual purpose; one, as noted above, is to relieve double taxation, the other being 'for the avoidance of fiscal evasion'. The Joint Standing Committee on Treaties has frequently referred to the articles that address profit shifting as relevant to the second limb of treaties' objectives.[2]

1.32 The special source articles Australia includes in its tax treaties are a clear example of how treaties can have the effect of increasing Australian source taxation.[3] Those rules explicitly define an Australian source for the purposes of Australian income tax law. Magney[4] explains that these rules, combined with Australia's arrangements for incorporating tax treaties into the municipal law, can have the effect of applying treaty source rules (as enacted) to income, notwithstanding inconsistency with rules in the ITAA 1936. Indeed Parliament introduced Section 3AA of the ITAA 1953 because source rules in tax treaties can change the source of income for Australian tax law purposes.[5]

1.33 Further, other jurisdictions do not always apply tax treaties in an exclusively relieving manner. The commentary to the OECD Model Tax Convention, on which Australia's tax treaties are based, acknowledges this. France appears similarly to extend its transfer pricing rules to the treaty limits. The Netherlands and Italy have applied their tax treaties in other areas with the effect of extending domestic taxation.

1.34 Even if it were relevant, there is another important principle underlying tax treaty practice which further weakens the 'sword and shield' analogy as it relates to transfer pricing in respect of *resident* enterprises and foreign associates. Subject of course to the arm's length

2 See, for example, the Joint Standing Committee's report on treaties, Report No. 48, page 16, paragraph 3.

3 See, for example, Article 21 of the Australia-United Kingdom tax convention.

4 Thomas Magney, *Australia's Double Tax Agreements — A Critical Appraisal of Key Issues* — pages 42 to 44.

5 When introducing the *New International Tax Arrangements (Managed Funds and Other Measures) Bill 2004*, the then Minister for Revenue and Assistant Treasurer noted the Bill amended the rules for determining the source of income derived by certain residents of treaty partner countries. In discussing an example of how certain conduit income was inappropriately taxed, the Minister observed 'the amendments ensure the domestic source rules rather than treaty source rules (**which have a wider potential reach**) apply in this case'. (emphasis supplied) Commonwealth, *Parliamentary Debates*, House of Representatives, 18 November 2004 (The Hon Mal Brough, Minister for Revenue and Assistant Treasurer).

test, tax treaties do not generally apply to restrict the right of states to tax their own residents. This principle underlies paragraph 6.1 of the OECD Model Commentary on Article 1 (added in 2000).

Current law

Judicial Comment

1.35 The application of treaty transfer pricing rules has not been specifically tested before the courts or the Administrative Appeals Tribunal,[6] although judges have made *obiter* comments in two cases. In neither case was the issue extensively argued before the court or tribunal. And in both cases it was accepted by the parties that the outcome of the case did not turn on this issue. In his *obiter* comments Justice Downes[7] noted there was a lot to be said for the proposition that treaties do not confer a power to assess; while Justice Middleton[8] saw some force in the argument that by the operation of subsections 170(9B) and 170(14) of the ITAA 1936 there is a clear legislative intention that the Commissioner may rely on either Division 13 or the relevant transfer pricing article.

Australian Taxation Office (ATO) position

1.36 Over a long period of time, the Commissioner has publicly maintained that Division 13 and/or Australia's tax treaty provisions could be used in making transfer pricing adjustments. The reasoning for this view was explained in Taxation Ruling TR 94/14 and reinforced in numerous rulings and public speeches. In 2009, the ATO published a supporting legal opinion from former Federal Court judge, Mr Ron Merkel QC.

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6 Submissions in consultation on this Bill cited other judgements commenting on the general role of allocation rules in tax treaties, which considered other treaty rules allocating taxing rights: Goldberg J in *Chong v Commissioner of Taxation* (2000) 101 FCR 134 at [27], [44]; Middleton J in *GE Capital Finance Pty Ltd v Federal Commissioner of Taxation* (2007) 159 FCR 473 at [27], [29], [36], [45] and [46]; and Lindgren J in *Undershaft (No 1) Ltd v FCT* (2009) 175 FCR 150 at [17] and [27]. But, importantly, these cases did not specifically test the question of whether transfer pricing articles had been incorporated into Australia's municipal law so as to give rise to a power to make or amend assessments.

7 Downes J in *Roche Products Pty Limited and Commissioner of Taxation* [2008] AATA 639 (22 July 2008) at [191]. His Honour noted the submissions by the parties on this point were 'limited' and both parties accepted that finding on the issue would not change the outcome of the case.

8 Middleton J in *SNF Australia Pty Ltd v Commissioner of Taxation* [2010] FCA 635 at [23-24]. In SNF, his Honour distinguished his earlier comments on the role of another treaty provision in *GE Capital Finance Pty Ltd*.

Permanent establishments

1.37 Much of the analysis above is relevant to tax treaty articles dealing with different legal enterprises within the same multinational group: for example those linked by parent-subsidiary relationships. The legal context surrounding transfer pricing between different parts of the *same* legal enterprise in respect of their cross-border dealings is somewhat different.

1.38 The business profits article (typically Article 7), relates to the attribution of profits within the same enterprise — for example between its head office overseas and its Australian 'permanent establishment' (branch). In this case, the second sentence of Article 7(1) would allocate a taxing right to Australia, Article 7(2) then provides a peremptory rule on how much income is to be attributed for the purposes of the second sentence of article 7(1). Finally, by virtue of the treaty source rule (discussed above) the income would be sourced in Australia. Effectively, such income would be taxed on the basis of treaty source rules rather than the source as determined under Division 13.

Implications for taxpayers

1.39 Consideration of whether a particular taxpayer is retrospectively disadvantaged as a result of the enactment of Subdivision 815-A depends firstly on a view that these amendments go beyond clarifying the law as it currently applies.

1.40 As mentioned above, the Commissioner has for some time publicly expressed the view that as a matter of law, a separate treaty power exists to make transfer pricing adjustments. Further, there are strong arguments that Parliament had intended there be a separate treaty power since at least 1982. Also as explained above, in the particular case of permanent establishments, these amendments confirm powers clearly available under treaty source rules.

1.41 In particular circumstances, there will be a threshold question as to whether an amendment made in accordance with the power conferred by Australia's tax treaties is less favourable to taxpayers than that available under Division 13. It is likely that Australia's tax treaties provide access to a greater range of transfer pricing methodologies and may permit the Commissioner to better question whether the arrangements made by multinational enterprises would have been made by independent parties.

1.42 To the extent that Subdivision 815-A provides for an alternative taxation power, that power is limited to the international consensus. Any increased Australian taxation will generally be capable of being offset to

some extent by compensating reductions in foreign taxation through mutual agreement procedures described below.

1.43 Taxpayers and their advisers should have been aware of the public statements made by successive Australian governments and the Commissioner in respect of this area of the law. This is particularly so for large multinational enterprises, generally representing a sophisticated segment of the tax paying community who seek specialist tax advice on transfer pricing issues.

Settled cases

1.44 Although these amendments apply to income years commencing from 1 July 2004, where a taxpayer has properly entered into a settlement with the Commissioner in relation to their non-arm's length international dealings, the Commissioner would generally be prevented by the terms of the settlement deed from applying Subdivision 815-A to impose a less favourable outcome on the taxpayer.

Penalties

1.45 Generally, additional penalties (such as administrative penalties) will be inappropriate in cases where amendments have application to prior years. In this case the application of that general principle is less clear as there is an argument that the law already applies in a way consistent with these amendments.

1.46 To the extent these amendments have retrospective application penalties will be calculated as though Subdivision 815-A had not applied. That is, penalties in relation to income years commencing prior to 1 July 2012 will be limited to amounts that can be substantiated under the provisions existing immediately prior to the enactment of Subdivision 815-A.

Mutual agreement procedures address any double taxation

1.47 The confirmation that Australia's laws can apply the internationally consistent arm's length principle will generally reduce the risk of double taxation. However, where taxing rights are determined with reference to cross-border arrangements, this risk will be inevitable.

1.48 Importantly, Subdivision 815-A only applies in treaty cases. All of Australia's tax treaties contain a mutual agreement procedure article (MAP). This is intended to ensure that double taxation does not occur.

