PCG 2018/D8 (Finalised) - Transfer pricing issues related to inbound distribution arrangements

Transfer pricing issues related to inbound distribution arrangements

Relying on this draft Guideline

This Practical Compliance Guideline is a draft for consultation purposes only. When the final Guideline issues, it will have the following preamble:

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

Table of Contents **Paragraph**

What this draft Guideline is about

1. This draft Guideline[1] outlines our intended compliance approach to the transfer pricing outcomes associated with the following activities of inbound distributors:

- distributing goods purchased from related foreign entities for resale, and
- distributing digital products or services where the intellectual property in those products or services is owned by related foreign entities.

2. Such activities, together with any related activities involving the provision of ancillary services, are referred to in this Guideline as 'inbound distribution arrangements.'

3. This Guideline applies to inbound distribution arrangements of any scale. Where you are an inbound distributor and you choose to adopt the distributor simplified transfer pricing record keeping option in Practical Compliance Guideline PCG 2017/2 *Simplified Transfer Pricing Record Keeping Options*, this Guideline will not apply and instead we will follow the compliance approach set out in PCG 2017/2.

4. We use the framework in this Guideline to assess the transfer pricing risk of inbound distribution arrangements and tailor our engagement with you. Where this Guideline applies, we rate the transfer pricing risk of your inbound distribution arrangements having regard to a combination of quantitative and qualitative factors.

5. If we rate your inbound distribution arrangements as having a low transfer pricing risk, you can expect that we will generally not apply compliance resources to review the transfer pricing outcomes of your arrangements. However, if your inbound distribution arrangements fall outside the low transfer pricing risk category, you can expect us to monitor, test and/or verify the transfer pricing outcomes of your arrangements. The higher the risk rating, the more likely we are to review your arrangements as a matter of priority.

6. This Guideline is limited to the transfer pricing risks associated with inbound distribution arrangements. It does not affect our compliance approach to other tax issues that might arise in connection with your inbound distribution arrangements (for example, the existence of withholding tax obligations or the application of the general anti-avoidance rule in Part IVA of the *Income Tax Assessment Act 1936*). If we consider that your inbound distribution arrangements pose a risk under other tax provisions, we will apply compliance resources to review your arrangements.

7. This Guideline does not limit the operation of the law.[2] The information provided in this Guideline does not replace, alter or affect our interpretation of the law in any way. It does not relieve you of your legal obligation to comply with all relevant tax laws, or create any safe harbour administrative concessions.

8. Having a low risk rating under this Guideline does not necessarily mean that your transfer pricing outcomes are correct or that you have a reasonably arguable position. Equally, having a high risk rating under this Guideline does not necessarily mean that your inbound distribution arrangements fail to comply with Australia's transfer pricing rules. Having regard to your particular circumstances, we may accept that your transfer pricing outcomes are reasonable.

9. You can use the framework set out in this Guideline to:

- assess the transfer pricing risk of your inbound distribution arrangements

[1] All further references to 'this Guideline' refer to the Guideline as it will read when finalised. Note that this Guideline will not take effect until finalised.

[2] For example, this Guideline does not limit the operation of Subdivision 284-E in Schedule 1 to the *Taxation Administration Act 1953* (TAA) which sets out special rules about unarguable positions for cross-border transfer pricing.

- understand the compliance approach we are likely to adopt given the transfer pricing risk profile of your inbound distribution arrangements
- work with us to mitigate the transfer pricing risk of your inbound distribution arrangements and be confident you have reduced your risk exposure, and
- understand the type of analysis we use when assessing the transfer pricing risk of your inbound distribution arrangements.

Structure of this Guideline

10. This Guideline is structured as follows:

- the main body sets out general principles relevant to our framework for assessing transfer pricing risk and applying compliance resources to inbound distribution arrangements to which the Guideline applies, and
- the schedules set out quantitative and qualitative indicators relevant to distributors generally or based on their industry sector, including those that operate in the life science, information and communication technology (ICT) and motor vehicle industries.

11. This Guideline does not provide advice or guidance on the technical interpretation or application of Australia's transfer pricing rules or other tax provisions.

Date of effect

12. When finalised, this Guideline will have effect from the date of publication and will apply to existing and new inbound distribution arrangements.

13. The use and application of the final Guideline will be under continuous review over the next three years. Any revisions to improve the Guideline will be made at the end of the review period or on an 'as necessary' basis. We will undertake consultation in relation to proposed material changes.

Inbound distributors

14. We consider you to be an inbound distributor if your business predominantly involves the distribution of goods purchased from related foreign entities for resale, or the distribution of digital products or services where the intellectual property in those products or services is owned by related foreign entities.

15. For the purposes of our risk assessment framework, an inbound distributor is an intermediary between the producer of a good and another entity in the distribution channel or supply chain. A distributor earns a gross profit from the difference between the price at which they sell the good, and the price which they pay. A distributor will typically incur various selling and administrative costs that must be covered by this gross profit in order for it to make a net profit.

