



Australian Government
Inspector-General of Taxation

Review into the Australian Taxation Office's management of transfer pricing matters

A report to the Assistant Treasurer

Inspector-General of Taxation

December 2013

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16 December 2013

Senator the Hon Arthur Sinodinos AO
Assistant Treasurer
Parliament House
Canberra ACT 2600

Dear Minister,

Review into the Australian Taxation Office's management of transfer pricing matters

I am pleased to present you with my report of the above review which was prompted by concerns raised by taxpayers, tax professionals and their representative bodies regarding the ATO's management of transfer pricing matters.

Internationally, there are government and community concerns regarding risks to revenue arising from transfer pricing, base erosion and profit shifting as evidenced in the OECD and G20 forums. This was also an important consideration in undertaking this review.

The review has found that key causes of the concerns were inadequate succession planning and resource management. Experienced specialist officers had left the ATO's transfer pricing area and their knowledge was not effectively disseminated across the organisation. Another significant cause was the complex interactions between the ATO's internal functions and a lack of clarity with respect to the decision-making process.

I have recommended a suite of measures aimed at developing sufficient organisational capability to address transfer pricing risks, including giving priority to measures that target the highest risks to tax revenue. There are 18 recommendations, 17 of which the ATO has agreed with in whole, part or principle. The recommendations are an integrated package where each builds upon the other. As the ATO has disagreed with certain recommendations or aspects thereof, the full benefit of the intended integrated outcome may not be realised.

Whilst the ATO has provided reasoning where they have disagreed, I remain concerned, particularly where I have sought to avoid lengthy disputes by allowing ATO specialists or taxpayers to challenge generalist case officer decisions earlier in the compliance cycle. Furthermore, the ATO's recent decision to limit consultation on transfer pricing matters may impede its awareness of emerging arrangements and potential risks.

I am grateful for the support, contribution and willingness of many who provided their time, expertise and experience in the conduct of the review.

Yours faithfully,

Ali Noroozi
Inspector-General of Taxation

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EXECUTIVE SUMMARY

The Inspector-General of Taxation's (IGT) review into the Australian Taxation Office's (ATO) management of transfer pricing matters was prompted by concerns raised by taxpayers, tax professionals and their representative bodies. Broadly, these concerns related to unnecessary costs and protracted timeframes involved, lack of ATO communication on issues of concern, inadequate public advice and guidance and ineffective use of consultative forums.

The key underlying theme was insufficient ATO capability to deal with transfer pricing matters. The ATO capability in this area had been stretched further in responding to the ongoing evolution of globalisation, recent international collaboration on base erosion and profit shifting (BEPS) emerging from OECDⁱ and G20ⁱⁱ forums as well as changes to domestic transfer pricing legislation.

At the start of this review the ATO acknowledged that improvement was required notwithstanding the relatively recent changes to its internal governance arrangements and management structures, including its 'decentralised' compliance model, whereby transfer pricing specialists no longer conducted case work with generalist operational teams making decisions on all technical issues drawing on specialist advice as required.

During the review, the ATO made significant changes to its compliance approach, such as moving from a discrete focus on transfer pricing tax risks to a broader focus which incorporated transfer pricing within a range of international and domestic tax risks. Although the resulting ATO administrative arrangements were progressively developed during the course of the review, certain elements remain in a state of flux at the time of finalising this report. Whilst such development may have provided the IGT with opportunity to influence and assist in shaping aspects of the ATO's approach, it has also been a challenge to identify specific improvement actions due to the ATO's uncertainty with some of the details of its approach.

Nevertheless, the review has made important findings including that inadequate succession planning and resource management were key reasons for the capability deficiency. Many experienced and specialist officers had left and their knowledge was not effectively disseminated across the organisation.

The ATO has agreed with a number of the IGT's recommendations aimed at developing improved organisational capability such as:

- the recruitment and retention of transfer pricing 'specialist' officers, the identification and development of the key abilities of those 'specialists' and the ongoing capture and dissemination of knowledge and experience gained from case work;

ⁱ Organisation for Economic Co-operation and Development.

ⁱⁱ Group of Twenty Finance Ministers and Central Bank Governors.

- improving the ATO's identification, assessment and management of risk in transfer pricing matters as well as their interaction with the operational functions; and
- developing terms of engagement for the ATO's operational and specialist units which would explicitly identify the decision maker, the decision to be made and the escalation process in the event that the decision was not followed.

Improved organisational transfer pricing capability will take time to develop, especially as the ATO also expects its operational officers to focus on a broader range of international and domestic tax issues. Therefore, the IGT has also made a number of recommendations aimed at optimising the use of the ATO's current resources while further capability is being developed. In this regard, the ATO has agreed to match the scope and scale of transfer pricing compliance activities with the available specialist capability. In addition, it has also agreed to limit the use of wide-ranging enquiries to identify emerging risks and give priority to project-based compliance activities that target the highest revenue risks. These recommendations are expected to reduce the protracted timeframes and excessive costs that taxpayers experience in transfer pricing compliance activities.

In addition to responding to ATO enquiries, taxpayers' transfer pricing tax obligations, such as documenting the evidence for arm's length pricing outcomes, impose substantial costs. These costs have a regressive effect, particularly for Small and Medium Enterprises (SMEs). As a result, the ATO has agreed to a number of recommendations which are aimed at reducing the compliance burden for SME taxpayers, including the increased use of safe harbours for lower value and more common transactions, reducing documentation requirements and considering a simplified International Dealings Schedule.

Improved project management of transfer pricing matters was also identified as an area providing opportunity to reduce compliance costs both for the ATO and taxpayers. The ATO has agreed with a number of the recommendations in this respect, including that it establish and adhere to more accurate timeframes for its compliance activities, ensure that case officers understand taxpayers' reasons for their financial performance before commencing audit activities and develop more refined comparables for use in risk reviews.

The review also focused on the administration of the Advanced Pricing Arrangement (APA) program which provides opportunities to reduce overall compliance costs by reaching a common understanding of views through a cooperative process. The IGT observed that the use of APAs for more complex arrangements was critical to maintaining taxpayer and broader perceptions of the utility of the program and therefore identified a need for greater ATO transparency on the reasons for 'audit-like' approaches in APA processes and the circumstances which would justify a transition to an audit. It was also noted that such APAs are expected to provide valuable intelligence on emerging business practices and issues. In this respect, the ATO has agreed to promote the use of the APA program, provide the criteria for the withdrawal from APA negotiations and improve communications with taxpayers on issues of concern. However, the ATO has not agreed to certain suggested improvements with respect to APAs including better resourcing and a 'stage and gate' process.

Overall, the IGT has made 18 recommendations which are an integrated package of improvements. The ATO has agreed to 17 recommendations, in whole, part or principle, the implementation of which should result in significant and enduring benefits. However, as the

ATO has disagreed with certain recommendations or aspects thereof, the full benefit of the package may not be realised.

The IGT is particularly concerned that despite the ATO's agreement to Recommendation 2.1 which requires the development of case teams that have a particular focus on international tax issues, the combined effect of the ATO's disagreement to Recommendations 2.6, 3.4(2) and 5.2(1) increases the risk of costly and unnecessary disputation as generalist officers, with limited transfer pricing experience or expertise, may make decisions without an early opportunity for the ATO's specialists to challenge those decisions or for taxpayers to address any misunderstanding of facts before the ATO formulates its views.

The ATO has also disagreed with the IGT's recommendation to provide a consultative forum for transfer pricing issues. This disagreement is consistent with the ATO's relatively recent rationalisation of all its consultative forums. Whilst the IGT has not reviewed this broader change, more dialogue is generally better than less dialogue. In this review, however, the IGT is, specifically concerned with the ATO's reduced collaboration with the tax profession on transfer pricing issues particularly in the light of international developments as well as recent changes to domestic legislation. Such a forum not only allows the tax profession and the ATO to discuss and address areas of uncertainty collaboratively but it is also a source of information on emerging risks.

CHAPTER 1 — BACKGROUND

CONDUCT OF REVIEW

1.1 This is the Inspector-General of Taxation's (IGT) report of his review into the Australian Taxation Office's (ATO) management of transfer pricing matters. It is produced pursuant to section 10 of the *Inspector-General of Taxation Act 2003* (IGT Act 2003).

1.2 The review arose from concerns raised by taxpayers, tax professionals and their representative bodies in relation to the long timeframes and excessive costs of dealing with the ATO on transfer pricing matters. The IGT started this review, pursuant to subsection 8(1) of the IGT Act 2003, by announcing the terms of reference on 25 October 2012 (a copy is reproduced in Appendix 1).

1.3 The IGT received a significant number of written submissions in response to the terms of reference and also met with a range of stakeholders, including academics, current and former ATO officers as well as taxpayers, tax advisers and their representative bodies, to better understand the issues covered by this review. Broadly, the issues raised related to the ATO's overarching strategy and recent organisational changes, protracted timeframes to complete compliance activities, lack of ATO communication during compliance activities, inadequate public advice and guidance and ineffective use of consultative forums. The key underlying theme seemed to be insufficient staff capability in dealing with transfer pricing matters.

1.4 Most submissions impressed on the IGT that the above issues have been exacerbated by major changes in the global business environment over the past two decades such as:

- ongoing evolution of globalisation leading to the decline of trade barriers and increasing the privatisation of business activity, which is said to have facilitated the expansion of many businesses globally and increased the importance of transfer pricing policies;
- ongoing (re)location of the production of final products and components to various jurisdictions to improve business efficiency with decisions based on production costs, infrastructure, tax incentives and skilled labour force;

- the concentration of service functions and assets, such as research and development, internal finance, production and intangible assets within different business units of a Multi-National Enterprise (MNE) which may be located in different jurisdictions; and
- advances in telecommunications that has allowed, amongst other things, the advent of electronic commerce and '24/7' trading.¹

1.5 To assist with the IGT's consideration of issues, the IGT established a working group comprising key tax practitioners and representatives: Richard Atkinson (Rio Tinto); Chris Bowman (BTTP Consulting); Stuart Coggin (GlaxoSmithKline); Michael Fenner (Chevron); Geoffrey Gill (Deloitte); Denise Honey (Pitcher Partners); Nick Houseman (PricewaterhouseCoopers); Jason Levine (GM Holden); Steve O'Connor (Lloyds International); Jesper Solgaard (Ernst & Young); Richard Vann (University of Sydney); and senior ATO officials.

1.6 We greatly appreciate the generosity of the members of this working group in freely giving their time and expertise. Their involvement has greatly enhanced the outcomes of this review.

1.7 The working group considered stakeholders' concerns and canvassed potential solutions to the systemic issues in a frank and confidential manner. It should be noted, however, that the views and recommendations expressed in this report are not necessarily those of individual members of the working group. The views and recommendations were finalised by the IGT after much deliberation, and based on input received and discussions with the ATO and a range of external stakeholders.

1.8 The IGT also worked progressively with ATO senior management to distil the scope for improvement and to agree on specific actions. Furthermore, the Commissioner of Taxation (Commissioner) was provided with an opportunity to make submissions on any implied or actual criticisms contained in this report.

1.9 The following material in this chapter sets out the background information needed to understand the nature of transfer pricing in the context of intra-group trade, its relationship to the tax rules, the international approaches to these rules and the Australian transfer pricing regime.

WHAT IS TRANSFER PRICING?

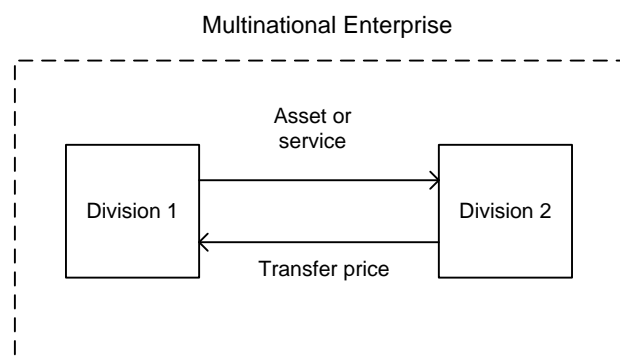
1.10 'Transfer pricing' is a management accounting and economic concept. It is defined as the amount that is charged by a part of an organisation to another part of

¹ United Nations Secretariat, *Transfer Pricing: History – State of the Art – Perspectives*, 10th mtg of Ad Hoc Group of Experts on International Cooperation in Tax Matters, ST/SG/AC.8/2001/CRP.6 (10-14 September 2001) p 1; Otto B Martinson, Ted D Englebrecht and Carla Mitchell, 'How Multinational Firms can Profit from Sophisticated Transfer Pricing Strategies' (1999) 10(2) *Journal of Corporate Accounting and Finance* 91, p 92.

the same organisation for assets or services.² Transfers may include tangibles or intangibles, including raw materials, semi-finished goods, finished goods, royalties, loans and various services.³

1.11 Accordingly, transfer pricing policies are common for organisations that have multiple business units operating in either the domestic or global market place. It is the process that establishes an exchange price for the assets or services being exchanged between these different business units in the course of intra-group trade.⁴ The figure below provides such an example for an MNE with two business units, or divisions.

Figure 1: Intra-group trade



Source: IGT.

SIGNIFICANCE OF INTRA-GROUP TRADE

1.12 The significance of intra-group trade has increased along with the emergence of global value chains and the expansion of activities of MNEs, particularly in Asia and other developing countries.⁵ The term MNE is no longer limited to very large organisations, but also includes smaller organisations with one or more subsidiaries or permanent establishments in countries other than where the parent is located.⁶

1.13 This expansion has significantly increased the amount of international transfers of assets and services.⁷ Whilst there is little direct data on international related party transactions, there is indirect evidence that suggests intra-group trade

² Charles T Horngren et al, *Introduction to Management Accounting* (Prentice Hall International Inc, 16th ed, 2012) p 336; Organisation for Economic Co-operation and Development (OECD), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing, 2010) p 19; Committee of Experts on International Cooperation in Tax Matters, United Nations, *Practical Manual on Transfer Pricing for Developing Countries*, 8th sess, agenda item 3(b), E/C.18/2012/CRP.1 (15-19 October 2012) p 3.

³ Martinson, Englebrecht and Mitchell, above n 1, pp 91-92.

⁴ *ibid* p 91.

⁵ Rainer Lanz and Sébastien Miroudot, 'Intra-firm Trade: Patterns, Determinants and Policy Implications' (Trade Policy Papers No 114, OECD, 2011) p 2; OECD, *Economic Outlook 2002* (2002) vol 1, ch IV.

⁶ UN Secretariat, 'Transfer Pricing History', above n 1, p 1.

⁷ Martinson, Englebrecht and Mitchell, above n 1, p 92.

represents a substantial share of world trade. It has been estimated that between 40 to 60 per cent⁸ of total international trade is carried out within MNEs. However, this percentage differs widely across countries and industries.⁹ For Australia, the ATO estimates that international related party transactions amount to approximately \$270 billion annually.¹⁰

1.14 Broad patterns of intra-group trade are said to arise in trade statistics and organisational-level data. These patterns suggest that 'intra-group trade and vertical integration occur predominantly among Organisation for Economic Co-operation and Development (OECD) countries and that organisational behaviour and relationships between buyers and suppliers explain the patterns of intra-group trade'.¹¹ These patterns are:

- First, a large share of world trade is between related parties, that is organisations that are linked through ownership. It is difficult to provide an average share for world trade, as data are available for very few countries. But for nine OECD countries, intragroup exports of foreign affiliates already represent 16% of total exports. Adding the exports of parent entities to their associates abroad, one could come close to the figure of one-third (as measured in U.S. trade statistics).
- However, this average masks wide differences; for example, the share of intragroup exports in total manufacturing exports is 51% in Sweden and 10% in Japan. Canada, Poland and Sweden are the countries where the share of intragroup trade is the highest. There are also wide differences across sectors. The share of intragroup trade is especially high in the automobile, pharmaceuticals and transport equipment industries.
- Data on intragroup trade in services is even rarer. According to U.S. balance of payments data, in 2008, the share of intragroup trade in total U.S. private services trade was 22% for imports and 26% for exports.
- In the case of the U.S. economy, the share of intragroup trade in total trade has remained more or less unchanged over the past 10 years, while the share of intragroup trade in services has increased. For other countries, there is evidence of an increase in intragroup trade in both goods and services industries.

