THE NEW AUSTRALIAN TRANSFER PRICING RULES:
ISSUES AND CONCERNS

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ABSTRACT

In an economy where approximately 50% of the cross-border transactions revenue derives from related party operations, transfer pricing rules are of unequivocal importance. This has been recognised at a global level by the OECD and also at the Australian level by the ATO.

The rules concerning transfer pricing in Australia are contained both in its tax treaties and in the ITAA36, and more recently in the ITAA97, after the introduction of the Tax Laws Amendment (Cross Border Transfer Pricing) Bill No. 1/2012.

The amendment to the domestic legislation is aimed at aligning the country’s transfer pricing policy with the OECD Transfer Pricing Guidelines and current international practices. In this respect, the paper will examine how and to what extent the new legislation actually interfaces with the OECD Guidelines and Australian tax treaties.

This paper will also study the relationship between the domestic legislation concerning transfer pricing and the corresponding provisions in Australian tax treaties.

Finally, the paper will analyse the impact of the retrospective nature of the new legislation on taxpayers’ compliance and how the retrospection of these new rules raises serious issues concerning the protection of taxpayers’ rights.

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2 Special thanks to Les Nethercott for his comments and review.
1. Introduction

“Transfer prices” are defined as the prices at which an enterprise transfers goods and intangibles or provides services to associated enterprises, i.e., companies which participate directly or indirectly in the management, control or capital of each other, or which are managed or controlled by same persons or group of persons.\(^3\)

Frequently, associated enterprises (also called related companies) are located in different countries, and the transactions they do with each other (also referred to as controlled transactions) usually happen under special conditions and not subject to the open market parameters and limitations that would normally be observed were the parties independent and unrelated (as in a comparable uncontrolled transaction]).\(^4\)

Controlled transactions are not restricted to artificially favourable prices, although they can be the most common distinguishing feature. They can also comprise peculiar structuring that wouldn’t normally be considered by independent parties. In this sense, Andreas Bullen explains:

“Associated enterprises sometimes make or impose special conditions in their commercial or financial relations (“controlled transactions”) which differ from those comparably placed unrelated enterprises would have made. When this is the case, the arm’s length principle may authorize a domestic tax administration to include in the profits of an enterprise, and tax accordingly, any profits which would have accrued to this enterprise in the absence of such special conditions. These special conditions will not necessarily only be the price conditions, but may also extend to any other conditions (establishing the contract structure). Hence, associated enterprises may not only value or price their transactions differently from independent enterprises, but


\(^4\) According to the OECD Transfer Pricing Guidelines, Comparable uncontrolled transactions are defined as: “a transaction between two independent parties that is comparable to the controlled transaction under examination. It can be either a comparable transaction between one party to the controlled transaction and an independent party (“internal comparable”) or between two independent parties, neither of which is a party to the controlled transaction (“external comparable’’). OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators 2010 OECD, 22 July 2010, Glossary, page 24.
may also structure them differently, and even enter into transactions which independent enterprises would not contemplate undertaking at all.”

In view of these issues, in 1979 the OECD issued the first set of rules that formed the international transfer pricing regime – the “OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators” (OECD TP Guidelines) – in order to address the practical difficulties related to tax compliance and double taxation involving multinational enterprises intra-group transactions as well as with their permanent establishments, especially concerning the determination of income and expenses of each branch/permanent establishment. These problems arise because in general, OECD countries tend to follow the approach of taxing the individual group entities of multinational enterprises separately, as if each member were an independent entity itself.

The whole transfer pricing regime finds its main fundament in the Arm’s Length Principle, which consists of:

“a range of figures that are acceptable for establishing whether the conditions of a controlled transaction are arm’s length and that are derived either from applying the same transfer pricing method to multiple comparable data or from applying different transfer pricing methods”.

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6 Permanent establishments are defined in the OECD Model Tax Convention (2005 version) article 5(1): “1. For the purposes of this Convention, the term ‘permanent establishment’ means a fixed place of business through which the business of an enterprise is wholly or partly carried on.”, and according to article 5(2), “2. The term ‘permanent establishment’ includes especially: a. a place of management; b. a branch; c. an office; d. a factory; e. a workshop, and f. a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.”. OECD Model Tax Convention. OECD, 2005.


8 Barry Larking (ed.). IBFD International Tax Glossary. 5th ed revised. 2005. IBFD Publications. Page 23. A more detailed definition of the Arm’s Length Principle can be found in the Glossary of the OECD Transfer Pricing Guidelines/2010: “The international Standard that OECD member countries have agreed should be used for determining transfer prices for tax purposes. It is set forth in Article 9 of the OECD Model Tax Convention as follows: where ‘conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly”. OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators 2010 OECD, 22 July 2010, Glossary, page 23.
Thus, the Arm’s Length Principle allows the identification of what needs to be adjusted in terms of material differences in controlled transactions so they can be comparable to any independent transaction in comparable circumstances.

Apart from the rules and mechanisms concerning international transfer pricing set forth in the OECD TP Guidelines, countries usually have their own set of specific transfer pricing provisions, generally comprising (i) the transfer pricing rules established in their Double Taxation Agreements (in the articles which deal with business profits and associated enterprises) as well as (ii) those set forth in their domestic tax legislation.

Following this outline of the general aspects of cross-border transactions, the second part of this paper will analyse the changes in the transfer pricing legislation in Australia. The issues and concerns related to the new Australian Transfer Pricing Bill will be discussed in the third part, and finally, a critical perspective of those matters will be presented at the end.

2. Australian transfer pricing rules: how they were, what has changed

Australian transfer pricing rules originally included (i) the provisions set forth in the business profits and associated enterprises articles found in Australian Double Taxation Conventions and (ii) Division 13 of the Income Tax Assessment Act 1936 (ITAA36), introduced in 1982, comprising sections 136AA to 136AF(6). Both Division 13 and the international provisions of the Double Taxation Conventions relied (and still do) on the Arm’s Length Principle, and it has been generally accepted by the Australian Taxation Office (ATO) and by the Australian Parliament that the transfer pricing rules of the tax treaties provided an alternate basis to Division 13.