1.49 The MAP article enables a taxpayer to initiate a procedure when they believe that the actions of one tax administration will result in taxation not in accordance with the treaty. The MAP article places an

obligation on the competent authority of each contracting state to endeavour to resolve double taxation that has occurred as a result of the actions of one or both of the contracting states.

1.50 To date, the ATO has been successful in reaching agreements with other jurisdictions through MAP and these amendments will not change the capacity of the competent authorities to reach a satisfactory solution should double taxation occur. Moreover, since the Commissioner currently has an unlimited period of time in which to make transfer pricing amendments, the application of Subdivision 815-A to income years commencing from 2004 will not alter a taxpayer's ability to access MAP.

Summary of new law

1.51 Subdivision 815-A operates on the basis of the Commissioner making a determination to negate a transfer pricing benefit that an entity receives.

1.52 Subdivision 815-A is designed to make certain two aspects of the operation of Australia’s transfer pricing rules:

- to ensure that the transfer pricing articles contained in Australia’s tax treaties are able to be applied independently of Division 13 through explicit incorporation into the ITAA 1997; and
- to require the arm’s length principle to be interpreted as consistently as possible with relevant OECD guidance.

1.53 Consistent with the policy underlying current transfer pricing arrangements, the operation of Subdivision 815-A does not require (or imply) a tax avoidance purpose with respect to ‘non-arm’s length dealings in order for a misallocation of profit to be adjusted.

1.54 Broadly, a ‘transfer pricing benefit’ is based on the difference between the profits that an entity would have made having regard to the arm’s length principle, and the amount it actually made. The Commissioner may make a determination under Subdivision 815-A to adjust the entity’s tax position in order to ‘negate’ this benefit.

1.55 Subdivision 815-A is designed to protect the integrity of the Australian tax system and as such its operation is limited to cases where its application will result in an entity having a greater amount of taxable

income, a decreased tax loss, or a decreased net capital loss, relative to what has been returned.

1.56 For an associated entity, a transfer pricing benefit will be determined by comparing the profits that have accrued to that entity with the profits that might have been expected to have accrued if the conditions operating between the associated entities in their commercial or financial relations had been those that might be expected to have operated between independent entities dealing wholly independently with each other. This calculation is made consistently with the OECD guidance having regard to the relevant circumstances of the entity and should produce an arm's length outcome.

1.57 For an Australian permanent establishment of a foreign entity, a transfer pricing benefit will be determined by comparing the profits attributed to the permanent establishment with the profits that it might have been expected to make if it were a distinct and separate enterprise. This calculation is made having regard to the relevant activities and circumstances of the permanent establishment and should produce an arm's length outcome having regard to the terms of the relevant tax treaty article.

1.58 The relevant circumstances will generally include a consideration of the activities performed by the associated entity or permanent establishment — its functions in relation to the relevant non-arm's length dealings or arrangements, taking into account the assets used and risks assumed.

Comparison of key features of new law and current law

New law	*Current law*
In addition to the current law, a transfer pricing adjustment may be made under Subdivision 815-A (which, for practical purposes will give the same result as the application of the transfer pricing provisions of a tax treaty). The new law addresses the debate under the current law around the application of the treaty transfer pricing articles — it ensures that the transfer pricing articles contained in Australia's tax treaties are able to be applied and operate to provide independent assessment authority through the rules contained in Subdivision 815-A.	A transfer pricing adjustment may be made under either Division 13 or the transfer pricing provisions of a tax treaty. However, there is debate as to whether the tax treaty transfer pricing articles have been effectively incorporated into municipal law despite Parliamentary materials showing this has been consistently assumed since 1982.
The determination of a transfer pricing benefit under Subdivision 815-A is based on the application of the internationally accepted arm's length principle which is to be determined consistently with the relevant OECD guidance (or other prescribed documents), which includes the OECD's Transfer Pricing Guidelines (OECD Guidelines).	The longstanding administrative practice has been to apply Australia's transfer pricing rules in accordance with relevant OECD guidance. Although the OECD guidance material has been widely used, a recent Full Federal Court decision cast doubt on the use of the OECD guidance material, finding that the Guidelines are not a legitimate aid to the construction of either Division 13 or the treaty transfer pricing articles (subject to being able to demonstrate that the state parties to a particular treaty have adopted the practice of applying the OECD Guidelines).
Where Division 820 (about thin capitalisation) applies to a taxpayer and the transfer pricing benefit relates to profits (or a shortfall of profits) that is referable to costs that are debt deductions, the calculation of the amount of the taxpayer's transfer pricing benefit is modified to ensure that Subdivision 815-A applies to establish an arm's length *rate* in relation to a debt interest before Division 820 applies.	No legislative provision specifically addresses the relationship between the transfer pricing and thin capitalisation rules. However, the administrative practice reflected in Taxation Ruling TR 2010/7 specifically addresses this issue and gives the same outcome as the new law will provide.

New law	***Current law***
Where the Commissioner makes a determination under Subdivision 815-A, a transitional rule applies to limit administrative penalties under Subdivision 284-C of Schedule 1 to the TAA 1953 to the penalty that would have applied had Subdivision 815-A not been enacted and the current law instead applied. This rule applies to an income year prior to the first income year starting on or after 1 July 2012.	Administrative penalties may apply where a transfer pricing adjustment has been made and the provisions of Subdivision 284-C of Schedule 1 to the TAA 1953 have been met.
Where the Commissioner makes a determination under Subdivision 815-A in respect of income years beginning on or after 1 July 2012, administrative penalties apply under Subdivision 284-C of Schedule 1 to the TAA 1953 to a 'scheme benefit' that would arise but for the application of Subdivision 815-A.	Administrative penalties may apply where a transfer pricing adjustment has been made and the provisions of Subdivision 284-C of Schedule 1 to the TAA 1953 have been met.

Detailed explanation of new law

What is the object of Subdivision 815-A?

1.59 The object of Subdivision 815-A is to ensure that Australia receives an appropriate share of tax from multinational firms. This taxation is to be based on an amount of profits which reflects the economic activity attributable to Australia, calculated in accordance with the internationally accepted arm's length principle. ***[Schedule 1, item 6, section 815-5]***

1.60 These rules require an allocation of profits consistent with the conditions that might be expected to have operated between independent parties in comparable circumstances dealing on a wholly independent basis.

1.61 Although the appropriate allocation of profits may be achieved by determining the arm's length price for particular transactions, the determination of an appropriate price for an individual transaction considered in isolation may not of itself produce an outcome consistent with the arm's length principle as articulated in Australia's international tax agreements.

1.62 The object of Subdivision 815-A is achieved by allowing the Commissioner to make a determination to negate a transfer pricing benefit an entity would otherwise get. ***[Schedule 1, item 6, subsection 815-10(1)]***

To whom can Subdivision 815-A apply?

1.63 Subdivision 815-A authorises the Commissioner to make a determination to negate a transfer pricing benefit that an entity receives. ***[Schedule 1, item 6, subsection 815-10(1)]***

1.64 In order for the Commissioner to make a determination under Subdivision 815-A, the following conditions must be satisfied:

- the entity gets a transfer pricing benefit,
- an international tax agreement applies to the entity; and
- the agreement contains an associated enterprises article or a business profits article.

[Schedule 1, item 6, subsection 815-10(2)]

1.65 In determining whether an entity receives a transfer pricing benefit, the text of the associated enterprises or business profits article contained in the international tax agreement will be relevant.

When does an international tax agreement apply?

1.66 An international tax agreement is an agreement which is given the force of law by the ITAA 1953. ***[Schedule 1, item 10, subsection 995-1(1)]***

1.67 The ITAA 1953 lists Australia's international tax agreements and these agreements set out the circumstances in which they will apply to an entity. Generally, such agreements apply to entities who are residents of one or both of the contracting states to the agreement.

What articles must be contained in the international tax agreement?

1.68 In order for Subdivision 815-A to apply to an entity for an income year, an agreement that applies to the entity must contain an associated enterprises article and/or a business profits article.