⁸ *ibid*; UN Secretariat, 'Transfer Pricing History', above n 1, p 1.

⁹ Lanz and Miroudot, above n 5, p 2; OECD, 'Economic Outlook', above n 5, ch IV.

¹⁰ ATO, *Compliance Program 2012-13* (2012) p 46; Mark Konza, 'Our Compliance Approach in the Large Market' (Speech delivered at the Tax Institute 28th Annual Convention, Perth, 13 March 2013); Mark Konza (Speech delivered 17 July 2013); Bruce Quigley, 'Tax Administration in a Global Environment' (Speech delivered at the ICAA Conference, 22 November 2012).

¹¹ Lanz and Miroudot, above n 5, p 2.

- Intragroup transactions are more common among OECD countries than among emerging economies. In 2009, 58% of U.S. goods imports from OECD countries were intragroup, while only 29% of U.S. goods imports from Brazil, the Russian Federation, India, Indonesia, China and South Africa (BRIICS economies) occurred between related parties. This is consistent with the fact that the bulk of foreign direct investment (FDI) is among OECD countries; and
- While intragroup trade is mainly in intermediate goods, connecting the different stages of global value chains, there are also significant intragroup trade flows for final goods. This is explained by the importance of distribution networks in international production chains.¹²

WHY DO ORGANISATIONS PRICE INTRA-GROUP TRADE?

1.15 There are a number of reasons why notional or actual transfer prices are charged for intra-group trade. 'From an operational point of view, a properly designed transfer pricing strategy will provide the framework for management to make decisions congruent with the [organisation's] goals and a basis for rewarding the managers for their performance. More importantly, from a strategic perspective, transfer pricing can play an important role in the achievement of [organisation-wide] goals'.¹³

1.16 A well-developed transfer pricing policy has become increasingly important to organisations with highly decentralised decision-making structures with profit responsibility allocated to individual business units.¹⁴

1.17 Decentralised decision-making structures are a response to the need to become more competitive and increase market share in today's global marketplace. To cope with the rapidly changing marketplace, organisations have divided themselves into strategic business units by, for example, products, services, function or location, each with its own revenues, expenditures and capital asset purchase programmes. Therefore, each unit has its own profit and loss responsibility which enables it to keep the day-to-day decision making at a lower organisational level where quality and speed of the decisions can be enhanced and some or all of the separate business units may be effectively, autonomous 'profit centres'.¹⁵

1.18 To further improve profitability and efficiency, business units may be located in different jurisdictions where, for example, particular skilled labour forces exist or where labour costs are particularly low. Frequently, this is how MNEs have come into existence in recent times.

1.19 Management accounting and economic literature commonly acknowledge the use of transfer pricing of assets and services between business units as providing

¹² *ibid* pp 5-6.

¹³ Martinson, Englebrecht and Mitchell, above n 1, pp 91- 92.

¹⁴ UN Secretariat, 'Transfer Pricing History', above n 1, p 1.

¹⁵ Jack Hirshleifer, 'On the Economics of Transfer Pricing' (1956) 29(3) *Journal of Business* 172, p 172.

incentives for unit managers to achieve the optimal level of output that will maximise the organisation's profit as a whole. This is because prices which are set on internal transfers affect the level of activity within the units.¹⁶

1.20 Charging transfer prices for intra-group transactions allows an organisation to also evaluate the performance of the business units. The individual units within an organisation may be separate profit centres and transfer prices are required to determine the profitability of the units. Therefore, by charging prices for goods and services transferred within an organisation, managers of business units are able to make the best possible decision as to whether to buy or sell goods and services inside or outside the organisation.¹⁷

1.21 The organisation's transfer pricing policy will define its rules for calculating transfer prices, amongst other things, including whether internal purchasing is mandatory or if business units have discretion to source purchases.¹⁸

MANAGEMENT ACCOUNTING TRANSFER PRICING METHODS

1.22 There are a range of methods and variations that are used in management accounting systems to calculate transfer prices. The typical transfer pricing methods are:

- dictated transfer prices which are determined by senior management and used where sufficient information is available concerning costs and demand characteristics that would optimise the profits for the overall organisation;¹⁹
- market-based transfer prices which may be used where there is a well-established, competitive and stable external market for the asset or service. This method is only useful where such a market exists and there is no economic distress or no particular pricing strategies, such as price discrimination;²⁰
- negotiated transfer prices which involves managers of business units negotiating a mutually agreed transfer price. This method may be used when managers have their own profit responsibility and may have the ability to source assets or services from external suppliers;²¹ and
- cost-based transfer prices which are based on the production costs of the supplying business unit and may be used where there is no established market for the asset or service. There are a number of variations of this method that seek to, for example, better align managers' incentives.²²

¹⁶ *ibid.*

¹⁷ UN Secretariat, 'Transfer Pricing History', above n 1, p 3.

¹⁸ Heath, Huddart and Slotta, 'Transfer Pricing' International Strategy WBA 434, p 3.

¹⁹ Martinson, Englebrecht and Mitchell, above n 1, p 99.

²⁰ Heath, Huddart and Slotta, above n 18, p 3.

²¹ *ibid.*

²² *ibid* 4-5.

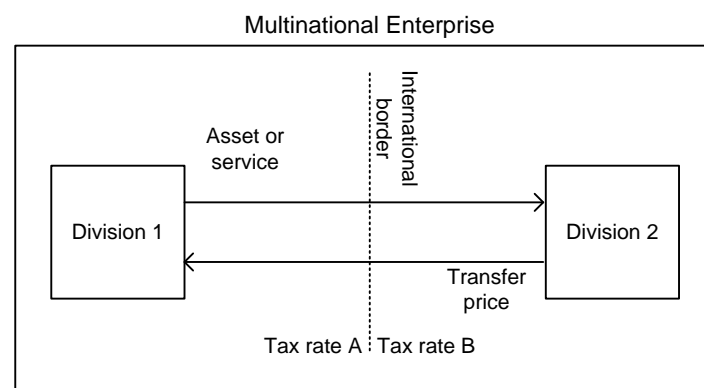
TRANSFER PRICING AND TAXATION

1.23 As outlined above, transfer pricing is used by managers for a number of genuine management accounting and economic reasons, such as group profit maximisation and performance measurement. The controversy with transfer pricing however, stems from the jurisdictional nature of MNEs and the overarching relationship between related business units, as opposed to unrelated organisations. Due to different rates of income taxation globally, it is possible for MNEs to use the relationship between their business units to set transfer prices that may reduce the MNE's worldwide tax bill.²³

1.24 Corporations law requires directors to focus on the overall profitability of the corporation. This is due to the agency relationship between directors and shareholders, which obliges management to optimise the returns on investment for their principals—the shareholders.²⁴ In discharging their obligations, managers take into account the corporate tax burden as it contributes to the overall profitability of the MNE.²⁵

1.25 For example, in the diagram below, if the 'tax rate B' is greater than the 'tax rate A' then the MNE may have an incentive to shift profits to the Division 1, located in the country with 'tax rate A' by paying a higher than arm's length transfer price.

Figure 2: Cross-border intra-group trade



Source: IGT.

1.26 The definition of cross-border transfer pricing for tax purposes is similar to the management accounting and economic concept. For example, the Bills Digest to Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012 defines cross-border transfer pricing as, 'the prices charged when one entity of a multinational

²³ Committee of Experts on International Cooperation in Tax Matters, United Nations, 'Practical Manual', above n 2, p 3; Wolfgang Schön, 'Transfer Pricing – Business Incentives, International taxation and Corporate Law' (Working Paper No 2011-5, Max Planck Institute for Tax Law and Public Finance, 2011) p 6.

²⁴ Schön, above n 23, p 4.

²⁵ *ibid* p 6-7.

group buys or sells products or services from another entity of the same group in a different country'.²⁶

1.27 The evolution of the global business environment and intra-group trade over the past two decades has had significant implications for the issue of cross-border transfer pricing. This is due to the impact of transfer pricing on the income generated on cross-border transactions and profits of business units which also impacts the tax paid in each jurisdiction.²⁷ Accordingly, transfer pricing is of interest to governments because it directly affects their corporate tax base.

1.28 Transfer pricing, in a base erosion and profit shifting (BEPS) context, is one of the most important global tax issues. This issue has received much attention in recent years at forums, including the OECD,²⁸ the Group of Eight (G8)²⁹ and the Group of Twenty Finance Ministers and Central Bank Governors (G20),³⁰ as governments are becoming increasingly concerned with corporate tax base erosion³¹ – the colloquially named 'double Irish, Dutch sandwich' arrangement is a prime example. Concerns have also become increasingly political with major governments launching inquiries into activities of a number of large corporations.³²

1.29 Although, the minimisation of tax liabilities may influence MNE transfer pricing policies and practices for cross-border intra-group transactions, it is not the only factor. As stated earlier, the need to set transfer prices is a normal aspect of how MNEs operate.

1.30 Indeed, the OECD states that the expression 'transfer pricing' is neutral, 'the consideration of transfer pricing problems should not be confused with the consideration of problems of tax fraud or tax avoidance, even though transfer pricing policies may be used for such purposes'.³³

1.31 The United Nations (UN) similarly states that the 'term transfer pricing is, however, sometimes used, incorrectly, in a pejorative sense, to mean the shifting of taxable income from a [business unit], belonging to [an MNE], located in a high taxing jurisdiction to a [business unit] belonging to the same [MNE] in a low taxing

²⁶ Bernard Pulle (Economics Section), *Bills Digest*, No 160 of 2011–12, 19 June 2012, p 4.

²⁷ Committee of Experts on International Cooperation in Tax Matters, United Nations, 'Practical Manual', above n 2, p 3.

²⁸ OECD, *Addressing Base Erosion and Profit Shifting* (2013).

²⁹ United Kingdom (UK), *UK Presidency of G8 2013*, GOV.UK <<https://www.gov.uk>>.

³⁰ Russia, *Russian Presidency of the G20: Outline*, G20 <<http://www.g20.org/>>.

³¹ The Treasury, 'Implications of the Modern Global Economy for the Taxation of Multinational Enterprises' (Issue paper, March 2013); The Treasury, 'Risks to the Sustainability of Australia's Corporate Tax Base' (Scoping paper, July 2013); Explanatory Memorandum, Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012; Explanatory Memorandum, Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013.

³² United States, Senate Committee on Homeland Security and Government Affairs, Permanent Subcommittee on Investigations, 'Offshore Profit Shifting and the U.S. Tax Code - Part 1' (20 September 2012) <<http://www.hsgac.senate.gov>>; United States, Senate Committee on Homeland Security and Government Affairs, Permanent Subcommittee on Investigations, 'Offshore Profit Shifting and the U.S. Tax Code - Part 2 (Apple Inc.)' (21 May 2013) <<http://www.hsgac.senate.gov>>.

³³ Committee on Fiscal Affairs, OECD, *Transfer Pricing and Multinational Enterprises: Report of the OECD* (1979) p 6.

jurisdiction through incorrect transfer prices in order to reduce the overall tax burden of the [MNE]’.³⁴

1.32 The UN also notes that,

[m]any MNEs prefer to maintain a good relationship with the tax authorities of the countries where they are active. Certainty about the amount of tax to be paid is a top priority for large companies and they usually operate a well-documented, straightforward transfer pricing system, which is... in the first place, a requirement of sound business economics.³⁵

1.33 It should also be noted that revenue authorities generally have opposing concerns compared to customs authorities.³⁶ For example, with inbound transactions, revenue authorities will be concerned with potential overpricing of transactions whereas customs authorities will be concerned with under-pricing of transactions to avoid duty.

ARM’S LENGTH PRINCIPLE

1.34 To avoid the erosion of the corporate tax base, each government has to scrutinise the transfer pricing policies of MNEs operating in its jurisdiction. OECD member countries use the arm’s length principle in determining whether a cross border transfer price is appropriate. This principle is described in the following terms:

[where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.³⁷

1.35 The arm’s length principle is based on the economic rationale that a business unit having a view to its own interests would only acquire assets or services from another related unit if the purchase price was equal to, or cheaper than, prices being charged by unrelated suppliers. This principle also applies, conversely, in relation to a unit providing an asset or service, as it would rationally only sell assets or services to an associated unit if the sale price was equal to, or higher than, prices paid by unrelated purchasers. On this basis, prices should gravitate towards the transaction price to which two unrelated parties would agree.³⁸

³⁴ UN Secretariat, ‘Transfer Pricing History’, above n 1, p 4.

³⁵ *ibid.*

³⁶ Committee of Experts on International Cooperation in Tax Matters, United Nations, ‘Practical Manual’, above n 2, pp 3-4.

³⁷ OECD, *Model Tax Convention on Income and on Capital: Condensed Version* (OECD Publishing, 2010) art 9.

³⁸ Committee of Experts on International Cooperation in Tax Matters, United Nations, ‘Practical Manual’, above n 2, pp 2-3.

1.36 The development of an arm's length principle in taxation rules had simple origins. In the domestic legislation of several European countries such as Austria, Germany, Luxembourg, the Netherlands and Switzerland, the arm's length principle was the underlying basis for the adjustment of income of shareholders who had received extraordinary benefits from a company which had not officially been declared as dividends. The adjustment in such cases is made by deeming such benefits to be dividends.³⁹

1.37 Accordingly, the arm's length principle featured in the treaties concluded by France, the United Kingdom (UK) and the United States (US) during the 1920s and 1930s.⁴⁰

1.38 Today, if the pricing of related-party cross border transactions does not accord with an arm's length price, the revenue authorities of many countries, including OECD countries, may consider it to be tax avoidance or evasion under their respective legislation.⁴¹

HISTORY OF INTERNATIONAL TRANSFER PRICING TAX RULES

1.39 The history of international transfer pricing tax rules to address profit shifting is one that continues to evolve.

1.40 One of the original international tax rules for transfer pricing was the predecessor of section 482 of the US Internal Revenue Code:

...Section 482 was enacted in 1928 as Sec. 45. Until 1986 it remained substantially unchanged. It gives authority to the Secretary of the Treasury — in the case of two or more organisations owned or controlled by the same interests — to distribute, apportion or allocate gross income, deductions, credit or allowances between or among these organisations if it is determined that such a distribution, apportionment or allocation, is necessary to prevent tax evasion or to clearly reflect the income of such organisations. This language is very broad and grants the Internal Revenue Service (IRS) extensive powers to make adjustments.⁴²

1.41 However, it was acknowledged that difficulties would arise if each country involved in cross-border transactions were to unilaterally impose tax on income generated within their borders without regard to the taxations rights of the other countries and the potential for double taxation.⁴³

1.42 Rules were needed to safeguard inter-jurisdictional equity between countries while at the same time not distorting the competitive environment within which both

³⁹ UN Secretariat, 'Transfer Pricing History', above n 1, p 5.

⁴⁰ OECD, 'Model Tax Convention', above n 37, p 7.

⁴¹ Committee of Experts on International Cooperation in Tax Matters, United Nations, 'Practical Manual', above n 2, pp 1-2.

⁴² UN Secretariat, 'Transfer Pricing History', above n 1, p 1.

⁴³ OECD, 'Model Tax Convention', above n 37, p 7.

independent organisations and business units within MNEs operate.⁴⁴ These rules are established through tax treaties which are more formally known as ‘Conventions for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion’.

1.43 The primary function of tax treaties is to control the way in which income is taxed by two countries to avoid or alleviate double taxation and reduce international tax avoidance bilaterally.⁴⁵ It is worth noting that most tax treaties include provisions which establish the Mutual Agreement Procedure (MAP) for eliminating double taxation and resolving conflicts of interpretation of the convention.⁴⁶

1.44 Since one of the two main goals of tax treaties is the avoidance of double taxation, the benefit of a standardised and uniform approach to clarify and confirm the economic situation of taxpayers who are engaged in activities in other countries, was first recognised in 1936 by the League of Nations in its Draft Convention on the Allocation of Profits and Property of International Enterprises.⁴⁷

1.45 The OECD continued the work of the League of Nations and, in 1963, released its draft Model Tax Convention (MTC).⁴⁸ The MTC and its commentary were clarified in 1977, with further revisions in 1992, 2008 and 2010.⁴⁹

OECD ADMINISTRATIVE GUIDANCE

1.46 Due to the increase in the number of MNEs and related party transactions within MNEs since the 1960s, the OECD considered it necessary to produce administrative guidance for its members’ revenue authorities. The development of these guidelines was significantly influenced by the US Treasury’s regulations of 1968 on the transfer pricing of tangible property.⁵⁰ In 1979, the OECD’s Committee on Fiscal Affairs, Working Party Number 6 sub-group, produced the guidelines which were entitled ‘Transfer Pricing and Multinational Enterprises’ (OECD Guidelines).⁵¹

The [guidelines were] not intended to establish a detailed standard of transfer pricing, but rather to set out the problems and the considerations to be taken into account and to describe which methods and practices were acceptable from a tax point of view in determining transfer prices.⁵²

⁴⁴ Schön, above n 23, p 2.

