STAGE ONE OF AUSTRALIA'S TRANSFER PRICING CHANGES: PUBLIC SUBMISSIONS (RE)ACTION

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This paper concerns the 2011 Australian Government's then proposed changes to the transfer pricing rules, referred to as the stage one amendments, and the consultation process to provide interested parties with an opportunity to comment. The paper covers the external submissions received, with a focus on the dominant issues raised in the submissions regarding the planned changes to the transfer pricing rules. Also examined is the extent to which the issues advanced by the interested parties were included in the Bill that was tabled in parliament for debate, and finally enacted in September 2012 as Tax Laws Amendment (Cross-Border Transfer Pricing) Act (No. 1) 2012 *(Cth).*

Using the methodology of grounded theory, we analyse 37 public submissions from the stage one consultations to ground a theory and explain the submitters' issues of concern. The key concerns about the proposed amendments are: opposition to any retrospective powers; requests protection for taxpayers from penalties arising from a transfer pricing amendment; resistance to assigning 'separate taxing powers' to Australian tax treaties; and a clear aversion to any 'discrimination' against foreign related parties that are resident of a country that has a tax treaty with Australia. Transfer pricing literature is used to validate the results. While there were consistent patterns of concern in the submissions from the interested parties, the adoption of their requests was low in the stage one amendments.

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1. INTRODUCTION

In 2011 the Australian Government initiated a consultation process by calling on interested parties for submissions on proposed changes to the transfer pricing (TP) rules, which are referred to as the stage one amendments. A consultation paper was subsequently released in November 2011.[1]

On 16 March 2012 an Exposure Draft (ED) of the proposed legislation and a draft Explanatory Memorandum (EM) were released.[2] On 24 May 2012 the draft Tax Laws Amendment (Cross-Border Transfer Pricing) Bill No 1 2012 (TP Bill) was debated in the House of Representatives and it was again made available for comment by interested parties before debate by the Senate.[3]

The International Tax Integrity Unit of the Australian Treasury and the Senate Economics Legislation Committee ('the Committees') managed the consultative process. The Committees thus received public submissions from a range of business organisations (some multiple) by the closing dates on

[1] The Treasury, 'Consultation Paper - Income Tax: Cross Border Profit Allocation - Review of Transfer Pricing Rules' (1 November 2011) <http://archive.treasury.gov.au/contentitem.asp?ContentID=2219>.
[2] Hon David Bradbury, 'Media release No 006: Draft amendments to transfer pricing regime released for consultation' (16 March 2012) <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/006.htm&pageID=003&min=djba&Year=&DocType=>.
[3] See <http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4815> for the full set of papers of the Parliamentary process of the TP Bill.

three different occasions, being November 2011, March and July 2012.

Detailed in this paper are the dominant issues about the proposed TP amendments contained in interested parties (public) submissions sent to the Committees. Also examined is the extent to which the Committees considered the issues advanced by the public were adopted in the final draft of the TP Bill that was tabled in parliament for debate. The TP Bill was enacted as *Tax Laws Amendment (Cross-Border Transfer Pricing) Act (No 1) 2012* (Cth) (the TP Act) and received Royal Assent on 8 September 2012. The TP Act inserts the new subdivision 815-A into the *Income Tax Assessment Act 1997* (Cth) (*ITAA 1997*) and makes consequential amendments to the *Income Tax Assessment Act 1936* (Cth) (*ITAA 1936*). The TP Act also amends the *Income Tax (Transitional Provisions) Act 1997* (Cth) (*ITTP 1997*) and the *Taxation Administration Act 1953* (Cth) (*TAA 1953*).[4]

A research question is not posed at this point. As will be explained, the grounded theory methodological approach is utilised, whereby the research question emerges after the data analysis.

Generally transfer pricing refers to the pricing of transactions between related businesses to determine the income of the parties to the transaction.[5] Prior to the TP Act, the Australian TP rules were found in a short and straightforward provision, which was later 'rendered almost completely

[4] See the web-link at n 3 above, which lists the final draft of the TP Bill (including the subdivision 815-A) that was first debated on the House of Representatives on 24 May 2012.

[5] Robert Feinschreiber, 'Practical Aspects of Transfer Pricing' (1996) 70 *Florida Bar Journal* 41.

impotent by the High Court'[6] in a TP dispute, *FCT v CAC Ltd*.[7] The Government's response to this case was to change the TP legislation in 1982 by the insertion of Division 13 into the *ITAA 1936* and the *International Tax Agreements Act 1953*. Taxation rulings—which reflect the opinion of the Commissioner of Taxation about TP—were subsequently issued to provide guidance to multinational enterprises about the application of the TP rules in Division 13. From 2010 SNF (Australia) Pty Ltd, a company with trading losses over several years, was a party to a transfer pricing court case. It purchased inventory from its French parent, which was sold to customers in the United States and the People's Republic of China. The Commissioner of Taxation argued for a transfer pricing adjustment of SNF's income tax liability on the basis of the relevant Double Tax Agreement (DTA) and Division 13, *ITAA 1936* (Cth). The matter went to appeal and the Commissioner of Taxation lost the case. The Full Federal Court, in making its decision, only referred to domestic transfer pricing legislation and disregarded the use of OECD Guidelines to interpret DTAs.[8] The outcome of this case prompted the Government to initiate a public consultation process on changes to Australia's transfer pricing rules.

For this paper, the 2011 and 2012 submissions from the public relating to stage one of the proposed TP changes have

[6] Richard Krever and Jiaying Zhang, 'Australia: Resolving the Application of Competing Treaty and Domestic Law Transfer Pricing Rules' in Michael Lang (ed) *Tax Treaty Case Law Around the Globe - 2011* (Linde, 2011) 201, referring to the now repealed *ITAA 1936* s 136(a).

[7] *Federal Commissioner of Taxation v Commonwealth Aluminium Corporation Ltd* (1980) 143 CLR 646.

[8] *Federal Commissioner of Taxation v SNF (Australia) Pty Ltd* (2011) 193 FCR 149 (*SNF*). See Krever and Zhang, above n 6, for a summary of the *SNF* issues. The basis of the Full Federal Court's decision was to reject the OECD Guidelines as just 'guidelines' that were 'not a legitimate aid to the construction of the double tax treaties'; *SNF*, [118].

been classified into automotive, resource and foreign investment industries (or sectors). These three industry categories are arguably the most likely to be affected by the amendments. A fourth category, global accounting firms (or Big Four) has also been separated out for examination. The rationale is that the Big Four members are frequently principal advisors to multinational organisations.

From the analysis of the issues raised in the submissions of these categories (and other organisations), it was found that the key concerns in regard to the proposed TP amendments were (i) opposition to any retrospective power; (ii) requests for taxpayer protection from penalties arising from a transfer pricing amendment; (iii) resistance to assigning 'separate taxing powers' to the Australian tax treaties; and (vi) a clear aversion to any 'discrimination' relating to foreign related parties, from a country that has a tax treaty with Australia.

In relation to the extent to which the submission issues were considered and/or adopted, the Committees disregarded the opposition to retrospectivity, as the new TP provisions are operative back to 1 July 2004.

On the other hand, it appears that the Committees made some positive responses to submissions from the public, as the TP Act includes a provision that would seem to protect taxpayers from penalties resulting from an adjustment made under subdivision 815-A *ITAA 1997*, when applied to a period prior to its enactment. There is still uncertainty about whether the TP Act actually confers 'separate taxing powers' to Australian tax treaties, as the Committees were silent on this issue. The wording of the new subdivision 815-A does not explicitly provide for separate powers under the tax treaties. Finally, while the Committees made no formal comment on whether the then proposed TP changes were discriminatory, the

stage one TP provisions apply exclusively to foreign related parties from countries with which Australia has a tax treaty.

This paper's contribution to stage one of Australia's TP amendments is an examination of the most common concerns in the primary data—the submissions from the public—and Committee's response to the issues raised as evidenced in the final TP Act.

2. METHODOLOGY

A qualitative approach is used to conduct this research. Qualitative research refers to 'the meanings, concepts, definitions, characteristics, metaphors, symbols, and descriptions of things',[9] such that the nature of things is examined. Qualitative research focuses more on principles from interpretive or critical social science and looks for the generation of new theories.[10]

The methodological framework of 'grounded theory' is used to analyse the data in order to ground a theory and, in this case, to explain the issues of concern in the draft of stage one transfer pricing provisions. Step one is to undertake a close reading of the public submissions to enable categorisation, or coding, of the content into matrices, and to ground a theory. The last step is to validate the theory/ies through comparative analysis with the literature. This framework and the method utilised are further described below.