1.69 An associated enterprises article is defined as:

- Article 9 of the United Kingdom convention (within the meaning of the ITAA 1953); or

- a corresponding provision of another agreement (within the meaning of the ITAA 1953).

[Schedule 1, item 6, subsection 815-15(5) and item 8, subsection 995-1(1)]

1.70 A business profits article is defined as:

- Article 7 of the United Kingdom convention (within the meaning of the ITAA 1953); or
- a corresponding provision of another agreement (within the meaning of ITAA 1953).

[Schedule 1, item 6, subsection 815-15(6) and item 9, subsection 995-1(1)]

When does an entity get a transfer pricing benefit?

1.71 There are two situations in which an entity can potentially get a transfer pricing benefit:

- where the entity is an Australian resident that has related parties offshore; or
- where the entity is a foreign resident with an Australian permanent establishment.

1.72 The associated enterprises and business profits articles deal with each of these situations respectively, and as such different rules based upon the relevant article will apply to determine when an entity gets a transfer pricing benefit in each situation.

Associated enterprises

1.73 Where the entity is an Australian resident it will be treated as having received a transfer pricing benefit where:

- it meets the requirements of the associated enterprises article contained in an international tax agreement that applies to the entity;
- an amount of profits that might have been expected to accrue to the entity given the circumstances described in the relevant associated enterprises article has not so accrued (essentially due to non-arm’s length features of the conditions in the commercial or financial relations between the entity and its associates); and

- had those profits accrued to the entity, its taxable income would have been larger, or its tax loss or net capital loss would have been smaller than the actual amount.

[Schedule 1, item 6, subsection 815-15(1) and item 11, subsection 995-1(1)]

1.74 Each associated enterprises article provides preconditions on participation in the management, capital or control of the enterprise which must be satisfied before the article may apply. In effect, these preconditions require that the enterprises must be associated in order for later questions in relation to the amount of profits to be relevant.

1.75 The concept of the profits which might have been expected to accrue to the entity is a restatement of the arm's length principle and is determined on the basis of the conditions that might be expected to operate in the commercial or financial relations between independent entities dealing wholly independently with one another.

1.76 The terms and text of a particular article that applies to the Australian entity will be relevant in determining whether the entity receives a transfer pricing benefit under Subdivision 815-A. This Subdivision will only apply where profits have not accrued to an entity because of non-arm's length conditions and the entity's Australian tax position is negatively affected from the perspective of the revenue as a result.

1.77 For an amount to be a transfer pricing benefit of an associated entity, it is a requirement that the profit, had it accrued to the entity, would have resulted in the entity having a greater taxable income, a smaller tax loss, or a smaller net capital loss for the relevant income year. This means that where profits or component amounts of profits (that is, revenues and expenses) would not have affected an entity's Australian tax position, they will not be relevant for determining whether the entity received a transfer pricing benefit. For example, if an amount of profit that might have been expected to have accrued to an entity would have been non-assessable, non-exempt income of the entity, it would not constitute a transfer pricing benefit.

1.78 The amount of a transfer pricing benefit is the difference between the entity's actual taxable income, tax loss or net capital loss for an income year, and the corresponding amount that the entity would have had if the expected profits had accrued to the entity in that income year. ***[Schedule 1, item 6, subsection 815-15(1)]***

Australian permanent establishments of a foreign resident entity

1.79 Where the entity is a foreign resident with an Australian permanent establishment, the entity will be treated as having received a transfer pricing benefit where:

- the amount of profits attributed to a permanent establishment is less than the amount that the permanent establishment might have been expected to make in the circumstances described in the relevant business profits article; and
- had the permanent establishment been attributed the expected amount of the profits, the entity's taxable income would have been larger, or its tax loss or net capital loss would have been smaller than the actual amount.

[Schedule 1, item 6, subsection 815-15(2) and item 11, subsection 995-1(1)]

1.80 Each of Australia's international tax agreements defines what constitutes a permanent establishment for the purposes of the agreement. Because of the use by Subdivision 815-A of the terms and text of the business profits articles, the treaty definition will be relevant for determining when the entity has a permanent establishment under this Subdivision. ***[Schedule 1, item 6, paragraph 815-15(2)(a)]***

1.81 In general, the attribution of profits to a permanent establishment should be determined by applying by analogy the principles developed for the application of the arm's length principle between associated enterprises by reference to the functions performed, assets used and risk assumed by the enterprise through the permanent establishment relative to the rest of the enterprise.

1.82 In contrast to the associated enterprises articles which identify a shortfall between expected and actual profits, the business profits articles operate on the basis of an absolute amount of profits being attributed to the permanent establishment. Given this difference in construction, an entity will only be taken to have received a transfer pricing benefit under Subdivision 815-A where the amount of profits that has actually been attributed to the permanent establishment falls short of the amount of profits that would be expected to have been attributed to the permanent establishment, had it been a distinct and separate entity engaged and dealing in the manner set out in the relevant article.

1.83 In ascertaining whether the amount of profits actually attributed to the permanent establishment falls short of the expected amount of profits, an assessment of whether the attribution of the expected profits would have resulted in the entity having a greater taxable income, a

smaller tax loss, or a smaller net capital loss is again necessary. As is the case with associated enterprises, amounts of profits that would not have affected the entity's taxable income, tax loss, or net capital loss will not constitute a transfer pricing benefit.

1.84 The amount of a foreign resident entity's transfer pricing benefit is the difference between the entity's actual taxable income, tax loss or net capital loss for an income year, and the corresponding amount that the entity would have had, had the expected profits been attributed to the entity's Australian permanent establishment in that income year. ***[Schedule 1, item 6, subsection 815-15(2)]***

1.85 The expected attribution of profits to a permanent establishment under Subdivision 815-A is to be done in accordance with the terms of the business profits article of the relevant international tax agreement. For example, the 1988 Australia-China international tax agreement includes rules on the deductibility of certain expenses including payments for royalties, fees or other similar payments for the use of patents or other rights: payments for services, and management and interest payments. These rules will be relevant to the determination of the expected profits to be attributed to the Australian permanent establishments of Chinese entities. Where other international tax agreements include specific rules relating to the determination of the profits to be attributed to a permanent establishment, these will also be relevant to the determination of the expected profits of a permanent establishment under this Subdivision.

1.86 In determining the amount of the transfer pricing benefit, regard should also be had to any limitations under the general principles of the law in Australia as to how dealings between different parts of the same entity should be treated and any specific provisions of the Act that may be relevant (such as Part IIIB of the ITAA 1936 in relation to foreign bank branches).

Calculating a transfer pricing benefit when there is no taxable income, tax loss, or net capital loss

1.87 An assessment of whether an entity receives a transfer pricing benefit, as well as the amount of any such benefit, requires consideration of the difference between two amounts: the first being based on the entity's actual tax position but for the operation of this Subdivision, and the second being based on the entity's expected tax position ascertained in accordance with the arm's length principle.

1.88 To ensure that the necessary calculation can still be performed where an entity has no actual taxable income (because it has no assessable income or its deductions equal or exceed its assessable income), or where an entity would not be expected to have had a tax loss or net capital loss,

the entity will be deemed to have a taxable income, a tax loss, or a net capital loss of an amount of nil (as appropriate). This will allow the relevant amount to be compared with the nil amount. ***[Schedule 1, item 6, subsection 815-15(3)]***

Multiple transfer pricing benefits

1.89 Where an amount of profits that would be expected to accrue to an entity or a shortfall in an amount of profits expected to be attributed to a permanent establishment relates to more than one aspect of the entity's tax position, the entity may be taken to have received multiple transfer pricing benefits. ***[Schedule 1, item 6, subsection 815-15(4)]***

Example 1.1: An entity gets two transfer pricing benefits in relation to one amount of profit

Aus Co is an Australian resident with an associate in the United Kingdom, Sub Co. A transfer pricing analysis finds that, but for the conditions operating between Aus Co and Sub Co, Aus Co might have been expected to accrue additional profit of $200 in an income year, all of which would have been assessable income of Aus Co. However, Aus Co's deductions for the income year exceeded its assessable income, so it had no taxable income for the year and instead recorded a tax loss of $50. Aus Co gets two transfer pricing benefits in relation to the $200 profit:

- a transfer pricing benefit of $50, being an amount of profit that, had it accrued to Aus Co, would have resulted in Aus Co having no tax loss for the income year. For the calculation in subparagraph 815-15(1)(d)(ii), Aus Co is deemed by paragraph 815-15(3)(b) to have an expected tax loss of a nil amount, which is an amount less than its actual tax loss amount of $50; and

- a transfer pricing benefit of $150, being an amount of profit that, had they accrued to Aus Co, would have resulted in Aus Co having an amount of taxable income that was $150 greater than its actual taxable income amount of nil. (In this case paragraph 815-15(3)(a) deems Aus Co, which has no actual taxable income, to have a taxable income amount of nil in order to allow the required comparison with its expected taxable income.)

