Australian Government
Australian Taxation Office

DISCUSSION PAPER: OPTIONS TO SIMPLIFY TRANSFER PRICING DOCUMENTATION

Purpose

1. To facilitate consultation with the Division 815 Working Group at the meeting on 14 March 2014.
2. To develop simplification measures to address compliance and administrative issues affecting the practical application of the transfer pricing documentation requirements in Subdivision 284-E of Schedule 1 to the *Taxation Administration Act* (TAA) *1953*.
3. To emphasise that any simplification measures must promote voluntary compliance, and be consistent with the transfer pricing rules and the general transfer guidance material for being developed by the Australian Taxation Office (ATO).
4. To work collaboratively with affected internal and external stakeholders to develop these measures.

Background

5. The ATO is developing new guidance material on Subdivisions 815-B, 815-C and 815-D of the *Income Tax Assessment Act 1997* (ITAA) 1997 and the documentation requirements and administrative penalties under Division 284 of Schedule 1 to the TAA 1953 (collectively referred to in this document as the transfer pricing rules).
6. The focus of the guidance material being developed is to provide the Commissioner's view of the transfer pricing documentation requirements and practical guidance on a process for documenting transfer pricing and for the administration of transfer pricing penalties. The purpose of these products is to explain the documentation required for transfer pricing generally and the consequences of not doing so.
7. While there is a need for the development of guidance material for transfer pricing generally, it is also desirable to explore compliance and administrative measures that are consistent with the intent of the transfer pricing rules but achieve this at reduced compliance or administrative cost.
8. The OECD in *Multi-Country Analysis Of Existing Transfer Pricing Simplification Measures - 2012 Update* (6 June 2012) identified five categories of simplification measures:
    - Exemptions from transfer pricing rules or from transfer pricing adjustment;
    - Simplified transfer pricing methods, safe harbour arm's length ranges/rates and safe harbour interest rates;

- Exemptions from or simplified documentation requirements;
- Exemptions from or alleviated penalties;
- Simplified Advance Pricing Arrangement ("APA") procedures or reduced APA charges.

9. As part of its administration of Division 13 of the ITAA 1936, the ATO developed a number of simplification measures for transfer pricing including simplified documentation requirements[1] targeting small and medium enterprises, simplified transfer pricing methods for intra-group services,[2] an exemption from disclosure for entities with lower levels of international dealings[3] and simplified advance pricing arrangements process[4] for certain taxpayers.
10. This discussion paper has been prepared to facilitate the development of simplification measures for transfer pricing documentation under the new transfer pricing rules and to engage more broadly with affected internal and external stakeholders.

Legal framework

Transfer pricing rules

11. The introduction of Subdivisions 815-B, 815-C and 815-D of the ITAA 1997 ensure that consistent rules apply to relevant dealings between associated entities and non-associated entities, and in both treaty and non-treaty cases. In addition, Subdivision 284-E of Schedule 1 to the TAA 1953 contains rules about transfer pricing documentation (see paragraph 15 below).
12. The broad aim of the transfer pricing rules is to ensure that the amount brought to tax in Australia from relevant dealings is determined through the application of the arm's length principle.

General record keeping requirements

13. Generally, the statutory requirements for a person carrying on a business is to keep records that explain all transactions and other acts as set out in section 262A of the ITAA 1936 for any purpose of this Act.[5]
14. The records to be kept include any documents which are relevant for the purpose of ascertaining income and expenditure but can also include records which explain the essential features of a transaction and its relevance to income and/or expenditure. From a transfer pricing perspective, this would include the records used in preparing the

[1] Simplified approach to documentation and risk assessment for SMEs http://www.ato.gov.au/General/International-tax/In-detail/Transfer-pricing/International-transfer-pricing--- a-simplified-approach-to-documentation-and-risk-assessment-for-small-to-medium-businesses/?page=6#What_documentation_is_required_
[2] Taxation Ruling TR 1999/01
[3] International Dealings Schedule: Instructions http://www.ato.gov.au/Forms/International-dealings-schedule-instructions-2013/?page=2#Trigger_points_that_will_require_completion_of_this_schedule
[4] Practice Statement Law Administration PS LA 2011/1: ATO's Advance Pricing Arrangement Program http://law.ato.gov.au/atolaw/view.htm?docid=PSR/PS20111/NAT/ATO/00001
[5] "This Act" is defined under subsection 6(1) of the ITAA 1936 to include the ITAA 1997, Schedule 1 to the TAA 1953 and Part IVC of the TAA 1953.

relevant tax return and which demonstrate that their transactions or profits as returned comply with Subdivisions 815-B and 815-C of the ITAA 1997.