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9 Australian double tax treaties normally follow the OECD Model Tax Convention and are directly incorporated into domestic legislation as schedules of the Agreements Act. That has two important reflections: firstly, taxpayers may rely directly on the treaty provisions before domestic Courts, and the interpretation rules that are valid for domestic tax legislation also apply to tax agreements, together with those set forth in the Vienna Convention. See Taxation Administration Act 1953, Taxation Ruling 2001/13 and Taxation Ruling 2011/11.

10 “1.11. 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.” “1.16. 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
As Double Taxation Conventions are directly incorporated into domestic tax legislation by force of the International Agreements Act 1953, the international provisions contained therein have the force of law\(^\text{11}\). Additionally, the Parliament has indicated that the treaty provisions are applicable in order to determine the tax liability arising in a transfer pricing case even when the treaty provisions were inconsistent with Division 13\(^\text{12}\), under the argument that countries have the power to decide the scope of the rules in a tax treaty, and there was no international tax principle that prevented them from attributing taxation powers to a tax treaty\(^\text{13}\).

Pursuant to that understanding, now applicable to the new Subdivision 815-A, if the parties of a treaty wished and decided so, the treaty could perfectly have tax imposing rules in addition to the tax competency attribution rules. In this sense, the Explanatory Memorandum (EM)\(^\text{14}\) to the Cross-Border Transfer Pricing Bill (the Bill) explains:


\(^{12}\)Regarding the interface between treaty and domestic rules, Minister David Bradbury recently stated that: “The treaty transfer pricing rules and the division 13 rules were intended to operate as alternatives in the event that one more effectively dealt with profit shifting than the other.” David Bradbury MP, Second Reading Speech. House of Representatives. 24 May 2012. Available at: http://parlinfo.aph.gov.au/parlInfo/genpdf/chamber/hansardr/7b0b2bac-de69-42c1-8a98-2d16329f051f/0048/hansard_frag.pdf;fileType=application%2Fpdf.

\(^{13}\)See Explanatory Memorandum to the Cross-Border Transfer Pricing Bill (no. 1) 2012. Paragraphs 1.22 to 1.30. Pages 9-10.

\(^{14}\)The ATO’s opinion in terms of interpretation and application of tax law is expressed through supportive documents, such as Explanatory Memorandums, Taxation Rulings, Taxation Determinations and Taxation Interpretative Decisions. In terms of transfer pricing, some examples of these documents are:

- Taxation Ruling 2000/16 and 2000/16-A: regulates transfer pricing and profit reallocation adjustments, and also deals with relief from double taxation and mutual agreement procedure.
- Taxation Ruling 2001/11: explains the operation of Australia’s permanent establishment attribution rules.
“1.29. (...) 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”.

Therefore, the Australian Parliament understands that although tax treaties usually act as a shield, in the sense they provide relief from double taxation by attributing the power to tax to one or other country, technically they could also act as a “sword”, as they could create and impose legitimate tax liabilities, provided there has been an agreement between the parties in that sense.

The provisions contained in Division 13, introduced in 1982, always operated as to increase the taxpayer’s liability, at the Commissioner’s discretion. The rules of Division 13, especially sections 136AD(1) to 136AD(4), can be considered quite generalist insofar as they grant the Tax Commissioner power to determine what should be the arm’s length consideration (price of goods or services) in transactions involving related parties when, also according to the Commissioner’s judgment, the consideration has been different (for more or less) than the consideration at arm’s length, or even when no consideration has been determined at all.

Although the domestic tax legislation has been under a comprehensive review that culminated with the publication of the Income Tax Assessment Act 1997 and its subsequent updates and amendments, not much has changed in terms of transfer pricing rules in the

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16 “Division 13 does not prescribe any particular methodology for the purpose of ascertaining an arm’s length consideration. This is a matter for the Court to determine. Any particular methodology chosen is not to be applied rigidly. The process to be undertaken in considering arm’s length consideration is one involving evaluation and judgement, and cannot be based upon any strict and inflexible rules. It may well be that in any given case, a number of different methodologies could be employed to arrive at a determination, even if only as a check and balance to ensure the correctness of the analysis initially undertaken.” Middleton J., Reasons for Judgement, paragraph 55, SNF (Australia) Pty Ltd v Commissioner of Taxation [2010] FCA 635. See also: PricewaterhouseCoopers Report. Australia. http://www.pwc.com/gx/en/international-transfer-pricing/assets/australia.pdf.

17 “Term used under the contract law of certain countries to refer to anything of value given in exchange for a promise or performance. In many countries consideration must be given for the contract to be binding. Typically consideration is the price paid for the supply of goods or services.” Barry Larking (ed.). IBFD International Tax Glossary. 5th ed revised. 2005. IBFD Publications. Page 86.
domestic legislation until very recently. On the other hand, the OECD TP Guidelines have been constantly discussed, reviewed and updated in order to match the evolution of international tax law practices.

Case law, although not extensive, also contributed for the enactment of the new transfer pricing rules. The recent decisions issued in the Roche and SNF’s cases, which were decided in favour of the taxpayer, brought attention to the fact that Division 13 did not indicate whether it was possible to resort to indirect or profit based methods, evidencing that the old legislation was deficient and outdated.

In November 2011 the Hon. Bill Shorten issued a Media Release no. 145, which announced the introduction of a new domestic set of transfer pricing rules specifically

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18 Roche Products Pty Ltd v Commissioner of Taxation [2008] AATA 639. This was the first Australian judgment involving substantive transfer pricing issues. It involved the transfer price of goods acquired by Roche Products (an Australian resident company) from its parent company located in Switzerland. The ATO found that Roche did not observe the arm’s length principle in the transaction, having purchased the goods for a price that exceeded the supposed arm’s length consideration, on the basis of Division 13 of the ITAA97. Source: PricewaterhouseCoopers Report. Australia. http://www.pwc.com/gx/en/international-transfer-pricing/assets/australia.pdf. See also: Neil Wickenden. The Practical Operation of Australia’s Transfer Pricing Provisions: Lessons to be Learned. Available at: http://www.hlbi.com/index.php?option=com_content&view=article&id=287:the-practical-operation-of-australias-transfer-pricing-provisions-lessons-to-be-learned.