16. In relation to the distribution of digital products and services, an inbound distributor is an intermediary between the intellectual property owner and the customer or end user of the digital product or service. We consider you to be an inbound distributor irrespective of whether you distribute digital products or services by granting rights to end users directly, or by facilitating the grant of rights to end users by related foreign entities.

17. Inbound distributors include entities that sell to retailers, merchants, contractors or industrial, institutional or commercial users. Their focus is on selling business to business,

rather than to household consumers. An inbound distributor may have some retail operation but their primary sales channel is not their own retail activity.

18. Inbound distributors play an important role as a value-adding link between foreign entity suppliers and customers. Inbound distributors seek to find and match suppliers' capabilities with customers' buying preferences. In the case of goods, an inbound distributor will commonly purchase in mass quantity and then on-sell the goods in smaller orders to its customers. The inbound distributor may also acquire goods from more than one supplier, and match its sales to the specifications and volumes requested by customers. In the case of digital products and services, an inbound distributor may seek to identify the most appropriate digital products or services for the end user by understanding the end user's business, technical needs and specifications. This may involve the inbound distributor offering bespoke or customised digital products or services to the end user.

19. Inbound distributors may pass important information in both directions. This may include information from suppliers regarding product benefits, changes to the product line-up, expected pricing and technical support. It may also include information from customers about their preferences, demand expectations and competitors.

20. The role of an inbound distributor can include a range of functions that support the primary activity of distribution. Many of these functions will be associated with sales, after sales support, procurement and administration. An inbound distributor may also undertake functions involving transportation, warehousing, inventory management and regulatory matters. The specific nature and combination of these functions will be unique to the inbound distributor's business.

21. The nature of an inbound distributor's sales function will vary depending on a range of matters including the nature of the product, the nature of the customers and the business strategies adopted by the inbound distributor. The sales function may include activities such as support for promotional efforts, product information, technical support, relationship building and order processing. It is usually important for an inbound distributor to have a good understanding of its customers and to be able to predict their needs.

22. As the concept of an inbound distributor is broad and can involve a variety of functions and transactions, we rely on a range of factors to help assess whether an entity is an inbound distributor. No individual factor is determinative, or has a 'bright-line' metric that differentiates inbound distributors from other entities. The factors we consider include:

- the main business activity disclosed on your tax return
- the proportion of tangible property expenditure of a revenue nature relative to cost of goods sold
- the proportion of tangible property expenditure of a revenue nature relative to total income
- the proportion of income from the sale of goods or digital products or services relative to other income
- the extent to which you undertake activities other than distribution activities, for example, the extent of contract research and development services provided, and
- the operating practice of your specific industry in relation to distribution activities.

23. No matter how you describe yourself, for example, as a routine distributor, a limited risk distributor or a marketer-distributor, the principles in this Guideline will apply if we consider you to be an inbound distributor to which this Guideline applies. However, your functional profile will be relevant when we consider the qualitative factors important to transfer pricing risk in your industry.

24. For the purposes of our risk assessment, we consider that inbound distribution arrangements do not involve the significant transformation of goods. If you undertake significant manufacturing, or you contract with another entity to manufacture for you, we will not treat those activities as part of your inbound distribution arrangements. Similarly, we do not consider finance or insurance activities, including those linked to sales activities, to be part of your inbound distribution arrangements. The transfer pricing risk associated with finance and insurance activities should be assessed separately, and Practical Compliance Guideline PCG 2017/4 *ATO compliance approach to taxation issues associated with cross-border related party financing arrangements and related transactions* and Law Administration Practice Statement PS LA 2007/8 *Treatment of non-resident captive insurance arrangements* may be relevant.

Our compliance approach

25. We concentrate our efforts on inbound distribution arrangements that pose the highest risk of not complying with Australia's transfer pricing rules.

26. This Guideline highlights inbound distribution arrangements where we see risk of non-compliance and sets out our approach where taxpayers transition their arrangements to lower risk positions.

27. The transfer pricing methods used in the risk framework in this Guideline are for risk assessment purposes only.

28. Consistent with the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010* and other documents covered by section 815-135 of the *Income Tax Assessment Act 1997*, you should use the transfer pricing methodology (or combination of methodologies) that is most appropriate and reliable for your circumstances when pricing your inbound distribution arrangements.

29. The quantitative and qualitative indicators set out in this Guideline are based on work we have undertaken in relation to Australian distribution activities. Accordingly, this Guideline sets out our compliance approach to the transfer pricing risk associated solely with inbound distribution arrangements.