Transfer pricing documentation

15. Subdivision 284-E of Schedule 1 to the TAA 1953 specifies that entities prepare and maintain records to evidence the arm's length conditions or profits, the method selected, the comparable circumstances relevant to identifying the arm's length conditions or profits, the application of the transfer pricing rules and why this approach best achieves consistency with the guidance material. In the event an entity does get a transfer pricing benefit and they do not hold the specified documentation, the entity will be presumed not to have a reasonably arguable position under section 284-255 of Schedule 1 to the TAA 1953 and a higher base penalty will apply.

Uniform penalty regime

16. Under section 284-224 of Schedule 1 to the TAA 1953, an administrative penalty will be reduced to the extent that the entity applied the law in a way that was consistent with advice given by the Commissioner, a general administrative practice under the law or a statement in a publication approved in writing by the Commissioner.
17. Under section 298-20 of Schedule 1 to the TAA 1953, the Commissioner may remit all or a part of the penalty.

General power of administration

18. Law Administration Practice Statement PS LA 2009/4: *Escalating a proposal requiring the exercise of the Commissioner's powers of general administration* provides the ATO's view on the scope of the Commissioner's general power of administration (GPA). The key points from this practice statement include the GPA being that it is:
    - narrow in scope - confined to management and administrative decisions;
    - unable to be used to extend, confine or undermine Parliament's intent;
    - unable to be used to remedy defects or omissions in the law;
    - unable to be used as an interpretative aid;
    - reconciled with the good management rule – supported by section 44 of the *Financial Management and Accountability Act 1997* (and the *Public Governance, Performance and Accountability Act 2013*, which commences on 1 July 2014); and
    - constrained by the operation of the appropriation power in section 16 of the TAA 1953.
19. In addition, the recent decision of *Macquarie Bank Limited v Commissioner of Taxation* [2013] FCAFC 119 (*Macquarie)* which upheld the decision of Edmonds J in the Federal Court in *Macquarie Bank Limited v Commissioner of Taxation* [2013] FCA 887, further clarified the scope of the Commissioner's GPA when their honours confirmed that it:
    - does not permit the Commissioner to dispense with the operation of the law or accept non-compliance by taxpayers;

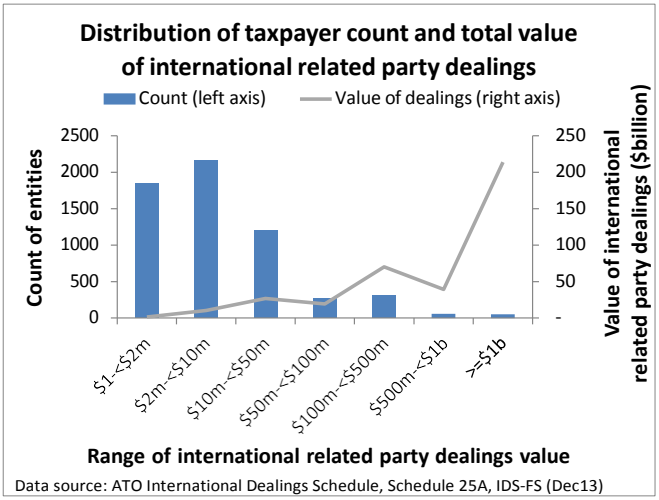
- is not a discretion to modify, or which itself modifies, the liability to tax imposed by the statute;
- does not affect the Commissioner's duty to act according to law and to assess taxpayers to the correct amount of liability imposed by the legislation;
- simply affects the Commissioner's administration of the tax Acts; and
- gives the Commissioner a discretion in making compliance decisions to reassess taxpayers or to decline to in fact reassess; but no such discretion can be exercised when the Commissioner has formed the view that the law imposes a liability.[6]

20. The decision in *Macquarie* confirms that the Commissioner cannot exercise his GPA to dispense with the proper operation of a tax law, nor modify a taxpayer's liability to tax that is imposed by statute. *Macquarie* would however remain supportive of the Commissioner making an administrative decision not to allocate compliance resources to a particular issue or category of cases (provided such a decision is reconciled with the good management rule and is not inconsistent with the intent of the relevant legislation).