⁴⁵ OECD, ‘Model Tax Convention’, above n 37, p 7.

⁴⁶ Centre for Tax Policy and Administration, OECD, *Manual on Effective Mutual Agreement Procedures (MEMAP)* (2007).

⁴⁷ League of Nations, *Draft Convention on the Allocation of Profits and Property of International Enterprises* (1936) art 6.

⁴⁸ OECD, *Draft Double Taxation Convention on Income and Capital* (1963) art 9.

⁴⁹ OECD, ‘Model Tax Convention’, above n 37, p 7; Centre for Tax Policy and Administration, OECD, ‘MEMAP’, above n 46; UN Secretariat, ‘Transfer Pricing History’, above n 1, pp 6-7.

⁵⁰ UN Secretariat, ‘Transfer Pricing History’, above n 1, p 6; OECD, ‘Model Tax Convention’, above n 37, p 7; Centre for Tax Policy and Administration, OECD, ‘MEMAP’, above n 46.

⁵¹ UN Secretariat, ‘Transfer Pricing History’, above n 1, p 7.

⁵² *ibid.*

OECD transfer pricing methods

1.47 For the purposes of taxation, the OECD and revenue authorities, such as the ATO, outline five generally acceptable pricing methods for the transfer of assets or services:

- The comparable uncontrolled price method (CUP) compares the transfer price for transactions between business units within an MNE (controlled transaction) and that charged for comparable transfers between the MNE and unrelated organisations (uncontrolled transactions).
- The resale price method uses the price at which assets or services that have been purchased from a related business unit are resold to an unrelated organisation (resale price). The resale price is then reduced by an appropriate 'resale price margin' which is determined by reference to the margins in comparable uncontrolled transactions.
- The cost plus method uses the costs incurred by the supplying business unit in controlled transactions plus an appropriate mark-up. The mark-up is determined by reference to the mark-up earned by suppliers in comparable uncontrolled transactions.
- The transactional net margin method (TNMM) uses a net profit indicator of comparable uncontrolled transactions. Net profit indicators include the ratio of net profit to costs, sales or assets.
- The transactional profit split method splits an MNE's combined profits from controlled transactions on an 'economically valid' basis that approximates the division of profits that would have been anticipated between unrelated organisations.⁵³

Difficulties in choosing transfer pricing methods

1.48 There are a range of factors that complicate management's choice of appropriate transfer pricing methods. These factors include:

- organisational management concerns, such as corporate strategic goals, incongruity between differing managers' goals, organisational culture, and performance measurement;
- organisational financial issues, such as management of cash flows, currency exchange rate fluctuations and valuation difficulties, including those with unique patents and other intangibles, highly specialised goods, particular forms of services and certain transactions that are rarely or never conducted between independent organisations;

⁵³ Centre for Tax Policy and Administration, OECD, *Transfer Pricing Methods* (2010) pp 2-8; OECD, 'Transfer Pricing Guidelines', above n 2; Australian Taxation Office (ATO), *Income Tax: Arm's Length Transfer Pricing Methodologies for International Dealings*, TR 97/20, 5 November 1997, ch 3.

- economic and industry pressures, such as intensity of competition and economic conditions; and
- regulatory issues, such as differing international taxation regulations, tariffs and custom duties, anti-dumping regulations, and restrictions on capital flows.⁵⁴

1.49 More fundamentally, not all management accounting transfer pricing methods easily align with, or are acceptable for, the purposes of taxation unless they reflect arm's length prices. This is due to management and revenue authorities having different areas of focus.⁵⁵ Management is focused on business optimisation and performance assessment whereas revenue authorities are concerned with the arm's length principle.⁵⁶ For example, dictated transfer prices or group profit maximising prices may not align with arm's length prices.

1.50 There are other potential incongruences between management accounting methods and methods acceptable to revenue authorities. For example, management accounting transfer prices consider synergies between business units that contribute to the overall profit of an organisation. These related party synergies are inherently at odds with the arm's length principle used by revenue authorities.⁵⁷

1.51 Another potential inconsistency between management accounting transfer pricing methods and methods acceptable to revenue authorities is that the former generally starts from marginal cost as a base for determining optimal transfer prices, whereas the latter starts from the market price as the best estimate for intra-group transfer pricing.⁵⁸

1.52 Tax legislation of a country may also have an impact on commercial transfer pricing approaches. If the commercial system is in conflict with the relevant tax rules, companies may either adopt a revenue authority's accepted system or, if allowed, maintain two systems, one for commercial purposes, the other for tax purposes.⁵⁹

1.53 Accordingly, from these conceptual differences, the efficient business transfer prices and those required under tax law may rarely coincide.⁶⁰

⁵⁴ Committee of Experts on International Cooperation in Tax Matters, United Nations, 'Practical Manual', above n 2, p 3; Martinson, Englebrecht and Mitchell, above n 1, p 98.

⁵⁵ Schön, above n 23, p 6.

⁵⁶ *ibid.*

⁵⁷ *ibid*; Committee of Experts on International Cooperation in Tax Matters, United Nations, 'Practical Manual', above n 2, p 3.

⁵⁸ Schön, above n 23, p 6.

⁵⁹ UN Secretariat, 'Transfer Pricing History', above n 1, p 4.

⁶⁰ Schön, above n 23, p 6.

1.54 Due to the difficulties in setting appropriate transfer pricing policies, many managers regard transfer pricing as an unsolved or unsolvable conundrum.⁶¹ Specifically, in relation to income tax, it has been said that:

[o]ne of the greatest challenges faced by multinationals in setting appropriate transfer pricing policies is the alignment of the applicable tax regulations and the corporation's business objectives.⁶²

CHALLENGES TO THE OECD'S APPROACH

1.55 Challenges to the OECD's approach to international transfer pricing is not new. For example, when the US tightened their domestic legislation in 1986, the changes induced both US and foreign groups to revise their transfer pricing methods that gave the US Treasury a greater proportion of tax revenue than, according to some commentators, was reasonable.⁶³ However, countries with less sophisticated tax systems and administrations ran the risk of significant loss of their corporate tax base at the expense of the more comprehensive US rules. Indeed, the UN states,

[c]ountries with less sophisticated tax systems and administrations have run the risk of absorbing the effect of stronger enforcement of transfer pricing in developed countries and in effect paying at least some of the MNEs' tax costs in those countries. In order to avoid this, many countries have introduced new transfer pricing rules.⁶⁴

1.56 The above tension led the OECD to revise its transfer pricing guidelines in 1995 in an attempt to bridge the differences.⁶⁵

1.57 The governments of developing countries are also turning their attention to new domestic legislation, building and refining auditing practices and capability, and increasing enforcement resources.⁶⁶

1.58 In the current global environment, the importance of countries such as Brazil, Russia, India, China and South Africa (BRICS Countries) has continued to grow. On some estimates, non-OECD countries will form the majority of global Gross Domestic Product (GDP) by 2030, as is set out in Figure 3 below.

⁶¹ Martinson, Englebrecht and Mitchell, above n 1, p 92.

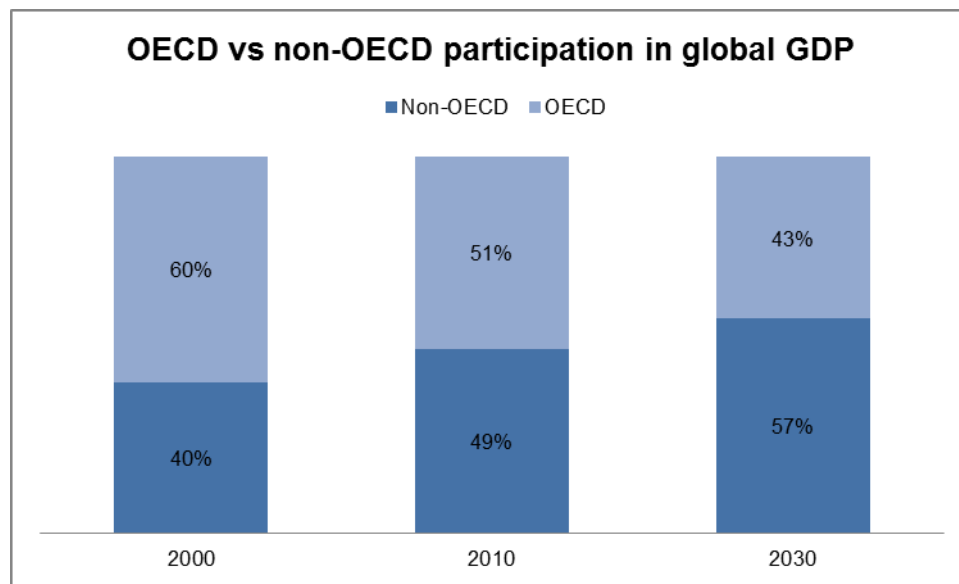
⁶² *ibid* p 99.

⁶³ UN Secretariat, 'Transfer Pricing History', above n 1, p 1.

⁶⁴ Committee of Experts on International Cooperation in Tax Matters, United Nations, 'Practical Manual', above n 2, para [1.3.9].

⁶⁵ UN Secretariat, 'Transfer Pricing History', above n 1, p 1.

⁶⁶ Ernst & Young, *UN Releases Draft of the Transfer Pricing Practical Manual for Developing Countries* (15 February 2013) <<http://tmagazine.ey.com>>.

Figure 3: OECD vs non-OECD participation in global GDP

Source: OECD Development Centre, *Perspectives on Global Development 2010: Shifting Wealth* (June 2010).

1.59 The UN entered the transfer pricing arena in 2009⁶⁷ by releasing its first working draft chapters of its *Practical Manual on Transfer Pricing for Developing Countries* (UN Manual) in 2010. The first version of this manual was published 2012. The UN also published a Model Double Tax Convention between Developed and Developing Countries (UN MDTC) in 2011.⁶⁸

1.60 Whilst the UN Manual and UN MDTC similarly adopt the arm's length principle,⁶⁹ the UN Manual also aims to reflect the realities for developing countries at different stages of their development. The specific experiences of developing countries and the work done in other forums, such as the OECD and African Tax Administration Forum is also accommodated.⁷⁰

1.61 A key difference between the OECD Guidelines and the UN Manual is the latter's emphasis on location savings and location-specific advantages. From a developing country perspective, the UN Manual emphasises that additional consideration should be given to the appeal that developing country markets offer companies doing business within their jurisdictions. Consideration is also given to the subsequent turnover generated from such activities, the availability of relatively low

⁶⁷ Committee of Experts on International Cooperation in Tax Matters, United Nations, 'Practical Manual', above n 2.

⁶⁸ Department of Economic & Social Affairs, United Nations, *United Nations Model Double Taxation Convention between Developed and Developing Countries* (2011).

⁶⁹ *ibid* art 9; Committee of Experts on International Cooperation in Tax Matters, United Nations, 'Practical Manual', above n 2.

⁷⁰ Committee of Experts on International Cooperation in Tax Matters, United Nations, 'Practical Manual', above n 2, para [1.10].

labour costs and skilled people to render services and the fact that there may be access to a large consumer force with spending power.⁷¹

1.62 Another significant difference to the OECD Guidelines is that the UN Manual includes a country-specific chapter on the BRICS Countries. In this chapter Brazil, China, India and South Africa list either the transfer pricing system in place in their country, such as Brazil's fixed margins system, or issues of particular concern for their respective jurisdiction, such as China's location-specific advantages, India's control over research and development activities and South Africa's challenges with comparability and the high cost of foreign management services.⁷²

1.63 Accordingly, the main challenges for the OECD Guidelines stem from the divergence of views of some BRICS Countries on the arm's length principle itself or on theoretical aspects, such as location-specific advantages and marketing intangibles.

CURRENT CHALLENGES FOR MANY COUNTRIES

1.64 In the current economic environment, many countries are experiencing lower government revenues. This experience has prompted many to re-examine the nature of cross-border transactions, the applicable rules and whether the risk of erosion of the corporate tax base is sufficiently addressed. The OECD observes that this is heightened because international standards have not kept pace with changing business environments that facilitate profit shifting:

While there clearly is a tax compliance aspect, as shown by a number of high profile cases, there is a more fundamental policy issue: the international common principles drawn from national experiences to share tax jurisdiction may not have kept pace with the changing business environment. Domestic rules for international taxation and internationally agreed standards are still grounded in an economic environment characterised by a lower degree of economic integration across borders, rather than today's environment of global taxpayers, characterised by the increasing importance of intellectual property as a value-driver and by constant developments of information and communication technologies.⁷³

1.65 Many countries now face the challenge to find the right balance between protecting their national tax base and avoiding double taxation that would hamper international trade.⁷⁴ As a net capital importer, Australia also faces the challenge of encouraging foreign investment while ensuring that MNEs pay an appropriate level of tax.

1.66 These challenges have been discussed in a number of international forums including the OECD, G8 and G20 as the potential remedies require a degree of

⁷¹ Committee of Experts on International Cooperation in Tax Matters, United Nations, 'Practical Manual', above n 2, para [1.10].

⁷² Ernst & Young, above n 66.

⁷³ OECD, 'Base Erosion and Profit Shifting', above n 28, p 5.

⁷⁴ Lanz and Miroudot, above n 5, pp 25-26.

international cooperation to protect sovereign revenues whilst avoiding double taxation or double non-taxation. To help facilitate discussion on the issues, the OECD has released an ‘action plan’ for base erosion and profit shifting.⁷⁵

1.67 As a result, these changes are contributing to uncertainty and complexity experienced by tax authorities and businesses alike.

SIMPLIFICATION MEASURES

1.68 Transfer pricing requirements may create a substantial amount of uncertainty for taxpayers. For taxpayers with comparatively less resources, the compliance burden can be significantly disproportionate to the risk to revenue and have a regressive effect. In this respect, many countries have adopted transfer pricing ‘simplification measures’ to reduce the compliance costs for Small and Medium Enterprises (SMEs) and those with smaller international transactions.

1.69 Indeed, the OECD in June 2012 published a paper acknowledging that transfer pricing documentation requirements should be reasonable and should not impose costs and burdens which are disproportionate to the circumstances.⁷⁶

1.70 The OECD paper outlines the transfer pricing ‘simplification’ measures of a range of OECD and observer countries. In summary, the paper generally found:

- 80 per cent of respondent countries (41 in total) indicated that they have transfer pricing simplification measures and are generally viewed favourably by taxpayers in their respective countries;
- almost 75 per cent of simplification measures benefit SMEs, small transactions and low value adding intra-group services (transactions deemed to carry limited risk); and
- all safe harbours reported are optional which probably explains why no country reported double taxation cases that may have been caused by the application of their own or another country’s simplification measure.

1.71 A further analysis of the types of simplification measures show:

- 54% are exemptions from or simplified documentation or reporting;
- 22% are simplified transfer pricing methods, safe harbour arm’s length ranges and interest rates;
- 11% are exemption from rules or adjustment;

⁷⁵ OECD, *Action Plan on Base Erosion and Profit Shifting* (2013).

⁷⁶ Centre for Tax Policy And Administration, OECD, *Multi-Country Analysis of Existing Transfer Pricing Simplification Measures* (2012) p 6.

- 10% are simplified Advance Pricing Arrangement (APA) procedures; and
- 3% are exemption or reduction from penalties.

1.72 As can be seen from the above break-down, the simplification measures mainly relate to documentation and transfer pricing methods.