2.1 Grounded theory

[9] Bruce L Berg, *Qualitative Research Methods for the Social Sciences* (Pearson, 5th ed, 2004) 3.
[10] W L Neuman, *Social Research Methods: Qualitative and Quantitative Approaches* (Pearson, 7th ed, 2011).

The grounded theory methodology is based on the Corbin and Strauss variation, described below and the primary data is the content of the public submissions from three phases of consultation.[11]

Grounded theory is about building a theory, rather than testing an hypothesis. It is an inductive, as opposed to deductive, approach. The aim is to build substantive theory on issues arising from the submissions and consider if the theory can be applied to broader areas. Despite the theory being grounded in the data, the researcher is required to be detached and objective.

In adopting the Corbin and Strauss approach to grounded theory, there is a three part coding process.[12] The first step, 'open coding', or theoretical sampling, is when data collection and analysis proceed concurrently. The first broad reading of the data (in this case submissions) immediately begins to suggest

[11] Juliet Corbin and Anselm L Strauss, *Basics of Qualitative Research: Techniques and Procedures for Developing Grounded Theory* (Sage, 3rd ed, 2008). Grounded theory was first introduced in 1967 by Glaser and Strauss; see Barney G Glaser and Anselm L Strauss, *The Discovery of Grounded Theory: Strategies for Qualitative Research* (Aldine, 1967). Then Strauss worked with Corbin on a 'more prescriptive' variation of grounded theory, and Glaser continued to solely research on the 'original' grounded theory technique, see Juliet Corbin and Anselm Strauss, 'Grounded Theory Research: Procedures,Canons, and Evaluatuve Criteria' (1990) 13 *Qualitative Sociology* 3; Barney G Glaser, *Doing Grounded Theory: Issues and Discussions* (Sociology, Press 1998).

[12] Corbin and Strauss,above n 11. Descriptions of other grounded theory variations can be found in Margaret McKerchar, *Design and Conduct of Research in Tax, Law and Accounting* (Thomson Reuters Lawbook, 2010); P Liamputtong and D Ezzy, *Qualitative Research Methods* (Oxford University Press, 2005); Ian Dey, *Grounding Grounded Theory* (Academic Press, 1999); Matthew Miles and Michael Huberman, *An Expanded Sourcebook:Qualitive Data Analysis* (Sage, 2nd ed, 1994); Antony Bryant and Kathy Charmaz, *The SAGE Handbook of Grounded Theory* (Sage, 2010); Kathy Charmaz, *Constructing Grounded Theory: A Practical Guide through Qualitative Analysis* (Sage, 2006).

theories and involves eliciting opinions, contexts, the consideration of, here, transfer pricing related events and other conditions. The data is then sorted and the phenomena labelled using a constant comparison process. Analytical, rather than descriptive, terms are used for labels, requiring the data to be constantly compared, back and forth, before assigning categories. Labels ideally use the *in vivo* (informant's terms) and the process continues until coding categories are exhausted. As the categorisation continues trends across data sets should emerge and aberrations can be identified. Here the theory is expected to become saturated; that is, the data adequately supports emergent theory. For instance, in July 2012 one unresolved TP issue concerned retrospectivity of the legislation and all submissions (with the exception of Australian Treasury's response), were against the prospect of backdating. Thus the category of 'retrospectivity' becomes dimensionalised.

As the researcher conducts data iterations, questions of, 'who, when, where, what and how' need to be asked to enhance theoretical sensitivity.[13] According to Neuman, 'coding data is the hard work of reducing mountains of raw data into manageable piles.'[14] In addition to making a large mass of data manageable, coding allows a researcher to quickly retrieve relevant sections. Afterwards, the constant comparison of data results in a reduced list of codes.

The second stage, axial coding, occurs once the categories in the matrix are fine-tuned and the researcher becomes familiar with the data. There is a review of codes and the establishment of 'relationships between the concepts'.[15] In other words, how one code might relate to another (or others) or not relate at all.

[13] See Graham Gibbs, "Grounded Theory, Open Coding, Part 4" (2010) < http://www.youtube.com/watch?v=7X7VuQxPfpk&feature=relmfu.> .
[14] Neuman, above n 10, 442.
[15] McKerchar, above n 12, 229.

Axial coding also looks for confirmations in the data and possible exceptions.[16] For example, submissions on one issue of the draft TP rules might share similar opinions, or on the contrary, hold unique points of view. At this stage the themes, patterns and connections should become apparent from the data matrix. A coding paradigm, or model, is drawn to illustrate the interrelationships of causal conditions, the central phenomenon, context, intervening events, action, interactions, strategies and consequences. Thus a theory is built.

Finally there is selective coding, which is about constructing the narrative. While Strauss and Corbin call for one core category to be related to other categories, other grounded theory advocates are open to more than one core category.[17] In either case a 'story line' is built around one or more core categories.[18] The core categories (or central phenomena) for this paper are the most common issues raised in the submissions to the Committees regarding the draft TP rules.

The three part coding process has some drawbacks that may affect the quality of the analysis. For example, the coding process may result in the data losing its depth of meaning, or the emerging codes 'may be inappropriate or not adequately capture the essence of the data'.[19] Thus a field research interview is also used to add depth to the narrative. Field research may more

[16] Graham R Gibbs, "Grounded Theory - Axial Coding," (2010) <http://www.youtube.com/watch?v=s65aH6So_zY&feature=relmfu>.
[17] See, eg, the constructivist approach in Charmaz, above n 12, 130.
[18] Graham R Gibbs, "Grounded Theory - Selective Coding," (2010) <http://www.youtube.com/watch?v=w9BMjO7WzmM&feature=relmfu>.
[19] McKerchar, above n 12, 229.

'realistically examine strategic processes and outcomes', as the research involves 'real managers and organisations'.[20]

The most crucial matter in this research does not concern numbers or figures, but the analysis of the practical problems with the legislation. It is important to understand how legislation works in practice because there may be provisions that are in the law but never applied, penalties that are severe but not imposed, or elements not in the law but implemented in practice.[21]

It would have been ideal to consider standpoints from different groups related to the TP field, such as academics, tax advisers, multinational enterprise executives and others. However, for this paper, only one tax specialist, a TP expert, from Melbourne was interviewed to expand on some of the public submission concerns. The 30 minute interview was carried out in late September, 2012, after the TP Act received Royal Assent. The interview questions are semi-structured and open in order to elicit longer and full, meaningful answers.[22] The interview was recorded for future analysis and interpretation of results. The interviewee was advised of the confidentiality of the interview, undertaken at the interviewee's workplace. After the interview the researcher made some notes.

In previous research in the tax law field McKerchar et al use grounded theory to determine the drivers for small business tax compliance costs.[23] Kraal's tax law research includes

[20] C C Snow and J B Thomas, 'Field Research Methods in Strategic Management: Contributions to Theory Building and Testing' (1994) 31 *Journal of Management Studies* 457, 457-458.
[21] Lynne Oats, *Taxation: A Fieldwork Research Handbook* (Routledge, 2012) 189.
[22] Refer to Appendix 1 for the full list of questions.
[23] Margaret McKerchar, Helen Hodgson and Michael Walpole, 'Understanding Australian Small Business and the Drivers of Compliance Costs: a grounded theory approach' (2009) 24 *Australian Tax Forum* 151.

consideration of community expectations and debate in relation to the Mineral Resource Rent Tax (MRRT) for which the method of media document analysis was used.[24] This study extends the Kraal enquiries through grounded theory, a dominant humanities discipline approach. Overall this study responds to the literature on grounded theory to manage rich and dense data, and draw out themes and patterns to extend the use of the grounded theory method to newly legislated tax issues.