The practical compliance and administrative issues

Affected population

21. For the 2012 income year, 9,608 taxpayers lodged an International Dealings Schedule (IDS), Schedule 25A (S25A) or IDS-Financial Services (IDS-FS). The threshold for lodging an IDS is $2 million, an increase from $1 million for the S25A. 6,699 taxpayers reported international related party dealings (IRPD) and 2,909 taxpayers reported no IRPD. The majority of IRPD was reported by taxpayers with $1 billion or more of IRPD.



22. The reported dealings include $200 billion in tangible property (stock in trade), $51 billion in services and $22 billion in interest.

Interaction between section 262A and Subdivision 284-E

23. The extent of records required under section 262A of the ITAA 1936 will depend on, and be proportional to, the evidence needed to support the application of the transfer pricing rules in the particular circumstances of the entity and the relevant dealings.

24. The ATO recognises that there will be circumstances where the record keeping requirements under section 262A of the ITAA 1936 are less than that required under Subdivision 284-E of Schedule 1 to the TAA 1953. That is, the documentation

[6] See paragraph 11 of *Macquarie*.

requirements under section 262A of the ITAA 1936 will always be approximately equal to or less than what is required under Subdivision 284-E.

Question for discussion: general record keeping requirements

i. Why is it appropriate (or inappropriate) from a practical perspective to target any special administrative guidance to dealings where the requirements under section 262A would be less than that required under Subdivision 284-E (to advocate a reasonably arguable position)?

Compliance costs

25. The Senate Economics Legislative Committee (SELC) in May 2013 stated legislative requirements for documentation should not be overly prescriptive in order to avoid imposing unnecessary costs on businesses. The Committee recommended on page 47 of their report:[7]

> 3.53 However, noting some of the concerns raised by several witnesses, and in particular concerns regarding the impact of the record keeping requirements on small and medium enterprise, the committee recommends that the government consider expanding its efforts to provide guidance to taxpayers so that they can make an informed judgement about the level of risk they are exposed to in terms of related party dealings.

26. Chapter 5 of the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010* on "Documentation" states:

> 5.7 Thus, while some of the documents that might reasonably be used or relied upon in determining arm's length transfer pricing for tax purposes may be of the type that would not have been prepared or obtained other than for tax purposes, the taxpayer should be expected to have prepared or obtained such documents only if they are indispensable for a reasonable assessment of whether the transfer pricing satisfies the arm's length principle and can be obtained or prepared by the taxpayer without a disproportionately high cost being incurred. The taxpayer should not be expected to have prepared or obtained documents beyond the minimum needed to make a reasonable assessment of whether it has complied with the arm's length principle.

27. The OECD recognise that the records required to demonstrate compliance with transfer pricing principles are proportional to the transfer pricing dealings and will involve an exercise of judgement on the part of the taxpayer and the tax administrator.

28. The majority of taxpayers with international related party dealings report the use of OECD methods for documenting their transfer prices in their IDS. There are a small number of taxpayers that report using non-OECD methods or report no transfer pricing method at all. This indicates that while many taxpayers already have documentation that is consistent with the OECD guidelines, there are a small number of taxpayers that have not yet adopted the OECD approach and they may face some transitional compliance costs to meet the new requirements.

29. Of the taxpayers that report that they have documentation, for many transactions the documentation covers less than 25% of the dealings. Compliance costs may be incurred to raise the level of documentation to cover all relevant dealings. Further analysis may be needed to understand the value, complexity and risk factors of the undocumented dealings.

[7] The Senate Economics Legislation Committee of May 2013 on the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profits Shifting) Bill 2013 [Provisions]

Questions for discussion: compliance costs

i. What are the approximate compliance costs (value, time, personnel) for documenting particular categories of transfer pricing in terms of materiality to the overall Australian tax position (value and % relative to tax payable) and the complexity of the dealings relative to other transfer pricing?

ii. How do the compliance costs relate to natural or already existing record keeping systems, the cost of professional advice and the cost of review or audit?

iii. In a self-assessment context, what are the main factors or features of transfer pricing that may result in compliance costs becoming disproportionate?

