

AUSTRALIAN TRANSFER PRICING ALERT



ATO TO INCREASE COMPLIANCE ACTIVITY IN RELATION TO CROSS BORDER FUNDING ARRANGEMENTS

As widely reported in the Australian media, Chevron Australia Holdings Pty Ltd (Chevron Australia) has reached a settlement in its long running dispute with the Australian Taxation Office (ATO) on the pricing of cross border intragroup funding. This turn of events will be significant to any Australian multinational that has cross border funding arrangements, and this comes at the end of a long running legal dispute between the ATO and Chevron Australia. Media reports suggest the total settlement could be in excess of AUD 1 billion. No doubt the amount in dispute plus potential interest, penalties and legal costs were all significant factors in the company's decision to reach a negotiated settlement with the ATO.

WHAT DOES THIS MEAN FOR TAXPAYERS AND HOW SHOULD YOU RESPOND?

The ATO is expected to increase its compliance activity focused on cross border funding transactions which will be focused on the risk assessment framework and the traffic light system outlined in recently issued Practical Compliance Guidance PCG 2017/D4 (PCG). The draft was issued in May 2017 and while the ATO plans to modify the guidance, the key areas highlighted by the ATO are likely to remain materially the same.

As a result, we encourage all multinational groups with operations in Australia to revisit their cross border funding arrangements. Specifically, we recommend that taxpayers:

1. Assess their funding arrangements against the PCG and be aware in what zone the arrangement falls
2. If the arrangement falls outside of the 'Green Zone' (as explained in the PCG and below), consider their options by:
 - a) Reviewing the extent of analysis or documentation prepared and terms of any agreements in place, and
 - b) Developing a strategy for defending the arrangements, or
 - c) Considering restructuring the funding arrangements
3. Ensure that key considerations in the Chevron Australia case - commerciality of the transaction, including consideration of the parental affiliation and group treasury policies - are taken into account when pricing and documenting funding transactions
4. Report (where required) as to whether they have self-assessed their risk position against the PCG criteria in the Reportable Tax Position Schedule which is lodged with the ATO

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5. Continue to include details of financing arrangements in the International Dealings Schedule which enables the ATO to quickly identify those multinational groups with affected funding arrangements
6. Importantly, consider their arrangements from a global perspective and not just from Australia's position, to evaluate any differences in approach. Where differences arise, groups will need to consider the potential for double taxation.

WHAT TAXPAYERS NEED TO KNOW IN DETAIL?

In April 2017, the Full Federal Court ruled in favor of the ATO on appeal in relation to the transfer prices on intragroup funding between Chevron Australia as the recipient of funds and its overseas related party. Chevron Australia requested leave to appeal the decision to the High Court, however, as a result of the settlement of the dispute, has now discontinued its application.

Chevron Australia's decision not to proceed will further boost the ATO's confidence in challenging intragroup funding arrangements. The recently issued PCG sheds some light on how the ATO is planning to risk assess cross border funding arrangements. The PCG follows a traffic light risk rating approach allowing taxpayers to self-assess following the ATO's prescribed process, and derive a risk rating, ranging from 'Green Zone' (i.e. safe

from ATO review apart from exceptional circumstances) to 'Red Zone', (i.e. likely to be subject to immediate ATO review or audit).

The ATO has already made numerous public statements that it is currently investigating what they believe to be material high risk cross border funding arrangements, frequently with low or no tax jurisdictions. The next step expected from the ATO is to extend the reach of these reviews to thousands of multinationals operating in Australia with the assistance of the PCG. This will assist the ATO to quickly risk assess the broader tax base including thousands of small to medium enterprise taxpayers, some of whom will find themselves in the ATO sights for the first time.

The ATO believes that the focus for the majority of taxpayers should be on the transitional arrangements outlined in the PCG, which is the 18 month period from 1 July 2017 which allows (or encourages) taxpayers to restructure their arrangements to fall within the 'Green Zone' without risk of penalties. As such, BDO recommends that all taxpayers need to be aware of their risk rating within the PCG framework before they consider next steps.

Given that the PCG is an Australian specific measure, there is a risk that it would depart from the OECD guidance on financing, which is expected to be released later this year, and also from the transfer pricing practices followed by other countries, most notably the UK and USA.

The ATO is unapologetic about the possibility that a large number of taxpayers will potentially fall outside of the 'Green Zone', which seems to be by design and is based on the ATO's perception of taxpayers' risk. We understand the ATO anticipates that approximately two thirds of taxpayers are likely to fall outside of the 'Green Zone', requiring some action to rectify or reassess, and the ATO is prepared to undertake its own activity to address those cases.

It is important to remember that the PCG is a risk assessment tool used by the ATO and does not replace the legislation and therefore it is not binding either on taxpayers or the ATO. Australia's transfer pricing provisions still apply and may result in a very different outcome for taxpayers when compared to the PCG framework.

Furthermore, the Chevron decision in the Full Federal Court did not consider the current transfer pricing laws under Sub-division 815-B. So whilst the decision by Chevron Australia provides taxpayers with an insight as to how the courts may apply transfer pricing legislation in cross border related party funding cases, the current law has not yet been tested in courts and, as such, financing structures should be managed with caution.

If you would like to discuss your cross border funding arrangements in more detail, please contact a member of our transfer pricing team or your BDO tax adviser.

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