



## AUSTRALIAN TRANSFER PRICING ALERT

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### AUSTRALIA LEADS THE WAY IN ENSHRINING OECD TRANSPARENCY MEASURES INTO LOCAL LAW

In order to enable tax authorities to better identify and tackle transfer pricing risks, one of the main outcomes of the BEPS project (Action 13) has been the introduction of new standards for transfer pricing documentation and Country-by-Country (CbC) reporting. The Australian Treasury has released exposure draft legislation which will insert Subdivision 815-E into the Income Tax Assessment Act 1997 to implement these requirements into Australian law.

#### Which groups are impacted by the new draft legislation?

The new rules apply to Australian residents or foreign residents with an Australian Permanent Establishment with annual global revenues of A\$1 billion. Therefore these rules apply even if the local Australian subsidiaries are small.

#### My group falls below the A\$1 billion threshold. Can I ignore BEPS and does this make me a lower audit risk from an ATO perspective?

The A\$1 billion threshold for the additional documentation requirements has been set at a level that introduces an additional transfer pricing compliance burden for the larger global groups in order to not place an undue burden on small and medium sized groups.

However, the ATO is taking a BEPS-focused approach the audits of businesses of all sizes. Whereas previously transfer pricing audits may have been led by a specialist transfer pricing case leader, the strategy for transfer pricing audits in the ATO is now set by the International Structuring and Profit Shifting (ISAPS) team supported by a specialist team of economists. The focus is on 'whole of code' i.e. not limited to transfer pricing matters. The ATO has invested heavily in new external hires including senior transfer pricing professionals and economists from industry and practice providing them with additional experience to target and resource transfer pricing cases.

Whilst smaller and medium sized groups will not have a formal requirement to comply with the new BEPS documentation requirements, based on our experience, the ATO is likely to raise similar and detailed questions on substance relating to profit shifting in the event of a risk review or audit as they will for large groups. So, ignoring the impact of BEPS on your transfer pricing structure (particularly on substance issues) could mean that small and medium businesses may face a higher risk of an audit adjustment than larger businesses that will be forced to formally confront BEPS early.

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### What do businesses exceeding the A\$1 billion threshold need to do now?

The new regulations apply for accounting periods commencing after 1 January 2016. This means that Australian headed groups with a June year end will only need to apply the rules for the year ending 30 June 2017, whilst December balancers (typically inbound investors) will have an earlier start date of the year ending 31 December 2016, i.e. this coming financial year. Under the new draft legislation, a statement by the taxpayer is required to be lodged with the ATO covering **one or more** of a:

- CbC report
- Master file
- Local file

The three reports together will provide an overview of global and local financial and operational activities of a global group, as well as the local activities, that is, full transparency for the ATO to assess transfer pricing risks. This statement will be due within one year of the year end. Therefore, the statement can be prepared at a later date than the Australian documentation which is due at the time of lodging the income tax return - usually 6 months and 15 days after year end.

**The CbC report** requires reporting of high-level information relating to the global allocation of a multinational group's income and taxes paid, as well as information about the location and main business of each constituent entity within the group.

**The master file** provides an overview of the multinational group's business operations that will enable tax authorities to place the group's transfer pricing practices in their global economic, financial, legal and tax contexts. It requires, the group's organisational structure, its intangibles and intercompany financial activities, financial and tax positions and a description of the group's businesses.

**The local file** focuses on specific transactions between the reporting entity and their associated enterprises in other countries. It requires identification of relevant related party transactions, the value of those transactions, and the entity's analysis of the transfer pricing outcomes and positions.

The ATO has the power to specify which of the above three documents it requires. To the extent that the Commissioner can obtain the CbC report through the (automatic) exchange of information with other Tax Authorities, it may only be necessary to supply a local file to the ATO.

### My overseas parent is preparing the master file. Do I have to do any further work over and above complying with the existing Australian transfer pricing provisions to have an acceptable local file?

With respect to the local file, it is envisaged that much of the content can be drawn from documentation that meets the requirements in Subdivision 284-E. For example, when a current entity has conducted and documented a comparability analysis for a transfer pricing treatment in accordance with Subdivision

284-E, that analysis may be used to meet the relevant local file content requirements without modification, effectively requiring large groups to lodge transfer pricing documentation in Australia. However, the content required for the local file **can go beyond** the requirements in Subdivision 284-E in several respects. For example, the local file will require the amount of intra-group payments and receipts for each category of controlled transactions involving the reporting entity— such as payments and receipts for products, services, royalties and interest — broken down by tax jurisdiction of the foreign payer or recipient. This information will be required in the local file in addition to the documentation prepared in accordance with Subdivision 284-E.

Importantly, the ATO can require different entities to provide various 'forms of information' depending on their individual circumstances.

### What are the penalties for large groups for non compliance with the new regulations?

Failure to provide a statement on time or in the approved form will not deny a company penalty protection under the existing reasonably arguable position (RAP) requirements provided they meet the existing Australian documentation requirements. However, the maximum penalty for tax avoidance and profit shifting arrangements will be doubled up to a maximum of 120% of the tax avoided for groups with a A\$1 billion global turnover. This is perhaps the most severe penalty regime in the OECD and seems to be arbitrarily linked with a MNC's global size.

### What impact will this have on my group if it falls within the new regime?

Groups have never had to file transfer pricing documentation upfront with the ATO. On a self-assessment basis, the ATO has had to rely on the income tax return including International Dealings Schedule (IDS) and accounts to assess transfer pricing risks. The ATO will now be able to more easily identify mismatches between profits arising in a low tax jurisdiction with people functions and assets/risks in the CbC reporting. When a perceived risk is identified, the ATO can investigate further into the wider group and Australian transfer pricing documentation to analyse the support for the current allocation of profits and, if appropriate, pursue a risk review and/or audit.

Given the experience that the ATO is gathering through ISAPS/ BEPS audits, there is a much higher risk of the ATO identifying exposures and commencing an audit than ever before.

### **What preparations can I make to get my business 'BEPS ready' and how can BDO help?**

Most businesses now have between 16 and 22 months before the end of the first accounting period under the revised BEPS regime. Many groups will have already made an investment in the group's business model and transfer pricing planning which, at a more basic level, could be a limited risk distribution structure and at a more sophisticated level, a complex value chain planning structure.

BDO's transfer pricing team can help a business carry out an independent risk assessment of the existing transfer pricing structure highlighting key transfer pricing risks and substance considerations allowing proactive management and Board consideration in relation to actions which may be required to minimise tax and reputational risk.

There are various Risk Mitigation Strategies available to Australian taxpayers, including achieving tax certainty through an Advanced Pricing Arrangement (APA) with the ATO. An APA will minimise the potential costs of an audit, as well as, adjustments/higher penalties. Our transfer pricing group has significant experience in successfully negotiating APAs to help strategically manage a group's transfer pricing risk.

#### **MORE INFORMATION**

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