Effective and efficient allocation of administrative resources

30. The tax system operates largely as a self-assessment system and compliance resources are necessarily allocated on the basis of risk. In the context of transfer pricing, the ATO has an end-to-end compliance process which includes risk identification, assessment and management. In managing risk more generally, the ATO has in the past provided guidance on accepted ways of applying the law to certain types of dealings or for certain categories of taxpayers. For the specified dealings or category of taxpayer, this provides greater certainty, makes it easier to comply, reduces compliance costs and reduces the need for the ATO to allocate compliance resources to examine the specified dealings. In these circumstances, the documentation would need to confirm that the taxpayer and the dealings are of the type specified and the rules were applied in the accepted way.

31. The OECD paper for public consultation titled *Draft Handbook on Transfer Pricing Risk Assessment* (30 April 2013) recognises that:

> Every tax administration operates with finite resources. While enforcement of transfer pricing rules is a key priority for most tax administrations, no country has the enforcement resources to perform a thorough audit of every possible transfer pricing case. As a result, decisions need to be made about how to most effectively deploy the available enforcement resources. Resource allocation ultimately requires an effective means to strategically select the cases that should be audited.

32. The draft handbook sets out how administrators can assess if a transfer pricing risk exists. The risk factors and indicators include losses or low profitability, significant dealings with low tax jurisdictions, excessive debt or interest expenses, business restructurings and transfer of intangibles to related third parties.

Questions for discussion: administration

i. Are there examples of low risk transfer pricing dealings that are relatively straight forward in terms of the records needed to demonstrate compliance with the transfer pricing rules?

ii. Are there industry accepted practices for applying the transfer pricing rules in particular circumstances? For example, use of industry benchmarks.

Options for discussion

33. The options aim to use available evidence about compliance and administrative issues to develop solutions that support practical voluntary compliance with, and administration of, the transfer pricing documentation requirements.

34. The guiding principle for any administrative option under consideration is that the general record keeping requirements under section 262A of the ITAA 1936 must be met and any option must promote voluntary compliance, and be consistent with the transfer pricing rules. It is important to note that the options are not mutually exclusive.

Option 1 - Proportional approach

If the records meet the general record keeping requirements (but not the minimum documentation requirements to qualify to advocate for a reasonably arguable position), the discretion to remit part of the administrative penalty may be exercised to undo the effect of the higher base penalty amount. This factor must be considered in light of all of the relevant circumstances of the taxpayer and will not itself be an overriding factor for the exercise of the discretion to remit.

35. The requirements under the general record keeping provision will be proportional to the nature of the transfer pricing dealings and may in the simplest of transactions require little more than records of the transactions themselves, provided the records demonstrate a reliable application of the arm's length principle. In more complex transfer pricing dealings, records required under the general record keeping provisions will be consistent with that specified in Subdivision 284-E of Schedule 1 to the TAA 1953.

36. For cases clearly in the former category, in the event of a transfer pricing adjustment, compliance with the general record keeping requirements could be specified as a relevant factor in deciding whether to exercise the discretion to remit part of the administrative penalty under 298-20 of Schedule 1 to the TAA 1953. Practically, this may allow consideration of a reasonably arguable position even though the Subdivision 284-E of Schedule 1 to the TAA 1953 requirements was not met.

37. The approach is consistent with the legislative design of the transfer pricing documentation requirements which ensures that taxpayers have a choice about whether or not to document their dealings in accordance with Subdivision 284-E of Schedule 1 to the TAA 1953 if this differs from that required under 262A of the ITAA 1936. Because the consequence of not complying with the Subdivision 284-E requirements is limited to a higher base penalty, entities are able to exercise their own judgment of the records they are required to keep based on an assessment of the risk that the Commissioner will not agree with their transfer pricing (and a transfer pricing adjustment is made). However, they will be exposed to a higher base penalty rate if a transfer pricing adjustment is made. This option may provide some protection from penalties if the dealings are such that compliance with the Subsection 284-E requirements in its entirety would be unnecessary.

38. A potential administrative option for consideration would be to design a threshold to support a proportional approach in relation to record keeping. The framework for such a threshold could be companies with total IRPD not greater than $15 million. The intent of this threshold is to target companies who represent a lower aggregate transfer pricing risk.