What guidance is relevant in determining when an entity gets a transfer pricing benefit and the amount of that benefit?

1.90 Establishing whether an entity gets a transfer pricing benefit, as well as the interpretation of a provision of an international tax agreement (for the purposes of this Subdivision), must be done consistently with the guidance material developed by the OECD. The use of OECD material in

relation to parts of Subdivision 815-A is potentially available under the ordinary rules of treaty interpretation. To provide a more direct legal pathway for accessing certain guidance material, two new rules will supplement the general rules of treaty interpretation: one rule applies to income years starting on or after 1 July 2012, and a transitional rule applies for prior income years from 1 July 2004.

1.91 Australia's international tax agreements are negotiated on the basis of the OECD Model and associated guidance material. The OECD is the primary international tax forum for Australia. The OECD material — the Model, its Commentaries and the Guidelines — are initially developed by working parties of the Committee on Fiscal Affairs, vetted by that Committee, and finally approved or adopted at OECD Council level. Australia is represented at each of these stages and the OECD consults extensively with the international business community as part of this process.

1.92 Most of Australia's trading and investment partners look to OECD material to ensure consistent application of transfer pricing rules. This consistency improves certainty of application of these rules for enterprises operating across borders. Further, if different standards were used, there would be a greater risk that jurisdictions might each tax the same amount under their transfer pricing rules (resulting in double taxation), or not tax an amount at all (leading to double *non*-taxation).

1.93 The OECD Guidelines, in particular, expand on the application of the 'arm's length principle' — the international consensus on transfer pricing. They contain authoritative international know-how on the application of transfer pricing rules and were described by the UK Special Commissioners as 'the best evidence of international thinking'[9] on transfer pricing'. While the OECD Council recommends tax administrations of member countries follow the OECD Guidelines in reviewing transfer prices, they are extensively used by non-member administrations, as well as international tax advisers.

1.94 For income years starting on or after 1 July 2012, establishing whether an entity gets a transfer pricing benefit, as well as the interpretation of a provision of an international tax agreement (for the purposes of this Subdivision), must be done consistently with the following material:

- the *Model Tax Convention on Income and on Capital* and its Commentaries as adopted by the OECD Council and last amended on 22 July 2010;

9 *DSG Retail Limited and Others v HMRC (2009)*

- the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* as approved by the OECD Council and last amended on 22 July 2010; and
- any other documents prescribed by the regulations for this purpose.

[Schedule 1, item 6, subsections 815-20(1) and (2)]

1.95 The phrase 'to the extent the documents are relevant' in subsection 815-20(1) sets out an important requirement for using the guidance material. These words provide sufficient flexibility to accommodate any differences between the specific text of a given transfer pricing article and the equivalent 'model' provision to which the relevant guidance material relates.

1.96 To the extent the text of a model article is the same as that of the transfer pricing article under consideration, the guidance material related to that text will be relevant under section 815-20.

1.97 Similarly, where the terms of the particular transfer pricing article deviate from the model provision in only minor respects, interpretive material relating to those aspects of the model provision will continue to remain relevant for the interpretation of the corresponding aspect of the transfer pricing article. In Australian international tax agreements, elements of the arm's length principle are frequently re-expressed, with little impact on the general character of that aspect of the article.

- In many instances changes were designed to provide a slightly more objective test than the OECD language, but the substance is very similar:
  - in Australian international tax agreements, conditions between associated enterprises are expressed to 'operate' — rather than being 'made or imposed' as under the OECD Model;
  - likewise, those conditions 'might have been expected to accrue — rather than 'have accrued'; and
  - those conditions relate to the commercial or financial relations which 'might be expected to operate' — rather than the 'would be made'.
- In comparing the conditions operating with those of independent enterprises, the range of enterprises for the

comparison is slightly qualified in Australian international tax agreements. Those enterprises must be 'dealing wholly independently with one another'. This is designed to reflect the significant body of law showing that independent parties can in fact deal with one another on other than arm's length terms. This additional treaty language is consistent with the Guidelines which already require comparisons to be with enterprises dealing independently with one another.

1.98 Where part of the text of a particular transfer pricing article deviates in substance from the corresponding part of the OECD Model, the guidance material in relation to that aspect of the OECD Model would not be relevant for interpreting that part of the transfer pricing article. Where the parties to an international tax agreement agree on a position that is different to one expressed in the model provision, the text of the agreement would be expected to explicitly reflect this difference.

- Australian international tax agreements contain a 'saving clause', dealing with insufficient information, and this is a substantive departure from the OECD Model text in Articles 7 and 9. However, there is a requirement that the clause is to be applied consistently with the principles of those Articles.

- Currently none of Australia's international tax agreements have included the 2010 OECD Model business profits article. As such, the commentary relating to that version of the article would not be relevant. However, the 2010 OECD Model, as published, includes an annex containing the previous version of the business profits article and commentary thereto. To the extent that a particular business profits article aligns with this prior version of the OECD Model, the commentary contained in the annex will be relevant.

Regulation making power in relation to documents

1.99 Regulation making powers are included to modify the list of documents set out under subsection 815-20(2). Under the *Legislative Instruments Act 2003*, regulations can only be made on a prospective basis. Requiring such modifications to be prescribed in this way by regulation strikes an appropriate balance between ensuring ongoing consistency with developing international arrangements while providing for Parliamentary scrutiny of future developments.

1.100 Regulation making powers are included so that additional documents or parts of a document may be prescribed for the purposes of section 815-20. These powers ensure sufficient flexibility to prescribe further guidance material that may be published by the OECD or by other organisations that may be relevant for interpretive purposes in the future. Such material might be supplementary in nature or address issues that are not considered by the current OECD material. ***[Schedule 1, item 6, paragraph 815-20(2)(c)]***

1.101 The OECD material referred to in paragraphs 815-20(2)(a) or (b) may also be disqualified by regulation. This allows material to be removed in the event that it is no longer relevant to determining whether an entity receives a transfer pricing benefit. This might occur if the document is subsequently revised, or if an alternate model or guidance material is adopted in the future. Similarly, in the event that Australia and another jurisdiction were to negotiate an international tax agreement on the basis of the OECD Model and adopted its words, but determined that the agreement or part of the agreement was not to be interpreted in accordance with the associated commentaries, this regulation making power provides a mechanism by which such material may be disqualified. The regulation making power may also disqualify a part of a document, which may, for example, be used where Australia reserves its position on that part of the document. ***[Schedule 1, item 6, subsection 815-20(3)]***

1.102 Regulations may also prescribe circumstances in which a document, or part of a document, is to be used or disqualified. An example of this may be where a document explains specific provisions contained in some transfer pricing articles but not in others. In such cases it may be appropriate to prescribe that document for the purposes of section 815-20. Alternatively, a regulation that disqualifies a document specified under subsection 815-20(2) may prescribe the circumstances in which those documents are to be disregarded. ***[Schedule 1, item 6, subsection 815-20(4)]***

Income years commencing before 1 July 2012

1.103 Special transitional rules apply to income years commencing before 1 July 2012. For these years, the OECD guidance materials prescribed under section 815-20 will be those adopted or approved by the OECD Council and last amended before the start of the relevant income year. ***[Schedule 1, item 12, section 815-5 of the Income Tax (Transitional Provisions) Act 1997 (IT(TP) Act 1997)]***

Example 1.2: Documents relevant to an income year

An entity to which the UK Convention applies has related party dealings in respect of an income year which commenced on 1 July 2007. When determining whether the entity gets a transfer pricing benefit and the amount of that benefit under subsection 815-15(1), Subdivision 815-A and the associated enterprises article for the purposes of Subdivision 815-A should be interpreted consistently with:

- the OECD Commentary on the associated enterprises article as the Commentary read after the adoption of the update by the OECD Council on 15 July 2005 (the last update adopted prior to 1 July 2007), insofar as Article 9 of the Australia-UK Convention accords with the associated enterprises article of the OECD Model; and

- the version of the OECD Guidelines incorporating all changes as approved by the OECD Council on 28 October 1999 (the last update prior to 1 July 2007).

