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Australia Adopts Simplified Transfer Pricing Documentation

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This article looks at the Australian Taxation Office simplified transfer pricing record-keeping requirements issued in February 2017 (see http://src.bna.com/nbP). In addition to simplified reporting requirements, the guidance introduces a number of safe-harbors for intra-group transactions.

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The author is showing his age but the Australian Taxation Office ("ATO") once marked transfer pricing documentation after audit review with a grade from one to five. A mark below three necessitated the taxpayer to make changes and then re-submit the documentation for a second review. A mark above three was considered to be sufficient to meet documentation requirements (something to take home and stick to the fridge with a magnet perhaps. . .).

However, the ATO have (in recent years) adopted an aggressive approach to transfer pricing challenges putting this fiscal authority alongside Germany and India as a high-risk transfer pricing jurisdiction for most multinational businesses irrespective of the size, scale and complexity of operations in those locations; we have been assisting a number of businesses with independent economic assessments of transfer pricing structures to help defend challenges.

The ATO have acknowledged in recent guidance (Practical Compliance Guideline PCG 2017/2) that existing transfer pricing requirements "may impose an administrative burden disproportionate to your risk of not complying with the transfer pricing rules." The revised guidance provides a reduced documentation requirement for certain situations that include:

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1. Small taxpayers;
2. Distributors;
3. Intra-group services;
4. Low level inbound loans;
5. Materiality;
6. Management and administration services;
7. Technical services; and
8. Low level outbound loans.

It is worth touching upon each of these in turn (note that there are distinct rules for financial and capital transactions).

1. Small Taxpayers

Businesses with annual turnover below AU$25 million (consolidated "Australian economic group" basis) will be eligible under this criterion providing the business:

- has not made sustained losses;
- does not have related-party dealings with entities in certain "specified countries";
- has not undergone a restructure within the year;
- does not have related-party dealings involving royalties, licence fees, or research and development arrangements;
- does not have related-party dealings greater than 15 percent of turnover;
- is not a distributor (separate eligibility criteria); and
- has assessed your compliance with the transfer pricing rules.

2. Distributors

This criterion will apply if the entity is a distributor and has annual turnover under AU$50 million (for the Australian economic group), and:

- does not have a profit-before-tax ratio of less than 3 percent;
- does not have not made sustained losses (the ATO like many Fiscal Authorities do not like persistent losses and believe this to be an indication that transfer pricing may be incorrect);
- does not have related-party dealings with entities in certain "specified countries";
- has not undergone a restructure within the year;
- does not have related-party dealings involving royalties, licence fees or research and development arrangements; and
- has assessed your compliance with the transfer pricing rules.

3. Intra-group Services

There is a de minimis rule for intra-group transactions that are lower than AU$1 million (combined received and provided) where:

- for services received—the total amount charged must not be more than 15 percent of the total expenses (of the Australian economic group);
- for services provided—the total amount derived must not be more than 15 percent of the total revenue of (of the Australian economic group);
- there is a mark-up on costs of the relevant services of 7.5 percent or less for services received (and 7.5 percent or more for services provided); and
- the business has not made sustained losses, does not have related-party dealings with entities in "specified countries," has not undergone a restructure within the year, does not have specified service related-party dealings, and has assessed compliance with the transfer pricing rules.

4. Low Level Inbound Loans

Under this criterion, the combined cross-border loan balance should be AU$50 million or less (for the Australian economic group) at all times throughout the financial year. Inbound loans should have an interest rate that is no more than the Reserve Bank of Australia ("RBA") indicator lending rate for "small business; variable; residential-secured term" and the funds actually provided under the loan should be Australian dollar funds as reflected in loan agreements. Associated expenses should also be paid in Australian dollars and the business should not have made sustained losses, does not have related-party dealings with entities in "specified countries," has not undergone a restructure within the year, and has assessed compliance with the transfer pricing rules.

5. Materiality

Under this criterion, total international related-party dealings should represent less than or equal to 2.5 percent of total turnover (for the Australian economic group) and the business should not have related-party dealings with entities in the "specified countries," does not have related-party dealings involving royalties, licence fees, or research and development arrangements, and has assessed compliance with the transfer pricing rules.

6. Management and Administration Services

Under this criterion, income from and expenditure on management and administration services must not be more than 50 percent of the total international related party dealings (of the Australian economic group), and the business has a mark-up on costs of the relevant services of 5 percent or less for service received and 5 percent or more for services provided. The business should not have related-party dealings with entities in "specified countries," and should have assessed compliance with the transfer pricing rules.

7. Technical Services

Income from and expenditure on technical services must not be more than 50 percent of the total international related-party dealings (of the Australian economic group), and there should be a mark-up on costs of the relevant services of 10 percent or less for services received and 10 percent or more for services provided. The business should not have related-party dealings with entities in "specified countries," and should have assessed compliance with the transfer pricing rules.

8. Low Level Outbound Loans

Under this criterion, combined cross-border loan balance must be AU$50 million or less (for the Australian economic group) at all times throughout the financial year, and (for each of the outbound loans) the interest rate is no less than the following rates:

- 4.91 percent in your 2015 income year of assessment;
- 4.37 percent in your 2016 income year of assessment; and
- 4.34 percent in your 2017 income year of assessment.

The funds must actually be provided in Australian dollar funds and this should be reflected in loan agreements with associated expenses paid in Australian dollars.

Conclusion

The de minimis limits are reasonable and attempt to differentiate between types of transaction (5 percent-7.5 percent-10 percent) mark-ups for routine transactions compared to the OECD blanket low value recommendation of 5 percent and rates of interest based on published bank rates). In time, one will be able to assess how much relevance the safe-harbors have for larger businesses and the references to X percent "or less" for services received and X percent "or more" for services provided may also help businesses to achieve balance under two-sided transfer pricing analysis.

The changes will benefit smaller and less complex jurisdictions. However, the changes will also free up ATO resource to keep going after larger and more complex multinational businesses with aggressive transfer pricing audits. We have been asked by a number of businesses to help them exit operations from Australia—something witnessed in the U.K. in the late 90s and is an example of how an onerous taxation policy and a heavy-handed approach can hamstring foreign direct investment.

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