



Second Commissioner of Taxation

Mr Jason McNamara
Executive Director
Office of Best Practice Regulation
Department of the Prime Minister and Cabinet
1 National Circuit
BARTON ACT 2600

Dear Mr McNamara

This letter certifies that the process undertaken by the Australian Taxation Office in implementing the transfer pricing record keeping simplification options has undertaken a process and analysis equivalent to a Regulatory Impact Statement as set out in *'The Australian Government Guide to Regulation'*.

Background

Transfer pricing provisions within subdivisions 815-B, C and D of the Income Tax Assessment Act (ITAA) 1997 apply for income years starting on or after 29 June 2013. These provisions require that Australian taxpayers self-assess their compliance with the statutory test set out therein. These transfer pricing rules also introduced Subdivision 284-E of Schedule 1 to the Taxation Administration Act (TAA) 1953, which contains rules about transfer pricing documentation. The purpose of the transfer pricing documentation requirement is that an entity can demonstrate that transfer pricing in a controlled transaction was consistent with the arm's length principle at that time.

The transfer pricing documentation requirements do not mandate the preparation or keeping of specific transfer pricing documentation in a prescribed form. However the consequence of not meeting the requirements set out in subdivision 284-E is that in determining the administrative penalty for a transfer pricing shortfall, there is a presumption that the entity does not have a reasonably arguable position and a higher base penalty amount will apply.

The ATO after considerable consultation has introduced four simplified record-keeping options for eligible businesses to help them comply with their transfer pricing requirements whilst minimising their record keeping and compliance costs. The options differentiate affected businesses based on turnover, type of business, or type of dealing. This covers small businesses and some other low level dealings. The aim was to keep the options simple so that compliance is easier and costs are reduced accordingly.

If a business is eligible and elects to apply and disclose its use of an option(s) the Commissioner will apply his discretion not to allocate compliance resources to examine their applicable transfer pricing records. The business must continue to self-assess compliance with the statutory test and to meet mandatory general record keeping requirements (s.262A of the ITAA 1936); including evidence that it meets the eligibility criteria. It is important to

note here that by undertaking not to allocate compliance resources to review or audit the transfer pricing records relating to the eligible transaction, we are not directly or indirectly warranting compliance with the transfer pricing rules.

The options are accessible, easily understood and supported by targeted communications including on-line guidance comprising simple, clear eligibility criteria and an explanation of how to apply each simplification option, together with illustrative examples. The conditions of eligibility, application and disclosure are clear along with our undertaking not to allocate compliance resources to look beyond the disclosure of the option, except to confirm eligibility.

We confirm that opting in and disclosing will mean that we will not review or audit those transfer pricing records that were the subject of the option. This undertaking neither limits nor derogates from the operation of the law. The options will be available for three income years starting from 29 June 2013. During this time their use will be carefully monitored and, based on outcomes; further consideration will be given to discontinuing or extending the options. The on-line guidance is supported by a Law Administration Practice Statement¹.

Addressing the Regulatory Impact Statement questions

The Australian Taxation Office considers that the process undertaken by the Division 815 Implementation Project and the Australian Taxation Office itself in developing the transfer pricing simplified record keeping options addresses the seven Regulatory Impact Statement questions set out in the Guide.

- Questions 1 and 2 consider the policy problem and why Government action is needed.

As noted, the transfer pricing rules enacted in 2013 specify certain records need to be kept for a taxpayer to take a 'reasonably arguable' position for penalty purposes. Further, that the compliance costs of transfer pricing rules have been raised by taxpayers and in reports by the Inspector General of Taxation and the Senate Economics and Legislation Committee. These reports included commentary and recommendations regarding the development and implementation of transfer pricing simplification measures.

It is recognised that the costs of documenting the way the arm's length principle applies to relevant dealings can impose an administrative burden on a taxpayer disproportionate to their transfer pricing risk. The Senate Economics and Legislation Committee² and the Inspector General of Taxation³ raised concerns that small business taxpayers are more likely to be disproportionately affected by this administrative burden. The 'simplification options' are designed to reduce compliance and administrative costs while not waiving the operation and application of the transfer pricing provisions. Specifically, it is made clear that eligible taxpayers are still required to self-assess their compliance with the transfer pricing rules.

Considerable analysis of the affected populations has been undertaken. As a general observation, a numerically large number of Australian taxpayers may be affected by the options, but the affected population accounts for a relatively small proportion of international related party dealings in the system (for example around 15% of entities lodging an International Dealings Schedule have turnover of less than \$25 million and would be eligible for these measures, but these entities' dealings account for only 1.4%

¹ Refer 'PS LA simplification transfer pricing record keeping' document attached below.

² Tax Laws Amendment (Countering Tax Avoidance and Multinational Profits Shifting) Bill 2013 [Provisions] – May 2013

³ Review into the Australian Taxation Office's management of transfer pricing matters report – December 2013

of total related party revenue dealings in and out of Australia). It is noted, that taxpayers had previously reported that their documentation covered less than 25% of their total related party dealings. This would mean that their compliance costs would have needed to increase to raise their level of documentation to that required, under subdivision 284-E.

- Questions 3, 4 and 6 require consideration of options to best address the policy problem and the need for Government action.

To facilitate comments and participation in developing the 'simplification options' and to engage more broadly with affected external stakeholders, a discussion paper on the transfer pricing documentation was released (refer to Attachment A). This comprehensive discussion paper set out the existing legal framework and the practical and administrative issues affecting taxpayers. It made references to external research and studies that highlighted the issues and the areas of the transfer pricing provisions where compliance burden can be alleviated. The scope of the Commissioner's general power of administration as outlined in the Law Administration Practice Statement PS LA 2009/4 was also clarified up front. It also referred to the recent decision of *Macquarie Bank Limited v Commissioner of Taxation* where the scope of the Commissioner's general power of administration was further clarified that it does not permit the Commissioner to dispense with the operation of the law or accept non-compliance by taxpayers.