Example 1.3: Documents relevant to an income year where an entity has a substituted accounting period

An entity to which the UK Convention applies has dealings with an associate in relation to an income year which commenced on 1 April 2011, being a substituted accounting period for its 2011-12 income year. When determining whether the entity gets a transfer pricing benefit under subsection 815-15(1), Subdivision 815-A and the associated enterprises article for the purposes of Subdivision 815-A should be interpreted consistently with:

- the OECD Commentary on the associated enterprises article as the Commentary read after the adoption of the update by the OECD Council on 22 July 2010 (the last update adopted prior to 1 April 2011) insofar as Article 9 of the Australia-UK Convention accords with the associated enterprises article of the OECD Model; and

- the version of the OECD Guidelines incorporating all changes as approved by the OECD Council on 22 July 2010 (the last update prior to 1 April 2011).

How is a transfer pricing benefit calculated when the thin capitalisation rules also apply to an entity for the relevant period?

1.104 Where Division 820 applies to an entity for an income year and the entity gets a transfer pricing benefit which relates to profits that are referable to its debt deductions, there is a special rule which limits the way in which Subdivision 815-A applies in working out the transfer pricing benefit. This limitation preserves the role of Division 820 as a comprehensive regime with regards to an entity's amount of debt. ***[Schedule 1, item 6, subsection 815-25(1) and item 7, note to section 820-30]***

1.105 The special rule aligns with the current administrative approach provided in Taxation Ruling TR 2010/7. Its inclusion was strongly advocated during consultation as necessary to clarify and provide certainty on the interaction between the thin capitalisation rules and this Subdivision, on the basis that depending on the priority given to each, the tax outcomes for an entity may vary substantially.

1.106 To the extent that an entity's debt deductions are worked out by applying a rate to a debt interest (such as by applying a rate of interest to a loan amount, or applying a rate to the amount of debt covered by a guarantee), the calculation of a transfer pricing benefit relating to those debt deductions is modified so that only the rate may be adjusted. That is, Subdivision 815-A would allow the Commissioner to adjust that rate to an arm's length rate, but the rate must be applied to the debt interest actually issued (and still on issue from time to time) in order to determine the amount of any transfer pricing benefit. This ensures that this Subdivision does not defeat the operation of Division 820. ***[Schedule 1, item 6, subsection 815-25(2)]***

1.107 Debt deductions calculated by reference to applying a rate to a debt interest could include any costs directly incurred in obtaining or maintaining a debt interest, for example interest or amounts in the nature of interest, guarantee fees, line fees and discounts on commercial paper.

1.108 The interaction of Subdivision 815-A with Division 820 operates as follows.

- Firstly, to the extent relevant, the arm's length rate applying to a debt interest is determined in accordance with the normal rules contained in section 815-15. In doing so, it will be necessary to consider (for an associated entity) the conditions operating between the entity and its associate(s) in their commercial and financial relations. The arm's length rate may need to be determined by having regard to the conditions which could be expected to operate between entities dealing wholly independently with each other. For example, in some exceptional cases (as provided by the relevant OECD guidance material), it may be appropriate to determine the arm's length rate having regard to the amount of debt the entity is likely to have had, had the conditions operating between it and its associate(s) been aligned to what they would have been if the entities had been independent of each other. Alternatively, it may be possible to determine an arm's length rate, directly or indirectly, by some other means without having to determine an arm's length amount of debt. Whether an entity's amount of debt meets the safe harbours

provided for the purposes of Division 820 is not relevant for this first step. ***[Schedule 1, item 6, paragraph 815-25(2)(a)]***

- Secondly, the arm's length rate is applied to the entity's actual amount of debt. The result of this second step would be used by the Commissioner in determining the amount of the transfer pricing benefit (if any) to be negated. The amount of debt deductions of the entity remaining after the transfer pricing benefit has been negated is the amount which would be otherwise allowable under this Subdivision, and which then becomes the amount of debt deductions to be considered for the purposes of Division 820. ***[Schedule 1, item 6, paragraph 815-25(2)(b)]***

- Finally, and after the consideration of any other part of the income tax law as may be necessary, Division 820 may reduce an entity's otherwise allowable debt deductions if in the case of a non-Authorised Deposit-taking Institution, the entity's adjusted average debt exceeds its maximum allowable debt.

1.109 The following examples illustrate the interaction of Subdivision 815-A and Division 820. They are intended purely to illustrate the respective fields of operation of Subdivision 815-A and the thin capitalisation rules and are not intended to suggest that a particular method for pricing debt must be applied to the circumstances of a particular case. Nor are the examples intended to preclude the use of other methods that produce an arm's length outcome.

Example 1.4: Thin capitalisation adjustment and transfer pricing adjustment

Aus Co is an Australian resident subsidiary company of For Co, a resident of the UK. Aus Co is an 'inward investment vehicle (general)' for the purposes of Subdivision 820-C.

For an income year, Aus Co has:

- a 'safe harbour debt amount', determined in accordance with section 820-195 of $375 million;

- 'adjusted average debt' determined in accordance with subsection 820-185(3) of $400 million, of which $200 million is borrowed from For Co at an interest rate of 15 per cent, and $200 million from an independent lender at an interest rate of 10 per cent; and

- equity of $100 million.

Aus Co's only debt deductions are for the interest incurred at a rate of 15 per cent on its $200 million related party debt, and 10 per cent on its $200 million debt from the independent lender, meaning that it has $50 million of debt deductions for the income year.

The Commissioner considers whether Aus Co has received a transfer pricing benefit under section 815-15. In doing so, the Commissioner has regard to the arm's length rate in relation to the debt interest (that is, the arm's length interest rate), applied to the actual amount of the related party debt.

Assume that the loan from the independent lender is sufficiently similar to the loan from For Co and the circumstances in which each amount of debt funding was provided do not present material differences that would affect the rate applicable to the debt interest or Aus Co's ability to obtain $400 million in debt funding (that is, the independent loan is directly comparable to the related party loan). As a result, the Commissioner determines that using a comparable uncontrolled price is the most appropriate method for determining the arm's length rate. In these circumstances it is commercially realistic for the Commissioner to determine that the arm's length interest rate is 10 per cent. In this case, Aus Co gets a transfer pricing benefit of $10 million (being the difference between an arm's length rate of 10 per cent applied to the debt interest arising from the loan from For Co ($200 million) and the actual interest rate of 15 per cent on the debt interest).

Further, to the extent that Aus Co has 'excess debt', Division 820 will apply to deny a corresponding proportion of Aus Co's debt deductions remaining after the $10 million reduction under Subdivision 815-A.

Example 1.5: Transfer pricing adjustment and no thin capitalisation adjustment

Assume the facts and circumstances are the same as in Example 1.4, except that Aus Co has $300 million of debt ($150 million from For Co and $150 million from an independent lender) and $100 million of equity, producing a safe harbour debt amount for Division 820 purposes of $300 million. The interest rate on Aus Co's debt to For Co is 15 per cent, so that, before applying Subdivision 815-A and Division 820, Aus Co has total debt deductions of $37.5 million.

As was the case in Example 1.4, the Commissioner determines that an arm's length interest rate of 10 per cent is to be applied to the debt interest from For Co. As such, Aus Co gets a transfer pricing benefit of $7.5 million (being the difference between the arm's length rate of 10 per cent applied to the debt interest from For Co ($150 million) and the actual interest rate of 15 per cent on the debt interest).