19 SNF (Australia) Pty Ltd V Commissioner of Taxation [2010] FCA 635. “The proceedings concerned an Australian distributor (SNF Australia) purchasing from offshore related parties. For 13 years SNF Australia had no income tax liability and made trading losses in all years bar two. The Commissioner argued that an arm’s length purchaser would never agree to the prices paid, given the sustained period of losses. In a significant win for the taxpayer, the Federal Court and the Full Federal Court both held that SNF Australia had successfully discharged its burden to satisfy the court that the price paid to offshore related parties did not exceed the arm’s-length price. SNF Australia did this through the application of a comparable uncontrolled price (CUP) method.” PricewaterhouseCoopers Report. Australia. http://www.pwc.com/gx/en/international-transfer-pricing/assets/australia.pdf. The case was also mentioned in the Explanatory Memorandum to the TP Bill: “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.” Explanatory Memorandum to the Cross-Border Transfer Pricing Bill (no. 1) 2012. Paragraph 1.12, pages 6-7.

20 Transfer pricing case law is not extensive in Australia. The two cases mentioned above (Roche and SNF) became notorious because they were the first ones to involve substantial application of Australian transfer pricing rules. Other transfer pricing cases judged in Australia: San Remo Macaroni Company Pty Ltd v Commissioner of Taxation (1999); Daihatsu Australia Pty Ltd v Commissioner of Taxation (2001); Syngenta Crop Protection Pty Ltd v Commissioner of Taxation (2005); WR Carpenter Holdings Pty Ltd v Commissioner of Taxation (2008). For more references, see: http://www.transferpricing.com/worldtransferpricing_files/world_files/australia/australia.htm.

21 Minister for Financial Services and Superannuation and Minister for Employment and Workplace Relations.
designed to deal with international related-party transactions. The new provisions were enacted as a new Division 815 to the ITAA97, as to:

“(…) reform the transfer pricing rules in the income tax law and Australia’s future tax treaties to bring them into line with the international best practice, improving integrity and efficiency into the tax system.”

The new rules, according to Minister Shorten, came with the specific purpose of ending the uncertainty concerning the power that Tax Treaties had to make transfer pricing adjustments independently of the transfer pricing rules of the ITAA36, as well as to explain that the transfer pricing rules found in Australian tax treaties operate as an alternative to the domestic law on the matter. Moreover, the Media Release no. 145 also stated that the new rules would apply to income years commencing on or after 1 July 2004, thus having a retrospective effect.

In July 2012 the new Division 815 (with operative clauses included as Subdivision 815-A) was added to the ITAA97, introducing cross-border transfer pricing rules that are conceived to be hierarchically equivalent to those found at double tax treaties but independent from these. According to the EM that accompanied the Bill, the purpose of these new rules was to prevent taxable profits from being shifted or misallocated offshore.

The operative clauses contained in Subdivision 815-A (Sections 815-1 to 815-40) operate subject to the existence of an applicable Double Taxation Convention and refer to the Business Profits and Associated Enterprises Articles to establish the parameters to be observed for assessment and calculation of a transfer pricing benefit.

According to Section 815-15, a transfer pricing benefit arises for an Australian resident entity when it benefits itself by having its taxable income reduced as a result either from reduced profits or increased losses or capital losses related to controlled cross-border

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24 Section 815-1.

25 Section 815-10.
transactions when the arm’s length principle is not observed. Or, as stated in the Explanatory Memorandum:

“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.”

The amount of the benefit would correspond to the difference in the values which that entity would be expected to derive had the transaction happened between independent parties under observance of the arm’s length principle. Whenever such benefit is observed, the Commissioner would have the authority to issue a determination negating it and making the necessary adjustments in the profits or losses in order to meet the Arm’s Length principle, reflecting the profits that would be obtained at an independent transaction.

Subdivision 815-A also states in Section 815-20 that the OECD TP Guidelines and the OECD Model Tax Convention are legitimate sources of guidance for interpreting and applying the Bill’s provisions in the purpose of assessing and negating a transfer pricing benefit.

Another relevant and very controversial aspect regards Section 815-1 of the Transitional Provisions of Division 815, which establishes the retrospective application of the new transfer pricing rules to the income years starting on or after 1 July 2004. This measure is now forcing Australian resident companies to re-examine the structure of their cross-border transactions to make sure they met the requirements of the arm’s length principle.

Notwithstanding the legitimate purpose of updating the domestic legislation and the commendable initiative by the Legislative in enacting the Bill, relevant issues and concerns are observed in relation to its provisions, especially regarding the application requirements and the retrospective effect. The following part of this paper will examine these issues and suggest solutions to them.

26 Explanatory Memorandum to the Cross-Border Transfer Pricing Bill (no. 1) 2012. Paragraph 1.20, page 8.

27 Section 815-15 to 815-20, 815-30, 815-35.
3. **Issues and concerns about Subdivision 815-A**

   a) **The interface between domestic provisions on transfer pricing and Double Taxation Agreements’ rules**

   The new transfer pricing rules were conceived to be independent from those found in the Double Tax Agreement, confirming the opinion of the Parliament that tax treaties should be a separate basis for transfer pricing adjustments

   “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.”

   In fact, since 1982 the treaties transfer pricing rules have had the force to amend assessments made through domestic legislation, according to subsections 170(9B), 170(9C) and 170(14) of the ITAA36. In view of this, it has been possible to state, since that time, that treaty transfer pricing provisions could apply alternatively to domestic legislation.

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28 *Explanatory Memorandum to the Cross-Border Transfer Pricing Bill (no. 1) 2012. Paragraphs 1.16 and 1.17, page 7.*


30 “(9B) Subject to subsection (9C), nothing in this section prevents the amendment, at any time, of an assessment for the purpose of giving effect to a prescribed provision, a relevant provision, or Subdivision 815-A of the *Income Tax Assessment Act 1997*.

   Note: Subdivision 815-A of the *Income Tax Assessment Act 1997* is about cross-border transfer pricing.

(9C) Subsection (9B) does not authorize the Commissioner, for the purpose of giving effect to a prescribed provision or a relevant provision, to amend an assessment made in relation to a taxpayer in relation to a year of income where:

   (a) in a case where the purpose of the amendment is to give effect to the prescribed provision in relation to the supply or acquisition of property—the prescribed provision has been previously applied, in relation to that supply or acquisition, in making or amending an assessment in relation to the taxpayer in relation to the year of income; or

   (b) in any other case—the prescribed provision, the relevant provision, or Subdivision 815-A of the *Income Tax Assessment Act 1997*, as the case may be, has been previously applied, in relation to the same subject matter, in making or amending an assessment in relation to the taxpayer in relation to the year of income.