39. There are 4,409 companies that currently lodge an IDS, S25A or IDS-FS which meet these criteria. These companies represent approximately 66% of taxpayers who report international related party dealings. The total value of related party dealings of these taxpayers is $16.6 billion or 4.4% of total international related party dealings.
40. The types of dealings are concentrated around tangible goods ($5.7 b) and services ($3.7 b) which together represent approximately 60% of the related party dealings of these companies.
41. Such an approach would help provide guidance to taxpayers and reduce the impact of record keeping requirements on small and medium enterprise in accordance with the recommendation of the SELC. It would do so within an acceptable level of risk to revenue (effected by the relatively low total revenue threshold).
42. In keeping with a proportional approach, the design of such an administrative option would need to have limitations to exclude certain entities. This could include entities that have undergone restructuring or involved in sectors such as the digital economy.
43. The design of this option would also need to take into account the Full Federal Court's decision in *Sanctuary Lakes Pty Ltd v Commissioner of Taxation* (2013) 212 FCR 483; [2013] FCAFC 50. This case held that the factors to be taken into account when exercising the discretion to remit a penalty should be unconfined and that the particular circumstances of the taxpayer must be taken into account.

Question for discussion: proportional approach

i. Is the proposed threshold to target a proportional approach appropriate?

ii. What likely effect would a proportional approach have on voluntary compliance with the transfer pricing rules?

iii. What features should a proportional approach have including scope and exceptions?

iv. What are the risks and what could be done to mitigate those risks?

Option 2 – Simplified transfer pricing methods

Publish a general administrative practice of an accepted approach to the application of the transfer pricing rules to particular low risk transaction types. Under this approach, the records would need to evidence that the entity is eligible to apply the simplified approach, that the transaction is of the type specified and demonstrate that the rules were applied in the accepted way.

Questions for discussion: simplified transfer pricing methods

i. What lower risk transactions should be the subject of a simplified transfer pricing methodology, how can they be defined and what compelling reasons or evidence support this?

ii. What is the appropriate methodology for such transactions and what is the evidence to support that this will promote voluntary compliance with the transfer pricing rules?

iii. What are the risks and what could be done to mitigate those risks?

Services

44. Taxation Ruling *TR 1999/1: Income tax: international transfer pricing for intra-group services* sets out administrative practices for services. The Ruling is designed to assist taxpayers and ATO officers to determine whether the prices for services or dealings with associated enterprises conform to the arm's length principle. The Ruling applies to intra-group services in the nature of work performed including administrative, management, technical, financial, marketing, sales or distribution, research and development and like services. It also provides guidance about identifying chargeable and non-chargeable services. In order to reduce compliance costs, the Ruling sets out circumstances in which the Commissioner is prepared to accept certain specified transfer prices used in tax returns as a reasonable approximation of arm's length prices.

> 75. Because of the difficulties frequently encountered in determining arm's length prices for intra-group services, other means are needed to apply the fair sharing of taxes concept which underlies the Associated Enterprises articles and Division 13. … In order to reduce compliance costs, especially where they might otherwise be disproportionately large, and provide greater certainty, but still approximate arm's length pricing, the Commissioner will exercise the discretion in Division 13 and the Associated Enterprises articles not to make transfer pricing adjustments in the circumstances listed …. The Commissioner will regard the use of the transfer prices specified …, in tax returns for the 1997-98 and later income years, as giving rise to a realistic outcome in these circumstances.

45. The Ruling reinforces that adequate documentation is an important element of the process of applying the transfer pricing rules and that generally, the transfer pricing rules should be applied in their entirety. Only in the specified circumstances can the general administrative practice be applied and accepted as an approximation of arm's length prices, as summarised in the following table.