AUSTRALIAN TRANSFER PRICING LEGISLATION

1.73 The Australian Parliament first enacted legislation to address the revenue concerns with transfer pricing under clause 28 of the *Income Tax Assessment Act 1922*.⁷⁷ The intention of this provision was to address concerns with foreign companies not paying appropriate tax in Australia.⁷⁸

1.74 Clause 28 was later revised as section 136 with the enactment of the *Income Tax Assessment Act 1936* (ITAA 1936). The intention of section 136 of the ITAA 1936 was to allow the Commissioner to reconstruct the taxable income of a taxpayer in situations where the Commissioner determined that profits had been transferred out of Australia to reduce their Australian taxation liabilities.⁷⁹

1.75 Over time, many issues were identified with the effectiveness of section 136 including:

- The section can be read as applying only in a direct parent-subsidiary situation... the provision can be avoided simply by adding one more company to the structure.
- The section is generally capable of application only to foreigners and does not set out to deal with tax avoidance through international transactions by Australians.
- The “control” test precludes application of the section when independent parties act in collusion to shift profits for mutually shared tax advantages.
- The limitation to business profits may preclude application to arrangements involving rents or other income not clearly business proceeds.
- The section may not be appropriate to allow only one element of business arrangements, e.g., payment of inflated royalties, to be examined in isolation.
- It is arguable that the section is applicable only to companies whereas the arrangements can be made also by individuals, trusts and other entities.
- The section's link with total receipts is arguably unduly restrictive; it could mean that, even where total receipts have been reduced by a tax avoidance ploy, the

⁷⁷ *Income Tax Assessment Act 1922* clause 28.

⁷⁸ Commonwealth, *Parliamentary Debates*, House of Representatives, 10 October 1922, p 1.

⁷⁹ Explanatory Memorandum, *Income Tax Assessment Amendment Bill 1982*, para [2].

Commissioner cannot look beyond the reduced amount in determining taxable income.

- The section is inadequate to impute derivation of income in a transaction which, if between independent parties, would produce it. (A common arrangement is the granting of interest-free loans to off-shore associates located in tax haven countries).⁸⁰

1.76 Some of the issues above became apparent in *Federal Commissioner of Taxation v Commonwealth Aluminium Corporation Ltd*,⁸¹ where the High Court of Australia (High Court) held that the test requiring a company to be controlled by non-residents before section 136 of the ITAA 1936 could be invoked, was not satisfied. The High Court found that although the Australian resident company was 90 per cent owned by two non-resident companies, the business was ‘controlled’ by its Australian resident directors. This case also found that the share ownership tests in section 136 were limited in their application.⁸²

1.77 Following the development of uniform and standardised international tax rules for transfer pricing during the 1960s and 1970s, and as a result of *Commonwealth Aluminium Corporation*,⁸³ the Australian Parliament in 1981 responded to domestic concerns by enacting Division 13 of the ITAA 1936.⁸⁴

1.78 Division 13 was designed to give the Commissioner broad powers to reset the prices for certain transfer pricing transactions and overcome the technical or potential deficiencies of the former section 136 of the ITAA 1936. With Division 13, the Commissioner gained the power to deem an arm’s length amount for both income and expenses.⁸⁵ As such, the Commissioner was authorised to apply the substantive provisions of Division 13 to adjust income or deductions in situations where property, including services, was acquired or supplied under an ‘international agreement’.⁸⁶

1.79 The substantive operation of Division 13 of the ITAA 1936 has been tested relatively recently, in two cases. These cases were *Roche Products Pty Ltd v Commissioner of Taxation*⁸⁷ and *Commissioner of Taxation v SNF Australia Pty Ltd* (SNF Case).⁸⁸ The Full Federal Court’s decision on appeal in the latter case raised a number of issues with the scope and operation of Division 13. The decision did not remove the doubt on the ATO’s authority to rely on tax treaties as a basis for assessment. Also, the decision did not allow the ATO to rely on the OECD Guidelines in interpreting Division 13. Importantly, it also rejected the ATO’s profit-based approach in requiring arm’s length consideration to be determined on all of the circumstances of the taxpayer, rather than a transaction based appraisal involving a comparison of

⁸⁰ Trevor Boucher, *Blatant, Artificial and Contrived: Tax Schemes of the 70s and 80s* (ATO, 2010) pp 167-168.

⁸¹ (1980) 143 CLR 646.

⁸² Explanatory Memorandum, Income Tax Assessment Amendment Bill 1982, paras [4]-[6].

⁸³ (1980) 143 CLR 646.

⁸⁴ *Income Tax Assessment Act 1936* ss 136AA-136AF.

⁸⁵ Peter Koit and Jerry Reillys, Thomson Reuters, *Income Tax Assessment Act 1936*, paras [136AA.10] to [136AG.1].

⁸⁶ Explanatory Memorandum, Income Tax Assessment Amendment Bill 1982, para [7].

⁸⁷ 2008 ATC 10-036.

⁸⁸ 2011 ATC 20-265.

purchases by independent parties with the same characteristics and circumstances of the taxpayer.⁸⁹

1.80 Following this decision, the Government announced its intention to replace Division 13 of the ITAA 1936 with modernised transfer pricing rules.⁹⁰

1.81 Essentially, the Government sought to ensure that Australia's modernised domestic transfer pricing rules were consistent with OECD principles and clarified that the treaty articles provided a separate power to make transfer pricing adjustments.⁹¹

1.82 The first tranche of transfer pricing reforms⁹² became law on 8 September 2012, which inserted Subdivision 815-A into the *Income Tax Assessment Act 1997* (ITAA 1997).⁹³ It applies retrospectively from 1 July 2004 and to cases involving jurisdictions with which Australia has a relevant tax treaty. The requirement for the Commissioner to determine the transfer pricing adjustment has been removed and the law has become self-executing which is more aligned with the self-assessment system.

1.83 Specifically, Subdivision 815-A of the ITAA 1997 is intended to confirm the broader profit-based approach through applying to a 'transfer pricing benefit'. Amongst other things, this subdivision incorporates the OECD Guidelines as extrinsic materials for the interpretation of the law.

1.84 The second tranche of transfer pricing reforms,⁹⁴ became law on 29 June 2013, repealing Division 13 of the ITAA 1936 and enacting Subdivisions 815-B to 815-E of the ITAA 1997. It operates prospectively and applies to cross-border dealings involving jurisdictions with which Australia does not have a tax treaty.

1.85 In addition to confirming the broader profit-based approach and the use of the OECD Guidelines as extrinsic materials, this tranche also sets out 'arm's length conditions' which effectively elevates into law the ATO's compliance approach in the SNF Case.

1.86 Importantly, penalties for no reasonably arguable position will be imposed on those taxpayers that do not maintain transfer pricing documentation that meets the requirements of Subdivision 284-E of the *Taxation Administration Act 1953*. This will enhance the need for taxpayers to maintain comprehensive and contemporaneous transfer pricing documentation. The new legislation also implements a seven-year

⁸⁹ *Commissioner of Taxation v SNF Australia Pty Ltd* 2011 ATC 20-265; ATO, *Decision Impact Statement: Commissioner of Taxation v SNF Australia Pty Ltd* (20 September 2011) <<http://law.ato.gov.au>>.

⁹⁰ Bill Shorten, 'Robust Transfer Pricing Rules for Multinationals' (Media Release, No 145, 1 November 2011); David Bradbury, 'Progressing Reforms to Australia's Transfer Pricing Rules' (Media Release, No 144, 22 November 2012).

⁹¹ Explanatory Memorandum, Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012; Bill Shorten, above n 90; David Bradbury, above n 90.

⁹² Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012.

⁹³ *Tax Laws Amendment (Cross-Border Transfer Pricing) Act* (No. 1) 2012.

⁹⁴ *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act* 2013.

time limit for transfer pricing adjustments. Previously the Commissioner had an unlimited period in which to make amendments in transfer pricing matters.

TRANSFER PRICING IN THE ATO

1.87 The following section will outline both the history of transfer pricing in the ATO and aspects of the ATO's current approach to transfer pricing.

History of the ATO's transfer pricing approach

1.88 The ATO's approach to transfer pricing has evolved over time from its increasing emergence as a taxation risk in the 1960s. From this time, the ATO performed a role in engendering a more focused coordination of international efforts to address profit shifting as a risk to sovereign revenue though its involvement in the OECD.⁹⁵

1.89 At that time, the ATO's internal organisational arrangements were geographically based on functional activities, such as audit and review. The ATO had no national compliance programs focused on assessing potential transfer pricing risks. However, during a pilot initiated in 1988 that focused compliance activities on large business, generally known as the Large Case Program, the ATO became aware that international tax was emerging as an important revenue risk in a very complex area at the larger end of the market.⁹⁶

1.90 During the 1980s, the ATO worked with the United States Internal Revenue Service (IRS) to develop a binding ruling approach to transfer pricing issues. This work was in response to US taxpayers and their representatives' requests for an alternative form of transfer pricing compliance. They sought a form that was less adversarial and more productive by agreeing on a pricing methodology that reflected profits. In 1990, the IRS released its Revenue Procedure for Advance Determination Rulings and shortly afterwards the world's first bilateral APA was concluded in 1991 between the ATO, IRS and an MNE.⁹⁷

1.91 In 1994, the ATO established the International Tax Division (ITD) as a specialist group to develop strong organisational capability to deal with international tax risks and to support the audit function.⁹⁸ Over time, the ITD was renamed the International Strategy and Operations (ISO) unit and was located in the Large Business and International (LB&I) business line.

⁹⁵ Leigh Edmonds, *Working for all Australians 1910–2010: A Brief History of the Australian Taxation Office* (ATO, 2010) ch 8; OECD, Working Party 6 Membership includes Australia.

⁹⁶ Pappas et al., Boston Consulting Group, ATO, 'Review of the Large Case Program: Australian Taxation Office' (1992).

⁹⁷ Michelle Markham, *Advance Pricing Arrangements: Past, Present and Future* (Kluwer Law International, 2012) pp 23–24.

⁹⁸ ATO, Communication 1 (17 April 2013).

1.92 The ISO's immediate focus was to develop public guidance. In the late 1990s, the ATO provided advice on links between the concepts of 'arm's length' and 'comparability' with the methods that can be used to establish the arm's length outcome in certain circumstances in *Taxation Ruling TR 97/20* and the documentation taxpayers should have in place to support their transfer prices in *Taxation Ruling TR 98/11*.⁹⁹

1.93 Soon after publishing *Taxation Ruling TR 98/11*, the ATO embarked on a 'transfer pricing record review and improvement project'. This project selected 190 companies from the large market to assess these companies' transfer pricing processes and documentation against that set out in *Taxation Ruling TR 98/11*. Companies that were assessed as a comparatively medium risk were either asked to explain how the transfer pricing practices and documentation complied with the arm's length principle or to lodge a schedule of information, Schedule 25A, with their next tax return. The project also sought to review taxpayers' use of the Schedule 25A and the accuracy of taxpayers' responses. Those with a comparatively higher risk were either subjected to a transfer pricing record review on their next tax return or a full audit.

1.94 Companies, notified by the ATO that they would be audited, were given the option of negotiating an APA allowing them to negotiate an agreement on the transfer pricing methodologies used. As a result of this project, the amount of tax paid by these companies increased by 32 per cent in the following year, even though the income for these companies fell by 5 per cent. The results were calculated by adding the net tax paid from all companies in the project beginning with the year preceding the project through to three years after the project was completed.¹⁰⁰

1.95 As ISO officers gathered more experience, the ISO area developed to fill capability gaps in the audit function by establishing a Transfer Pricing Practice (TPP) and International Audit Review Committees (later renamed the Transfer Pricing Review Panel (TPRP)) with these experienced officers. These ISO officers became directly involved in conducting reviews and audits involving transfer pricing issues (transfer pricing case work) although Operational case teams were still expected to remain involved in transfer pricing case work.¹⁰¹ This approach is referred to as the 'centralised' approach.

1.96 The ATO also identified that many medium sized enterprises were also involved in international related party dealings. This had been facilitated by developments in technology and the movement towards a more integrated global economy which provided greater mobility of labour, capital and value chains.

1.97 As a result, the ATO established two case teams in the SME business line in 2003-2004 to exclusively conduct transfer pricing case work. Although a large majority of these cases are said to involve less complex technical issues as larger business cases, SME cases could involve greater complexities as there is comparatively less publicly available information on non-publicly listed companies and high wealth individuals.

⁹⁹ John Braithwaite, *Market in Vice, Markets in Virtue* (Oxford University Press, 2005).

¹⁰⁰ *ibid* pp 90-94.

¹⁰¹ ATO, 'Communication 1 (17 April 2013)', above n 98; ATO, Communication (24 October 2013).

Therefore, the ATO's concerns in this market segment were more focused on understanding the reasons for taxpayers' economic performance.

1.98 During the period 2004 to 2009 the ATO identified transfer pricing as a major focus area with emerging risks including:

- business restructures;
- guarantee fees;
- intra-group loans;
- transfer of intangible property;
- foreign banks (profit allocations); and
- transfer of losses between jurisdictions.¹⁰²

1.99 The ATO undertook a number of specific projects during this period to address these risks, such as the intangibles project. To assist with Australia's economic recovery following the Global Financial Crisis (GFC), the Government also provided specific funding to the ATO for a 'Strategic Compliance Initiative' (SCI) in 2009. Of this funding, \$50.7 million over four years was allocated by the ATO to focus on the above emerging transfer pricing risks under the Transfer Pricing SCI (TPSCI) project. Under this project, 100 ATO officers were to conduct a number of transfer pricing matters.¹⁰³ As there were not enough transfer pricing specialists within the ATO at the time, the ATO recruited staff with varying capability. Conscious of taxpayers' compliance costs, the ATO took a differentiated approach to compliance activities.¹⁰⁴

1.100 Although the ATO received increased funding to address transfer pricing matters, the ISO area faced its own challenges. The ISO unit, and the TPP, had lost a number of key experienced and technically equipped officers to other areas of the ATO or the private sector or through retirement. The ATO was aware that the capability of the departing key ATO officers would take a number of years to develop and replace.¹⁰⁵

1.101 Tensions between the ISO unit and business lines also began to arise as the operational case teams in the business lines considered that they lacked opportunities to develop their capability by being excluded from more challenging transfer pricing case work. A view emerged in the business lines that there was no need for a specialist unit to do transfer pricing work as the key competencies required were centred on

¹⁰² Specific issues included, a 'hedge book dump' in Australia of losses arising from the Global Financial Crisis, pharmaceutical companies not returning the same EBIT/Sales ratio as they were in other jurisdictions and some taxpayers not generating a profit in Australia for a number of years.

¹⁰³ The Treasury, *Budget Measures: Budget Paper No. 2* (2009) p 388; Note: The TPSCI Project had a maximum of 70 officers, but averaged between 40 and 50 officers over the life of the project.

¹⁰⁴ ATO, Communication 2 (15 March 2013); ATO, Communication (12 March 2013); ATO, Communication 2 (17 April 2013).

¹⁰⁵ ATO, 'Communication 1 (17 April 2013)', above n 98.

business knowledge and complex accounting skills rather than tax law. This may have led to the decline in overall ISO staff morale.¹⁰⁶

1.102 In 2007, the ATO was aware that the rate of APA applications had slowed, which may have been due, in part, to increasing criticisms by taxpayers.¹⁰⁷ In mid-2007, the ATO responded to a number of issues regarding large and complex APAs by implementing the Transfer Pricing Management System (TPMS) (reproduced in Appendix 2). Through this system the ATO sought to establish 'a uniform approach to the management of transfer pricing throughout the [ATO], including processes to ensure the quality and consistency of transfer pricing work and develop capability in transfer pricing via a technical network'.¹⁰⁸ The TPMS implemented cross-line specialist support for operational matters through a Transfer Pricing Network (TPN), a new emphasis on intelligence and data flows as well as cross-line representation on forums and committees to strengthen intelligence and coordination.¹⁰⁹

1.103 Following the implementation of the TPMS, the ATO engaged PricewaterhouseCoopers (PWC) Legal to undertake a review of its APA program in 2008 (2008 APA Review). At the time of the 2008 APA Review, PWC Legal noted that the TPMS had 'yet to have the intended traction', with the majority of feedback and experiences with the TPMS not being considered as part of their review. PWC Legal was of the opinion that full implementation of the TPMS may address a number of the issues raised in their review.¹¹⁰

1.104 The review made recommendations directed at a number of aspects of the APA program, including:

- improving the consistency and certainty in the application of the ATO's APA processes;
- improving the ATO's communications on the reasons for information requests and their focus;
- providing oversight of the APA program by a 'dedicated team' which would allocate cases to appropriately capable APA teams;
- requiring detailed project plans to be agreed upfront and adhered to;
- reviewing work completed to resolve issues at each stage and not re-raising those issues unless previously agreed to between the parties – a 'stage and gate' approach;
- increasing investment in and the structure of ATO officer training and development;

¹⁰⁶ ATO, 'Communication 1 (17 April 2013)', above n 98.