Example 1.6: Transfer pricing adjustment and no thin capitalisation adjustment

Assume the facts and circumstances are the same as in Example 1.5, except that the entire $300 million of debt is borrowed from For Co at an interest rate of 15 per cent. Aus Co's debt deductions for the interest incurred on its $300 million debt total $45 million for the income year.

Unlike the previous examples, there is no internal comparable uncontrolled price that provides an arm's length rate. As such, the Commissioner determines the arm's length rate of interest for the loan having regard to available data of market reference rates and the credit standing that the capital markets would be likely to give Aus Co. The market data shows that Aus Co's credit standing would allow it to borrow $250 million from independent lenders. Having regard to the information available, the Commissioner determines that the closest commercially realistic arm's length scenario at which a loan might reasonably be expected to exist between independent parties dealing wholly independently with one another is a loan of $250 million at 10 per cent.

In this case, the Commissioner is able to determine the amount of the transfer pricing benefit by reference to an amount less than the actual amount of the debt interest (being an arm's length amount). (The fact that Aus Co's debt amount is less than its safe harbour debt amount for Division 820 purposes is not relevant to determining the amount of the transfer pricing benefit.)

The Commissioner determines that Aus Co's transfer pricing benefit is $15 million (as required under subsection 815-25(2)). This is worked out by applying the 10 per cent arm's length interest rate to Aus Co's actual debt amount ($300 million), and comparing this to Aus Co's actual debt deductions of $45 million.

Determinations to negate transfer pricing benefits

1.110 Where an entity receives a transfer pricing benefit, the Commissioner may make a determination to negate that benefit. ***[Schedule 1, item 6, subsection 815-10(1)]***

1.111 Negating a transfer pricing benefit involves the Commissioner making the necessary adjustment to an entity's tax position in order for it to reflect that which would have existed had the entity not received the transfer pricing benefit. As such, to negate a transfer pricing benefit, the Commissioner is authorised to make a determination to increase an entity's taxable income, decrease its tax loss, or decrease its net capital loss. ***[Schedule 1, item 6, paragraphs 815-30(1)(a) to (c)]***

1.112 In contrast to a determination in relation to a net capital loss, a specific determination adjusting a net capital gain is not required as it will be covered by a determination in relation to an entity's taxable income.

1.113 Given that a transfer pricing benefit relates to the shortfall amount of an entity's taxable income, tax loss, or net capital loss, the Commissioner will only be required to make a single determination in relation to each transfer pricing benefit that an entity receives in an income year. As noted above, however, it is possible for an entity to receive multiple transfer pricing benefits in an income year, and in relation to a single amount of profit.

Determinations taken to be attributable to particular items

1.114 Where the Commissioner makes a determination to adjust an entity's taxable income, tax loss, or net capital loss under subsection 815-30(1), the Commissioner must specify the extent to which the determination is taken to be attributable to one or more of the following:

- an increase in assessable income for an income year under a particular provision of the Act;
- a decrease of a particular deduction for an income year;
- an increase of a particular capital gain for an income year; and
- a decrease of a particular capital loss for an income year.

[Schedule 1, item 6, paragraphs 815-30(2)(a) to (d)]

1.115 Where the Commissioner specifies that a determination is taken to be attributable to particular items, nothing done in relation to this determination will affect the validity of the related determination under subsection 815-30(1). ***[Schedule 1, item 6, subsection 815-30(4)]***

1.116 The Commissioner will only be relieved of the obligation to specify the extent to which a determination is taken to be attributable to one or more of the above where it is not possible or practicable to do so. ***[Schedule 1, item 6, subsection 815-30(3)]***

1.117 It would ordinarily be the case that in establishing that an entity received a transfer pricing benefit, the Commissioner will have had regard to the underlying components as they would have related to the entity's taxable income, tax loss, or net capital loss. In such circumstances, the Commissioner will be required to specify these component parts. For example, the calculation of a transfer pricing benefit may involve a

determination that the amount received from the disposal a capital asset should have been greater than that actually received, with the effect of changing the capital loss that the entity received in relation to that asset into a capital gain. If this were the case, it would be both possible and practicable for the Commissioner to further specify that the determination to negate the transfer pricing benefit under subsection 815-30(1) is taken to be attributable to both a decrease of a particular amount in a particular capital loss (to nil), and an increase of a particular amount of a capital gain.

1.118 Similarly, where the Commissioner makes a determination under subsection 815-30(1) in relation to a transfer pricing benefit that has been calculated by reference to the requirements under section 815-25, it will be both possible and practicable for the Commissioner to specify the extent to which the determination is attributable to a decrease in particular amounts of the entity's debt deductions.

1.119 Where it is only possible or practicable to make a further determination under subsection 815-30(2) in relation to some component part of a transfer pricing benefit but not the whole of the benefit, the Commissioner will be obliged to make the further determination only to that extent. That is, although the determination under subsection 815-30(2) may provide further detail in relation to the underlying components of part of the determination made under subsection 815-30(1), it may not be possible or practicable for further detail of this kind to be provided in relation to every component of the transfer pricing benefit. In some cases this may arise where information is not available to the Commissioner, or in unusual cases, a net profit approach, such as the OECD's 'profit split' method or some other method may have been used in circumstances which do not allow adjustments to assessable income or allowable deductions to be particularised.

1.120 The phrase 'taken to be attributable' denotes that the specific characterisation of the adjustment to an entity's taxable income, tax loss, or net capital loss as a change in a particular amount under subsection 815-30(2) will have effect for all purposes of the income tax law. This assists the correct application of other provisions which may be affected by the determination. For example, given that the thin capitalisation rules apply to the whole amount of the entity's otherwise allowable debt deductions, the additional information provided by way of a further determination under subsection 815-30(2) is necessary to correctly calculate the entity's debt deductions for the purpose of applying Division 820. If this did not occur, the Division 820 adjustment amount could be excessive if it does not take into account that the amount of debt deductions otherwise allowable to the entity had already been reduced by Subdivision 815-A. Similar interactions will exist with other areas of the income tax law.

Example 1.7: Making a further determination

The facts are the same as in Example 1.4 above. Aus Co gets a transfer pricing benefit of $10 million. Aus Co does not have a tax loss. The Commissioner makes a determination to negate the benefit by increasing the amount of Aus Co's taxable income. The Commissioner makes a further determination that the increase is wholly attributable to a reduction in the amount of debt deductions allowable to Aus Co.

Following these determinations, the amount of Aus Co's debt deductions that are otherwise allowable as a result of the application of Subdivision 815-A is $40 million. Section 820-220 then operates to deny $2.5 million of Aus Co's remaining $40 million of debt deductions because, by reference to the statutory safe harbour debt amount applied by Aus Co, it has excess debt of $25 million.

The total debt deductions disallowed to Aus Co are $12.5 million ($10 million under Subdivision 815-A and $2.5 million under Division 820).

Multiple determinations

1.121 Where an entity receives multiple transfer pricing benefits it will be necessary for the Commissioner to make multiple determinations — one to negate each transfer pricing benefit. For example, the Commissioner may make a determination reducing an entity's tax loss to nil, and a further determination increasing the entity's taxable income above a nil amount. In negating a series of transfer pricing benefits, both the nature and the amounts of those transfer pricing benefits will be relevant. ***[Schedule 1, item 6, subsection 815-10(1) and subsection 815-30(1)]***

1.122 Where an entity gets transfer pricing benefits in relation to more than one jurisdiction, any determinations made by the Commissioner to negate each transfer pricing benefit will need to be made separately in relation to each jurisdiction having regard to the specific terms and text of the transfer pricing articles contained in each international tax agreement. Because a separate determination must made in relation to each transfer pricing benefit, a taxpayer will be able to apply to the correct competent authorities for relief from any double taxation arising in relation to the relevant jurisdiction.