   (…) (14) In this section, unless the contrary intention appears: "double taxation agreement" means an agreement within the meaning of the *International Tax Agreements Act 1953*.
Assuming that, in terms of transfer pricing, tax treaties and domestic rules apply independently and alternatively, technically Subdivision 815-A should be applicable by itself as to create a tax liability resulting from the negation of a transfer pricing benefit. However, that is not what would happen, once the introduction of the “Treaty requirement” by Section 815-10(2) as a condition for the application of the Bill creates a dependency relation of the Bill onto the Tax Treaties:

“815-10 Transfer pricing benefit may be negated

(1) The Commissioner may make a determination mentioned in subsection 815-30(1), in writing, for the purpose of negating a transfer pricing benefit an entity gets.

Treaty Requirement

(2) However, this section only applies to an entity if:

(a) the entity gets the transfer pricing benefit under subsection 815-15(1) at a time when an international tax agreement containing an associated enterprises article applies to the entity; or

(b) the entity gets the transfer pricing benefit under subsection 815-15(2) at a time when an international tax agreement containing a business profit article applies to the entity.”

"limited amendment period", for an assessment, means the period within which the Commissioner may amend the assessment:

(a) under item 1, 2, 3 or 4 of the table in subsection (1); or

(b) under paragraph (3)(a) or (b).

"prescribed provision" means section 136AD or 136AE.

"relevant provision" means:

(a) a provision of a double taxation agreement that attributes to a permanent establishment or to an enterprise the profits it might be expected to derive if it were independent and dealing at arm's length; or

(b) paragraph 7, 8 or 9 of Article 5, or Article 7, of the Taxation Code in Annex G to the Timor Sea Treaty or a provision of any other international tax sharing treaty that corresponds with any of those paragraphs or that Article.

"scheme" has the meaning given by subsection 995-1(1) of the Income Tax Assessment Act 1997.

In practice, what can be observed from the wording of Section 815-10(2) is that the treaty rules can really be applied independently from the domestic transfer pricing provisions of Subdivision 815-A; nevertheless, Subdivision 815-A is not applicable in the absence of a Double Taxation Treaty. In other words, while Tax Treaties are independent from the domestic transfer pricing legislation and do form an alternative basis for taxation of transfer pricing benefits, Subdivision 815-A is dependent from Tax Treaties and does not constitute an alternative set of provisions for taxing such benefits.

The “Treaty Requirement” as well as the relation of dependency resulting thereof can be observed at Sen. Don Farrell’s speech during his second reading to the Bill:

“Importantly, these provisions can only apply where a tax treaty is applicable and therefore a party affected by these measures will be able to access the treaty mechanisms designed to relieve any double taxation that could arise.”

This dependency on the existence of a Double Taxation Convention is precisely the first point of concern, for two main reasons. Firstly, the “Treaty Requirement” as it is presented in Section 815-10(2) goes against the Parliament’s intention of enacting Subdivision 815-A as an alternative set of transfer pricing provisions. In this sense, it is worth mentioning Section 815-1 of Subdivision 815-A, according to which:

“The cross-border transfer pricing rules in Subdivision 815-A are equivalent to, but independent of, the transfer pricing rules in Australia’s double tax agreements.”

Considering the provision above, in theory, Subdivision 815-A should be applicable to any cross-border related-party transaction from which a transfer pricing benefit arises for an entity, regardless of the existence or application of a Double Tax Treaty between the countries. Only this way the domestic and international transfer pricing legislation could technically operate as alternatives to each other.

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Instead, what is observed is that the domestic provisions do not form an alternate basis to the Tax Treaty rules. The intrinsic relationship between the two sets of rules is remarked in the Explanatory Memorandum:

“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.”

The second reason for concern regards the violation of the non-discrimination principle at the domestic level, that is, among Australian resident taxpayers. As it is stated in the Explanatory Memorandum, the transfer pricing tax liability only arises from the application of the domestic rule (Subdivision 815-A), not from the international agreement itself.

“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 [to the provisions of the tax treaties] 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

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32 Explanatory Memorandum to the Cross-Border Transfer Pricing Bill (no. 1) 2012. Paragraph 1.64, page 19.

33 Although the general function of a Double Taxation Agreement comprises the allocation of the power to tax, there is no international rule that prohibits the countries (the parties) to agree in the sense that the treaty between them could impose a tax liability. That reasoning derives from the fact that International Treaties are, in essence, a contract that is entered between two Countries under special conditions defined in International Law, and the treaties’ clauses are necessarily subject to negotiation of each party’s intentions and interests. The presence of this observation clearly addresses the statement that treaties operate as a shield rather than as sword, which means that tax treaties normally do not have the capacity of creating tax liabilities for the taxpayers, operating only by allocating the power 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.”

Considering that only the internal rule can create the tax liability, an Australian entity that benefited from a controlled transaction with a related party located in a country which doesn’t have a Tax Treaty with Australia would take advantage over an Australian entity that dealt with a related party located on a country that has a Tax Treaty with Australia, resulting in discriminatory treatment. The breach of the non-discrimination principle can be visualized in the following example.

Scenario 1: Entity “A”, an Australian resident, enters into a cross-border controlled transaction with entity “B”, a resident of a country that doesn’t have a tax treaty with Australia. From that transaction, “A” has a transfer pricing benefit.

Assuming that:

(i) the tax liability in transfer pricing cases can only arise from the internal rule – Subdivision 815-A, and

(ii) according to Section 815-10(2), Subdivision 815-A only applies when there is an applicable tax treaty;

Then, it is possible to conclude that:

Because of the lack of a Tax Treaty, entity “A” would not be subject to having its transfer pricing benefit negated under the provisions of Subdivision 815-A and would not be subject to any tax liability that could result thereof.

Scenario 2: Entity “C”, an Australian resident, enters into a cross-border controlled transaction with entity “D”, resident of a country that has a Tax Treaty with Australia. From that transaction, “C” has a transfer pricing benefit.