¹⁰⁷ Markham, above n 97, p 31.

¹⁰⁸ ATO, *ATO Response to PwC Legal Report on the APA Program Review* (4 July 2009) <www.ato.gov.au>.

¹⁰⁹ PricewaterhouseCoopers Legal, ATO, *Review of Advance Pricing Arrangement Program* (2008) app C.

¹¹⁰ *ibid* pp 2, 5, 21.

- publishing safe harbours and benchmarks; and
- improving the performance measures for the APA program.

1.105 The complete list of recommendations can be found in Appendix 3.

1.106 In 2009, the ATO released its draft response to the 2008 APA Review where it stated that it ‘agrees with the broad thrust of the recommendations but does not necessarily agree with each of the specific sub recommendations’.¹¹¹ However, the ATO did identify the priorities for implementing the recommendations and additional measures by consulting with two of its key forums, the Large Business Advisory Group (LBAG) and the (former) National Tax Liaison Group (NTLG) Transfer Pricing Sub-group.¹¹²

1.107 As a result, the ATO established an APA Co-design Committee in January 2009 as a subcommittee of the former NTLG Transfer Pricing Sub-group, comprising tax practitioners, their representatives and ATO officers. This committee was responsible for co-designing aspects of the ATO’s APA program in line with the 2008 APA Review, including a process for negotiating complex APAs.¹¹³ Key aspects of this work included:

- identifying the issues to be agreed in advance between the ATO and the taxpayer on the scope of an APA during the pre-lodgment phase;
- developing guidelines for a differentiated APA Program;
- developing a project management framework for all APAs; and
- establishing a review mechanism which provides taxpayers with a right of review for ATO decisions regarding the APA process.¹¹⁴

1.108 The culmination of this co-design work was ultimately documented in *Practice Statement PSLA 2011/1*.

1.109 Importantly, around 2008, ATO senior management became aware that in some case work, which focused on narrow aspects of transfer pricing, a number of key non-international tax risks, such as capital gains, may not have been considered.¹¹⁵

1.110 At this time, the ATO also commissioned two internal reviews of the function and operations of the ISO unit, one in 2008 and one in 2009.¹¹⁶

1.111 The latter internal review, the *International Review Project into ‘Achieving Best Practice for Managing International Work across the ATO’* (International Review),¹¹⁷ was

¹¹¹ ATO, ‘Response to PwC Legal Report’, above n 108.

¹¹² *ibid.*

¹¹³ *ibid.*

¹¹⁴ *ibid.*

¹¹⁵ ATO, ‘Communication (12 March 2013)’, above n 104.

¹¹⁶ ATO, ‘Communication 1 (17 April 2013)’, above n 98.

conducted by a senior officer who had worked in the ISO unit.¹¹⁸ The findings of the review were discussed in a number of internal ATO forums and, although the ATO has been unable to locate this report for the IGT,¹¹⁹ senior ATO officers advise that the key findings of that review included the following:

- Although it was a good idea in 1990 to establish a specialist group to develop the capability to deal with transfer pricing matters, the organisational arrangements made it difficult to disseminate that capability more broadly within the ATO. In particular, the ISO unit and TPP had become too involved in conducting casework at the expense of developing the capability of others in the business lines to deal with international tax risks.¹²⁰ When a number of key influential and experienced transfer pricing officers left the ATO, succession planning had failed to address the resulting capability gap.¹²¹
- The ATO's strategy and risk management of transfer pricing involved unclear and complicated interactions between different areas of the ATO (see Appendix 2 which sets out the TPMS as at 2007) and effective treatment of international tax risks needed strengthened leadership and clearer accountabilities.¹²²
- There was inadequate interaction and integration between the TPP and other units in the ATO.¹²³ In particular, some international tax risks may have been missed because of 'siloing' of tax law specialisations in the international area.¹²⁴

1.112 The issues were presented to the ATO's Executive and the following four recommendations were endorsed:

1. International work needs to be appropriately handled in a diversified way across the ATO and managed largely as 'business as usual'. (Recognising diversification)
2. The International Steering Committee (ISC), which is represented by compliance, law and operations, should help to steer and co-ordinate international work across the ATO. (Better steering and co-ordination)
3. Clearer ownership of, and accountabilities for, international risks. (Clearer ownership and accountabilities)
4. Need for a more strategic approach in our relationships with Treasury, Government etc and in international relations. (More strategic approach to relationships).¹²⁵

¹¹⁷ ATO, 'ATO Executive Meeting – Submission Paper: International Review – Proposed Changes to, and Options for, Organisational Structure and Staffing' (4 October 2012) Internal ATO Document, p 9.

¹¹⁸ ATO, 'Communication 1 (17 April 2013)', above n 98.

¹¹⁹ Note: The ATO advises that the report for this review is the proposal put to the ATO Executive in October 2010. However, this proposal sets out what changes are needed to implement the previous ATO Executive decision and not the findings of the review on which that previous ATO Executive decision was based.

¹²⁰ ATO, 'Communication 1 (17 April 2013)', above n 98.

¹²¹ ATO, 'Communication 1 (17 April 2013)', above n 98.

¹²² ATO, 'International Review', above n 117, p 3.

¹²³ ATO, 'Communication 1 (17 April 2013)', above n 98.

¹²⁴ ATO, 'Communication (12 March 2013)', above n 104.

1.113 Further ATO work was undertaken to identify what action should be taken to implement these recommendations.

International review — changes to the ATO's approach in 2010

1.114 A proposal, 'International Review — Proposed Changes to, and Options for, Organisational Structure and Staffing' (International Review Proposal), was presented to, and endorsed by, the ATO Executive on 12-13 October 2010. The following is a summary of actions that the ATO carried out:

- Restructure the ISO function by:
 - replacing the ISO area with an Internationals unit comprising:
 - 1 an International Strategy & Risk Unit with a 3-5 year strategic plan to design risk mitigation strategies, assist the ATO to develop a comprehensive approach to the management of international strategy and risk, work closely with and support the ISC and provide assurance to the ATO Executive;
 - 2 a Jurisdictional Income Practice (later renamed the Profit Shifting Practice (PSP)) that would be removed from case work and provide a specialist advisory role to the business lines on an expanded scope of technical issues involved in 'profit shifting', including transfer pricing, thin capitalisation, offshore banking units, cross-border arbitrage, treaties and withholding taxes;
 - 3 an Offshore Non-Disclosure & International Relations Practice (later renamed the International Engagement and Transparency Practice) that would work towards increasing international cooperation on international tax risk issues in accordance with a 3 year strategic plan;
 - Moving 120 Full Time Equivalent (FTE) staff in the Offshore Compliance Program to the Micro Enterprises and Individuals (MEI) business line so as to, amongst other objectives, help the Internationals unit focus on higher level strategy and risk tasks while helping to develop capability in the business lines;
 - Moving the Internationals New Measures function to the LB&I New Measures area;
 - Moving the Joint International Tax Shelter Information Centre (JITSIC) function from the ATO's Aggressive Tax Planning business line to the Internationals unit to, among other objectives, provide the JITSIC with more support from the Internationals unit;

¹²⁵ ATO, 'International Review', above n 117, p 9 (refers to an undated ATO Executive decision to approve the recommendations).

- Incorporating the Economist Practice into the Internationals unit temporarily to, among other objectives, provide a stronger link between the tax law and economic aspects of transfer pricing;
- Rationalise the ATO's internal and external committees responsible for international tax risks and restructuring their reporting by:
 - establishing a new International Steering Committee (ISC)¹²⁶ that would report directly to the ATO Executive rather than the Income Tax Steering Committee (ITSC) which reported indirectly to the ATO Executive through the Compliance Executive;
 - moving the reporting of various international committees to the newly formed ISC, rather than reporting to the ITSC and LB&I business line Executive;
 - absorbing the Treaties Steering Committee, Non-Resident Withholding Tax Steering Committee and Transfer Pricing Steering Committee into a newly formed Jurisdictional Income Working Group (now called the Profit Shifting Working Group); and
 - absorbing a number of NTLG sub-groups into one Internationals NTLG Sub-group.¹²⁷

1.115 At this time, the ATO also identified the need for an improved international data set to assess risk and to facilitate the strategic management of international compliance risks. The ATO considered that although Schedule 25A obtained information relating to international related party transactions, it did not capture enough information on emerging international arrangements. These arrangements include those, such as involving trade in international financial markets/products, intangibles and services.

1.116 Accordingly, the ATO considered that numerous international risks could not be adequately mitigated without obtaining better data. It also considered that the ATO's strategic management of international compliance risks would become increasingly vulnerable without better data to monitor market and industry wide patterns and trends.¹²⁸

1.117 As a result, the ATO sought to replace the Schedule 25A and the Thin Capitalisation Schedule to the income tax return, with a new schedule. The proposed schedule comprised 40 questions, 30 of which were replicated from the former schedules. The ten new questions were the subject of public consultation. The resulting

¹²⁶ Note, the Charter states that the ISC is a new Committee, however, the submission to the ATO Executive states that it is an existing Committee: ATO, *International Steering Committee Charter* (4 April 2012) Internal ATO Document; ATO, 'International Review', above n 117.

¹²⁷ ATO, 'International Review', above n 117, pp 4-5, 10.

¹²⁸ ATO, National Tax Liaison Group (NTLG) Internationals Sub-group Minutes (July 2012) app 3 <www.ato.gov.au>.

single schedule is now known as the International Dealings Schedule (IDS). The ATO's consultation process for the IDS is summarised as:

In 2011, the ATO wrote to 32 taxpayer and industry forums, groups and associations seeking written feedback on the IDS and requested the professional associations which are members of the International subcommittee of the National Tax Liaison Group (I-NTLG) to provide representatives to participate in the consultation on the IDS 2012.

Membership of the consultation group was sought from these associations to enable feedback to be obtained from their membership base, which constitutes a range of taxpayers or taxpayers' representatives across all markets. A volunteer(s) was also sought from the Corporate Taxpayers Association as a taxpayer representative. The final external consultation group consisted of members from CPA, Law Council, Institute of Chartered Accountants and Taxation Institute. A representative from the Corporate Taxpayers Association joined the consultation group halfway through the process.

Due to the sudden illness of a key ATO officer who had been developing the IDS and the consultation process and also due to the Tax Time 2012 systems requirements, a four week period of scheduled telephone consultation on the IDS was conducted during October and November 2012. Consultation on the supporting instructions was extended until the first week in December 2012.¹²⁹

1.118 In November 2011, the ATO acknowledged that some questions required data not previously captured by taxpayers' reporting processes. It also recognised that the IDS requires some data already requested in other tax return schedules. However, it would not make further changes to the IDS as formal consultation on the IDS had closed.¹³⁰

1.119 The IDS was introduced from 2012 as a schedule to the income tax return. Taxpayers with international related party dealings of more than \$2 million, or other types of international activities, are required to complete the IDS. Approximately 11,000 taxpayers are expected to complete the IDS in 2012, with the majority comprising taxpayers from the SME market segment.¹³¹

Governance and management of transfer pricing issues

1.120 The key to understanding the ATO's governance and management of transfer pricing issues is to first consider how the ATO has organised itself to deal with the risks raised by transfer pricing.

1.121 As the ATO does not have the resources to verify compliance for all taxpayers on all issues for every reporting period, the ATO takes a risk-based approach to identify potential risks of non-compliance from available data. For example, profit shifting risks are identified from sources of data including the IDS. These potential

¹²⁹ *ibid.*

¹³⁰ ATO, National Tax Liaison Group (NTLG) Internationals Sub-group Minutes (November 2011) <www.ato.gov.au>.

¹³¹ ATO, *SME Communicator - December 2011* (17 February 2012) <www.ato.gov.au>.

risks form the basis of risk hypotheses.¹³² The ATO then develops appropriate 'treatment strategies' such as the compliance activities the ATO may undertake to test the hypotheses and address the risks. Other treatment strategies may include providing advice and guidance, initiating legislative change and increasing international cooperation.

1.122 The ATO generally separates responsibility between the risk function and the compliance, or operational function:

- the risk function considers risks of non-compliance with the tax laws and how the ATO can best address or 'treat' those risks?
- the operational function explores whether the risk is evidenced in a particular taxpayer's affairs and, if so, and in 'treating' that risk, what should the outcome be for that particular taxpayer?

1.123 These two functions have their own specialist officers, forums, internal reporting and governance requirements, which may overlap in some circumstances.

1.124 The operational function for 'treating' transfer pricing risks by conducting compliance activities, or case work, are carried out by two different business lines within the ATO:

- the LB&I business line, that focuses on those corporate taxpayers with annual turnovers of \$250 million and above;
- the SME business line, that focuses on taxpayers with turnovers between \$2 million and \$250 million and individuals with net wealth of more than \$5 million.¹³³

1.125 These two business lines have their own staff, forums, reporting lines and governance.

1.126 It should be noted, however, that towards the finalisation of this IGT review, the ATO changed its focus of these two business lines. The LB&I business line now focuses on listed and unlisted public companies and is now called the Public Groups and International (PG&I) business line. The SME business line now focuses on private businesses and is now called the Private Groups and High Wealth Individuals (PG&H) business line. As no details on the impact of these changes were available at the time of drafting, it is unknown how the ATO's arrangements to manage transfer pricing issues will be affected.

¹³² Michael D'Ascenzo, 'Risk: The Framework, the vision, the Values' (Speech delivered at the CPA Public Sector Finance and Management Conference, Barton, 12 August 2010).

¹³³ Note, the ATO has recently re-characterised its business lines.

Risk function — corporate governance and management of transfer pricing risks

1.127 The ATO governs and manages all its risks through its enterprise risk management framework.¹³⁴ All of the risks covered by this framework include tax risks such as risks that taxpayers are not complying with particular aspects of the tax law as well as corporate risks such as risks that the ATO itself is not complying with certain legislative obligations.

1.128 Particular risks governed by this framework may be specific to a certain aspect of the ATO's operations and therefore managed by that particular area. Other risks may span a number of different areas in the ATO, enterprise level risks, which are managed on a whole-of-ATO basis, regardless of the ATO's internal divisions of allocated responsibilities and work.

1.129 The ATO treats the transfer pricing tax risk as an operational level risk under its enterprise risk management framework. Each business line's approach to managing transfer pricing risk will be outlined in the section below.

1.130 International tax risks are governed by the ISC, which is to provide:

- assurance directly to the ATO Executive that international tax work across the ATO is being effectively managed; and
- high level strategic direction on international tax work is consistent with ATO objectives.

1.131 Membership of the ISC includes ATO National Program Managers (generally Deputy Commissioners) and senior ATO officers from the Law and Practice, SME, LB&I, MEI, Indirect tax – GST, Serious Non-Compliance, Debt Collection, Superannuation and Tax Practitioner and Lodgment business lines.

1.132 The above membership is similar to the ITSC, which previously had responsibility for international tax risks. However, the formation of the ISC is intended to strengthen the ATO's focus on strategically managing the risks as the forum is focussed solely on international tax work, which includes:

...all work, in the broadest sense, on international tax measures and issues (wherever the work is performed in the ATO and whatever the head of revenue). In particular, it includes work on those tax measures affecting Australian residents in relation to offshore activity and non-residents in relation to Australian-connected activity.¹³⁵

¹³⁴ ATO, *Risk and Issues Management*, PS CM 2003/02, 28 May 2013.

¹³⁵ ATO, 'ISC Charter', above n 126.