30. Where this Guideline applies, you can expect the following compliance approach depending on your risk zone.[3]

Risk zone	**Our approach**
Low	We will generally not allocate compliance resources to assess your transfer pricing outcomes in relation to your inbound distribution arrangements other than to confirm your characterisation as an inbound distributor, and the extent of the activities you undertake. We will be open to entering into early engagement advance pricing arrangement (APA) discussions with you and will be more likely to invite you to make a formal APA application. In addition, you will be eligible to request a pre-qualified unilateral APA process.[4]
Medium	We will monitor your arrangements using available data and may contact you to seek a better understanding of your circumstances before deciding to allocate further compliance resources. We will be open to entering into early engagement APA discussions with you and may invite you to make a formal APA application. In addition, you will be

[3] Refer to paragraph 46 of this Guideline.
[4] Refer to paragraphs 53 to 60 of this Guideline.

	eligible to request a pre-qualified unilateral APA process, although your prior year outcomes may be reviewed.
High	We will consider appropriate treatment options and recommend that you review your transfer pricing policy. This may involve us: • writing to you to express our concern • actively monitoring your inbound distribution arrangements, or • commencing a review or audit. When selecting our compliance activity, we will take into account various factors in addition to the framework in this Guideline. These factors include consideration of your global supply chain, the tax profile of your related parties and the amount of tax at risk. We consider that entities with inbound distribution arrangements that consistently suffer losses pose a very high transfer pricing risk. We will ordinarily prioritise a review of you where you have been in an overall loss position for the aggregate of your current and previous two income years. You may seek to enter into early engagement APA discussions with us, but you will not be eligible to request a pre-qualified unilateral APA process.

How we risk assess your inbound distribution arrangements

31. We assess the transfer pricing risk of your inbound distribution arrangements by comparing the profit outcome of your arrangements against our profit markers for inbound distributors. The profit markers relevant to you are based on the industry sector in which you operate and the extent to which your distribution arrangements involve activities that we see as generally adding incremental value in Australia.[5]

32. We analyse the profit outcome of your inbound distribution arrangements using Earnings Before Interest and Tax (EBIT) relative to sales. The EBIT margin earned by an inbound distributor can be affected by a range of commercial factors. However, we consider the EBIT margin provides a reasonable basis for us to identify transfer pricing risks for inbound distribution arrangements.

33. Due to the circumstances of inbound distributors, in particular the predominance of spot or short term sales and their typical asset profile, we would expect to find similarity between their EBIT and Profit Before Tax. We do not generally expect inbound distributors to enter into substantial debt arrangements.

34. Our approach to assessing the transfer pricing risk of your inbound distribution arrangements has similarities with the OECD transactional net margin method. However, this does not necessarily mean that we view this method as being the correct transfer pricing method to price your arrangements.

Profit markers

35. We have undertaken a benchmarking exercise to understand the net profit margins earned by distributors operating independently that we believe are relevant to the Australian economy. The exercise looked at distributors generally, and also focused on distributors in certain industry sectors.

36. These specific industry sectors were chosen due to the potential level of transfer pricing risk we see in those sectors based on the total value of the goods imported into Australia and previous case work we have undertaken.

[5] Refer to paragraphs 35 to 40 of this Guideline.

37. From this benchmarking exercise, we have developed a set of profit markers that we use for assessing transfer pricing risk based on the industry sector in which the inbound distributor operates. The profit markers also take into account activities undertaken by the inbound distributor that we consider incrementally generate value in the industry sector, and which are therefore relevant to transfer pricing risk.[6]

38. We analyse the profit performance of your inbound distribution arrangements against these profit markers in order to assess your transfer pricing risk. As a measure of profit performance, we calculate a five year weighted average EBIT margin.

39. In calculating the five year weighted average EBIT margin, where possible, we use financial information which accurately isolates the revenues and costs of your inbound distribution arrangements from the revenues and costs of any other business activities you carry on. This information may include statutory or management accounts that we have obtained in the course of our general compliance activity. However, in instances where this information is not available, we will assess whether, based on the information we do have, there are revenues or costs in the EBIT margin which make it inappropriate to assess your transfer pricing risk in this way. This will generally be the case where the revenues or costs unrelated to your inbound distribution activities are material. Determining the significance of unrelated revenues and costs to the risk assessment process is a matter of judgment.

40. The profit markers are set out in the Schedules at paragraphs 66 to 89 of this Guideline. We will update the profit markers based on future benchmarking work as required.

Activities that incrementally generate value

41. The characterisation of an entity as an inbound distributor largely reflects its economically significant functions in the context of its industry and its business strategies.

42. Where inbound distributors undertake more economically significant functions relative to the generation of overall value, we would generally expect them to earn a relatively higher profit. As a result, in determining the relevant profit marker to assess your transfer pricing risk, we have regard to the extent to which you undertake activities that incrementally generate value. In assessing risk, we expect entities that undertake more activities which incrementally generate value to earn higher profit margins overall.