Assuming that the same premises of Scenario 1 are also valid for Scenario 2, and knowing that there is an applicable Tax Treaty, entity “C” could have its transfer pricing

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34 Explanatory Memorandum to the Cross-Border Transfer Pricing Bill (no. 1) 2012. Paragraph 1.18, page 8.
benefit negated and be subject to a tax liability resulting from the application of Subdivision 815-A.

Therefore, entities “A” and “C”, both residents of Australia, would be treated differently and “A” would have the unfair advantage of not being subject to the rules of Subdivision 815-A. This example shows that the “Treaty Requirement” of Subdivision 815-A breaches the non-discrimination principle[^35], which is one of the main pillars of the Australian Tax System and is present in all Australian Double Taxation Conventions.

Considering these issues, it is questionable how the Australian tax authorities, and further on, the Courts, would treat a transfer pricing benefit arising from a cross-border transaction involving Australia and a country with which there is no Double Taxation Convention, and which, therefore, doesn’t fulfil the treaty requirement for the application of s 815-10 and 815-30. Bringing the example above into more concrete terms, an Australian resident entity which had a transfer pricing benefit arising from a cross-border transaction involving a related party in Brazil or in Greece technically couldn’t have its benefit negated by the Commissioner due to the lack of a Double Taxation Agreement between the countries. The discrimination lies precisely on the fact that another Australian resident that entered into a controlled transaction with a Canadian related party and which, therefore, observed all the criteria for application of the law, would be in a disadvantaged position, as it could have its transfer pricing benefit negated by the tax authorities.

All the issues and factors discussed above indicate that the “treaty requirement” not only goes against the very purpose of the Bill of being independent of the international rules

and working as an alternate basis\textsuperscript{36}, but most importantly, it breaches the non-discrimination principle.

A reasonable solution to this issue could go through amending the Bill as to:

- exclude the “treaty requirement” as a condition of application, maintaining the possibility of resorting to the international rules in case there is an applicable Double Taxation Treaty;
- include general provisions dealing with business profits, associated enterprises and permanent establishments, which could be drafted along with the recommendations of the OECD TP Guidelines and the OECD Model Tax Convention to be applied in case of absence of an applicable tax treaty.

This would allow Subdivision 815-A to apply to all Australian resident entities regardless of the existence of an applicable tax treaty, bringing the legislation in line with the non-discrimination principle.

\textbf{b) Retrospective application of law}

Retrospective rules are a highly controversial matter in general law. \textit{Ex post facto}\textsuperscript{37} provisions have the capacity of reaching facts that happened before their entry into force. In the hands of an inept, corrupt or dictatorial government, retrospective rules can be and usually are used for seriously illegitimate and harmful purposes, and may impact directly some fundamental human rights, such as freedom (in case of retrospective criminal laws) or

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\textsuperscript{36} As expressly mentioned by the Hon. Bill Shorten, in the Media Release no. 145: “Mr. Shorten indicated the Government will also address a related area of potential uncertainty: whether tax treaties provide a power to make transfer pricing adjustments independently of the transfer pricing rules in the Income Tax Assessment Act 1936. ‘I am therefore introducing amendments to the law to clarify that transfer pricing rules in our tax treaties operate as an alternative to the rules currently in the domestic law’."
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\textsuperscript{37} “Ex post facto”, adv. [latin “from a thing done afterward”] After the fact; retroactively. Done or made after the fact; having retroactive force or effect. \textit{Ex post facto law}. A law that impermissibly applies retroactively, esp. in a way that negatively affects a person’s rights, as by criminalizing an action that was legal when it was committed. Ex post facto criminal laws are prohibited by the US Constitution. But retrospective civil laws may be allowed. Garner, Bryan A. (ed). Black’s Law Dictionary. 8\textsuperscript{th} edition. United States, Thomson West, 2004, page 620.
\end{flushright}
the right to private property (regarding both criminal and tax law). In this respect, F A Hayek explains in a clear and direct way the connection between the principles of non-retrospectivity and the rule of law in the following passage:

“Nothing distinguishes more clearly a free country from a country under arbitrary government than the observance in the former of the great principles known as the Rule of Law. Stripped of technicalities this means that government in all its actions is bound by rules fixed and announced beforehand – rules that make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances and to plan one’s individual affairs on the basis of this knowledge. Thus, within the known rules of the game, the individual is free to pursue his personal ends, certain that the powers of government will not be used deliberately to frustrate his efforts.”38

The non-retrospectivity principle reassures stability and legal certainty in the application of law, and these are some of the main distinguishing features between a State of Law and a dictatorship. Non-retrospectivity is, therefore, intimately linked to the certainty and predictability of law, once according to these principles, citizens have the right to reasonably know what to expect from their authorities in terms of compliance matters. This means they must be able to rely on and refer to the law as it was at the time of their actions, and that necessarily goes through maintaining stable non-retroactive rules, especially in the fields of criminal and tax law. In this sense, Erik Claes explains that:

“Anglo-American scholars often explain the relation between legal certainty and the legality in terms of a citizen’s ability to ‘organise his affairs in such a way that he does not infringe the law’, or of having the right to an adequate warning from public officials that engaging certain types of behaviour will result in criminal liability. When criminal offences are drafted in vague and ambiguous ways, or when they have a retroactive effect, citizens are not only faced with unpredictable

behaviour by enforcement officials, they are also denied a fair opportunity to avoid punishment.\textsuperscript{39}

In terms of taxation, the non-retrosectivity principle is also responsible for protecting the citizens’ and legal entities’ right to private property, once individuals and entities must disburse their own money or assets to pay their tax duties. Therefore, by relying on non-retrospective rules, taxpayers, especially companies and other legal entities are able to organize themselves in terms of meeting compliance standards and rules.