2.2 Institutional theory

Institutional theory is part of critical theory and is seen as most applicable to this paper's topic to explain some of its findings. Institutional theory refers to the phenomenon in which 'highly structured organisational fields' tend to be homogenous in 'structure, culture and output'.[25] There are three mechanisms through which institutional change occurs: i) coercive; ii) mimetic; and iii) normative. The first mechanism results from the pressure of other organisations and cultural expectations in society.[26] The second mechanism, is the consequence of uncertainty and organisations modelling themselves upon other institutions.[27] Finally, the normative mechanism for institutional change is associated with professionalization – individuals from the same industry receiving similar university education and belonging to the same trade associations.[28]

[24] Diane Kraal, 'Australia's Minerals Resource Rent Tax: the multi-national mining industry response' (2012) 15 *Australasian Journal of Natural Resources Law & Policy* 77; Diane Kraal, 'A Grounded Theory Approach to the Minerals Resource Rent Tax' (forthcoming 2013) *Australian Tax Forum.*
[25] Paul J Di Maggio and Walter W Powell, 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields' (1983) 48 *American Sociological Review* 147.
[26] Ibid 150.
[27] Ibid 151.
[28] Ibid 152.

Fogarty and Dirsmith highlight that institutional theory plays a 'key role in helping organisations achieve their missions'.[29] They also claim that organisations exhibit their 'structure to constituents to demonstrate' they are acting in a 'rational, stable, and predictable manner'.[30] Nevertheless, institutional theory has also been subject to criticism. For example, Kondra and Hinings argue that by focusing on the movement towards institutional norms, institutional theory has ignored 'organizational diversity and how organizations change.'[31] However DiMaggio maintains that organisations interact in different ways as boundaries 'have become less distinct, while traditional arm's-length market transactions have become more intimate.'[32] Institutional theory is used here to understand the pattern of opinions found in the submissions.

3. DATA ANALYSIS AND THEORY CONSTRUCTION

The results of the three step (open, axial and selective) coding process follow in the sections below.

3.1 Open coding

Over the period April to August 2012 the 37 publically available submissions[33] from 23 organisations were downloaded from the Australian Treasury (Treasury) website, which held the

[29] Timothy J Fogarty and Mark W Dirsmith, 'Organizational Socialization as Instrument and Symbol: An Extended Institutional Theory Perspective' (2001) 12 *Human Resource Development Quarterly* 247.
[30] Ibid 247-248.
[31] A Z Kondra and C R Hinings, 'Organizational Diversity and Change in Institutional Theory' (1998) 19 *Organization Studies* 743, 743.
[32] Paul J DiMaggio, 'Making Sense of the Contemporary Firm and Prefiguring its Future' in Paul DiMaggio (ed) *The Twenty-First Century Firm: Changing Economic Organization in International Perspective* (Princeton University Press, 2001) 4.
[33] Three were confidential and inaccessible.

documents that covered the three consultation periods (November 2011, March and July 2012).[34]

A close reading of each submission led to the classification of issues using *in vivo* (the informant's term) for the labels. The broad categorisations were captured in an Excel spreadsheet.

The first row of the 'open coding' table shows the *in vivo* labels; the first columns show organisation name; the submission dates (some organisations forwarded more than one submission); and the body of the table uses a '1' to indicate the issues raised by each submitter organisation (see Appendix 2). The 'others' label depicts opinions that were generally unique to a particular organisation. Submission No 21, from Treasury, contained the official response to many of the issues raised in the public submissions and thus was included in the table, but not in the issue count. A raw count of the most common issues from the 37 submissions shows: most were against legislative retrospectivity (20); views against separate taxing powers to the Australian tax treaties (7); and an aversion to discrimination against tax treaty countries (11). Many submissions conveyed a call for protection against penalties arising from the proposed legislation (8).

3.2 Axial coding

Once the data in the submissions were open coded, the focus of the analysis shifted to three sectors that are arguably more likely to be affected under the proposed TP changes: the automotive industry, resource industry and foreign investment. A fourth category was the global accounting firms (known as the 'Big Four') as its members are frequently principal advisors

[34] See the public submissions at <http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=economics_ctte/completed_inquiries/2010-13/tlab_cross_border_transfer_pricing_2012/submissions.htm>.

to multinational organisations. The significance of TP to the economy is confirmed by the Treasury submission that reveals revenue to be protected by the proposed TP amendments as substantial, noting '$1.9 billion of tax relating to transfer pricing issues in current audits' is in dispute.[35]

The following analysis of the categories includes general information on the organisations in each category; the main issues raised regarding the proposed TP changes; the basis of the submitters' concerns; and the extent to which the Committees addressed the concerns unique to each category. How the Committees addressed the dominant concerns is covered in the narrative, at section 3.3.

3.2.1 Automotive Industry

The automotive category of submissions comprised GM Holden Ltd (Holden) and the Federal Chamber of Automotive Industries (FCAI). The FCAI submission notes that the automotive industry includes 'significant importers and exporters of goods and services in Australia'[36] with a turnover that 'exceeds $160 billion per annum.'[37] Holden is 'one of only three OEM's [original equipment manufacturers] which still makes cars in this country'[38] and is a member of FCAI. For the automotive industry, where the volume of international trading is significant, as is its size in terms of monetary value, changes in TP legislation may have a substantial impact on the financial processes of its organisations. Recent years have seen Australian automotive manufacturing struggle. For example, in mid-2012

[35] T McDonald, 'Sub No 21 The Treasury' (2012) 5.
[36] I Chalmers, 'Sub No 6 Federal Chamber of Automotive Industries' (13 April 2012) 1.
[37] Ibid.
[38] J Levine, 'Sub No. 5 GM Holden Ltd' (9 July 2012) 1.

Ford hinted that it may abandon its operations[39] and its closure announcement was eventually made in May 2013.

The main concerns of the automotive group were the inclusion of a retrospective power in the legislation and the potential for divergence between the treatment of transactions from an income tax and customs duty perspective.[40]

The proposed retrospective power to make draft subdivision 815-A operational back to 1 July 2004 was considered to be unfair. Holden noted the proposed backdating would mean taxpayers would have to re-evaluate tax positions for previous years. Holden claimed that retrospectivity would create uncertainty among the automotive industry as businesses considered 'two separate sets of transfer pricing laws.'[41]

The Corporate Tax Association was also concerned about the automotive industry, whereby Australian importers might be subject to two sets of TP valuation rules. It claimed the draft subdivision 815-A and its corresponding EM seemed to imply a shift in the TP rules from transactions-based to profit-based methods.[42]

By contrast, customs duty rules are currently premised on transactions-based methods.[43] As a consequence of the proposed change, organisations could be subject to two sets of valuation rules; one for income tax purposes, the other for customs duty. The Australian Customs and Border Protection Service submission also identified this disparity as worrisome and

[39] Richard Blackburn, 'Ford Hints End Nigh for its Car Making' *The Age Online* (2012). < http://theage.drive.com.au/motor-news/ford-hints-end-nigh-for-its-car-making-20120828-24yvl.html>.
[40] See Appendix 3.
[41] Levine, above n 38, 2.
[42] F Drenth, 'Sub No 2 Corporate Tax Association - Attachment 1' (30 November 2011) 4.
[43] *Customs Act 1901* (Cth) s 159.

highlighted potential problems for customs duty refund applications.[44]

The automotive industry recommended a 'whole of Government approach,' with legislation to be drafted in such a way as to take into consideration how taxpayers would be affected by the two areas of taxation.[45] The Treasury submission argued that under the draft TP rules priority is not being given to profit-based methods, but the submission was silent on customs duty. In fact, Treasury claimed, draft subdivision 815-A includes interpretive provisions to ensure consistency with the OECD approach, which requires the use of the 'most appropriate method'.[46]

As the wording in the draft TP Bill[47] and its EM[48] imply a profit-based approach it appears the automotive industry's concerns about the draft TP Bill having an effect on customs duty taxation were not actioned by the Committees.

That members of the automotive category (Holden and FCAI) shared similar views regarding the draft TP Bill can be explained by normative isomorphism. Holden belongs to the trade association (FCAI), which promotes the interests of manufacturers and importers of vehicles in Australia. The association conducts meetings where members (including Holden) discuss topics and reach a consensus on what is best for their industry, creating and instilling a normative framework.

[44] S Nyakuengama, 'Sub No 23 Australian Customs and Border Protection Service' (25 July 2012) 1.
[45] P Allan, 'Sub No 6 Federal Chamber of Automotive Industries' (11 July 2012) 2.
[46] McDonald, above n 35, 9.
[47] See, eg , section 815-5 *ITAA 1997*.
[48] See, eg, [1.56] and [1.57].