1.133 The Profit Shifting Working Group (PSWG) reports to the ISC on transfer pricing risks. The three main roles of the PSWG are:

1. managing and evaluating ATO work on jurisdictional income risk for the International Steering Committee (ISC) and other corporate forums as required. Specific tasks will include:
 - evaluating the assessment of jurisdictional income risks from across Internationals and the ATO;
 - contributing to the development of mitigation strategies;
 - recommending mitigation strategies;
 - escalating identified gaps in mitigation strategies to the ISC; and
 - engaging with relevant committees including the [LB&I Risk and Intelligence Committee].
2. evaluating the effectiveness of mitigation strategies against agreed indicators i.e. effectiveness measures.
3. provide an assurance to the ISC that international jurisdictional income tax risks are being effectively managed.¹³⁶

1.134 It can be inferred from the ISC Charter that the PSWG would receive information about international tax matters from business lines and the Internationals unit. The PSWG's members include senior ATO officers from the PSP, International Centre of Expertise, and operational compliance areas of the LB&I, SME and ME&I business lines.

1.135 It should be noted that the ATO has advised the IGT towards the end of the review that the ISC is currently reviewing the PSWG in line with the ATO's broader corporate review of its committee structures and, accordingly, the PSWG is currently suspended.¹³⁷

1.136 In addition to the committees that govern the management of operational level risks, particular responsibilities are placed on 'operational risk owners' and 'risk managers'. Their roles and responsibilities are described below:

Operational risk owners have accountability and responsibility for managing a discrete risk population or group (risk pool) within an enterprise risk category. Operational risk owners are responsible for:

- working with Enterprise risk owners to create a whole-of-enterprise view of related risks and controls

¹³⁶ *ibid.*

¹³⁷ ATO, Communication 1 (1 November 2013).

- monitoring changes in the risk environment
- assessing and evaluating risks
- designing treatment, including design of risk controls
- resourcing identification and negotiation for controls management
- defining and monitoring measures of effectiveness...

Risk managers have responsibility for managing risk controls, treatment or mitigation, and aspects of risk assessment and identification as directed by an enterprise risk owner. Risk managers do not have overall responsibility for the management of risks at the enterprise or operational level.¹³⁸

1.137 The ATO has also advised that risk managers are expected to work with the business risk and operational areas.

Risk function — business line governance and management of transfer pricing risks

1.138 In addition to the governance arrangements outlined above, each ATO business line has its own risk committee with the role of reviewing and assessing risk 'treatment plans' to test the risk hypotheses, consistent with the broader ATO approach, but also within the scope of the business line's work. These treatment plans are expected to be endorsed by the relevant business line executive and reviewed annually.

1.139 During this review, the LB&I business line subsumed the management of transfer pricing risk into a broader scope of risk, the profit shifting risk, which also includes other 'manifestations' of profit shifting, such as thin capitalisation and attribution. Non profit shifting international tax risks, such as non-resident withholding tax is managed as a separate operational risk.¹³⁹ The LB&I Internationals unit is responsible for providing strategic guidance and assisting the business lines understand, prioritise and mitigate all international risks.¹⁴⁰

1.140 The SME business line similarly has subsumed the management of transfer pricing risk but into a single international tax risk manager whose responsibilities include both profit shifting and non-profit shifting international tax risks. Previously, the SME International Strategic Unit (ISU) was responsible for developing and implementing appropriate strategies and working with other units, such as the LB&I Internationals unit and supporting the SME International Risk Manager among other

¹³⁸ ATO, 'PS CM 2003/02', above n 134.

¹³⁹ ATO, Communication (31 October 2013).

¹⁴⁰ ATO, 'Internationals, LB&I - About us' (27 November 2012) Internal ATO Document.

things. However, during the review, with the broader restructure of the ATO's business lines mentioned earlier, the ISU has been disbanded.¹⁴¹

1.141 The ATO's operational risk owners and risk managers are expected to develop the 'treatment plans' and liaise closely with the business line risk committees so that the business lines' risk assessments are coordinated.¹⁴² Implicit in developing a treatment plan is the design of a compliance strategy that is achievable with the available operational resources.

1.142 In the LB&I business line, as a result of concerns identified by risk managers, the latter in conjunction with the LB&I Risk, Intelligence and Systems Support (RISS) unit, are to develop a prioritised list of 'lower consequence' large business taxpayers that should be subjected to a risk review. The prioritised list would then be referred to the LB&I Case Selection Sub-Committee (CSSC) of the Risk and Intelligence Committee (RIC) for review and confirmation. The LB&I Executive, LB&I Operations Senior Executive Service (SES) Group and LB&I RIC would then provide final endorsement of the 'lower consequence' case pool.¹⁴³ During this review, the ATO modified its risk assessment and case selection process for lower consequence taxpayers which will be further explored later in this chapter.

1.143 The 'higher consequence' taxpayers are subject to continuous monitoring with approval for review required by the responsible senior executive officer. Risk managers or the LB&I RISS unit may identify risks for the LB&I Operations case teams to consider and determine the scope of the review¹⁴⁴ (this will be further explained in Chapter 3). Therefore, while the 'strategic risk' is managed in various committees which will be described later below, the risk of particular taxpayers is managed by risk managers and LB&I Operations case teams.

1.144 In relation to the LB&I business line, there is a committee called the Profit Shifting Governance Group (PSGG). Some ATO documents indicate that the PSGG has also a role to play in case selection and allocation with respect to profit shifting risks.¹⁴⁵ However, the ATO has advised during the finalisation of this review that it intends to establish an International Structuring and Profit Shifting (ISPS) unit which would fulfil this function, which will be further described at the end of this chapter.¹⁴⁶

1.145 The LB&I Operations SES Group is responsible for the allocation of LB&I Operations resources to cases. Whilst the risk managers, RISS and CSSC decide on the population that ought to be reviewed, the LB&I Operations SES Group ultimately decides on how many cases will be conducted.

¹⁴¹ ATO, 'S&ME International Strategic Unit (ISU) Overview' (24 January 2013) Internal ATO Document; ATO, Communication (7 November 2013).

¹⁴² ATO, 'Communication (24 October 2013)', above n 101; ATO, 'Communication (31 October 2013)', above n 139.

¹⁴³ ATO, 'LB&I Case Selection and Approval Guide' (21 February 2013) Internal ATO Document; ATO, 'Communication (24 October 2013)', above n 101.

¹⁴⁴ ATO, 'Case Selection and Approval Guide', above n 143; ATO, 'Communication (24 October 2013)', above n 101.

¹⁴⁵ ATO, 'TPRR Procedural Manual' (23 July 2012) Internal ATO Document.

¹⁴⁶ ATO, Communication (19 July 2013).

1.146 There is an expectation that the CSSC will consult with the LB&I Operations SES Group to ensure that resources are available to conduct the proposed compliance activities. The ISC Charter also expects the PSWG to ‘work actively with the LB&I CSSC and LB&I RIC to ensure risks are properly managed and resourced within the Enterprise Risk Management Framework.’¹⁴⁷

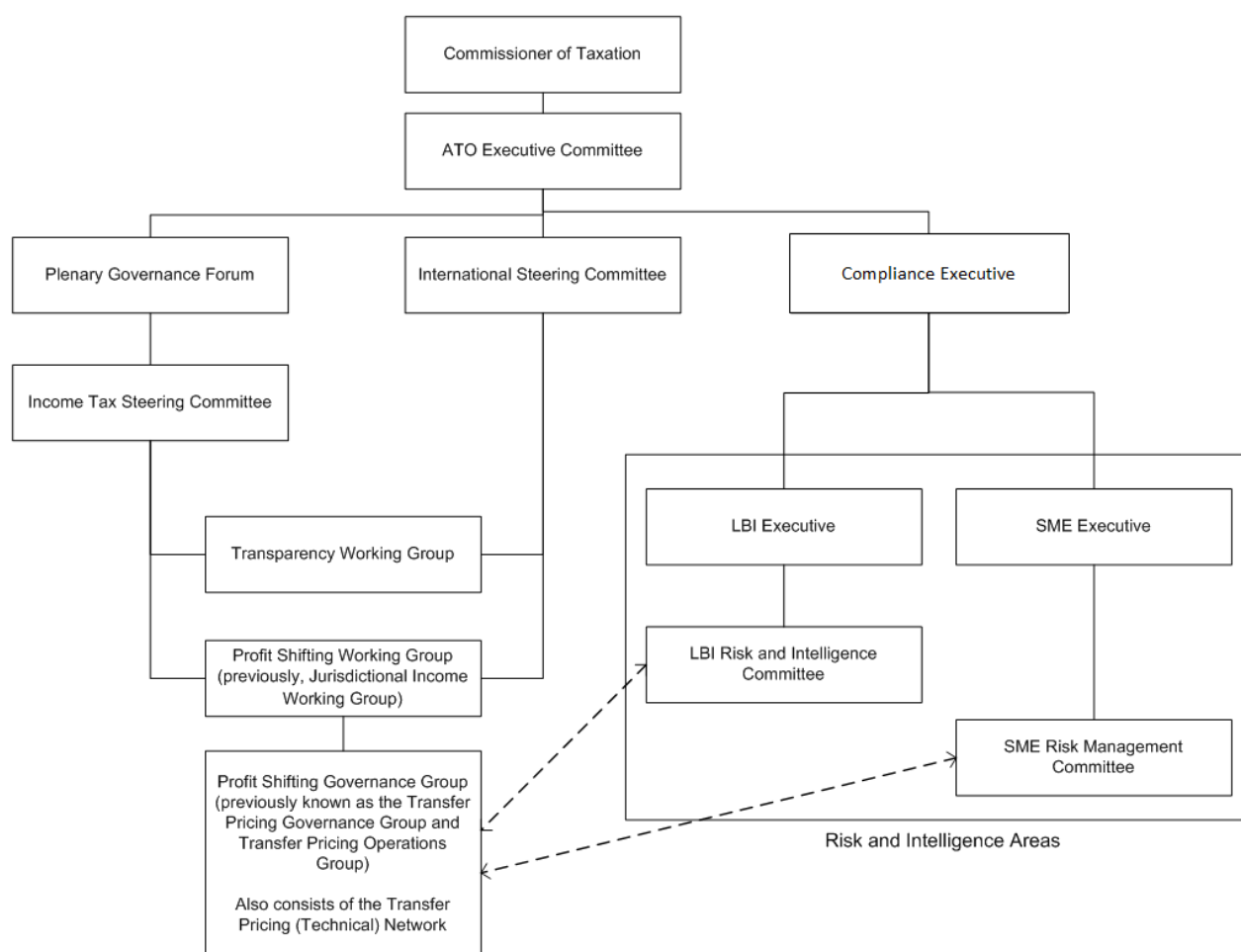
1.147 Similar arrangements for case selection are in place in the SME business line, whereby a committee performs the ‘case selection’ function, to ensure the business line’s resources are directed to the areas and taxpayers of greatest perceived risk.

1.148 Once the risk population has been decided, the risk reviews are conducted by ATO officers in operational areas. In the LB&I business line, this area is called LB&I Operations. In the SME business line, this area is called SME General Compliance.

1.149 The following diagram visually sets out the relevant bodies that have a role in governing the management of transfer pricing risks. As the ATO’s internal arrangements are in a state of flux, the following diagram has been compiled from a number of different ATO documents and discussions with different ATO officers.

¹⁴⁷ ATO, ‘ISC Charter’, above n 126.

Figure 4: ATO governance of the transfer pricing risk



Source: IGT.

Case work — governance and management of transfer pricing case work

1.150 The ATO business line executives have responsibility for planning, resourcing and executing compliance activities, amongst other activities, that contribute to the ATO's broader compliance program. In this respect, the business line executives themselves are responsible to the Compliance Executive for the conduct of case work, who in turn is responsible to the ATO Executive.

1.151 The business lines are responsible for selecting the cases that operational case teams will review in their work program. Once a case is selected, these operational teams are responsible for the conduct and management of compliance activities, such as Transfer Pricing Record Reviews (TPR Reviews), audits, APAs, Annual Compliance Reports and, in the future, MAPs. The operational case teams conducting transfer pricing case work are ultimately accountable to their respective business line executive for the conduct of compliance activities.

1.152 One important implication of the 2010 changes was that all international case work, including transfer pricing case work, would now be carried out by generalist operational case teams in the LB&I and SME business lines. These generalist

operational case teams would be responsible for the management of all casework involving international tax issues as well as domestic tax issues, including: fact finding, evidence gathering¹⁴⁸ and the application of the ATO's views on all international tax issues including transfer pricing matters.¹⁴⁹

1.153 The exceptions to this approach, until recently, were the use of dedicated transfer pricing case teams in:

- LB&I operations that worked on the TPSCI, until the teams were disbanded on 30 June 2013; and
- SME General Compliance which continued to complete transfer pricing case work until those teams were disbanded in September 2013.

Site Governance in the LB&I business line

1.154 In addition to the ATO governance arrangements above, the LB&I business line has recently implemented an ATO location-based governance process called Site Governance. The governance sessions are 'envisaged' to consider all facets of business within each site and may include:

- international strategies and risks;
- risk strategy;
- active compliance and compliance assurance (projections and effectiveness);
- case leadership and callover;
- interpretative advice and disputes;
- New Measures and Government Relations; and
- financial and workforce reporting.¹⁵⁰

1.155 In relation to 'callovers' of compliance case work:

Aspects of the AC Case Callover Program will be incorporated as part of the focus of the Governance session. The overarching analysis of the AC case program (previously prepared prior to case selection for callovers) will be provided to the sites and the Governance panel. The panel will discuss the AC case program at a strategic level and may recommend specific cases for workshopping by case leaders and subject matter

¹⁴⁸ ATO, *Transfer Pricing Review Work*, PS LA 2005/14, 14 May 2007; ATO, 'TPRR Procedural Manual', above n 145; ATO, 'Streamlined Audit Manual for Transfer Pricing' (October 2005) Internal ATO Document; ATO, *ATO's Advance Pricing Arrangement Program*, PS LA 2011/1, 7 May 2012, ch 11.

¹⁴⁹ ATO, 'PS LA 2005/14', above n 148; ATO, 'TPRR Procedural Manual', above n 145; ATO, 'Audit Manual', above n 148; ATO, 'PS LA 2011/1', above n 148, ch 11; ATO, Communication 1 (14 March 2013).

¹⁵⁰ ATO, 'LB&I Executive Minutes: Proposal – LB&I Governance Sessions' (January 2013) Internal ATO Document.

experts. This gives Site SES the opportunity to have case leaders and subject matter experts work with them to follow up on the outcomes of the Governance sessions. However, case callover processes will not be the primary focus of the governance sessions.¹⁵¹

1.156 The ATO has advised that Site Governance callovers focus on different aspects and types of cases, such as 'aged cases', and there are different criteria for triggering the callover of any particular case depending on the 'quantum of risk' as determined by the operational case team. If follow-up is needed, there may be case workshops involving site leaders or the LB&I Technical Leadership Group (TLG).¹⁵²

1.157 It is unclear how the SME business line manages its governance or callovers of transfer pricing case work after March 2013.