For all these reasons, several countries have explicit constitutional prohibitions regarding retrospective rules\textsuperscript{40}, with very limited and strict exceptions, usually referring to criminal or tax law provisions when the retrospective application is beneficial to the subject. In the fields of International Law and international treaties, the non-retrosectivity principle has been internationally recognized since 1969 in article 28 of the Vienna Convention on the Law of Treaties (1969), which expressly states the non-retroactivity of treaties:

“Unless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party”.\textsuperscript{41}


\textsuperscript{40} Examples of countries which expressly forbid retroactive rules are Brazil (Brazilian Constitution, article 5), Canada (Section 11(g) of the Charter of Rights and Freedoms), Germany (Article 103 of German Basic Law), Indonesia (Article 28I of the Indonesian Constitution), Iran (Article 169 of Iran’s Constitution), Ireland (Article 15.5.1 of the Constitution of Ireland), Italy (Article 25, paragraph 2 of the Italian Constitution, Article 11 of the preliminary provisions to the Italian Civil Code, and Article 3, paragraph 1 of the Statute of Taxpayer’s Rights), Japan (Article 39 of the Constitution of Japan), New Zealand (Section 7 of the Interpretation Act 1999 and Article 26 of the New Zealand Bill of Rights Act 1990), Norway (Article 97 of the Norwegian Constitution), Pakistan (Article 12 of the Constitution of Pakistan), Philippines (Section 22 of the 1987 Constitution of the Philippines), Russia (Articles 54 and 57 of the Russian Constitution), Spain (Article 9.3 of the Spanish Constitution), South Africa (Section 35(3) of the South African Bill of Rights), Turkey (Article 38 of the Constitution of Turkey).

\textsuperscript{41} Vienna Convention on the Law of Treaties. Available at: \url{http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf}.
Notwithstanding that rule, some countries still pass retrospective tax laws. That is the case of the new section 815-1 of the transitional provisions of Division 815 ITAA97, according to which:

“Subdivision 815-A of the Income Tax Assessment Act 1997 [the new cross-border transfer pricing rules] applies to income years starting on or after 1 July 2004.”

The announcement of this rule caused significant stir among tax practitioners and companies for a series of reasons, which are analysed in the paragraphs below.

The first and most obvious reason is that it breaches the principle of non-retrospectivity of tax rules, which although not being constitutionally expressed in Australia, has been widely acknowledged by the doctrine and even by the Legislative itself, given its direct connection to the certainty of law. The Dissenting Report issued by the Australian House of Representatives regarding the Tax Laws Amendment (2012 Measures no. 2) Bill 2012 and the Pay as You Go Withholding Non-Compliance Tax Bill 2012 (the “PAYG Bill”) explained clearly the relation between the principle of non-retroactivity and the certainty of law:

“(…) Certainty in the law: taxpayers clearly enter into transactions on the basis of the law as it is on the day they enter into them, not the law as it may be rewritten at some time in the future after the transactions have occurred. As a result, retrospective changes that alter a taxpayer's tax liability are likely to disturb the substance of a bargain that had been struck between taxpayers who have made every effort in good faith to comply with the prevailing law at the time of the agreement. In addition, typically taxpayers undertake transactions based on what they consider to be known exposures to tax liabilities. Retrospective changes could give rise to unexpected joint and several liabilities for taxpayers. (…)”42

In fact, the transitional rule set forth in s 815-1 opens the doors for excessively discretionary and even arbitrary determinations concerning what should be the arm’s length consideration in cross-border transactions between related parties. A remarkable extract from Senator Don Chipp’s speech referring to the “Bottom of Harbour” tax schemes in 1982 illustrates the relation between retrospective rules and arbitrary exercise of power:

“(…) One of the few protections that the ordinary citizen has is that he knows the law. If he abides by that law he knows he is safe from prosecution and safe from the instruments of politicians, namely, the police. He knows exactly where he is.

Good heavens; give politicians the chance to legislate retrospectively and we will open a Pandora's box. I find that quite frightening. On this occasion a Pandora's box is opened in the excuse of catching the filthy people who cheat on tax. It is done for a noble purpose, one might say, and I agree. But I have never been one to subscribe to the view that the end justifies the means.”

This speech was given at the second reading of the Unpaid Company Tax Assessment Bill 1982, when Senator Chipp expressed his deep concerns regarding the

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43 The “Bottom of the Harbour” schemes were a series of tax avoidance schemes performed in Australia in the 1970s, in which the companies were stripped of their assets and accumulated profits before their tax liabilities became due. Then, the company was transferred to a person with limited interest in its past activities, and all the records of the operations were destroyed or disappeared, leaving the company in an insolvency state and all its creditors, including the tax authority, unsecured. Because there were no documents, the ATO couldn’t prove anything and the companies ended paying no tax. In the 1980s, a retrospective legislation was passed criminalizing the “bottom of the harbour” schemes. See: Adam Sutton. *Bottom of the Harbour Tax Evasion Schemes.* In Peter Grabosky and Adam Sutton (eds). *Stains on a White Collar: Fourteen Studies in corporate Crime or Corporate Harm.* Sydney: The Federation Press, Available at: http://www.aic.gov.au/documents/3/7/4/%7B37416853-BDE6-43D4-9743-3C34E6051317Dwhitecollar.pdf


retrospective rules that were being introduced, in spite of the supposedly justifiable argument of maintaining the fairness of the tax system and ensuring the distribution of the tax burden by application of the new retrospective rules. Although these commentaries were made 30 years ago, they remain a strong argument against the retrospectivity of rules, and are fully applicable to the transitional provision set forth in section 815-1.

The Explanatory Memorandum to the new Cross-border Transfer Pricing Bill strictly defines that the Bill, being a revenue protection measure, does not have any revenue impact. If the Bill was conceived to be a revenue protection measure with no revenue impact, it could not have any provisions that allowed any sort of tax collection, not even through indirect ways.

Furthermore, the succinct justification presented at the Explanatory Memorandum in the sense that the retrospective effect of the Bill reaffirmed the Parliament’s previous understanding that the treaties provided a separate basis for making transfer pricing adjustments simply does not seem to be plausible to justify such a serious and harmful measure. In addition to that, it does not seem to be a logical reason as to allow the retrospectivity of the rules, especially in face of the recommendation of the Australian Parliament’s Legislation Handbook in the sense that:

“provisions that have a retrospective operation adversely affecting rights or imposing liabilities are to be included only in exceptional circumstances and on explicit policy authority”\(^{46}\).

\(^{45}\)“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 ITAA36.
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 ITAA36 and contained explicit statements at 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).” Explanatory Memorandum to Division 13, p. 7-8.

The existence of a retrospective provision in the Bill allowing the tax authority reshape business structures in order to tax income that otherwise was not taxable clearly indicates the purpose of increasing revenue collection by taxing now what was not taxable before. In fact, increasing revenue collection appears to be the only reason why a retrospective Bill would be enacted. Therefore, it seems reasonable to argue that the inclusion of such retrospective provision allowing the new transfer pricing rules to apply to past events much probably had an underlying purpose of increasing revenue collection.