43. In certain industry sectors, we have identified activities that we consider incrementally generate value from inbound distribution arrangements. We see these activities as making a significant contribution to an overall value chain, and hence they have the potential to create increased value in Australia relative to other distributors that do not undertake such activities. Where relevant, the value-generating activities that we consider for risk assessment are specified as different categories of inbound distributors within the Schedules of this Guideline. Where we have identified categories of inbound distributors in an industry sector, we have developed profit markers for each category for that industry sector.

44. In addition to industry factors, we have regard to whether inbound distributors are significantly developing, enhancing, maintaining, protecting or exploiting intangibles when assessing risk. As this information becomes available to us, it may influence our view of the arm's length outcome from the overall activities such that we perceive a higher level of transfer pricing risk than indicated by the profit markers.

[6] Refer to paragraphs 41 to 44 of this Guideline.

The risk assessment framework

45. Our risk assessment framework for inbound distributors is made up of three transfer pricing risk zones – low, medium and high.

46. The Schedules of this Guideline set out the profit markers we use to determine your risk zone based on your industry sector and your category of activities that incrementally generate value. For each category, there are two profit markers, A and B. Your risk zone is determined by your profit outcome relative to the markers for your category.

Risk zone	You relative to the profit markers
Low	At or above profit marker A
Medium	Below profit marker A, but at or above profit marker B
High	Below profit marker B

47. The risk framework in this Guideline does not apply to you where any of the following cover your inbound distribution arrangements for the current income year:

- an APA
- a settlement agreement between you and us
- a court or Administrative Appeals Tribunal decision that applies to you as a party to the proceeding, or
- we have conducted a review of your inbound distribution arrangements and provided you with a low risk or high assurance rating for those arrangements.

48. If you fall outside the low risk zone, we do not presume that your inbound distribution arrangements are uncommercial or that they fail to comply with Australia's transfer pricing rules. Falling outside the low risk zone means we consider your inbound distribution arrangements may give rise to an inappropriate transfer pricing outcome. Therefore, we will generally conduct some form of compliance activity in relation to your inbound distribution arrangements.

49. Schedule 1 of this Guideline sets out the profit markers that we use for determining the transfer pricing risk for inbound distributors generally (general distributors). Further schedules apply to inbound distributors operating in the life science sector, the ICT sector and the motor vehicles sector. We apply Schedule 1 unless a more specific schedule applies.

50. If more than one Schedule applies to your inbound distribution arrangements, we will use the industry schedule that we consider best fits your circumstances.

51. The profit markers in the Schedules are provided to give you transparency in relation to our compliance approach. You should not use the profit markers as a safe harbour to adjust your arrangements so that you sit lower within a particular zone merely because it does not change your overall risk zone. We will monitor outcomes for inbound distribution arrangements over time to ensure there is no unexplained 'drift' within a risk zone.

52. We may ask you to tell us in writing whether you have reviewed the compliance risk of your inbound distribution arrangements and which risk zone you believe your arrangements fall within. You may be required to inform us which risk zone you believe you fall within via the Reportable Tax Position schedule.

How to increase certainty through the advance pricing arrangement program

53. Our APA program provides you with the opportunity to engage with us in a constructive way to reach agreement on the transfer pricing of your inbound distribution arrangements for a fixed period of time. An APA may assist you with managing and mitigating your transfer pricing risk and provide you with greater certainty on a prospective basis. Our practice and procedures for entering an APA are set out in Law Administration Practice Statement PS LA 2015/4 *Advance Pricing Arrangements*.

54. No matter what risk zone your inbound distribution arrangements are in, you are able to seek to enter into discussions with us as part of the early engagement stage of the APA process.

55. Where your inbound distribution arrangements are in the high risk zone and you expect them to stay there, there are likely to be factors that would make reaching an agreement on an APA difficult. In particular, to the extent that the proposed APA relies on the use of a transactional net margin method, we would be likely to enter into discussions with significantly divergent views on appropriate outcomes. We may also wish to focus on past transfer pricing outcomes as part of our compliance approach.

56. In addition, a significant divergence between your EBIT and Profit Before Tax would require attention as part of the early engagement discussions. For example, we do not generally expect inbound distributors to enter into substantial debt arrangements due to the nature of the sales income and asset profile.

57. There are opportunities to reduce the level of work and additional information ordinarily required under certain steps of the APA process where you are able to pre-qualify based on the approach set out in this Guideline.

58. In particular, where you are able to demonstrate that this Guideline applies to you as an inbound distributor, and you are interested in proposing an APA method and application aligned to the profit markers in this Guideline, your APA process will be considered to have pre-qualified for certain aspects of the APA (a pre-qualified APA). A pre-qualified APA may benefit from saving time and resources, as there is likely to be:

- reduced information gathering with a focus on confirming your characterisation as an inbound distributor, the extent of your incremental value-generating activities and the applicability of the transactional net margin method, and
- no requirement for you to prepare benchmarking as we will provide the profit benchmarks most relevant to your circumstances (see paragraphs 35 to 40 of this Guideline).