Table 1 – General administrative practice for intra-group services

	Services acquired from foreign associated enterprises		**Services supplied to foreign associated enterprises**	
	Administrative practice for non-core services	Administrative practice in de - minimus cases	Administrative practice for non-core services	Administrative practice in de - minimus cases
Applies to all services?	No	Yes	No	Yes
Principal restrictions on the application of the administrative practices	The total amount charged for the services is not more than 15% of the total expenses of the Australian group companies Adequate documentation is maintained by the company	The total direct and indirect costs of providing the services is not more than $500,000 in the year Adequate documentation is maintained by the taxpayer	The total amount charged for the services is not more than 15% of the total revenues of the Australian group of companies Adequate documentation is maintained by the taxpayer	The total direct and indirect costs of providing the services is not more than $500,000 in the year Adequate documentation is maintained by the taxpayer
Acceptable transfer prices	Not more than the lesser of: (a) The actual charge; and (b) The cost of providing the services plus a mark-up of 7.5%	Not more than the lesser of: (a) The actual charge; and (b) The cost of providing the services plus a mark-up of 7.5%	Not less than the lesser of: (a) The actual charge; and (b) The cost of providing the services plus a mark-up of 7.5%	Not less than the lesser of: (a) The actual charge; and (b) The cost of providing the services plus a mark-up of 7.5%
Alternative mark-ups in transfer prices for particular countries	Up to 10% with additional documentation	Up to 10% with additional documentation	Down to 5% with additional documentation	Down to 5% with additional documentation
Count of eligible taxpayers	2,517	1,232	1,830	909
Value of related party services ($m.)	14,736	222	11,607	175

46. Globally, the OECD report on *Dealing Effectively with the Challenges of Transfer Pricing* (2012:14) recognises:

> the pricing difficulties that can arise because intra-group transactions are not directly comparable to transactions that commonly take place between unrelated parties, or because they involve the provision of highly specialised services and the use of unique intangible assets, are becoming more commonplace. It follows that where these factors are present transfer pricing enquiries and disputes require high levels of resource and specialist industry and economic expertise that is scarce within tax administrations and which may need to be obtained externally.

Question for discussion: intra-group services

i. What changes would be necessary to ensure that this simplified transfer pricing methodology is appropriate under the new transfer pricing rules?

ii. What are the compliance savings of the simplified transfer pricing methodology and how does this compare to promoting voluntary compliance with the transfer pricing rules?

iii. What are the risks and what could be done to mitigate those risks?

Interest rates on borrowings (interest deductions)

47. A preliminary analysis was undertaken by the Economist Practice to assess the coverage of establishing a safe harbour interest rate for taxpayers that report less than $20 million in related party borrowings.

48. 1,364 taxpayers would be impacted by a safe harbour interest rate at the $20 million borrowings threshold. This is relatively significant when compared to the number of entities that report related party dealings (8,620 taxpayers) and interest bearing borrowings (2,145 taxpayers).

49. However, these companies reporting less than $20 million in interest bearing related party borrowings account for only 3% of total interest bearing borrowings ($6.6 billion) and 4% of total interest ($375 million).

50. One third of companies with related party borrowings less than $20 million do not pay tax and would not be impacted by the introduction of a safe harbour interest rate benchmark.

Questions for discussion: interest rates on borrowings

i. In considering the above, who should be able to apply a simplified transfer pricing methodology for interest rates on borrowings and what type of borrowings should it apply to?

ii. What are the compelling reasons for introducing a simplified transfer pricing methodology for interest rates?

iii. Is there any existing industry practice that could inform the development of a simplified methodology?

iv. What are the compliance savings of the suggested simplified transfer pricing methodology and how does this compare to promoting compliance with the transfer pricing rules?

v. What are the risks and what could be done to mitigate those risks?

Distributors

51. An analysis by the Economist Practice scoped the population for simple distributors that may be covered by a transfer pricing safe harbour. The analysis focuses on simple distributors of manufactured products only.[8]

52. The report identifies 641 taxpayers as potential simple distributors, with annual income of less than $250 million and significant purchases of stock in trade from international related parties.

53. Using the earnings before interest and taxes (EBIT) to income as a measure of profitability, the interquartile range (being the middle 50% of results) of profit results of the 641 taxpayers is 1.6% to 10.7%, with a median of 4.6%.

- the majority (n=493) performed above the lower end of the independent distributors.
- 360 taxpayers reported profits above the top end of 3.8% EBIT to income.
- 152 simple distributors performed below the lower end of 1.1%.

[8] Luu, A, *Simple distributor population,* PG&I Economist Practice, October 2013

Question for discussion: distributors

i. In considering the above, how could simple distributors be defined and what is an appropriate simplified transfer pricing methodology?

ii. What are the compelling reasons for introducing a simplified transfer pricing methodology for distributors?

iii. What administrative benefits would be achieved by a simplified transfer pricing methodology?

iv. What likely effect would a simplified methodology have on voluntary compliance with the transfer pricing rules?

v. What are the risks and what could be done to mitigate those risks?