3.2.2 Resource Industry

The resource industry category comprised the Minerals Council of Australia (MCA) and Chevron Australia Pty Ltd. Chevron, part of an American multinational enterprise in the oil and gas industry, is not a member of the MCA. The MCA member companies[49] 'produce more than 85% of the nation's annual mineral wealth and account for more than 50% of Australia's exports.'[50] Chevron is currently undertaking the Wheatstone and Gorgon natural gas projects, which will position Australia as the leading supplier in the Asia-Pacific region.[51]

For this submission category the most pressing issue in the proposed TP changes was retrospective power, submissions also called for protection measures against penalties if the retrospective power was legislated. Some of the reasons to oppose the retrospective power included that retrospectivity is not synonymous with an 'equitable and efficient tax system'[52] and would create regulatory uncertainty for foreign investors in Australia.[53] Chevron was also one of three organisations to point out the possible inconsistency between the retrospective power

[49] Minerals Council of Australia, 'MCA Member Companies' (2012) <http://www.minerals.org.au/corporate/about_the_mca/mca_member_companies>.
[50] Minerals Council of Australia, 'Sub No 7 Minerals Council of Australia ' (July 2012) 2.
[51] Chevron Australia, 'Wheatstone' (undated) <http://www.chevronaustralia.com/ourbusinesses/wheatstone.aspx>.
[52] Minerals Council of Australia, above n 50, 2.
[53] Chevron Australia, 'Sub No 16 Chevron Australia Pty Ltd' (30 November 2011) section 3.0 (iv).

and Article 1(2) of Australia's Double Tax Agreement (DTA) with the USA.[54]

The MCA was the only organisation that requested clarification of what constitutes an Australian resident under draft s 815-15(1) *ITAA 97*, as it claimed there may be differences in this respect under domestic legislation and treaties.[55]

Mimetic isomorphism may explain why the MCA and Chevron concur on certain issues regarding the proposed TP changes. Although Chevron is not a member of the MCA, both organisations belong to the same industry and as a consequence of uncertainty we find that organisations model themselves upon other institutions in the same field. Provisions in the draft TP bill may entail significant uncertainty for these organisations in terms of their potential tax liabilities.

3.2.3 Foreign Investment

The only member of the foreign investment submission category was the American Chamber of Commerce in Australia (AmCham), which represents the interests of US companies with business activities in Australia. AmCham claimed the USA is the main source of foreign investment in Australia.[56] While the Committees did not receive any other submissions from organisations representing foreign interests, Moore Stephens[57]

[54] Ibid [3.0(iii)]. The Australia-US DTA at Article 1(2) is about non-restriction 'in any manner any exclusion, exemption, deduction, rebate...laws of either Contracting State.'
[55] Minerals Council of Australia, above n 50, 3.
[56] R Doyle, 'Sub No 14 American Chamber of Commerce in Australia' (11 July 2012) 1.
[57] Moore Stephens Accountants and Advisors.

submitted that the proposed TP changes might negatively affect Australia's reputation as a foreign investment destination.[58]

AmCham primarily criticised two aspects of the proposed TP amendments: the likely retrospective power; and the discrimination against investors from countries with a double tax treaty with Australia. It claimed retrospective legislation might generate 'uncertainty and business risk' about the Australian business environment.[59] It believed that several of its members could suffer an adverse impact of over AUD 100 million each if retrospective measures were introduced.[60] Further, draft subdivision 815-A might disturb the flow of foreign investment to Australia through loss of confidence.

AmCham was also concerned that the proposed TP amendments would only affect Australian subsidiaries of organisations from countries with DTAs with Australia.[61] Furthermore, AmCham asserted the TP amendments might override safe harbour levels for debt under the thin capitalisation requirements of Division 820 *ITAA 1997*.[62] In this regard, the draft EM states that its s 815-25 will preserve the thin capitalisation 'role of Division 820 as a comprehensive regime with regards to an entity's amount of debt'[63] and will ensure that subdivision 815-A 'does not defeat the operation of Division 820'.[64]

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[58] D Yeoh and S Edwards, 'Sub No 18 Moore Stephens' (13 July 2012) 1.
[59] Doyle, above n 56, 1.
[60] C Blunt, 'Sub No. 14 American Chamber of Commerce in Australia - Attachment 1' (30 November 2011) 3.
[61] Ibid 3.
[62] Ibid 4.
[63] Explanatory Memorandum, Tax Laws Amendment (Cross-border Transfer Pricing) Bill (No. 1) 2012, [1.104]. <http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4815>.
[64] Ibid [1.106].

AmCham criticised the Government's first consultative paper released on November 2011 for the minor mention of the US in comparison to the UK.[65] AmCham suggested that the proposed TP changes by the Commonwealth Government should not continue without taking into account their impact on US investors and the interpretation of the Australia-USA DTA.[66]

Institutional theory may explain why AmCham made an issue of the draft TP Bill references to the UK DTA, as opposed to the US DTA, for in the US it is normative to look internally at US documents and agreements for guidance and therefore less appropriate to their argument.[67]

3.2.4 The Big Four

The widely accepted category of 'Big Four' comprises the large accounting firms of Ernst and Young, Deloitte, KPMG and Pricewaterhouse Coopers (PwC). Their revenue in Australia for the year ending 30 June 2012 was respectively AUD 1.125 billion,[68] AUD 1.1 billion,[69] AUD 1.120 billion[70] and AUD 1.479 billion[71]. Big Four clients are from a wide range of industries and many are global.

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[65] C Blunt, 'Sub No. 14 American Chamber of Commerce in Australia - Attachment 1' (30 November 2011) 1.
[66] Ibid 1.
[67] Ibid. Eg, s 815-15(5) the meaning of associated enterprises article is taken from 'Article 9 of the United Kingdom convention…'
[68] Ernst & Young, 'Ernst and Young at a Glance ' (2012) <http://www.ey.com/AU/en/Newsroom/Facts-and-figures>.
[69] A King, 'Deloitte breaks $1bn income barrier,' *Financial Review* (Sydney), 13 June 2012.
[70] KPMG, 'Performance' (2012) <http://www.kpmg.com/au/en/whoweare/performance/pages/default.aspx>.
[71] Price Waterhouse Coopers, "Annual Review and Corporate Responsibility Review," (2012) <http://www.pwc.com.au/publications/assets/annual-review/Annual-Review-12.pdf>.

Ernst and Young claimed that as its client base includes multinational enterprises, it was in a prime position to identify potential exposures and develop strategies for firms affected by the proposed TP amendments.[72] Each of the Big Four firms made submissions to the Committees and generally claimed they would remain dominant in the practice of applying the various sections in the draft subdivision 815-A.

While acknowledging the uncertainty caused by *SNF*, the main issues raised were: opposition to legislative retrospectivity; an associated call for protection against penalties arising from the proposed amendments, concerns about separate taxing powers to the Australian tax treaties; and an aversion to discrimination against investors from tax treaty countries.

The Big Four opposed the draft TP Bill's retrospectivity for several reasons. Ernst and Young considered it 'inherently unfair, technically flawed and potentially damaging to Australia's trade and direct investment.'[73] It is unfair to firms 'currently in dispute with the Australian Tax Office (ATO)' declared PwC,[74] while KPMG argued that it may 'materially disadvantage taxpayers.'[75] Deloitte asserted 'it is neither appropriate, nor necessary, nor fair to taxpayers' to apply TP changes retrospectively.[76]

Regarding the issue of protection against penalties, the individual positions of the firms varied. These included recommendations to limit penalties under subdivision 284-B of the *TAA 1953* regarding application of penalties to past

[72] Ernst & Young, 'Tax Insight: The Wait is Over - Australia's New Transfer Pricing Rules Passed' (21 August 2012) 4.
[73] P Balkus and J Solgaard, 'Sub No. 4 Ernst & Young' (9 July 2012) 1.
[74] P Calleja and Peter Collins, 'Sub No 17 PricewaterhouseCoopers' (11 July 2012) 4.
[75] A Seve and D Preshaw, 'Sub No 13 KPMG' (11 July 2012) 1.
[76] F Craig, 'Sub No 8 Deloitte' (13 April 2012).