Actions by the Commissioner

1.123 Where the Commissioner makes a number of determinations that relate to various transfer pricing benefits, these determinations may be set out under a single document. ***[Schedule 1, item 6, subsection 815-30(8)]***

1.124 In giving effect to a determination under section 815-30, the Commissioner may take any action that is considered necessary. Such action would generally involve amending an assessment to ensure an entity's transfer pricing benefit is appropriately negated. ***[Schedule 1, item 6, subsection 815-30(5)]***

1.125 The Commissioner must provide a copy of any determination that is made under section 815-30 to the entity to which the determination relates. Although there is a statutory obligation upon the Commissioner in this regard, the failure to provide a copy of the determination is not of itself sufficient to invalidate the determination. ***[Schedule 1, item 6, subsection 815-30(6) and (7)]***

Example 1.8: Transfer pricing benefits in relation to more than one jurisdiction

Aus Co is an Australian resident and is a subsidiary company of For Co, a resident of the United Kingdom. Aus Co and For Co are considered to be associated enterprises for the purposes of Article 9 of the Australia-UK Convention.

Sub Co is, in turn, a subsidiary of Aus Co and is a resident of the United States, and thus Aus Co and Sub Co are considered to be associated enterprises for the purposes of Article 9 of the Australia-USA Convention.

A transfer pricing analysis determines that Aus Co received a transfer pricing benefit in relation to the conditions operating in its commercial and financial relations with For Co. The transfer pricing benefit amount was $100 million.

The transfer pricing analysis also determines that Aus Co received a transfer pricing benefit in relation to the conditions operating in its commercial and financial relations with Sub Co, being an amount of $50 million.

The Commissioner makes two determinations in order to negate Aus Co's transfer pricing benefits, one in relation to each transfer pricing benefit. The Commissioner includes the two determinations in a single document. Assuming Aus Co had a taxable income for the relevant income year, each of the transfer pricing benefits entailed an understatement of taxable income. The Commissioner adjusts Aus Co's taxable income and issues an amended assessment to give effect to the determinations.

For Co and Sub Co are able to apply to the competent authorities of the UK and the US for relief from double tax in relation to the adjustments made by the Commissioner, being in the amounts of $100 million and $50 million, respectively.

Consequential adjustments

When can the Commissioner make a consequential adjustment?

1.126 Where there is an adjustment to the Australian tax position of an entity as a result of a determination made under subsection 815-30(1), additional rules under Subdivision 815-A provide for consequential adjustments to ensure that taxpayers are subject to the appropriate amount of tax within Australia. The taxpayer can be either the entity subject to a section 815-30 determination or another entity.

1.127 The Commissioner may make a consequential adjustment in favour of a disadvantaged entity where:

- the Commissioner makes a determination under subsection 815-30(1) to negate the transfer pricing benefit that an entity gets;
- the disadvantaged entity might have been expected to have a smaller taxable income, a greater tax loss, a greater net capital loss, or a smaller amount of withholding tax payable in respect of interest or royalties, had there been no transfer pricing benefit; and
- the Commissioner is satisfied that it would be fair and reasonable in the circumstances to make the consequential adjustment.

[Schedule 1, item 6, subsections 815-35(1) and (2)]

1.128 In ascertaining whether a transfer pricing benefit has resulted in an entity being disadvantaged, a similar calculation will be required to that which is performed in determining whether an entity gets a transfer pricing benefit under section 815-15. In this instance the question will be whether an entity might have been expected to have had a smaller taxable income, a greater tax loss, a greater net capital loss, or a smaller amount of withholding tax and will again involve a comparison between the actual and expected amounts.

1.129 For similar technical reasons as under section 815-15 (see paragraph 1.88) a specific rule is included under this section to ensure that the necessary calculation can be performed where no actual or expected amount exists (for example, where the disadvantaged entity had taxable income but would have been expected not to have any taxable income). As such, where an entity has, or might have been expected to have had, no taxable income, tax loss or net capital loss, the entity will be deemed to have had a nil amount of taxable income, tax loss, or net capital loss.

A similar rule is not required in relation to an entity's withholding tax liability. ***[Schedule 1, item 6, subsection 815-35(3)]***

How will a consequential adjustment be made?

1.130 Where the Commissioner considers that it is fair and reasonable to adjust the disadvantaged entity's tax position, the Commissioner may make one or more determinations in order to:

- decrease the taxable income of an entity for an income year;
- increase the tax loss of an entity for an income year;
- increase the net capital loss of the entity for an income year; or
- decrease the withholding tax payable by the entity in respect of interest or royalties.

[Schedule 1, item 6, paragraphs 815-35(4)(a) to (d)]

1.131 The Commissioner may also take actions necessary to give effect to each determination made under this section. An example of such an action would be the remission of the relevant tax paid by an entity subject to a determination under this section, notwithstanding the absence of a specific provision in the law to that effect. ***[Schedule 1, item 6, subsection 815-35(5)]***

1.132 A copy of the determination must be provided to the disadvantaged entity. A failure by the Commissioner to provide a copy of the determination will not, however, affect the validity of the determination. Determinations relating to different income years may be included in the same document. ***[Schedule 1, item 6, subsections 815-35(6) to (8)]***

Example 1.9: Consequential adjustment to interest withholding tax paid

An Australian resident company has paid interest on a loan to a foreign resident associated entity. In accordance with the arm's length principle, the Commissioner determines that the interest is excessive and, in order to negate the resulting transfer pricing benefit, makes a determination under subsection 815-30(1) to increase the taxable income of the Australian entity. A further determination under subsection 815-30(2) is made which attributes the adjustment to a reduction in the Australian entity's allowable deductions.

The interest payment to the foreign resident associated entity was subject to interest withholding tax. The Commissioner determines that it is fair and reasonable to make a consequential adjustment in respect

of the interest paid to the foreign company in excess of the arm's length amount that was subject to interest withholding tax.

To give effect to the determination the Commissioner refunds the relevant amount of interest withholding tax to the foreign resident associated entity.

Can an entity request a determination be made to reflect a consequential adjustment?

1.133 A taxpayer may make a written request to the Commissioner to make a determination in relation to a consequential adjustment, and the Commissioner must decide whether or not to grant the request and give notice of the decision in this regard. ***[Schedule 1, item 6, subsection 815-35(9)]***

1.134 If an entity is dissatisfied with the Commissioner's decision, the entity may object against the decision in accordance with Part IVC of the TAA 1953. This rule is designed to extend the benefit of the ordinary objection and appeal provisions to a taxpayer dissatisfied with any decision of the Commissioner not to make a consequential adjustment in favour of the entity. ***[Schedule 1, item 6, subsection 815-35(10)]***

How does Subdivision 815-A ensure that a transfer pricing benefit is not subject to double tax?

1.135 To avoid double taxation, a transfer pricing benefit that is negated as the result of the application of Subdivision 815-A will not be taken into account again under any other provision of the income tax law to increase an entity's assessable income or reduce its deductions or net capital loss. ***[Schedule 1, item 6, subsection 815-40(1)]***

1.136 This rule over-rides section 136AB, which ordinarily provides that nothing in the income tax law would limit the operation of Division 13. ***[Schedule 1, item 6, subsection 815-40(2) and item 1, note to subsection 136AB(1) of ITAA 1936]***

1.137 To the extent an amount that would otherwise be a transfer pricing benefit has already been taken into account under a Division 13 determination, it would not constitute a transfer pricing benefit for the purpose of Subdivision 815-A. This is because in such cases the entity's actual tax position will already reflect its expected tax position under Subdivision 815-A.

1.138 In some cases both Division 13 and Subdivision 815-A may apply to an entity in an income year, but in doing so apply discretely to separate amounts. For example, Division 13 may be applied to address non-arm's length consideration for a supply or acquisition between an

Australian entity and another entity in a jurisdiction with which Australia has no double tax agreement, while Subdivision 815-A may be applied to address transfer pricing benefits which arise from conditions between the Australian entity and its associates in a treaty-partner jurisdiction. Where this is the case, subsection 815-40(1) does not prevent the application of Division 13 to amounts not negated under this Subdivision 815-A.

1.139 Nothing in Subdivision 815-A limits Division 820 in its application to further reduce the debt deductions of an entity ***[Schedule 1, item 6, subsection 815-40(3) and item 7, note to section 820-30].***

1.140 Section 815-40 does not preclude the Commissioner's ability to rely in appropriate cases on other provisions of the Act as alternative grounds to support an amended assessment.

What penalties apply to adjustments made under this Subdivision?