Another point of concern deriving from the retrospective character of the new transfer pricing rules is that tax compliance costs will certainly increase significantly for Australian companies, as they will have to revise all their documents and structures back to 2004 in order to make sure they comply with the new rules, as well as make any necessary amendments and re-assessments, including the payment of additional tax when applicable. Here, again, retrospective provisions violate the principles of certainty of law and predictability of law. This is because it forces the taxpayers to revisit their past actions and decisions which have been made using all due diligence to comply with the law in force at that time. Re-examining and re-assessing all transactions and operations which could involve the application of transfer pricing rules can obviously affect negatively a company’s public reputation in the present, and that would not be a result of their own misconduct, but of an arbitrary change of legal parameters, which the taxpayer could not predict at that time.

All this re-adjustment work will have to be performed on an “as soon as possible” basis, given the fact that the new Bill does not provide for any sort of “transitional adjustment period”\textsuperscript{47} so that taxpayers could have some time to make the necessary adjustments and reorder their affairs without the risk of being punished for their otherwise correct past actions, which now may have became unacceptable under the new Bill.

Going further, the whole financial structure of certain companies could be affected. For example: a company participated on related-party cross-border transactions in 2005 and followed all the necessary measures and procedures that were available at that time to assure the observance of the arm’s length principle. As a result of those transactions it was able to pay dividends of $“X” to its shareholders. Later, in 2012, applying retrospectively the

\textsuperscript{47} In this sense, see Erik Claes. Idem.
new transfer pricing Bill, the tax authority considers that those transactions were not at arm’s length and, therefore, negates the transfer pricing benefit which the company obtained in 2005. How and who could determine the impact that the new assessment would have had on the company’s profits in 2005 time as to recalculate how much could have been paid as dividends?

Furthermore, the existence of retrospective rules of this nature will obviously have a negative impact on the prospection of future investments and in the sovereign risk, creating and environment of great insecurity in terms of tax relations and tax liabilities.48

These are just some examples of the harmful effects of the introduction of a retrospective rule of this magnitude, and certainly many other issues will arise from the practical application of Subdivision 815-A. These issues will sooner or later have to be examined by the administrative bodies and by Courts, and there are some questions that seem to stand out. For example: how would the ATO deal with cases where the taxpayer had also paid tax in the other country during the retrospective time-span? How would the retrospective effect of consequential adjustment rules49 operate if the other country (the other party in the tax treaty) expressly prohibited retroactive effects? How could a taxpayer eventually try to recover any tax that has been originally paid at the other country but now has become due to Australia as a result of a retrospective assessment? Would taxpayers in that situation simply be double taxed, as treaty provisions do not have retrospective application and the other

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48 The impact of retrospective legislation on sovereignty risk and future investments has been addressed by Justice Michelle Gordon in a speech (“The Commonwealth’s taxing powers and its limits - Are we there yet?”) given at the 2012 Annual Tax Lecture, at the University of Melbourne, on 29 August 2012.

49 Consequential adjustments are defined as an “adjustment to the tax liability of the associated enterprise in a second tax jurisdiction made by the tax administration of that jurisdiction, corresponding to a primary adjustment made by the tax administration in a first jurisdiction, so that the allocation of profits by the two jurisdictions is consistent. The adjustments correspond to each other in the sense that the end result for both parties should be that which would have applied between parties dealing with each other at arms length. Where one adjustment leads to an increase in taxable profits for one party, the corresponding adjustment would therefore lead to a reduction in taxable profits for the other party. Corresponding adjustments are provided for in the OECD and UN model (referred to as an ‘appropriate adjustment’) but are often not included in bilateral treaties. Under standard treaty provisions (when included), such an adjustment is not required unless the tax authorities of the country in question consider the primary adjustment reflects an arm’s length standard. The purpose of such an adjustment is to prevent double taxation which would arise as a result of the primary transfer pricing adjustment.” Barry Larking (ed.). IBFD International Tax Glossary. 5th ed revised. 2005. IBFD Publications. Page 96-97.
country is not obliged to provide relief from double taxation resulting from the application of retrospective rules?

One final point of concern regards the rule set forth in s 815-10, which determines the application of scheme penalties in pre-commencement period as if only the old law applied:

“(1) This section applies if:

(a) a determination under subsection 815-30(1) of the Income Tax Assessment Act 1997 has effect in relation to an entity in an income year; and

(b) the income year starts before 1 July 2012.

(2) Subdivision 284-C in the Schedule 1 to the Taxation Administration Act 1953 applies in relation to the entity and the income year as if:

(a) Subdivision 815-A of the Income Tax Assessment Act had not been enacted; and

(b) each other provision of a taxation law applied in relation to the entity in the way it would have if that Subdivision had not been enacted.”

According to these provisions, if a taxpayer has a transfer pricing benefit negated under s 815-30 regarding an income year starting before 1 July 2012 – noting that there is no mention of a time limit for the past years – then this taxpayer would be subject to the penalties established in Subdivision 284-C in Schedule 1 of the Tax Administration Act 1953, as if the new Subdivision 815-A had not been enacted. Apparently, the rule leads to a paradox: if the authorization for retroactive application of those scheme penalties results exactly of the enactment of the new Subdivision 815-A, then how could it be applied as if Subdivision 815-A itself had not been enacted? The reasoning behind this provision seems quite illogical, because if only the old law applied, then there could be no retrospective punishment for the taxpayer, once the old law did not have any retrospective application clauses. Therefore, what the new transfer pricing Bill does is provide retrospective effect not only for its own provisions, but also for the old legislation, which is even more concerning.
From all the aspects analysed above, it is suggested that retrospective provisions can never positively affect the taxpayers or the tax system of any country. A retrospective Bill effectively punishes the taxpayers who did comply with the old legislation, which was perfectly valid at the time of their actions. The risks and concerns inherent to the enactment of retrospective laws are very high and most likely do not stand up to the supposed benefit of allegedly promoting tax justice, they only serve the purpose of increasing tax collection. Justice needs to be done according to the law that is in force at the time of the events, that is the general rule of law. Applying retrospective rules under the allegation of allowing an equal distribution of the tax burden and promoting tax justice is just the same thing as disguising the utter objective of increasing revenue collection.