periods;[77] clarifying possible penalties on the draft subdivision 815-A and/or s 284-145 of the *TAA 1953*;[78] suggesting that penalties for any TP adjustments be zero where taxpayers make a 'genuine and reasonable attempt' to comply with the legislation;[79] and ratifying that when a Tax Determination relies (wholly or partly) on the proposed subdivision 815-A, that penalties or interest charges be inapplicable.[80]

Both KPMG and PwC maintained that the TP amendments were not a mere clarification of the law, but in fact the allocation of additional taxing powers to the Commissioner of Taxation.[81] PricewaterhouseCoopers even claimed that 'principles of statutory interpretation, general international practice, parliamentary documents in relation to tax treaties and case law' provide no basis for the view that tax treaties support a separate taxing power to the Commissioner.[82]

On the issue of discrimination against investors from tax treaty countries, PwC highlighted that it is unusual to propose a law that might result in more detrimental outcomes to taxpayers. In this instance, those from tax treaty countries may be treated less favourably when compared to residents from non-treaty countries.[83] Deloitte noted that the distinction in the law between treaty and non-treaty countries may raise 'very serious

[77] Seve and Preshaw, above n 75, 3.
[78] Craig, above n 76, 3.
[79] Lyndon James and I Farmer, 'Sub No 17 PricewaterhouseCoopers' (30 November 2011) 15.
[80] Balkus and Solgaard, above n 73, 2.
[81] Seve and Preshaw, aboove n 75, 1; James and Farmer, above n 79. Submission No 17 to the Treasury, 'Consultation Paper - Income Tax: Cross Border Profit Allocation - Review of Transfer Pricing Rules', (30 November 2012).
[82] Lyndon James and Peter Collins, 'Sub No 17 PricewaterhouseCoopers' (24 February 2012) 2.
[83] Lyndon James and Peter Collins, 'Sub No 17 PricewaterhouseCoopers' (13 April 2012) 6.

issues of fairness and arbitrariness in the application of Australian international tax laws.'[84] In the same vein KPMG stated that favouring foreign related parties from non-treaty countries may be counterintuitive and present a situation where investors from tax-treaty countries might be subject to Division 13 *ITAA 1936* and the new subdivision 815-A of the *ITAA 97*, whereas non-treaty investors need only consider Division 13 of the *ITAA 1936*.[85]

Normative isomorphism serves to explain why the Big Four's submissions covered similar issues about the proposed TP changes in that members provide similar services in areas such as advisory and taxation; employees have a reasonably standardised accounting and/or finance background; and their clientele profiles include many multinational enterprises with similar requirements.

[84] F Craig and P Riley, 'Sub No 8 Deloitte' (30 November 2011) 2.
[85] Seve and Preshaw, above n 75, 3.

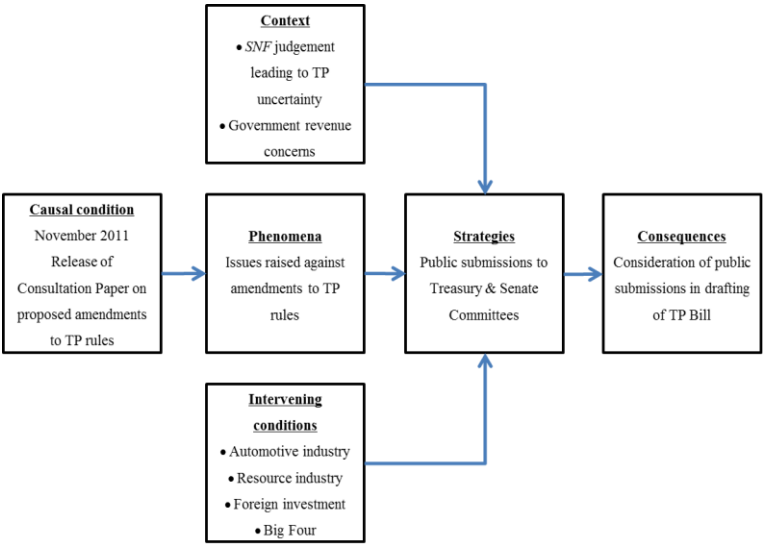

Figure 1: Axial coding: model construction[86]

The phenomena analysed in this research are the issues raised in public submissions about the proposed changes to TP rules. Figure 1 depicts the model constructed after the axial coding analysis. The initial causal condition, or reason, for the criticisms was the November 2011 Treasury release of the Consultation Paper on proposed TP changes. The method to communicate support and/or opposition to the proposed TP changes was by formal public submission to the Committees. The context for the submissions is the uncertainty caused by the loss by the Commissioner of Taxation in the transfer pricing case, *SNF* and Treasury concerns about the negative impact on government revenue. The intervening conditions in this scenario are the weight of submissions made by organisations in the

[86] Adapted from Gibbs, above n 16.

automotive, resources and foreign investment industry categories and the Big Four. Finally, the consequences of the issues raised in the submissions are considered in relation to the final version of the TP Bill, which was then sent to Parliament for debate.

3.3 Selective coding: The narrative

The narrative that follows draws on the model depicted in Figure 1, the close reading of the public submissions and a TP expert's personal opinions and professional insights from an interview conducted after Royal Assent of the TP Act.

This research has found that the four most controversial issues in the submissions were: application of the proposed legislation in a retrospective manner; potential rises in penalties if retrospectivity is introduced; unease about tax treaties being treated as a 'separate taxing power' from Division 13 of the *ITAA 1936*; and concerns about discrimination against investors from tax treaty countries. The Government's consultation process was subject to criticism from various parties, including the TP expert, who stated:

> I think if you look at the consultation process on paper, it's been a reasonable …but I think it has been really frustrating though, for everyone involved, because basically it wasn't listened to.[87]

This criticism is now considered in the context of the narrative below that also draws on submissions not yet covered in this paper.

3.3.1 Retrospective power

The retrospective effect of the draft TP Bill meant the application of provisions to a period some eight years prior to

[87] Researcher A Lugo Marin and TP expert, Interview, 28 September 2012.

enactment, ie, from 1 July 2004.[88] Considered the most contentious issue in the draft TP Bill, 20 organisations prepared 30 submissions that all opposed such a retrospective power in the proposed legislation. For example, both the Australian Private Equity & Venture Capital Association (AVCAL) and the Law Council of Australia (LCA) submissions argued against retrospective legislation. In the case of AVCAL this opposition was partly on the basis of an inadequate transition period.[89] It claimed that the Government had not justified backdating the law and that retrospectivity would affect business confidence and as such 'is bad policy'.[90] The LCA submitted that the Commissioner's view is not necessarily the same as the parliament's intention and there is no justification for a retrospective legislation.[91]

In response the Treasury submission rationale was that there was a significant risk of losing this revenue if retrospectivity was not enacted.[92]

The TP expert commented:

> If you look at the description in the Exposure Draft and the Explanatory Memorandum, it's very clear that it is written to actually support retrospective application. It doesn't have anything to do with whether retrospective application is actually appropriate.[93]

The draft EM states that, since at least 1982, parliament has considered tax treaties as a separate power to make TP

[88] See Appendix 4.
[89] K Woodthorpe, 'Sub No 22 Australian Private Equity & Venture Capital Association' (14 July 2012) 1-2.
[90] Ibid.
[91] S Walker, 'Sub No 9 Taxation Committee of the Business Law Section, Law Council of Australia' (11 July 2012) 1.
[92] McDonald, above n 35, 5.
[93] Interview.

adjustments.[94] Furthermore, the draft EM restates the parliamentary view on tax treaties and that retrospectivity power would commence from 2004.[95] However, the TP expert identified that subdivision 815-A, especially in combination with the OECD TP Guidelines, 'actually does not provide the ATO with much power.'[96]

3.3.2 Protection against penalties

A number of submissions argued that the retrospective power in the proposed subdivision 815-A might result in taxpayers being penalised for tax adjustments for periods back to 1 July 2004. It can be seen in Appendix 4 that twelve submissions from eight organisations had this concern and some even suggested which sections of the draft TP Bill could be modified in order to produce legislation fairer for the taxpayer.

Besides the MCA, Chevron and the Big Four submissions already cited, the Corporate Tax Association was also concerned about retrospective power and called for protection against penalties.[97]

The Treasury highlighted that in regard to transitional provisions regarding penalties the aim of the draft TP Bill was to ensure taxpayers would 'not be subject to a different or further [penalty] amount' apart from that already issued prior to the enactment of subdivision 815-A.[98] It pointed to draft section 815-10, that states 'a scheme penalty applies in pre-commencement period as if only the old law applied.' The draft EM notes the limitation of 'administrative penalties under

[94] Explanatory Memorandum, [1.16].
[95] Ibid [1.17].
[96] Interview.
[97] F Drenth, 'Sub No 2 Corporate Tax Association - Attachment 2' (13 April 2012) 4.
[98] McDonald, aboove n 35, 8.