- Question 5 asks who will be consulted and how will they be consulted.

Taxpayers have been consulted and provided with the opportunity to comment on the proposals and feedback has been positive. A 'user testing' workshop was held with a small number of tax agents representing the smaller end of the international related party population; the options were issued in draft form to members of the Division 815 Technical Working Group with a request for feedback; there has been ongoing external consultation with taxpayers and their representatives through the Division 815 Technical Working Group.

- Question 7 asks how the regulatory option will be implemented and evaluated.

Small businesses and businesses with low level dealings (target population) that are eligible to apply one or more of the options are recognised as posing a low risk of not complying with the arm's length principle. Businesses opting in will inform the Commissioner through a disclosure on their International Dealings Schedule⁴.

The options will be introduced for a trial period of three years and will be monitored to determine if the outcomes are as expected or if risks of misapplication are evident or whether further compliance savings can be generated through appropriate extension of the concessions to a broader range of transaction types and taxpayers. This will include consultation and voluntary sampling with the appropriate stakeholders. A risk assessment will determine if the options will be extended, amended or removed.

These simplified transfer pricing record keeping options will be monitored by the ATO's Economist Practice (through the disclosure required on the International Dealings Schedule) for expected outcomes and any evidence of misapplication. In parallel with Economist Practice monitoring of the aggregated data and Public Groups and

⁴ International Dealings Schedule 2015 business case to create a new code within the existing "percentage of dealings" documentation requirement label has been prepared

Internationals consultation and voluntary sampling, the ATO Deregulation Team and Revenue Analysis Branch will also monitor compliance cost savings from the trial.

This will be a 'living approach' which will monitor risks to system integrity, risk to revenue and successful compliance cost reduction by continuous scrutiny of aggregated data which captures behavioural response and consequences.

Estimation of the regulatory burden

It has been estimated that for the estimated affected taxpayers (3,200) there would be a potential start-up cost of \$809 per taxpayer. The start-up cost accounts for the time taxpayers would need to familiarise themselves with the proposed measure.

The increased regulatory burden is offset by the removal of the requirement for the estimated affected taxpayers to prepare transfer pricing documentation reports and seek specialist advice. It is estimated for approximately 2,900 entities with less than \$250 million turnover the average cost to prepare the required documentation would be \$22,640 and \$49,000 for 330 entities with a turnover greater than \$250 million.

Regulatory Burden and Cost Offset (RBCO) Estimate Table

Average Annual Compliance Costs

Costs (\$million)	Business	Community Organisations	Individuals	Total Cost
Total by sector	(\$80.9 million)	\$0	\$0	(\$80.9 million)

Cost offset (\$million)	Business	Community Organisations	Individuals	Total by source
Agency	\$0	\$0	\$0	\$0

Are all new costs offset? <input type="checkbox"/> Yes, costs are offset <input type="checkbox"/> No, costs are not offset <input checked="" type="checkbox"/> Deregulatory—no
Total (Change in costs – Cost offset) (\$million) = (\$80.9 million)

I am satisfied that the processes followed by the Australian Taxation Office in developing the transfer pricing record keeping simplification options represents a thorough analysis of the impact on the estimated affected taxpayers and certify that the processes are equivalent to those required for a Regulatory Impact Statement as set out in the Guide. Relevant background documents are attached for your information.

Should the Office of Best Practice Regulation have any further queries in relation to this matter, please contact Andrew Watson on 08 8208 1826 or at andrew.watson@ato.gov.au.

Yours sincerely

A handwritten signature in black ink, appearing to read "M. Cranston". The signature is written in a cursive style with a large initial "M" and a long, sweeping tail.

Michael Cranston
Acting Second Commissioner of Taxation
9 April 2015

Attachments

Attachment A: DISCUSSION PAPER: OPTIONS TO SIMPLIFY TRANSFER PRICING DOCUMENTATION



TP Documentation
Discussion Paper_Div

Attachment B: Division 815 Technical Working group minutes March 2014 – Agenda item 4 – Discussion – options to simplify transfer pricing documentation

<https://www.ato.gov.au/General/Consultation/In-detail/Technical-and-special-purpose-working-groups---minutes/Division-815-Technical-Working-Group/Division-815-Technical-Working-Group-minutes---March-2014/>

Attachment C: Division 815 Technical Working group minutes 3 July 2014 – Agenda item 4 – Discussion – options to simplify transfer pricing documentation

<https://www.ato.gov.au/General/Consultation/In-detail/Technical-and-special-purpose-working-groups---minutes/Division-815-Technical-Working-Group/Division-815-Technical-working-group-minutes---3-July-2014/>

Attachment D: Division 815 Technical Working group minutes 31 July 2014 – Agenda item 4 – Discussion – options to simplify transfer pricing documentation

<https://www.ato.gov.au/General/Consultation/In-detail/Technical-and-special-purpose-working-groups---minutes/Division-815-Technical-Working-Group/Division-815-Technical-working-group-minutes---31-July-2014/>

Attachment E: Practice Statement Law Administration 2014/3 – Simplifying transfer pricing record keeping

<http://law.ato.gov.au/atolaw/view.htm?dbwidetocone=05%3APSR%3ABY%20Type%3ALaw%20Administration%20Practice%20Statements%3A2014%3A%2300003%23PS%20LA%202014%2F3%20-%20Simplifying%20transfer%20pricing%20record%20keeping%3B>