59. If you request a pre-qualified APA, we will still undertake a triage process as set out in PS LA 2015/4 to identify whether there are tax issues other than transfer pricing that are material impediments to entering into an APA. Where you have been reviewed under a tax assurance review, and we have obtained a high level of assurance, we will generally seek to use that information for our triage review.

60. The transactions covered by an APA entered into after 4 April 2017, including a pre-qualified APA, will generally be considered to be low risk for the purposes of the diverted profits tax (DPT) for the period of the APA.[7] A pre-qualified APA for your inbound distribution arrangements may include a DPT clause that provides written assurance that we will not seek to make a DPT assessment in relation to the transactions covered by the APA.[8] If you would like a DPT clause to be included in an APA, we ask that you make note

[7] Refer to paragraph 18 of Practical Compliance Guideline PCG 2018/5 *Diverted profits tax*.
[8] Refer to paragraphs 53 to 55 of PCG 2018/5.

of it in your APA submission or as early as possible in the APA process as further information may be required to enable us to make a decision in relation to any such request.

Transitioning existing arrangements to the low risk zone

61. We encourage willing and co-operative compliance and recognise that the publication of this Guideline may prompt you to review your inbound distribution arrangements. This may cause you to adjust your inbound distribution arrangements to come within our low risk zone prospectively.

62. For the period of 12 months from the date of publication of this Guideline, we will consider remitting shortfall penalties[9] to nil and shortfall interest charge[10] to the base rate if certain pre-conditions are met. The conditions are that you make a voluntary disclosure in relation to all income years where your arrangements are in place and adjust your historic and prospective pricing to reflect an appropriate transfer pricing outcome. If you do so, we will view this as a strong factor in favour of exercising the Commissioner's discretion to remit.[11]

63. You can inform us of your intentions to transition your arrangements at any time before you are notified of the commencement of an audit.

Who to contact

64. If you wish to discuss your inbound distribution arrangements with us, you may contact ISCStrategy@ato.gov.au.

65. Alternatively, if you have a dedicated relationship manager, you may approach them directly for assistance with your case.

Commissioner of Taxation
23 November 2018

[9] Division 284 in Schedule 1 to the TAA.
[10] Division 280 of Schedule 1 to the TAA.
[11] The Commissioner's guidelines on remission of shortfall penalties are set out in Law Administraion Practice Statement PS LA 2011/30 *Remission of administrative penalties relating to schemes imposed by subsection 284-145(1) of Schedule 1 to the Taxation Administration Act 1953*, Law Administraion Practice Statement PS LA 2012/4 *Administration of penalties for making false or misleading statements that do not result in shortfall amounts*, Law Administraion Practice Statement PS LA 2012/5 *Administration of penalties for making false or misleading statements that result in shortfall amounts,* Law Administraion Practice Statement PS LA 2014/2 *Administration of transfer pricing penalties for income years commencing on or after 29 June 2013*, Law Administraion Practice Statement PS LA 2014/4 *Administration of the penalty imposed under subsection 284-75(3) of Schedule 1 to the Taxation Administration Act 1953* and Law Administraion Practice Statement PS LA 2016/2 *Administration of scheme penalties arising from the application of Subdivision 815-A for income years which started on or after 1 July 2004 and before 1 July 2012 (transition period).* The Commissioner's guidelines on remission of shortfall interest charge are set out in Law Administration Practice Statement PS LA 2006/8 *Remission of shortfall interest charge and general interest charge for shortfall periods*.