Subdivision 284-C, *TAA 1953*.'[99] The effect of not mentioning subdivision 284-B, *TAA 1953*, which is about the limitation of penalties, is unclear at this stage.

3.3.3 Tax treaties as a 'separate taxing power'

The draft TP Bill sought to clarify whether Australia's tax treaties with other countries have a 'separate taxing power' from Division 13, *ITAA 1936*. The uncertainty about whether the ATO might use either Division 13 or a treaty to tax multinational enterprises arose post-*SNF*. Ten submissions from seven organisations opposed the introduction of a 'separate taxing power' into the draft TP Bill.[100]

Apart from the submission from PwC, already cited, other organisations opposing the separate taxing amendment were The Tax Institute and RSM Bird Cameron. The Tax Institute considered the differences between tax treaties and stated that a separate power 'may be constrained so as to limit tax liability to the amount which might arise under another taxing power'[101] while an independent power will 'widen the tools and methods available to the ATO'[102] to calculate a tax liability. The Tax Institute suggested that parliament did not intend that tax treaties would increase a taxpayer's liability, as this was previously expressed by the Joint Standing Committee on Treaties.[103] Critical of the draft TP Bill for its unfairness toward treaty countries, RSM Bird Cameron claimed they would experience a 'double jeopardy of complying with two sets of transfer pricing rules.'[104]

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[99] Explanatory Memorandum, 18.
[100] See Appendix 4.
[101] K Schurgott, 'Sub No 15 The Tax Institute' (11 July 2012) 3.
[102] Ibid.
[103] Ibid 5.
[104] C Paoliello and A Hayley, 'Sub No 11 RSM Bird Cameron' (11 July 2012) 3.

The Treasury submission on the draft TP Bill commented on why tax treaties have a separate power for taxation purposes. It claimed that tax treaties can have various purposes; such as to relieve double taxation, and to prevent international fiscal evasion. It also pointed out that 'there is no principle under international law that tax treaties are to be applied in an exclusively relieving manner.'[105] In listing various amendments to the income tax law dating from 1982, Treasury showed that Parliament understood that 'treaty based TP rules' provide an alternate basis for TP adjustments.[106]

The TP expert was of the view that subdivision 815-A does not provide tax treaties with a 'separate taxing power' from Division 13 of the *ITAA 1936:*

> If you look at 815-A it doesn't give the treaties a separate power. What it does, it actually incorporates an analysis that's in the treaties in Australian legislation. But it doesn't say anywhere that the treaties provide a separate power.[107]

The TP expert claimed this 'separate' power is not mentioned until the final EM, which is only used for interpretative purposes thus, 'from a TP perspective, the EM is pretty much irrelevant.'[108] The matter of whether tax treaties provide a 'separate taxing power' based on the wording of the law itself is for the Courts to rule on.[109]

The draft EM used the word 'separate' but it is unclear if this was meant to have the interpretation given by the Tax Institute.[110] The draft EM states that in some cases treaty TP rules may result in a better outcome than Division 13 of the

[105] McDonald, above n 35.
[106] Ibid 15.
[107] Interview.
[108] Ibid.
[109] Ibid.
[110] Explanatory Memorandum, 3.

ITAA 1936,[111] that the amendments may be considered a mere rewrite of existing rules[112] and that nothing prevents tax treaties applying, even if the adjustment results are less than in domestic provisions.[113] The draft EM gave examples of foreign jurisdictions using tax treaties to extend taxation.[114] The TP expert acknowledged the final EM wording and commented that although subdivision 815-A introduces some changes; such as business restructuring and financing, overall it is just 'business as usual.'[115] The new subdivision is just a confirmation of the approach the ATO has applied in the past.[116]

3.3.4 Discrimination against investors from treaty countries

The draft TP Bill contained s 815-10 stating that subdivision 815-A will only apply when an Australian entity has transactions with a foreign related party that is a resident of a country that has a tax treaty with Australia. Thirteen submissions from 11 organisations argued against this 'discriminating' provision.[117]

While AmCham had as one of its main concerns discrimination against investors from countries with a double tax treaty with Australia,[118] the Institute of Chartered Accountants in Australia (ICAA) argued taxpayers who deal with related parties in DTA countries 'will be worse off' as they

[111] Ibid [1.12].
[112] Ibid [1.15].
[113] Ibid [1.19].
[114] Ibid [1.33].
[115] Interview.
[116] Ibid.
[117] See Appendix 4.
[118] As previously discussed, see Doyle, above n 56, 1.

will have to face two sets of legislation.[119] The Australian Banker's Association (ABA) agreed, claiming an 'anomalous' result, as investors from non-treaty countries could get more favourable outcomes. The ABA also claimed that the distinction is 'at odds with the principle of equity for Australian taxpayers.'[120]

On the other hand, the Treasury submission argued that multinational enterprises could offset the tax liabilities resulting from the application of the proposed subdivision 815-A with the help of a mutual agreement procedure (MAP), where automatic relief is not available. It also pointed out that all Australia's tax treaties have a MAP article.[121] However Treasury did not explain how readily a MAP might be formed. The Treasury denied assertions of potential breaches of non-discrimination articles,[122] claiming that treaty TP rules 'apply to enterprises without discrimination as to nationality or ownership.'[123]

Draft s 815-10 stated determinations under s 815-30(1) would be relevant only if an international tax agreement applied to the entity. The draft EM explained that subdivision 815-A would only be applicable in cases involving tax treaty countries. However, it stated that MAPs would be available in cases of double taxation.[124] The TP expert mentioned the use of MAPs in Australia and considered that the procedures work very well,

[119] P Stacey, 'Sub No 19 Institute of Chartered Accountants in Australia' (13 July 2012) 2.
[120] T Burke, 'Sub No 3 Australian Bankers' Association' (2 Decemeber 2011) 3.
[121] McDonald, above n 35, 8.
[122] See, eg, Article 23 of the Australia-US tax treaty.
[123] McDonald, above n 35, 11.
[124] Explanatory Memorandum, [1.48].

with the exception of some countries with which they are slightly difficult to fulfil.[125]

3.4 Intangible assets

Intangible assets may be considered one of the most complex items to deal with from a TP perspective and provide a practical example of TP complexity. Intangibles tend to be unique in nature and carry uncertainty about their future returns, resulting in a more difficult valuation process.[126] By virtue of their distinctiveness, it is very challenging to find comparables – independent comparable transactions – substantially identical to an intangible under scrutiny to which can be applied the arm's length principle.

The interview with a TP expert resulted in some interesting comments regarding intangibles in general and the impact of subdivision 815-A on their treatment. Given the enactment of subdivision 815-A, the TP expert predicted the normal continuation of scrutiny by the ATO of organisations with substantial amounts of intangibles trading. While the ATO had indicated it would not use the retrospective power to actively start scrutinising such transactions of organisations,[127] the TP expert forecast significant changes in the area of intangibles, as the OECD was in the process of rewriting Chapter VI of the *OECD TP Guidelines*. The expert claimed this new chapter would have a greater focus on the economics side of intangibles, rather than the legal aspects.[128]

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[125] Interview.
[126] R Phatarphekar and A Pradeep, 'Transfer Pricing and Intangibles Pose Tricky Questions' (2010) *International Tax Review, supplement* 11.
[127] Interview.
[128] Ibid. See OECD, 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (2010). < http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-guidelines.htm>.

By taking into account the preceding three-part analysis the following two theories, grounded in the data, have been constructed:

Theory 1: The central phenomenon concerns the issues raised against amendments to the TP regime, the result of a range of contextual pressures. In this instance, the pressures were the loss of the SNF case by the Commissioner of Taxation and falling federal tax revenues. A government either makes unilateral tax decisions (based on wider-community benefits), or modifies its position in response to formal public submissions, which may or may not be representative of wider opinion.

Theory 2: Intervening conditions from lobby groups can interrupt the acceptance, or perception, of benefits from tax amendments, with powerful effects such that the consequences of a lack of support from 'elites' can be fatal for a government.