4. Alignment with the latest international transfer pricing practices

Notwithstanding the issues and concerns explained above, the new Australian transfer pricing legislation did reach its objective of meeting the latest developments of the OECD Transfer Pricing Guidelines. Although the OECD documents do not have any enforcement power insofar as there are no sanctions for not complying with them, it is recognized that they provide the most developed research database and probably form the most complete and updated set of recommendations, practices and models in international taxation. Therefore, even if technically they bear the status of recommendations, there is no international principle preventing a government from expressly recognizing them as a lawful source of guidance, legitimating the resource to them as it has been done in the Bill.

Section 815-20 of Subdivision 815-A actually fills the gap that existed when only Division 13 was in force, as it was not possible to securely resort to those OECD documents because they did not have the force of law, but only constituted supporting aids in the interpretation of the old legislation. Once that difficulty has been solved, the application of the new transfer pricing rules in Subdivision 815-A would be consistent with the latest OECD TP Guidelines. In this sense, it is worth mentioning Minister David Bradbury’s speech, explaining the goals of the new Division 815:
“(…) it [The Bill] will require that the transfer pricing rules in this bill are interpreted as consistently as possible with the relevant OECD guidance.

The work of the OECD reflects the best international thinking on transfer pricing and has shaped transfer pricing regimes around the world. The OECD’s transfer pricing guidelines are widely used by tax administrations and multinational enterprises globally.

This provision will provide a clear legal pathway to the use of OECD guidance. It will avoid the costly necessity for users to get expert advice on whether the state parties to a particular treaty apply the guidance and will make it clear which set of guidelines is to be used.”

Furthermore, as there are no provisions in the Bill itself detailing procedures and methods to reach an arm’s length price or to determine what could be an arm’s length structure, the inclusion of section 815-20 expressly authorizing resource to the OECD Transfer Pricing Guidelines and to the OECD Model Tax Convention, both in the 2010 versions, indicates that the tax authority and the taxpayers will be able to use the methodologies and techniques explained in those documents in analysing and structuring cross-border related-party transactions.

Another important aspect of the new legislation is that it details the role of the Commissioner and the procedures he must follow in assessing the existence of a transfer pricing benefit, reducing the chances of arbitrary actions and discretionary decisions. By detailing the parameters that must be observed in the determination of a transfer pricing benefit, even through resource to the OECD Guidelines, the new legislation closes the gap that could otherwise lead to arbitrary decisions. The new Subdivision 815-A is, therefore, much more precise and clear than Division 13 was in terms of the parameters and criteria that must be followed by the tax authorities in their assessments and determinations.

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5. Critical perspective

The initiative from the Legislative to update the legislation in the fields of international taxation as to meet the most recent practices in terms of international related-party operations, with the ultimate goal of promoting tax justice through the correct allocation of profits is certainly commendable. This is even more important when the legislation concerns international trade and multinational, multibillion-dollar transactions involving related parties. There is an obvious need for close monitoring and strict rules as to keep those transactions in line with international trade and tax principles and to assure that those taxpayers are correctly taxed.

The new Bill has also clarified the otherwise nebulous issue of resorting to OECD documents during the interpretation and application of transfer pricing rules. It made clear that the OECD Transfer Pricing Guidelines, in their latest version, do constitute an updated and legitimate resource for both taxpayers, during the structuring of their related-party transactions, and, later on, for tax authorities, when taxing the profits deriving from those operations.

It also improved the existing legislation by introducing provisions which determine and detail the procedures and approaches for assessing (and negating, where applicable) a transfer pricing benefit, thus minimizing the opportunities and chances of arbitrary tax determinations that were more frequent in the old Division 13. In international taxation matters, especially dealing with related-party transactions that respond for approximately 50% of the total cross-border transactions revenue, having well defined procedures and methodologies, as well as establishing the means to assess the legitimacy of those operations is a matter of utmost importance for both taxpayers and tax administration.

However, the Bill has two major issues that urge to be addressed. The first problem concerns the relation of dependency on Double Tax Treaties which violates the

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principle of non-discrimination. As explained before, a Bill dealing with tax issues of this magnitude simply cannot rely on the existence of a Double Tax Treaty as a condition for application, because that would imply discriminatory treatment for some Australian resident companies. As suggested before, the Bill must be amended as to exclude this requirement and include supplementary provisions dealing with the terms and expressions otherwise referred to in the Tax Treaties.

Secondly, the retrospective effect that has been given to the Bill as to reach past events up to almost a decade ago not only constitutes a serious breach to the rule of law, but also has the capacity of jeopardizing the main objective of the Bill, which is promote the correct allocation of international profits and therefore promote fair taxation of that income. Bad outcomes are expected for taxpayers as a result of the retrospective application of this Bill, including the risk of double taxation (as other countries are not obliged to provide relief from double taxation under retroactive rules) and also the financial consequences that may affect the entire structure of certain entities. Retrospective application of laws, as mentioned before, has never done any good for the taxpayers or for the country. By breaching the certainty of law and seriously jeopardizing the predictability in law, it will have a negative impact in terms of sovereign risk and future investments.

Considering all these reasons, urgent adjustments need to be done to the new Australian transfer pricing rules in order to guarantee its fair and constitutional application. The tax treaty requirement needs to be revised and the retrospective effect definitely needs to be eliminated. If applied the way it has been enacted, this Bill will certainly legitimate undue taxation and open the way to arbitrary measures, putting in risk the future economic development of the country.

6. Conclusion

The new transfer pricing Bill was enacted with the purpose of allowing the correct allocation of profits in order to promote tax justice. It also represented a much-needed update in the domestic legislation, as to reflect the current practices in international transfer pricing regulation. Because of its recent enactment, there aren’t yet any cases discussing the
operation of the new rules. At the moment it is impossible to predict how the ATO or the Courts will approach the issues that have been analysed in this paper, especially concerning the “treaty requirement” and the retrospective application of the new rules, as well as the practical problems that will certainly arise thereof. Meanwhile, tax practitioners and taxpayers will have to carefully examine their operations, structures and contracts for the past eight years in order to comply with the new legislation, trusting that the principles of certainty and predictability of law are respected in the enforcement of the new legislation.