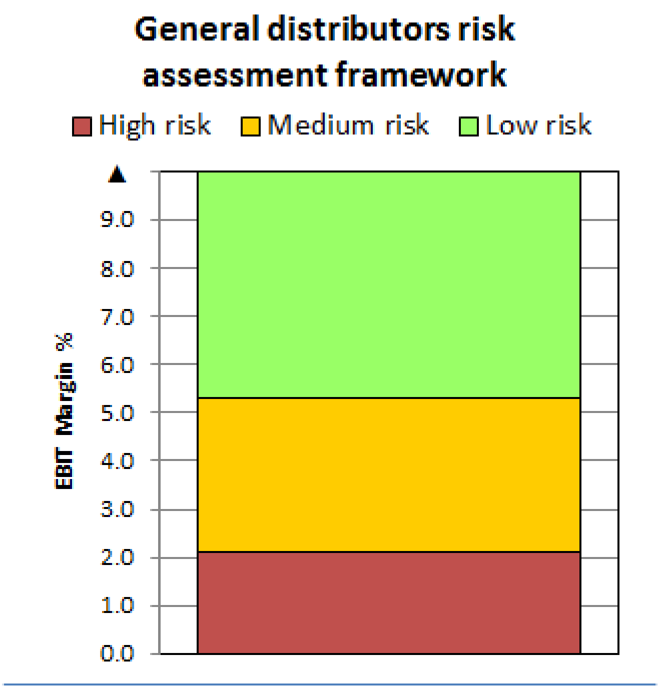
SCHEDULE 1 – GENERAL DISTRIBUTORS

66. We apply this Schedule if you are an inbound distributor and no other specific industry schedule applies.

67. The fundamental characteristics of an inbound distributor are set out in the main body of this Guideline.[12]

68. As the general distributors category is a broad category that covers a wide range of industries and circumstances, we do not specifically identify categories of activities that we consider incrementally generate value. Accordingly, we assess transfer pricing risk for general distributors as a single category based on one set of profit markers. As set out in the main body of this Guideline, we would generally expect taxpayers that perform more activities to have a higher profit.

69. We use the following profit markers for assessing transfer pricing risk for general distributors.



High risk	Below 2.1%
Medium risk	Between 2.1% - 5.3%
Low risk	Above 5.3%

[12] Refer to paragraphs 14 to 24 of this Guideline.

SCHEDULE 2 – LIFE SCIENCE

70. We apply this Schedule if you are an inbound distributor in the life science industry sector.

71. The fundamental characteristics of an inbound distributor are set out in the main body of this Guideline.[13]

72. The life science industry consists of entities involved in the discovery, development, production and sales, and marketing of medicine. For the purposes of this Guideline, the industry comprises five sub-sectors:

- innovative/patented
- medical equipment and devices
- generic/biosimilar
- over-the-counter, and
- animal health.

73. In assessing transfer pricing risk for inbound distributors in the life science industry sector, we assess entities under categories based on the extent to which they undertake activities that incrementally generate value. We do this by having regard to the facts and circumstances of a business, which may include considering revenue or operating expenses associated with an activity, and interactions between activities in different categories.

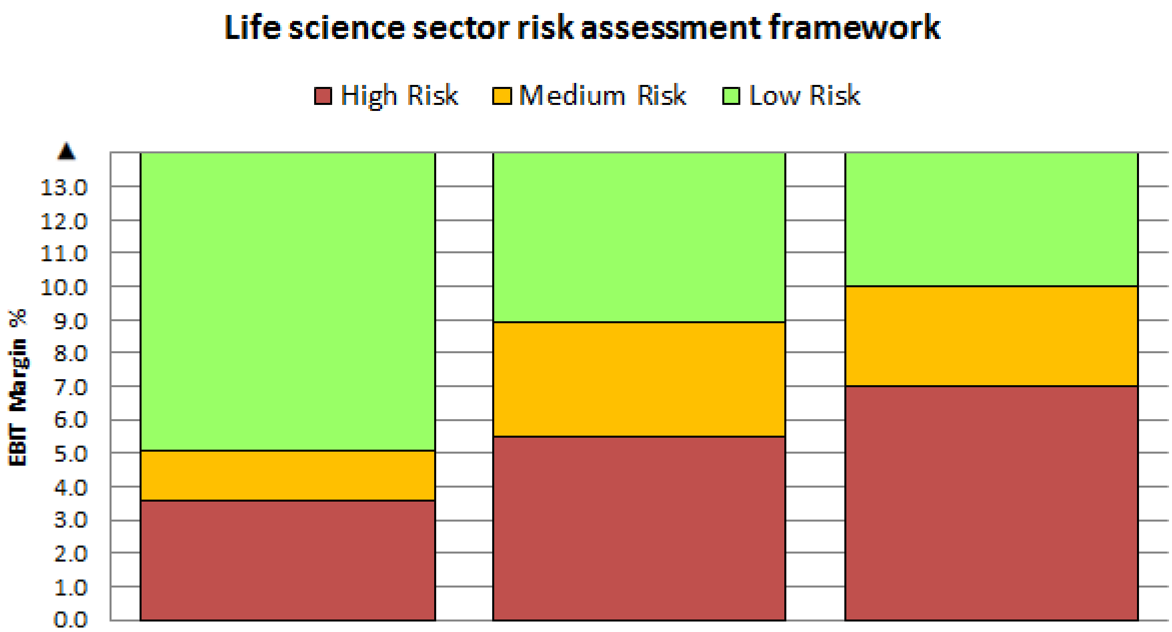
74. We use the following categories for the life science industry sector.