1.141 For income years commencing on or after 1 July 2012, the administrative penalty provisions provided in Subdivision 284-C in Schedule 1 to the TAA 1953 will apply to the scheme benefit that the entity would have received had Subdivision 815-A not negated a transfer pricing benefit of the entity. That is, the scheme benefit for the purposes of Subdivision 284-C will equal the transfer pricing benefit (or transfer pricing benefits) of the entity calculated under Subdivision 815-A for a particular income year. ***[Schedule 1, item 13, subsection 284-145(2A) in Schedule 1 to the TAA 1953]***

1.142 Given that these rules will have retrospective effect in relation to some income years commencing prior to 1 July 2012, transitional rules are included to ensure that an entity will only be liable to administrative penalties in relation to the scheme benefit which could have been denied by another provision of the tax law had Subdivision 815-A not been enacted. ***[Schedule 1, item 12, subsections 815-10(1) and (2) of the IT(TP) Act 1997]***

1.143 These transitional rules allow an alternate hypothesis based upon the law as it stood prior to the enactment of Subdivision 815-A to be applied for the purposes of calculating administrative penalties in the transitional period. Subsections 815-10(1) and (2) of the IT(TP) Act 1997 ensure that an entity cannot be liable to a greater amount of administrative penalties where the Commissioner makes a determination under Subdivision 815-A to negate a transfer pricing benefit than would have been the case had the amount of that transfer pricing benefit instead been dealt with under a provision of the tax law that could have applied had Subdivision 815-A not been enacted.

Application and transitional provisions

1.144 Subdivision 815-A apples to income years beginning on or after 1 July 2004. ***[Schedule 1, item 12, sections 815-1 of the IT(TP) Act 1997]***

1.145 The amendment made to the TAA 1953 in relation to administrative penalties, applies to income years beginning on or after 1 July 2012. ***[Schedule 1, item 14]***

1.146 This measure also inserts other provisions into the IT(TP) Act 1997. These provisions deal with the guidance material that will be relevant for the interpretation of Subdivision 815-A for income years that are covered by Subdivision 815-A that commence prior to 1 July 2012 (for an explanation, see paragraph 1.103).

1.147 Similarly, this measure also inserts provisions that cover administrative penalties in relation to a transfer pricing benefit that is negated during the same period (for an explanation see paragraphs 1.142 and 1.143).

Consequential amendments

1.148 Subsection 170(9B) of the ITAA 1936 provides that the Commissioner is able to amend assessments for the purposes of giving effect to either Division 13 or a relevant provision. Subsection 170(9C) limits the period for making a subsequent amended assessment under Division 13 in relation to the same supply or acquisition of property, or under a relevant provision in relation to the same subject matter. The changes to subsections 170(9B) and 170(9C) as a result of these amendments make certain that the same conditions apply to amended assessments made to give effect to determinations made under Subdivision 815-A. ***[Schedule 1, item 2, subsection 170(9B) of the ITAA 1936, item 3, note to subsection 170(9B) of the ITAA 1936, and item 4, paragraph 170(9C)(b) of the ITAA 1936]***

1.149 These amendments also update the checklist in section 10-5 to include a reference to 'cross-border transfer pricing'. ***[Schedule 1, item 5, item in the table headed 'profits' in section 10-5]***

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Treaty-equivalent cross-border transfer pricing rules

1.150 This Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

1.151 This Bill inserts Subdivision 815-A into the ITAA 1997 to confirm that the internationally consistent transfer pricing rules contained in Australia's tax treaties and incorporated into Australia's domestic law provide assessment authority to address treaty related transfer pricing.

1.152 This Bill also ensures that the tax treaty transfer pricing rules are applied in a manner consistent with the relevant OECD guidance material.

1.153 This Bill applies for income years commencing on or after 1 July 2004.

Human rights implications

1.154 This Bill does not engage any of the applicable rights or freedoms.

1.155 This Bill ensures Parliament's view as to the way in which the transfer pricing rules in Australia's tax treaties operate is effective even though there are strong arguments for concluding that under the current income tax law these rules apply alternatively to Division 13. If this is the case, these amendments constitute a mere rewrite of those rules. To the extent that some deficiency exists in the current law, these amendments ensure the law can operate as the Parliament intended.

1.156 Although the Parliament has indicated the law applies in this way since at least 1982, the application date for this Bill of income years commencing on or after 1 July 2004 follows the most recent Parliamentary statement to this effect.

1.157 For income years commencing prior to 1 July 2012, to the extent administrative penalties are applicable as a result of adjustments made

under Subdivision 815-A, the amount of the penalty under Subdivision 284-C of Schedule 1 to the TAA 1953 will be limited to amounts that would otherwise have applied had Subdivision 815-A not been enacted. This ensures for the retrospective years, commencing on or after 1 July 2004, that an entity will only be liable to administrative penalties in relation to the scheme benefit which could have been denied by another provision of the tax law had Subdivision 815-A not been enacted.

Conclusion

1.158 This Bill is compatible with human rights as it does not raise any human rights issues.

Assistant Treasurer, the Hon David Bradbury

Index

Treaty-equivalent cross-border transfer pricing rules

Bill reference	*Paragraph number*
Item 1, note to subsection 136AB(1) of ITAA 1936	1.136
Item 2, subsection 170(9B) of the ITAA 1936, item 3, note to subsection 170(9B) of the ITAA 1936, and item 4, paragraph 170(9C)(b) of the ITAA 1936	1.148
Item 5, item in the table headed ‘profits’ in section 10-5	1.149
Item 6, section 815-5	1.59
Item 6, subsection 815-10(1)	1.62, 1.63, 1.110
Item 6, subsection 815-10(1) and subsection 815-30(1)	1.121
Item 6, subsection 815-10(2)	1.64
Item 6, subsection 815-15(1)	1.78
Item 6, subsection 815-15(1) and item 11, subsection 995-1(1)	1.73
Item 6, subsection 815-15(2)	1.84
Item 6, subsection 815-15(2) and item 11, subsection 995-1(1)	1.79
Item 6, paragraph 815-15(2)(a)	1.80
Item 6, subsection 815-15(3)	1.88
Item 6, subsection 815-15(4)	1.89
Item 6, subsection 815-15(5) and item 8, subsection 995-1(1)	1.69
Item 6, subsection 815-15(6) and item 9, subsection 995-1(1)	1.70
Item 6, subsections 815-20(1) and (2)	1.94
Item 6, paragraph 815-20(2)(c)	1.100
Item 6, subsection 815-20(3)	1.101
Item 6, subsection 815-20(4)	1.102
Item 6, subsection 815-25(1) and item 7, note to section 820-30	1.104
Item 6, subsection 815-25(2)	1.106
Item 6, paragraph 815-25(2)(a)	1.108
Item 6, paragraph 815-25(2)(b)	1.108
Item 6, paragraphs 815-30(1)(a) to (c)	1.111
Item 6, paragraphs 815-30(2)(a) to (d)	1.114
Item 6, subsection 815-30(4)	1.115

Bill reference	Paragraph number
Item 6, subsection 815-30(3)	1.116
Item 6, subsection 815-30(5)	1.124
Item 6, subsection 815-30(6) and (7)	1.125
Item 6, subsection 815-30(8)	1.123
Item 6, subsections 815-35(1) and (2)	1.127
Item 6, subsection 815-35(3)	1.129
Item 6, paragraphs 815-35(4)(a) to (d)	1.130
Item 6, subsection 815-35(5)	1.131
Item 6, subsections 815-35(6) to (8)	1.132
Item 6, subsection 815-35(9)	1.133
Item 6, subsection 815-35(10)	1.134
Item 6, subsection 815-40(1)	1.135
Item 6, subsection 815-40(2)	1.136
Item 6, subsection 815-40(3)	1.139
Item 7, note to section 820-30	1.139
Item 10, subsection 995-1(1)	1.66
Item 12, sections 815-1 of the IT(TP) Act 1997	1.144
Item 12, section 815-5 of the IT(TP) Act 1997	1.103
Item 12, subsections 815-10(1) and (2) of the IT(TP Act 1997)	1.142
Item 13, subsection 284-145(2A) in Schedule 1 to the TAA 1953	1.141
Item 14	1.145