4. VALIDATION OF THE THEORIES

The method of comparative analysis is used to validate the two grounded theories against the literature, as follows.

Theory 1: Literature validating the range of contextual pressures that precipitated the public consultation on TP regime amendments can be found in research articles arising from the TP 'watershed' case of *SNF*. In *SNF*, the court established the principle of using the comparable uncontrolled price (CUP) method for transaction pricing, and confirmed that CUP does not have to meet 'the exact facts and circumstances of the taxpayers' in order to determine an arm's length price.[129] Krever

[129] P McNab, P Calleja, and C Little, 'Trends and Developments in Transfer Pricing Case Law in Australia: A Paradigm Shift' in *27th National Convention - The Tax Institute* (National Convention Centre, Canberra 2012), 6. The main TP methodologies acceptable to the ATO include traditional methods, such as

and Zhang, for instance, report that the case generated controversy in three aspects: whether profit methods, such as the profit split and transactional net margin method (TNMM), can be used in Australia; whether the *OECD TP Guidelines* can be applied to interpret DTAs and TP domestic law (the court rejected the *OECD TP Guidelines* and allowed consideration of only domestic TP provisions); and finally, the correctness of the Commissioner applying certain articles from treaties instead of TP domestic law, if treaties will yield a higher tax liability.[130] The appeal court affirmed the view that the Commissioner of Taxation could base a TP assessment on a treaty, if it would yield a higher liability than provisions in the domestic law, but the court's view in this instance is not binding.[131]

Hayley and Smith note that *SNF* also clarified whether a profit method, such as TNMM, is valid under domestic law,[132] as the appeal court dismissed TNMM in preference to CUP. The court claimed, based on *SNF*, 'it is absolutely imperative that they [taxpayers] prepare and maintain high-quality and commercially relevant TP documentation' to defend their position against the ATO.[133]

McNab and James argue that post-*SNF* if the preference for CUP was followed by the courts, this 'will provide support for loss-making and low profitability taxpayers to defend' their position against the ATO.[134] They claim the precedent would

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comparable uncontrolled price (CUP), resale price and cost plus; and profit methods such as profit split and transactional net margin method (TNMM).

[130] Richard Krever and Jiaying Zhang, above n 6, 200.

[131] Ibid.

[132] A Hayley and S Smith, 'Australian Court Rejects ATO's Transfer Pricing Approach' (2011) 22 (11) *Journal of International Taxation* 50.

[133] Ibid 51.

[134] P McNab and Lyndon James, 'Court Questions OECD's Connection to Australian Law at SNF Appeals Hearing' (2011) 19, no. 22 *Tax Management Transfer Pricing Report* 1237.

require the ATO not to focus on the taxpayer's overall profitability, but instead to look at the nature of international related-party transactions. McNab and James contend that the result of *SNF* is important for future TP disputes for 'importance of and availability of evidence will vary from case to case'.[135]

Bolton highlights the differences in interpreting what is a 'comparable' from the *SNF* case. The court confirmed a comparable as something 'substantially like, rather than (as the Commissioner contended) being effectively identical.'[136] McNab, Calleja et al argue that the *SNF* case shows that companies 'operate and compete on a global stage'; therefore it would be difficult to limit a market 'to a specific geographic location.'[137] They forecast consequences for the Commissioner and taxpayers as a global analysis would be required to either accept or reject 'transactions as potentially comparable.'[138]

These papers illustrate the pressure put on the Australian Government to address uncertainty and make legislative changes in the wake of *SNF*. As the submissions also reveal, the proposed TP amendments were not representative of wider public opinion.

Finally, the Government was further pressured to make amendments to the TP regime post-*SNF* because tax revenues from the Minerals Resource Rent Tax and company tax were lower than expected, which jeopardised 2012 Federal Budget promises, such as infrastructure projects, and attracted wide media attention.[139] In its submission Treasury reported tax

[135] Ibid 1237-1239.
[136] Rebecca Bolton, 'Broadening the Concept of Comparable for Transfer Pricing Purposes' (2011) 46 *Taxation in Australia* 139.
[137] P McNab, P Calleja, and C Little, above n 129, 9.
[138] Ibid.
[139] See, eg, David Crowe and Matthew Franklin, 'Mining Tax Billions are an Illusion: Fortescue Chief,' *The Australian* (Sydney), 3 May 2012; Jennifer

revenue was at significant risk with $1.9 billion related to transfer pricing in dispute.[140]

Theory 2: Validation of the powerful impact of intervention from lobby groups, such as academic 'elites', can interrupt the acceptance, or perception, of benefits from tax amendments can be found in a range of articles. For instance, King writes that the TP methodologies found in the *OECD TP Guidelines* fail to provide certainty about an organisation's tax liability and to help allocate income across different jurisdictions equitably and consistently.[141] Further, Prescott Haar and Ces claim that 'Australia's major trading partners generally consider the *OECD TP Guidelines* of limited precedential value.'[142]

McNab et al contend that even though 'the *OECD TP Guidelines* were not before the court in *SNF*, [the court] adopted many aspects of that document in the process of analysis.'[143] Krever and Zhang see a problem in the appeal court's rejection of the *OECD TP Guidelines* 'as an appropriate aid to interpretation' of treaties and domestic TP law.[144] They even suggest that if Australian courts follow this view, Australia is likely to diverge from international norms.[145] On the other hand, McNab and James remark that should the *OECD TP Guidelines* be incorporated into Australian domestic law, non-Australian court decisions will play a bigger role in the development of Australian jurisprudence.[146] Hayes questions whether principle

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Hewett, 'Corporate Tax Headache,' *Australian Financial Review* (Sydney), 14 August 2012.

[140] McDonald, above n 35, 5.

[141] E King, *Transfer Pricing and Corporate Taxation* (Springer, 2009) 183.

[142] L Prescott Haar and A Ces, 'Australia: Proposed Amendments to Transfer Pricing Rules' (2012), no. May *Transfer Pricing International Journal* 3.

[143] McNab, Calleja and Little, above n 129, 16.

[144] Krever and Zhang, above n 6, 208.

[145] Ibid 211.

[146] McNab and James, above n 134, 1238.

source countries will follow the OECD Model Treaty as many others have done so.[147]

Much of the literature concerns the meaning of 'comparables' and its lack of clarity. For instance, Markham comments that the *OECD TP Guidelines* refer to what 'independent enterprises' would have done in similar circumstances, yet these enterprises cannot be found, especially if the term 'similar' is narrowly defined.[148] King notes that for intangible items, such as intellectual property, comparables available from different entities are unlikely to exist, although there are exceptions, such as franchise arrangements and trademarks.[149] Furthermore, King asserts that the use of CUP methodology appears to be inadequate.[150] Lagarden and Menninger argue the reason for the lack of comparables is that intangibles are not normally traded in an active market, thus it may be hard to find valid identical or similar benchmarks.[151]

Phatarphekar and Pradeep highlight the difficulties of dealing with intangibles in TP. Intangibles tend to have a unique nature, lacking external comparables and having uncertainty about their future returns, which results in difficulties for their valuation for tax purposes.[152] Riley points out that the 2005 ATO guide to marketing intangibles in regard to 'comparable

[147] T Hayes, 'Source Country Taxation and International Tax Transparency Moves Pose Tax Planning Challenges' (2012) 22 *Thomson Reuters Weekly Tax Bulletin* 797. The principal source countries include Brazil, Russia, India and China.
[148] M Markham, *The Transfer Pricing of Intangibles* (Kluwer Law, 2005) 84.
[149] E King, *Transfer Pricing and Corporate Taxation* (Springer, 2008)24.
[150] Ibid 25.
[151] M Lagarden and J Menninger, 'Brand Valuation - A Transfer Pricing Essential' (2012) *Transfer Pricing International Journal*, available from Bloomberg BNA database.
[152] R Phatarphekar and A Pradeep, 'Transfer Pricing and Intangibles Pose Tricky Questions', available from Business Source Complete database.

independent enterprises' fails to mention how organisations might determine what other companies are spending on marketing, or the range of spending to be considered acceptable.[153]

Markham remarks that Division 13 of the *ITAA 1936* does not cover the definition of intangible per se and instead the section 136AA(1) definition of 'services' includes the concept of 'royalty', which is subsequently defined in section 6(1) of the *ITAA 1936*.[154]