Case work — LB&I business line operational case teams and specialist units

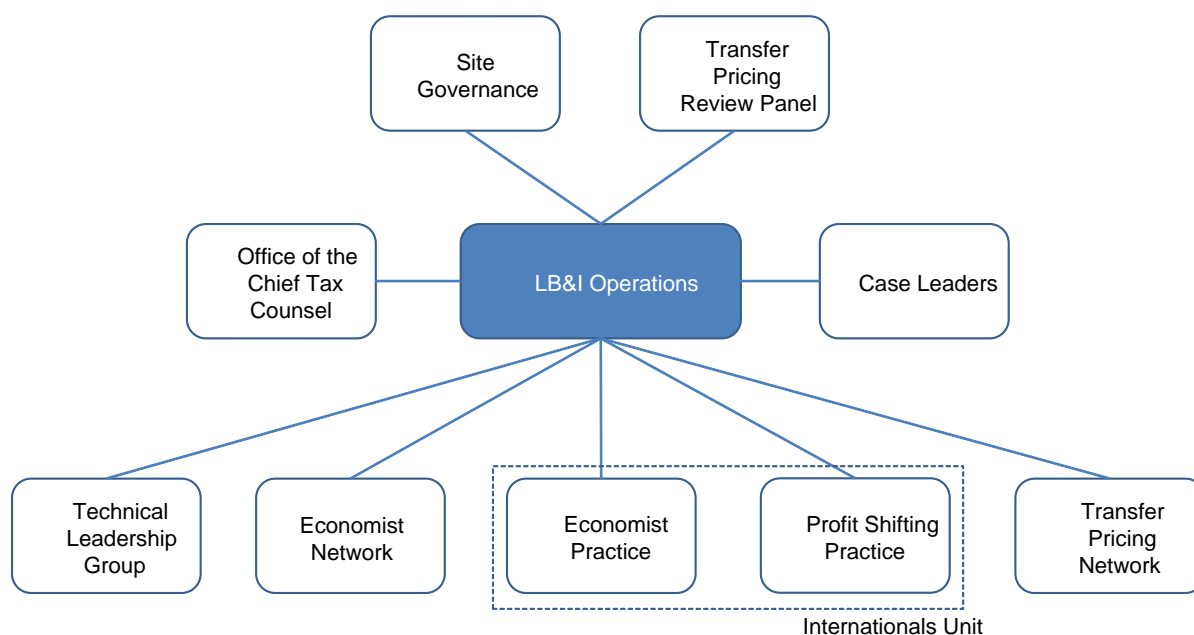
1.158 Operational case teams are expected to have a wide ranging knowledge both in terms of international and domestic tax law and commercial awareness. The ATO has advised that the case team members are not able to maintain specialist knowledge in all areas. Therefore, case teams are expected to draw on the assistance of specialist units within the ATO, including the Internationals unit, when needed. This approach assumes that the operational case teams:

- are aware of the different assistance available to them and when such assistance should be sought; and
- have the capability to manage the different units involved.

1.159 The figure below seeks to depict the operational case teams and the specialist units for international tax matters. Each unit identified below is discussed separately in more detail in the sections that follow.

¹⁵¹ ATO, 'LB&I Governance Sessions: Overview of LB&I Governance Sessions' (March 2013) Internal ATO Document.

¹⁵² ATO, Communication (10 May 2013).

Figure 5: LB&I operations case teams and specialist areas on international tax

Source: IGT.

LB&I Operations

1.160 The LB&I Operations unit has two different types of case teams that deal with transfer pricing: ‘business as usual’ (BAU) and ‘dedicated international’ case teams.¹⁵³

Business as Usual case teams

1.161 The higher consequence BAU case teams are responsible for reviewing and auditing approximately 100 taxpayers with the highest turnover, or ‘higher consequence’ taxpayers. These teams specialise in dealing with their allocated taxpayer. However, they are ‘generalist’ teams in the sense that they conduct compliance activities in respect of all tax risks identified for that taxpayer, including transfer pricing.

1.162 The BAU operations generally comprise:

- Senior Compliance Audit Directors, which are:

accountable to plan, organise and direct the work of other managers including other EL2s. They are the principal specialist and will provide leadership and direction in the development and implementation of compliance strategies and the resolution of complex, significant, precedential and priority technical issues, through collaborative processes with various internal and external stakeholders. They will lead and manage a very large and complex set of resources, with a whole of business area focus;¹⁵⁴

¹⁵³ This was the term used in: ATO, ‘Communication (19 July 2013)’, above n 146.

¹⁵⁴ ATO, Communication (18 April 2013).

- Compliance Audit Directors, which are:

accountable to perform [a]... leadership role and are expected to lead and manage change and take an active role in the implementation of the ATO strategic direction. They will provide leadership and direction in the development and implementation of compliance strategies and the resolution of complex, significant, precedential and priority technical issues through collaborative processes with various internal and external stakeholders;¹⁵⁵

- Senior Auditors, which are:

accountable for coordinat[ing] and undertak[ing] detailed, complex, technical or sensitive projects that impact on strategic, political or operational outcomes for the ATO... [They] will be part of a team undertaking case work of a highly complex nature relating to any market segment or revenue products. They are accountable for the management of cases within acceptable timeframes and the appropriate management of operational risks to ensure the work program is achieved;¹⁵⁶

- Auditors, which are:

accountable for delivering results in accordance with the requirements of their work area and team plans... They will undertake or lead case work that will generally be of a complex nature, in relation to any market segment or revenue products. They [are] required to conduct risk assessments, audits (including field, telephone and desk audit), settlement negotiations and dispute resolution... [and] manage relationships with [taxpayers]... and make decisions exercising sound judgment;¹⁵⁷ [and]

- less experienced officers, are generally accountable to undertake a range of procedural, operational and administrative activities.¹⁵⁸

1.163 Accordingly, Senior Auditors and Auditors in BAU case teams are accountable for making decisions with direction provided by more senior team members. These officers may also draw on a range of support outside their team to assist in the conduct of their work as demonstrated in the diagram above.¹⁵⁹

1.164 Lower consequence taxpayers are also reviewed by LB&I Operations case teams. These teams, however, are not dedicated to particular taxpayers. Lower consequence taxpayers are not necessarily the subject of year-to-year engagement or review (unlike higher consequence taxpayers). Furthermore, should they be reviewed again in the future, they will not necessarily be reviewed by the same team that reviewed them previously.

¹⁵⁵ *ibid.*

¹⁵⁶ *ibid.*

¹⁵⁷ *ibid.*

¹⁵⁸ *ibid.*

¹⁵⁹ ATO, 'PS LA 2005/14', above n 148; ATO, 'TPRR Procedural Manual', above n 145; ATO, 'Audit Manual', above n 148; ATO, 'PS LA 2011/1', above n 148, ch 11; ATO, 'Communication 1 (14 March 2013)', above n 149.

Dedicated international case teams

1.165 During the review the ATO advised the IGT that as part of ongoing internal restructurings, it plans to implement dedicated international cases teams to focus on conducting case work on business restructuring issues. At the time of writing, the ATO was unable to provide further details.¹⁶⁰

Internationals unit

1.166 Although the Internationals unit is located within the LB&I business line, it is a ‘gateway’ for all internationals related tax risks in the ATO and is expected to interact with other business lines and units that may encounter and deal with international tax risks.

1.167 The Internationals unit comprises six units, PSP, Economist Practice, International Engagement and Transparency Practice, International Risk Strategy and Intelligence Unit, JITSIC and the Program Management Office, which have different roles. The units that assist officers with transfer pricing case work are the PSP and the Economist Practice.

1.168 The JITSIC unit provides assistance in relation to joint audits with other tax authorities. The other units within the Internationals unit do not have a role in assisting in the conduct of transfer pricing case work.

Profit Shifting Practice

1.169 The PSP is responsible for building organisational capability to deal with international tax issues across the ATO such as, providing ‘technical advice and assistance where capacity exists.’¹⁶¹ The operational case teams may draw on the PSP to:

- become involved in case teams’ workshops on international tax issues;¹⁶²
- provide additional assistance in TPR Reviews where ‘the nature of the transfer pricing risk requires’ such assistance;¹⁶³ and
- provide additional support where necessary in audits.¹⁶⁴

1.170 The PSP unit maintains its own referral form which asks case officers to provide comprehensive details of cases such as:

- the identified issue;
- relevant facts, law, ATO view or other guidelines;

¹⁶⁰ ATO, ‘Communication (19 July 2013)’, above n 146.

¹⁶¹ ATO, ‘The Jurisdictional Income Practice – About us’ (20 January 2012) Internal ATO Document.

¹⁶² *ibid.*

¹⁶³ ATO, ‘TPRR Procedural Manual’, above n 145.

¹⁶⁴ ATO, ‘Audit Manual’, above n 148.

- the referring officer's preliminary view;
- whether there are any additional comments or documents that would assist in understanding the referring case officer's view; and
- any other matters that would assist the International unit in providing a comprehensive response.¹⁶⁵

1.171 The PSP also houses the ATO's three officers who are Competent Authority Representatives (CARs). These officers are designated officials who may approve the terms of the agreement of bilateral and multilateral APAs and MAPs. The CARs become involved to ensure key steps of the process are followed, including information gathering review and interpretation guidance. The CARs are expected to act independently from auditors and in professional good faith with the overseas counterparts.¹⁶⁶ CARs are discussed in more detail in Chapter 4.

1.172 The PSP also 'sponsors' the TPN and provides officers to staff the TPRP.¹⁶⁷

Transfer Pricing Network

1.173 The TPN is a cross business line forum, the operation of which is ensured by the TPN Leader who is currently a transfer pricing 'specialist' from the PSP.¹⁶⁸ The TPN is coordinated by the PSGG. It is an 'open forum for all officers with an interest in [transfer pricing] and international issues who are prepared to commit to the program of formal and informal training and [transfer pricing] casework'.¹⁶⁹ Standing members of the TPN include ATO case officers with transfer pricing experience and the ATO's transfer pricing 'specialists' from a range of units within the ATO, such as the PSP, the Internationals unit, LB&I TLG, Economist Practice, LB&I Operations, SME and the Tax Counsel Network.¹⁷⁰

1.174 The TPN was established by the ATO as a means of providing technical support to ATO case officers with transfer pricing case work and build capability through a range of activities such as: phone meetings, delivery of technical bulletins and identifying intelligence, capability and training opportunities.¹⁷¹ The ATO views its technical networks, such as the TPN, as a platform to achieve appropriate knowledge management and capability building through their activities.¹⁷²

1.175 The ATO has advised that case officers unfamiliar with transfer pricing that have been allocated transfer pricing case work, are identified by PSGG site

¹⁶⁵ ATO, 'Referral to Internationals: Request for Assistance' (1 March 2013) Internal ATO Document.

¹⁶⁶ ATO, 'PS LA 2011/1', above n 148, ch 11; ATO, 'E-wiki: Transfer Pricing' (29 November 2012) Internal ATO Document; ATO, Communication (22 March 2013); ATO, Communication 1 (13 March 2013). Work Processes for Mutual Agreement Procedures refers to: Centre for Tax Policy and Administration, OECD, 'MEMAP', above n 46, pp 10-11.

¹⁶⁷ ATO, 'JIP - About us', above n 161; ATO, *The Transfer Pricing Review Panel (TPRP)*, PS LA 2004/13, 17 December 2004.

¹⁶⁸ ATO, 'Transfer Pricing Network Charter' (October 2012) Internal ATO Document.

¹⁶⁹ *ibid.*

¹⁷⁰ *ibid.*

¹⁷¹ *ibid.*; ATO, 'E-wiki', above n 166, Transfer Pricing Network.

¹⁷² ATO, 'E-wiki', above n 166, Compliance Technical Networks.

representatives who then nominate those officers to the TPN Leader for inclusion into the TPN. The PSGG site representatives are senior officers in the site and are aware of all cases where transfer pricing is an issue for their site.¹⁷³

1.176 Case ‘ownership’ remains with the operational case teams, including the responsibility for finalising case work.¹⁷⁴

1.177 In relation to TPR Reviews, operational case teams with transfer pricing case work may request the involvement of a TPN member. According to the ATO’s procedures, such requests are made via the PSGG site representative.¹⁷⁵ The ATO advises that the TPN member allocated to TPR Reviews will normally be more experienced in transfer pricing matters¹⁷⁶ and will ‘supervise’ the case work.¹⁷⁷

1.178 The TPN also has a role in identifying, monitoring and reporting on emerging transfer pricing risks from case work across the ATO and escalating issues to the PSGG.¹⁷⁸

Transfer Pricing Review Panel

1.179 The membership of a given TPRP is determined by the Chairperson,¹⁷⁹ who ‘should’ have regard to ‘the nature, complexity and priority of the issue(s) and any particular expertise needed to effectively and efficiently hear the case’.¹⁸⁰ Unless the case is an audit, the Chairperson need not be a member of the PSP.¹⁸¹ On occasions the TPRP will consist of only the Chairperson. However, there is an expectation that for all but the least complex cases, the TPRP would have at least three members from each of the Internationals unit, Economist Practice and an ‘industry specialist’ from the relevant business line (LB&I or SME).¹⁸²

1.180 The TPRP is the central forum to ensure consistency and technical accuracy of all transfer pricing compliance case work, other than MAPs and objections. It is managed by the PSP¹⁸³ and replaces the previous International Audit Review Committee.

1.181 The role of the TPRP is to:

- oversee the Tax Office's transfer pricing (TP) compliance program with a view to maintaining a high standard of technical and case management decision making to ensure that a sound and consistent approach is taken with TP casework; and

¹⁷³ ATO, Communication (21 May 2013).

¹⁷⁴ *ibid*; ATO, ‘TPN Charter’, above n 168.

¹⁷⁵ ATO, ‘TPRR Procedural Manual’, above n 145; ATO, ‘Transfer Pricing Risk Assessment Guide’ (May 2012) Internal ATO Document.

¹⁷⁶ ATO, ‘Communication (12 March 2013)’, above n 104.

¹⁷⁷ ATO, ‘TPN Charter’, above n 168.

¹⁷⁸ *ibid*; ATO, ‘E-wiki’, above n 166, Transfer Pricing Network.

¹⁷⁹ ATO, ‘PS LA 2004/13’, above n 167, para [18].

¹⁸⁰ *ibid* para [19].

¹⁸¹ *ibid*.

¹⁸² *ibid*.

¹⁸³ *ibid* paras [16]-[17].

- ensure that the principles and practices in Tax Office TP Rulings and other guidance are reflected in TP casework.

... [and] includes:

- providing an independent quality review of TP cases to ensure that the approach taken and technical decisions made are consistent, sound and appropriately reflect the Tax Office view;
- providing advice to facilitate the making of Division 13 determinations and applications of the corresponding Treaty Articles on a sound basis by the most appropriate officer; and
- ensuring that a 'whole of ATO' approach is adopted in dealing with TP issues.¹⁸⁴

1.182 The ATO notes that there is a need for a degree of flexibility in the referral processes to the TPRP so as not to impede the effective and efficient performance of case work. However, there is an expectation that the requirements outlined in *Practice Statement PSLA 2004/13* must ordinarily be met. *Practice Statement PSLA 2004/13* states that ATO compliance case teams 'must' refer transfer pricing issues to the TPRP for its 'advice and guidance'.

...This includes the following:

- the determination of a risk rating for a TP record review or other type of TP review that requires such a rating, subject to paragraphs 11 and 12;
- the approach to be taken in the auditing of a TP issue, including significant case management decisions related to the planning and conduct of the audit;
- a Position Paper, Discussion Paper or similar type of document that is to issue to the taxpayer in an audit or APA case;
- the decision to make a Division 13 determination or apply a corresponding Treaty Article;
- the decision to take no further action in respect of an audit of a TP issue;
- the decision to accept an APA application, if there is doubt;
- the approach to be taken in considering an APA application or pre-lodgement proposal, including significant case management decisions related to the planning and conduct of the work; or
- the determining of a Tax Office position on the terms and conditions of an APA (but not including decisions made during MAP, as per paragraph 6).

¹⁸⁴ ibid paras [1], [4].

11. Regarding the first dot point in the previous paragraph, in accordance with *Taxation Ruling TR 98/11* a TP review (eg. a TP record review) involving an assessment of documentation quality and commercial realism of outcomes is required before proceeding to audit. The risk rating resulting from such a review requires TPRP involvement. This is the case whether the TP review is performed as part of a client risk review (CRR) or independently of a CRR. It is also the case if the TP review is performed in streamlined form.

12. However, not all TP risk assessments involve such a TP review and risk rating and therefore need be referred to the TPRP. For instance, a TP issue may be risk assessed in performing a CRR without the need for TPRP involvement.¹⁸⁵

1.183 The ATO advises that the TPRP may also be involved in information requests in complex cases.¹⁸⁶

1.184 *Practice Statement PSLA 2004/13* outlines that the advice of the TPRP ‘should’ be followed by case teams subject to any relevant escalation processes. Where this advice is not followed, the TPRP should be advised of the reasons for this to ensure that these reasons are taken into account in giving future TPRP advice. The advice of the TPRP does not displace officers’ responsibility for the proper exercise of their authority to make transfer pricing decisions.¹⁸⁷

Economist Practice

1.185 The Economist Practice is a unit of approximately 60 economists within the Internationals unit in the LB&I business line and is led by an SES officer.¹⁸⁸ During the conduct of this review, the Economist Practice issued *Practice Statement PSLA 2013/2* which outlines its role and function which,

...supports international and non-international work across the ATO with a focus on three broad areas:

- building economist skill sets, including through the Economist Network
- operational advice on cases including active compliance, advisings and litigation, particularly in relation to multinational taxpayers
- strategic research on economic issues which includes support for law reform and effectiveness evaluation.¹⁸⁹

¹⁸⁵ *ibid* para [10]; ATO, *Referral of Work to International Strategy and Operations*, PS LA 2006/9, 9 November 2010; ATO, ‘International Review’, above n 117; ATO, ‘JIP – About us’, above n 161; ATO, ‘PS LA 2011/1’, above n 148, ch 11; ATO, ‘Communication 2 (15 March 2013)’, above n 104.

