Ruling Compendium – TR 2011/1

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2010/D2 – Income tax: application of the transfer pricing provisions to business restructuring by multinational enterprises

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response
1.	The Ruling should be absolutely clear about recharacterisation of the transactions being applied to only exceptional cases.	Paragraph 21 has been amended. *'….The ATO has regard to the OECD Guidelines in applying the arm's length principle under both Division 13 and the associated enterprises article.'* The last line of paragraph 21 in the draft ruling has been deleted. The revised OECD Guidelines relating to business restructurings were released in July 2010 at Chapter IX paragraph 9.169. This in turn refers back to the concepts in paragraphs 1.64-1.69 of the OECD Guidelines.
	The Ruling should show a clear process of how to apply the arm's length pricing to an existing transaction rather than provide basis for recharacterisation.	Paragraph 19 of TR 2010/D2 provides ample guidance on the 3 step process that has been well established in Taxation Ruling TR 98/11 and is widely acknowledged as being practical and reasonable. It should be noted that the processes set out in TR 98/11 and TR 2010/D2 are neither mandatory nor prescriptive and need to be tailored to the particular facts.
	A checklist or chart may be useful.	It is impractical to attempt to list every conceivable permutation and combination of where the economic substance may differ from its form. Moreover the ruling is not intended to be prescriptive.

1. cont	While the ruling recognises that some restructuring transactions will make sense only from the perspective of a multinational enterprise (MNE) as a group rather than each individual taxpayer within the group, the relevant paragraphs (that is 76 – 79 and 96 – 97) should be moved into the body of the ruling, which would make them legally binding. Comparability issues remain in situations where taxpayers have differentiated their business models for competitive advantage. Therefore, a clearer definition of the exceptional circumstances that warrant hypothecation should be considered.	There is no compelling reason to incorporating paragraphs 76-79 of TR 2010/D2 into the main body of the Ruling as the Australian Taxation Office (ATO) has regard to the OECD Guidelines. This issue has been adequately dealt with above.
2.	Documentation requirements in TR 2010/D2 are much more detailed than in TR 98/11 and therefore, this requirement should not be retrospectively applied. Documentation requirements outlined in the draft ruling should not be imposed in the review and rating of the existing transfer pricing documentation. The taxpayers could not have been expected to prepare contemporaneous transfer pricing documentation following the 3 step process prior to the finalisation of TR 2010/D2.	The matter has been addressed by the inclusion of paragraph 22A in TR 2010/D2 indicating that it is not intended that the Ruling be anymore onerous in relation to documentation than the existing requirements outlined in TR 98/11. At paragraph 1.6 TR 98/11 the extent of the documentation will depend is proportional to the complexity and size of the dealings in line with the OECD Guidelines.

3.	The fact that the ATO is reserving the right to enforce its own view if they do not agree with the OECD position poses a significant risk of double taxation. The final ruling should be consistent with the OECD position, including the OECD interpretation of the general principles. The ATO's view on 'compensation for the restructuring' seems to be contrary to the OECD Guidelines. The ATO expresses the view that it has the authority to impute an adjustment purely for transfer of functions, assets and risks, while the OECD view is that compensation is required for transfer of assets or rights.	The point is acknowledged. The revised OECD Guidelines in relation to business restructurings were released on 10 July 2010 and it is the intention of the ATO to have regard to these guidelines in the administration of Division 13. Amended wording at paragraph 21 TR 2010/D2. *'The OECD in July 2010 released a report on the transfer pricing aspects which have also been incorporated into its Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines). These guidelines are relevant to the application of treaty Article 9 of the OECD Model Convention on Income and Capital, and therefore to the Associated Enterprises Articles of Australia's tax treaties. The ATO has regard to the OECD Guidelines in applying the arm's length principle under both Division 13 and the associated enterprises article. The ATO has regard to the OECD Guidelines in applying the arm's length principle under both Division 13 and the associated enterprises article.'* The ATO expresses the view at paragraph 124 TR 2010/D2 that *'…. the functions and risks of themselves have no value or benefit that are transferred from one entity to another. The fact that an entity presently performs a function or assumes a risk does not of itself give a right to compensation for loss of any profits from future performance of that function or assumption of that risk by another entity.'*

3. cont	It remains unclear in which circumstances the ATO might seek additional compensation for the transfer of functions, assets and risks, and the basis on which they would determine what that compensation might be.	This is also appropriately reflected in paragraph 125, TR 2010/D2 '*…. assumption of a risk does not guarantee the risk-taker a profit, risk may be both the opportunity to make a profit and to incur a loss. Therefore, where a business risk is transferred as part of a business restructuring, the transferor would not be expected to receive any consideration …. The mere transfer of a function and its associated risk is not a compensable transfer of property or supply of a benefit …*'
4.	There is a possibility that different results may arise from analysis of a fact pattern under Division 13 versus Article 9. No clear guidance is provided on the relationship and interaction between Division 13 and anti-avoidance rules, even though both may be applied to business restructuring transactions.	The ATO is of the view that Division 13 and Article 9 are fundamentally consistent as they are both based on the concept of the arm's length principle, refer to paragraphs 9 & 10 of TR 2010/D2. It was never the intention of the ATO to consider the implications of Part IVA and the CGT regime in TR 2010/D2.
5.	Additional guidance, perhaps by way of examples, is needed to practically apply the processes outlined in the draft ruling as the ATO too often reverts to hypothecation and redefinition of arrangements, which should occur only in 'exceptional circumstances'. For example, the Case Study in Appendix 1 should be expanded to cover various scenarios. The ATO should be careful not to use hindsight in evaluating 'how the value chain has changed' (see paragraph 63) and to only consider facts and circumstances existing at the time of the restructure. Further clarification on this point would be welcomed.	The issue has been adequately dealt with above.

5. cont	Paragraph 63 requires the taxpayers to document the consequences of the restructure but the documentation requirements should be limited to the restructure itself, not subsequent events. Also, MNEs should not be required to document the implementation of each step resulting from the restructuring decision and each commercial development as they constantly change as a result of external pressures.	The point is acknowledged. Amended wording at paragraph 63 TR 2010/D2: *'The ATO analyses the value chain for the particular business operations at the time of the restructure with a view to determining how it was expected to be changed as a result of the business restructuring and what the expected benefit of the changes were (as distinct from using hindsight to judge the changes and benefits that actually resulted in the event) ….'*
	Paragraph 66 requires MNEs to perform 'full cost benefit analysis' but the real requirement should be for the Australian company to undertake an analysis similar to what it would undertake for any material decision in the normal course of its business operations.	The point is acknowledged. Amended wording at paragraph 66 TR 2010/D2: *'In making the decision to restructure, a MNE would typically undertake a detailed cost benefit analysis or similar type of objective analysis. If it exists the ATO will seek such documentation ….'*
	It is a concern that the ATO is expanding the scope of the required arm's length analysis to foreign affiliates of the Australian taxpayer involved in the business restructure. The options realistically available to a foreign parent company and other group companies are likely to be broad and extensive and documenting these would be too impractical and burdensome.	If there is in an analysis of the realistic viable options in existence the ATO will seek such documentation in so far as it impacts on the relevant Australian entities.
	The ATO should assess adherence to the ruling approach perhaps 12 months after the final ruling is issued. The ruling be prospective in application and not retrospective.	The ATO is subject to existing stringent quality control measures including the Public Rulings Panel process. To remain both retrospective and prospective. There has been no change of interpretation in the ATO position yet there is a perception the ATO is seeking additional information and more onerous record-keeping requirements.