Then there is the issue that various types of intangibles may be differently defined in various jurisdictions.[155] Markham argues intangibles pose new challenges for TP within corporations. Similarly, Anderson claims that the most difficult TP matters tend to be related to the treatment of intangible property.[156] Phatarphekar and Pradeep suggest there is a divergence among countries regarding the definition of routine and non-routine intangibles. When this definition across jurisdictions is unclear, there is a risk that tax administrators may argue that intangibles in their own jurisdiction are non-routine and higher profit is expected.[157]

In regard to discrimination against Australia's treaty countries, Preshaw and Seve note that under various provisions with wider powers the draft TP Bill had 'the potential to lead to tax outcomes where taxpayers who transact … in non-tax treaty countries (eg, Bermuda, Caymans) will be subject to TP adjustments based on only Division 13 of the *ITAA 1936;* whereas taxpayers who transact in … tax treaty countries (eg,

[153] P Riley, 'Distributors put on Notice' (2006) 76 (7) *In The Black* 56.
[154] Markham, above n 148, 44.
[155] Ibid 3, 45.
[156] P Anderson, 'Australia' (1997) *International Tax Review, suppl. Transfer Pricing*.
[157] Phatarphekar and Pradeep, above n 152.

US, UK, Japan) could be subjected to TP adjustments'.[158] Bell writes that the draft TP Bill received criticism from AmCham, asserting the update to Australia's TP rules may be 'inconsistent with the current Australia-US tax treaty.'[159]

Preshaw and Seve note with concern that the retrospective power in the amendments would result in taxpayers entering 'protracted and expensive' MAPs in order to avoid potential double taxation.[160] Power warns the 'retrospective nature [of the new provision] may threaten international investment.'[161] Furthermore, retrospectivity may result in double taxation for multinationals.[162] Collin et al agree, noting several countries, such as the US and Sweden, have opposed retrospectivity and incorporated rules prohibiting its implementation in their constitutions.[163] Riley states that previously the ATO had an indefinite period of time to make TP adjustments and suggests that a better approach would be for the ATO to form a view 'within a period of no more than four years'.[164]

Not only were there public submissions from lobby groups against the proposed TP amendments but, as the preceding literature reflects, there was also a lack of support from the

[158] D Preshaw and A Seve, "Transfer Pricing Bill Produces some Positives, but Negatives too - Retrospectivity still a Concern" (2012) 24 *Thomson Reuters Weekly Tax Bulletin*.
[159] K A Bell, 'AmCham Says Proposed Australian Reform Of Transfer Pricing Violates US Tax Treaty' (2012) 20 *Tax Management Transfer Pricing Report* 916.
[160] Preshaw and Seve, above n 158.
[161] B Power, 'Are Borders Meaningless?' (2012) 83(8) *Charter* 26.
[162] Ibid 28.
[163] Peter Collins, Lyndon James, and Piotr Klank, 'The Smoke and Mirrors around the "Sstage One" Transfer Pricing Reforms' (2012) 15 *The Tax Specialist* 210.
[164] Riley, above n 153, 56.

academic 'elite'.[165] Nonetheless stage one of the TP changes was enacted.

Not only have the two theories been validated by comparison to a range of relevant literature, it is also suggested that the theories have a degree of reliability in the context of the research.

5. CONCLUSION

This paper has been concerned with the issues raised in public submissions to the Committees on proposed amendments to the TP rules. On 8 September 2012, the TP Act received Royal Assent.[166]

Common issues of concern have been identified in the public submissions. Stakeholders, such as the automotive industry, were concerned with retrospectivity and the divergence in treatment of transactions from an income tax and customs duty standpoint. The resource industry was apprehensive about retrospectivity and recommended the implementation of measures to protect organisations against related penalties. The foreign investment group also criticised retrospectivity and discrimination against tax treaty countries. Finally, the Big Four pointed out four key issues: retrospectivity; a call for penalty protection measures if retrospectivity is introduced; concerns about tax treaties being considered a 'separate taxing power'; and aversion to discrimination against investors from tax treaty countries.

This work may be considered significant and timely to TP in Australia. It contributes to the identification of issues of concern

[165] 'Elite' is term used to refer to those that hold power in a particular field.
[166] *Tax Laws Amendment (Cross-border Transfer Pricing) Act No. 1, 2012*. The Act introduces Subdivision 815-A and amends the following tax legislation: *ITAA 1936*, *ITAA 1997*, *IT (TP) 1997* and *TAA 1953.*

about the proposed changes to the TP rules, known as the stage one amendments. The submissions from several organisations in Australia and the opinions of a TP expert have been compiled. To date, there does not seem to be a publication that has put the opinions of so many stakeholders together into one single study.

Also queried was the extent to which the submission issues were adopted in the Bill that was finally enacted. The TP Act contains new provisions on transfer pricing that apply retrospectively, but only to tax treaty countries. On the other hand, there is an added section that seems to protect taxpayers against penalties. It is still unclear whether the new legislation actually confers tax treaties a 'separate taxing power'.

While it would have been ideal to have discussions concerning the Bill with a number of tax specialists, the single field study interview was valuable, adding an informed observer dimension. The authors are considering a review of stage two of transfer pricing reform for which a range of interviews could enhance data sources.

The deadline for public submissions on stage two of TP reforms was December 2012 and the stage two bill, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, received Royal Assent in June 2013.[167] It would be interesting to undertake a similar study for the submissions from the public from the second stage of consultations. It is noted that the stage two TP legislation repeals Division 13 of the *ITAA 36* and subdivision 815-A; and

[167] See the details of the stage two Transfer Pricing Bill's parliamentary reading dates at: <http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4965>.

substitutes two new subdivisions, 815-B and 815-C into the *ITAA 97*.[168]

Another important area for future consideration is the treatment of intangible assets, seen by some as the most complex area of TP. Further research in this field may enlighten both tax practitioners and legislators in regard to the fairest way to price transactions involving intangible assets.

[168] Explanatory Memorandum (for stage two TP bill), 'Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, [2.13].

APPENDICES

Appendix 1: Interview questions

New Subdivision 815-A of the *Income Tax Assessment Act 1997*

1. What is your view of the quality of the consultation process for the new subdivision 815-A of the *Income Tax Assessment Act 1997* (Transfer Pricing rules)?

2. Most of the submissions received by the Committees opposed the introduction of a retrospective power into the transfer pricing legislation. However, the new provisions contain this retrospective power. How are you planning to face the challenges of this retrospectivity?

3. Do you have confidence that the ATO will be 'fair' when applying the retrospective powers?

4. In your view, will the valuation of intangible assets become problematic?

5. In your view, will organisations that have been dealing with intangibles in the last eight years have a greater risk of having their past transfer pricing positions audited, compared to the ones that deal mainly with tangible assets?

6. What is good about the recent changes in transfer pricing legislation?

7. In terms of the new transfer pricing provisions impact, can you reveal the percentage of your clients which belong to a country with a DTA with Australia?

8. What is your view on the potential for the new transfer pricing provisions to 'privilege' Australian tax treaties as a separate and/or independent taxing source from 815-A of the

ITAA 97 and Division 13 of the *ITAA36*? If so, what will be the implications of privileging Australian tax treaties?

Transfer pricing methodology

1. In TR97/20 the Australian Taxation Commissioner recommends various arm's length methodologies for transfer pricing purposes; such as the comparable uncontrolled price and the profit split method. Which transfer pricing methodology do you usually employ to price transactions involving intangible assets? Why?

2. What are the most important aspect(s) to ensure compliance with the legislation and prevent a challenge by the ATO when dealing with intangible assets?

OECD

Prior to the new subdivision 815-A of the *ITAA 97*, to what extent did you rely on the OECD Guidelines for the purpose of interpreting the Div. 13 *ITAA 36* transfer pricing provisions and subsequently advising clients?

APAs

What is your view on your clients entering an advance pricing arrangement (APA)?

Appendices 2 to 4

Editor's note: Due to formatting constraints, it was not possible to reproduce the data contained in these appendices. This data is available on the *Journal of Australian Taxation* website, www.jausttax.com, as a downloadable Excel file, with each appendix as a separate worksheet in this file. A copy is on file also with the lead author and the editor.

Appendix 2: Open coding table

Appendix 3: Axial coding table

Appendix 4: Selective coding table