Category	Activities that incrementally generate value
1	Entity engaged in the **distribution** of life science products. This may include performing any of the following activities in relation to your inbound distribution arrangements: • **Detailing and marketing** activities such as development of local detailing and marketing plans, including localisation; delivering detailed medical information and clinical research data to potential prescribers such as general practitioners, pharmacists and specialist physicians; visiting hospitals, doctors, and institutions; promoting life science products; and advising clients on the most suitable products for their needs. • **Logistics and warehousing** functions depending on the nature of the product.
2	Entity engaged in: • **activities specified in Category 1**, and • **regulatory approval, market access or government reimbursement activities** such as regulatory application, certification, registration, compliance and relationship management activities with regulatory bodies (eg Therapeutic Goods Administration and Pharmaceutical Benefits Scheme including Pharmaceutical Benefits Advisory Committee); interpreting clinical trial data and generating data and product awareness through engagement with the scientific and medical community.

[13] Refer to paragraphs 14 to 24 of this Guideline.

3	Entity engaged in: • **activities specified in Category 1 and Category 2**, and • **specialised technical services** such as training and assistance in conducting surgical procedures involving medical devices (including implantables).

75. Based on the above categories, we use the following profit markers for assessing transfer pricing risk so as to take into account the activities that we consider incrementally generate value in the life science sector. As set out in the main body of this Guideline, we would generally expect entities that perform more activities to have a higher profit.



	Category 1	Category 2	Category 3
High risk	Below 3.6	Below 5.5%	Below 7%
Medium risk	Between 3.6% - 5.1%	Between 5.5% - 8.9%	Between 7% - 10%
Low risk	Above 5.1%	Above 8.9%	Above 10%

SCHEDULE 3 – INFORMATION AND COMMUNICATION TECHNOLOGY

76. We apply this Schedule if you are an inbound distributor in the ICT industry sector.

77. The fundamental characteristics of an inbound distributor are set out in the main body of this Guideline.[14]

78. The ICT industry sector includes all types of consumer and enterprise computer hardware and software products, digital communication devices, applications, IT solutions and ancillary services that enable interaction through technology.

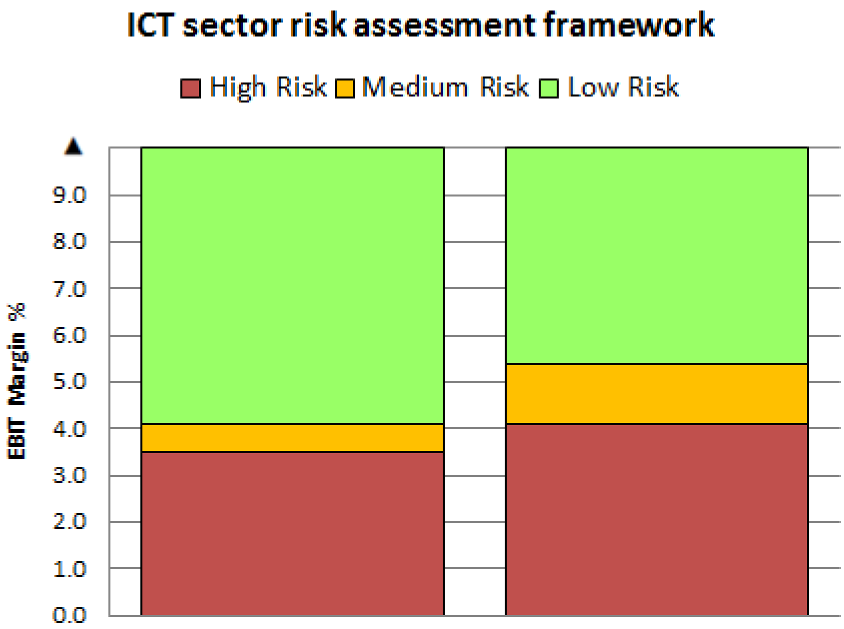
79. In assessing transfer pricing risk for inbound distributors in the ICT industry sector, we assess entities under categories based on the extent to which they undertake activities that incrementally generate value. We do this by having regard to the facts and circumstances of a business, which may include considering revenue or operating expenses associated with an activity, and interactions between activities in different categories.

80. We use the following categories for the ICT industry sector.

Category	Activities that incrementally generate value
1	Entity engaged in the **distribution** of ICT products. This may include performing any of the following activities in relation to your inbound distribution arrangements: • **Sales and marketing activities** such as the execution, development or localisation of sales and marketing plans, the management of partner relationships with intermediaries, and the general promotion of ICT products and services. • **Pre and/or post-sales services** such as pre-sale consultation services, product demonstrations, training, technical support, maintenance (including spare parts and repairs) and warranty services. • **Logistics and warehousing functions** depending on the nature of the product.
2	Entity engaged in any of **the activities specified in Category 1** and any of the following: • **complex sales processes** such as a customisable product portfolio, specialised local technical expertise, solution building, developing proof of concepts, and providing bespoke offerings. • **direct selling activities** which support or supplement predominant distribution activities such as partner-led assisted retail activities and branded retail activities. • **large customer relationship management** such as enterprises and/or government organisations including tendering, contract negotiation processes and ongoing relationship management.