Option 3 – A de minimus rule

To support the practical administration (and voluntary compliance) of the transfer pricing rules, the ATO could work with the Economist Practice, Risk Owners and external stakeholders to develop a de minimus rule for transfer pricing. The rule could apply to defined dealings or entities so that the ATO generally will not undertake compliance activity if, for example, the dealings are below a certain threshold. It would be appropriate to override the general administrative practice if there is evidence that the entity is trying to circumvent the proper application of the transfer pricing rules.

54. This option is similar to simplified transfer pricing methodologies but could be applied to a more broadly defined group of dealings or entities.

55. The OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010* recognise that safe harbours can simplify compliance, provide greater certainty and allow administrative resources to be allocated to higher risk dealings. However, any safe harbours must be in balance with the risk to revenue, any consequences for entities in other jurisdictions and the requirements under the law. The guidelines in particular highlight at paragraph 4.102 that:

> It is difficult to establish satisfactory criteria for defining safe harbours, and accordingly they can potentially produce prices or results that may not be consistent with the arm's length principle.

56. While safe harbours are more akin to simplified transfer pricing methods, they are also relevant to a discussion of a de minimus rule, particularly the observations made in paragraph 4.122.

> On the other hand, tax administrations have considerable flexibility in administering the tax law. They can choose to concentrate more resources on cases involving large taxpayers or an important proportion of controlled transactions and show more tolerance towards smaller taxpayers. While more flexible administrative practices towards smaller taxpayers are not a substitute for a formal safe harbour, they may achieve, to a lesser extent, the same objectives pursued by safe harbours. In view of the above considerations, special statutory derogations for categories of taxpayers in the determination of transfer pricing are not generally considered advisable, and consequently, the use of safe harbours is not recommended.

57. Using a general administrative practice to communicate to taxpayers areas that generally will attract compliance resources and those that will not is seen by the OECD to be a more appropriate way of differentiating how the transfer pricing rules will be

applied to certain entity types or types of dealings. The benefit of this approach is that it will not prevent the ATO from responding appropriately to emerging compliance risks (or diminishing compliance risks) and will also provide taxpayers with an opportunity to reduce compliance costs by focussing their own resources on higher risk transfer pricing matters.

58. If this option is progressed, consideration will need to be given to how the integrity of the transfer pricing rules could be protected. For example, in testing whether an entity comes within the scope of a general administrative practice, regard must be had to whether there is evidence of non-compliance such as incorrectly reporting relevant dealings in order to come within the general administrative practice.
59. If an entity does not fall within a de minimus rule, other administrative options may be available such as an advance pricing arrangement or annual compliance arrangement.
60. The following data from Economist Practice provides some evidence that may support the introduction of a de minimus rule. They found that almost half of all entities who lodged an IDS had between $1 and $50m of IRPD. Nearly all entities reporting $50m or more of IRPD were companies.
61. The majority of IDS lodgers had turnover of less than $50m in 2012, while the majority of IRPD was reported by entities with $100m or more of turnover as per their company tax return.
62. 59% of IDS, Schedule 25A or IDS-FS lodgers did not report any services IRPD, while 70% did not report any interest IRPD.
63. An alternative approach proposed by the Inspector General of Taxation is a $15 million threshold for IRPD.
64. It is important to emphasise that a general administrative practice cannot affect the Commissioner's duty to act according to law and to assess taxpayers to the correct amount of liability imposed by the legislation. General administrative practices can be used however to manage administrative resources effectively and efficiently. Practically, the Commissioner will stand by an administrative practice unless there is evidence of non-compliance with that practice. In the event that an adjustment is made, the taxpayer will be protected from administrative penalties to the extent that they have relied on a general administrative practice.

Question for discussion: de minimus rule

i. What are the compelling reasons or evidence to support the introduction of a de minimus rule?

ii. What administrative benefits would be achieved by a de minimus rule?

iii. What likely effect would a de minimus rule have on voluntary compliance with the transfer pricing rules?

iv. What features should a de minimus rule have including scope and exceptions?

v. What are the risks and what could be done to mitigate those risks?

Submissions or comments

65. The ATO would like to invite comments and to work with internal and external stakeholders to develop these options. Any options pursued must be supported by evidence and must be consistent with the intent and operation of the relevant legislative requirements.

Contact

Megan Butcher
Phone: (07) 3213 5771
Email: megan.butcher@ato.gov.au