JANUARY 2019

AUSTRALIAN TRANSFER PRICING ALERT

Simplified Transfer Pricing Record Keeping

The ATO has released an updated version of Practical Compliance Guideline PCG 2017/2, its guidance on simplified transfer pricing record-keeping options, which significantly changes the eligibility criteria for access to the simplified transfer pricing record-keeping options.

BACKGROUND

The simplified transfer pricing record keeping regime was initially introduced in 2015 to help reduce the transfer pricing compliance burden for lower risk businesses and transactions from a transfer pricing perspective. The most comprehensive update of these rules took place in 2017, when the ATO issued Practical Compliance Guideline PCG 2017/2 (previous guidelines) which provided new concessions for small businesses, intra-group services and non-material transactions.

The ATO issued an updated version of PCG 2017/2 on 9 January 2019 (new guidelines) which they have stated is intended to further simplify the rules and ensure consistency between methodologies.

Following a detailed review of the new guidelines compared to the previous guidelines, BDO note there are a number of helpful concessions and simplifications that have been made by the ATO that will be welcomed by businesses. At the same time, the ATO has added additional criteria to different parts of the guidelines that could limit the ability of business to make use of the concessions. On 16 January 2019 the ATO also released an updated version of Practice Statement PS LA 2014/3 to reflect the changes made to the simplified transfer pricing record-keeping options in PCG 2017/2, in particular the removal of the management and administration services option.

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WHEN DO THE NEW RULES APPLY?

The new guidelines apply to accounting periods beginning on or after 1 July 2018. However, in the short term, these new guidelines will not have any impact on groups that currently are making use of the previous concessions due to the inclusion of a transition period that allows the application of the previous guidelines for another year. This provides taxpayers with the opportunity to re-evaluate existing dealings under the scope of the updated guidelines prior to its application.

WHAT ARE THE KEY CHANGES AND THEIR IMPLICATIONS?

Removal of the dealings with specified countries criterion

Removal of the specified country criterion from the new guidelines could be useful to businesses with low risk transactions with these countries. However, the way in which the new guidelines are drafted, higher risk transactions with specified countries are still unlikely to fall within the simplified rules e.g. royalty/leasing arrangements or the provision of high value services.

New combined $500,000 threshold criterion for royalties, licence fees or research and development arrangements

A new $500,000 combined limit for IP or R&D related party dealings is a welcome pragmatic concession from the ATO ensuring that SMEs with low value IP transactions may still be able to access the simplified rules under the new guidelines.

Changes to the turnover threshold for the small taxpayer's option

Under the new guidelines, the turnover threshold for small businesses has doubled to $50 million which is a generous concession opening the rules to larger SMEs. However, a further criterion requires that the small taxpayer does not have specified service related party dealings greater than 15% of their turnover.

This criterion has become more difficult to fulfil as the definition of specified services has been broadened to any service that is not a low value adding intra-group service. This will require a subjective analysis of the potential specified services to justify whether a specific intra-group service is a service constituting the core business of the multinational group or contributing to the creation, enhancement or maintenance of value in the group.

IF TAXPAYERS CHOOSE TO APPLY ONE OR MORE OF THE OPTIONS IN THE PCG, THE ATO WILL NOT ALLOCATE COMPLIANCE RESOURCES TO REVIEW ARRANGEMENTS, HOWEVER TAXPAYERS WILL NEED TO KEEP CONTEMPORANEOUS DOCUMENTATION PROVING ELIGIBILITY.

In practice, the changes in relation to transactions with specified countries and IP transactions could make the concession easier to meet for some SMEs. However, it is likely that a large number of SMEs will be caught by the tightened specified services exclusion making this concession less generous.

Addition of the turnover threshold for the materiality option

The materiality criteria under the previous guidelines was met where the total international related-party dealings comprised 2.5% or less of total turnover, and the taxpayer did not have related-party dealings with entities in the specified countries or related-party dealings involving royalties, licence fees, or research and development arrangements.

This concession maintains the 2.5% or less of total turnover test, however, may now be easier to apply with the removal of the specified countries exclusion and the $500,000 combined allowable limit for IP related transactions. On the other hand, there is now a total turnover limit of $100 million, so this exemption will no longer be available to larger groups that are mostly domestic focussed. It is also not available to groups that are sustained loss makers or who have recently undergone a restructure.

Removal of the management and administration services option - now consolidated into the new low value adding intra-group services option

The previous guidelines provided two options for low value services, the management and administrative services option and the low value intra-group services option. The management and administrative services option was particularly generous as it covered up to 50% of related party dealings provided the mark-up was 5% and you did not have any transactions with specified countries.

The new consolidation exemption is more complex to apply and less generous than in the previous guidelines. Materiality conditions can now be satisfied by either a de minimis $2 million threshold (which is higher than the $1 million threshold under the old guidelines), or for intragroup charges above $2 million, inbound and outbound services must not exceed 15% of related party dealings. Under both options, however, intragroup charges must not exceed 25% of pre intra group service charges profit.

This combined concession is still useful and is likely to be widely used, but arguably it will offer less utility than the two separate options that previously existed. The new profitability exemption will increase the complexity of the application of the rules and could limit the benefit of the concession which is likely to result in more businesses having to fully document their intra-group services.

Low-level inbound loans: same interest rate methodology as low-level outbound loans

The concession for inbound loans was quite generous under the previous guidelines, applying to loans of $50 million AUD or less with an interest rate linked to an RBA indicator for small businesses. This rate moves over time but the rate included in the example of the previous PCG was 7.1%. This interest rate may be considered generous for an ATO position regarding inbound intra-group loans following the Chevron Case and the ATO's new guidelines on funding.

It was also inconsistent with the much lower rate applied to outbound loan funding. The ATO has now harmonised both inbound and outbound rates to an interest rate of 3.76% which is significantly lower than the rate provided in the previous inbound loans option. This means that a number of inbound loan arrangements are not likely to meet this concession and will either need to be restructured to a lower rate or supported by more comprehensive transfer pricing documentation.

BDO COMMENT

Please contact your local BDO advisor for more information and to discuss how the ATO's changes to the simplified transfer pricing record keeping rules may impact you.