81. Based on the above categories, we use the following profit markers for assessing transfer pricing risk so as to take into account the activities that we consider incrementally generate value in the ICT industry sector. As set out in the main body of this Guideline, we would generally expect entities that perform more activities to have a higher profit.

[14] Refer to paragraphs 14 to 24 of this Guideline.



	Category 1	Category 2
High risk	Below 3.5%	Below 4.1%
Medium risk	Between 3.5% - 4.1%	Between 4.1% - 5.4%
Low risk	Above 4.1%	Above 5.4%

SCHEDULE 4 – MOTOR VEHICLES

82. We apply this Schedule if you are an inbound distributor in the motor vehicles industry sector.

83. The fundamental characteristics of an inbound distributor are set out in the main body of this Guideline.[15]

84. We consider you to be in the motor vehicles industry sector if your business trades in passenger vehicles, trucks, buses, motorcycles or other recreational motorised vehicles or their associated parts.

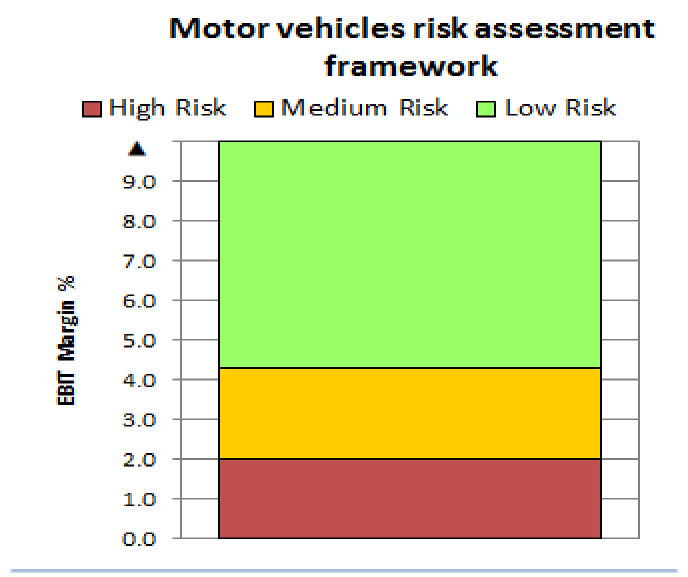
85. The motor vehicles industry is diverse and encompasses upstream and downstream activities. Upstream activities relate to the development and construction of motor vehicles and include activities involved in the design, testing, engineering, manufacturing and assembling of motor vehicles and their associated components. Downstream activities relate to the distribution and use of motor vehicles and include sales, servicing and repairs, provision of fuels, recycling and disposal, and aftermarket activities.

86. The role of a motor vehicle distributor includes a range of functions that support the activity of distribution. These functions include marketing and sales, after sales support, procurement and administration, insurance activities, as well as functions involving transportation, warehousing and inventory management.

87. Motor vehicle distributors generally sell through an independent dealership network, which they support to maintain a strong relationship. While motor vehicle distributors may have some retail operation, their primary sales channel is not their own retail activity.

88. We do not identify categories of specific activities that we consider incrementally generate value for motor vehicle distributors. Accordingly, we assess transfer pricing risk for motor vehicle distributors as a single category based on one set of profit markers.

89. We use the following profit markers for assessing transfer pricing risk for motor vehicle distributors. As set out in the main body of this Guideline, we would generally expect entities that perform more activities to have a higher profit.



High risk	Below 2%
Medium risk	Between 2% - 4.3%
Low risk	Above 4.3%

[15] Refer to paragraphs 14 to 24 of this Guideline.

Your comments

90. You are invited to comment on this draft Guideline, including the proposed date of effect. Please forward your comments to the contact officer by the due date.

91. A compendium of comments is prepared for the consideration of the relevant Public Advice and Guidance Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: **21 December 2018**

Contact officer details have been removed following publication of the final guideline.

References

ATOlaw topic	International issues ~~ Transfer pricing ~~ Profit shifting
Legislative references	ITAA 1936 ITAA 1936 Pt IVA ITAA 1997 ITAA 1997 815-135 TAA 1953 TAA 1953 Sch 1 Div 280 TAA 1953 Sch 1 Div 284 TAA 1953 Sch 1 Subdiv 284-E
Related Rulings/Determinations	MT 2012/3 MT 2008/1 TR 2014/8
Other references	PCG 2017/2 PCG 2017/4 PCG 2018/5 PS LA 2006/8 PS LA 2007/8 PS LA 2011/30 PS LA 2012/4 PS LA 2012/5 PS LA 2014/2 PS LA 2014/4 PS LA 2015/4 PS LA 2016/2 Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, OECD, 22 July 2010
ATO reference	1-FBU6XG6
ISSN	2209-1297
BSL	PGI