¹⁸⁶ ATO, ‘PS LA 2006/9’, above n 185; ATO, ‘International Review’, above n 117; ATO, ‘JIP – About us’, above n 161; ATO, ‘PS LA 2004/13’, above n 167; ATO, ‘PS LA 2011/1’, above n 148, ch 11; ATO, ‘Communication 2 (15 March 2013)’, above n 104.

¹⁸⁷ ATO, ‘PS LA 2004/13’, above n 167.

¹⁸⁸ ATO, ‘Economists – About us’ (12 April 2012) Internal ATO Document; ATO, ‘Communication 1 (14 March 2013)’, above n 149; ATO, ‘Organisational Chart for Economist Practice’ (11 March 2013) Internal ATO Document.

¹⁸⁹ ATO, *Provision of Accredited Economic Advice*, PS LA 2013/2, 20 June 2013.

1.186 The advice of the Economist Practice to the case teams includes analysis of:

- price, profit and other outcomes arising from commercial, business and tax contexts;
- taxpayer decision making, which may include examining internal and external factors such as preferences, available options, market context, regulatory framework and the tax environment; and
- patterns and trends in taxpayer and industry performance in the context of wider market and economic cycles.¹⁹⁰

1.187 Specifically, in relation to TPR Reviews, the Economic Practice also assists case teams in completing the commercial realism report and key ratios, summary of key findings as well as the risk assessments and risk ratings.¹⁹¹

1.188 In audits involving transfer pricing issues, the ATO outlines in its Streamlined Audit Manual for Transfer Pricing that the Economist Practice:

- 'should' be consulted by operational case teams in the development of case plans;
- 'will' assist operational case teams with information gathering;
- 'to' research comparables relied on by taxpayers;
- 'to' replicate the taxpayer's comparability search, their accept and reject criteria and the integrity of the process;
- 'improve' on the taxpayer's search criteria and determination of comparables where possible;
- 'benchmark' the comparables by using appropriate profit level indicators;
- 'work with' the case teams to complete the functional and comparability analyses; and
- 'input' to the Position Paper.¹⁹²

1.189 *Practice Statement PSLA 2013/2* also describes the role of the Economist Practice as including:

(b) the economist will determine the economic issues to be examined with the referring area, and will outline the approach to analysing and resolving the economic issues. In a case advice setting, this may include determining:

¹⁹⁰ *ibid.*

¹⁹¹ ATO, 'TPRR Procedural Manual', above n 145.

¹⁹² ATO, 'Audit Manual', above n 148.

- (i) the information required
- (ii) characterisation of issues including functional analysis
- (iii) analytical approach
- (iv) choice of method, and
- (v) benchmarking and arm's length range (where applicable).¹⁹³

1.190 The advice provided by Economist Practice is prioritised according to the:

- (a) availability of economists
- (b) materiality and revenue impact
- (c) risk to the ATO reputation and the integrity of the system
- (d) technical complexity and precedential value
- (e) Compliance Program and ATO objectives.¹⁹⁴

1.191 The Economist Practice has for a number of years maintained an engagement or referral form which requests details of:

- the economic issues that require assistance; and
- any risk profiling work, tax returns and schedule analysis and any relevant documentation already completed or on hand.

1.192 The ATO has also advised that Economist Practice requires access to all information held by case officers.¹⁹⁵

Economist Network

1.193 The Economist Network is a technical network that seeks to build economic capability in the ATO and provides support to ATO strategy and operations. Membership of the network provides another way to access economic analytical skills, including assurance of work completed outside of the Economist Practice.¹⁹⁶ The Economist Practice manages the Economist Network.

¹⁹³ ATO, 'PS LA 2013/2', above n 189.

¹⁹⁴ *ibid.*

¹⁹⁵ ATO, 'Communication 1 (14 March 2013)', above n 149; ATO, 'Referral to Economist Practice' (undated) Internal ATO Document.

¹⁹⁶ ATO, 'PS LA 2013/2', above n 189.

Case and Topic Leaders unit

1.194 The Case and Topic Leaders (CTL) unit membership is drawn from both the LB&I business line's Case Leaders and the TLG.¹⁹⁷

Case Leaders

1.195 Case Leaders may be engaged by LB&I operational case teams to provide oversight and strategic direction of key compliance cases. They may also provide technical leadership on cases involving more complex issues, such as transfer pricing, and aged cases. Case Leaders may also participate in site governance case callovers. For example, Case Leaders provide guidance, counsel and leadership in managing technical issues and the case itself to ensure the case is progressing appropriately. The nature and extent of Case Leaders' engagement varies from one case to another. However, Case Leaders do not manage any cases. The operational case teams remain responsible for planning and active case management.¹⁹⁸

Technical Leadership Group

1.196 The TLG focuses primarily on the resolution of technical issues and comprises technical leaders and advisers. LB&I operational case teams may engage the TLG to provide advice, guidance and support on low and medium risk precedential or technical issues of law, covering consolidations, capital gains tax, insurance, finance and investment, international tax and areas of administrative law. The TLG may attend taxpayer meetings, participate in risk workshops, and participate in the site governance case callovers and monthly review processes. The TLG may also review and provide input into audit position papers, private rulings and objections.¹⁹⁹ The role of TLG does not include case management or establishing facts such as assisting case officers with conducting functional analyses in transfer pricing compliance activities.²⁰⁰

Office of the Chief Tax Counsel

1.197 The Office of the Chief Tax Counsel (OCTC) is responsible for formulating the ATO's precedential view on various technical issues amongst other things. It comprises the ATO's most senior technical officers and is part of the ATO's Law Group. The OCTC may provide technical expertise and leadership on the highest risk technical issues.²⁰¹

1.198 Operational case teams may engage, either formally or informally, the OCTC in accordance with *Practice Statement PSLA 2012/1*. There is a joint commitment by all

¹⁹⁷ ATO, 'Case and Topic Leaders - About us' (27 August 2012) Internal ATO Document.

¹⁹⁸ *ibid*; ATO, 'Communication 2 (15 March 2013)', above n 104.

¹⁹⁹ The callover process was modified as part of LB&I's governance shift to 'national strategy, local delivery'. The governance processes are now based around the different ATO sites and managed by site SES and includes active compliance, interpretative advice and internationals. They look at case plans as well as risk spots around capability. Site SES ask about specific cases. If needed, there is follow up with case workshops with site leaders or TLG.

²⁰⁰ ATO, 'LB&I Technical Leadership Group' (16 November 2012) Internal ATO Document; ATO, Communication 2 (13 March 2013); ATO, 'Communication 2 (15 March 2013)', above n 104; ATO, Communication 1 (19 March 2013); ATO, 'Communication (10 May 2013)', above n 152.

²⁰¹ ATO, 'Law and Practice - What we do' (6 February 2013) Internal ATO Document.

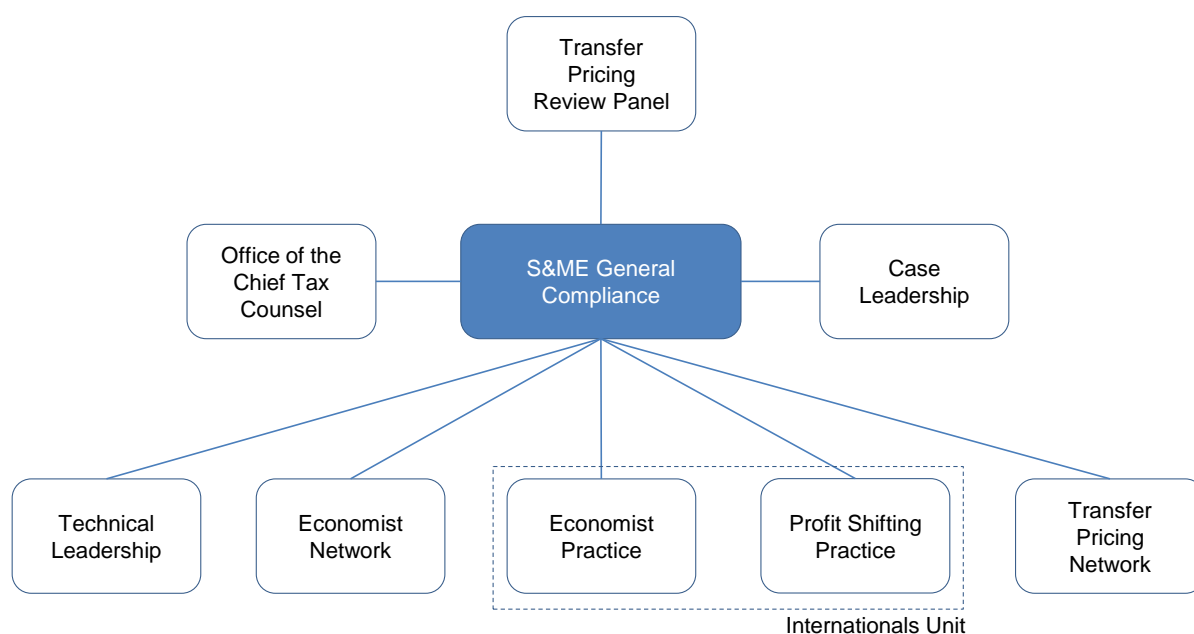
business lines and tax technical officers involved to ensure commitments under the *Taxpayers' Charter* and relevant ATO service standards are met.²⁰²

Case work — SME business line operational case teams and their access to specialist units

1.199 Prior to September 2013, transfer pricing case work in the SME business line was largely undertaken by two dedicated teams²⁰³ with transfer pricing specialist support. Following a recent restructure of the SME business line, transfer pricing risks and issues are now addressed by all General Compliance teams. Officers from the former dedicated teams have either been integrated with other General Compliance teams or SME Technical Leadership²⁰⁴

1.200 There are a range of units that SME General Compliance case teams may access for assistance in relation to transfer pricing. These are represented visually in Figure 6 below. The International units including the TPRP and OCTC provide the same type of support to the SME General Compliance case teams as they do to the LB&I Operations case teams. As a result, a description of their roles and responsibilities is not duplicated below.

Figure 6: SME case teams on transfer pricing case work



Source: IGT.

²⁰² ATO, *Management of High Risk Technical Issues and Engagement of Tax Technical Officers in Law and Practice*, PS LA 2012/1, 31 August 2012.

²⁰³ These two dedicated teams were previously within the SME Internationals unit before the unit was disbanded and those teams became 'dedicated teams' within SME General Compliance.

²⁰⁴ ATO, Communication (15 July 2013).

SME General Compliance case teams

1.201 The SME General Compliance case teams conduct compliance activities on taxpayers with turnovers from \$2 million to \$250 million and high wealth individuals. The types of taxpayers a case team may examine will vary from sole traders, partnerships, closely held private groups, not-for-profit organisations, and Australian entities of foreign MNEs. From September 2013, any SME General Compliance case team can conduct transfer pricing case work, following a similar approach to that of the LB&I operations teams in Figure 5.

Technical and Case Leadership

1.202 The Technical and Case Leadership (TCL) unit includes both the Technical Leadership unit and the Case Leadership unit.

Technical Leadership

1.203 The Technical Leadership unit provides technical guidance for complex case work which may include cases involving transfer pricing issues.

1.204 This unit offers advice, support and feedback by reviewing documents, including those prepared by the SME General Compliance case teams. Depending on the issues, the extent of this unit's involvement could range from full involvement in the case work to only undertaking a monitoring role. In consultation with the SME General Compliance case team, the Technical Leadership unit will also provide assistance in respect of case management in appropriate circumstances.²⁰⁵ However, this unit is not responsible for the management of cases or preparing documentation associated with the case. This remains the primary responsibility of the case team.

1.205 The ATO's internal referral guidelines for the Technical Leadership unit states that the unit must be involved in certain matters including where:

- fraud or evasion is in contemplation;
- a penalty of 50% or more (including uplifting penalties) is in contemplation...;
- audit cases that are identified as having a possible dispute (that is, an objection is likely to be lodged) and officers are unable to resolve the issues that have potential for dispute...;
- a precedential technical issue which requires resolution, including the creation of an ATO View; and
- a high risk technical issue is identified which may require engagement with Law & Practice. The risk associated with failing to address the issue must be assessed as outlined in PS LA 2012/1 and the Guide to managing high risk technical issues.²⁰⁶

²⁰⁵ ATO, 'About Technical and Case Leadership' (22 February 2013) Internal ATO Document.

²⁰⁶ *ibid.*

1.206 The Technical Leadership unit may also be involved on other issues, including:

- international issues including, transfer pricing and where use of section 264A is in contemplation/considered necessary;
- taxpayers with foreign trusts, companies, and/or superannuation funds in the structure (controlled foreign company – CFC, foreign investment fund – FIF and Division 6 ITAA 1936);
- taxpayers treating certain dividends as [non] assessable non-exempt income under section 23AJ ITAA 1936. Significant Australian Transaction Reports and Analysis Centre (AUSTRAC) activity – particularly with tax havens;
- disposals of intellectual property (including goodwill) and royalty payments offshore; and
- issues which are not high risk as outlined in PS LA 2012/1 but referral to Law and Practice is in contemplation.²⁰⁷

1.207 The two ATO officers that led the two dedicated case teams before September 2013 were moved to the Technical Leadership unit.

Case Leadership

1.208 Case Leadership in the SME business line aims to build collective capability within case teams whilst not diminishing the individual leadership or decision-making responsibilities of those who have carriage of a case. Case Leadership involvement is directed towards more complex casework or cases which deal with significant systemic or reputational risks. The extent to which Case Leadership becomes involved in a particular case will vary and will depend on the complexity of the case, the level of risk involved, and the capability of the officers involved.

1.209 The ATO guidelines state that cases should be referred to Case Leadership if any of the following indicators are present:

- significant revenue impact – where potential increase in tax payable is greater than \$15m for all years under review/audit;
- major reputational risk issues including, issues with the potential to attract media attention or to adversely impact on community confidence in the tax and superannuation system;
- systemic issues;

²⁰⁷ *ibid.*

- significant or unresolved blockers which are delaying case progress or completion (whether or not the case is already an aged case). For example, blockers which will cause compliance cases to exceed cycle time or fail Taxpayers' Charter requirements; or
- cases which are moving towards settlement, dispute resolution or litigation.²⁰⁸

1.210 Case Leadership input may also be identified through their participation in case workshops, callovers and other sources of information in addition to referral from case teams.²⁰⁹

1.211 In the SME business line, the Risk Management Committee conducts callovers to review ratings and ensuring compliance activities are balanced and prioritised accordingly.²¹⁰

The ATO's approach to transfer pricing compliance activities

1.212 As mentioned earlier, compliance activities are one of the main means through which the ATO identifies and addresses tax risks. A description of the ATO's various compliance products is provided in Appendix 4.

1.213 Generally, the ATO seeks to target its compliance approach to the identified risk. The information that the ATO requires to identify risk can result in significant administrative and taxpayer compliance costs. Therefore, the intensity of the information gathering exercises, such as annual lodgment, risk reviews and audit, are generally aimed to be proportionate to the perceived risks involved.²¹¹

1.214 The ATO is concerned that the characteristics of international tax risks may be difficult to identify from lodgment data alone without undertaking more involved compliance activities. Furthermore, the ATO does not limit the scope of compliance activities to only international tax risks gleaned from the information provided in income tax returns as otherwise the operational case teams may not fully consider other tax risks.²¹²

1.215 The more involved compliance approach may provide increased assurance that identifiable risks have been addressed. However, it may also increase the overall compliance burden for taxpayers.

1.216 Where a transfer pricing risk is identified for review, it may be initially examined through ATO risk review 'products', such as TPR Reviews, Client Risk Reviews²¹³ (CRR) or specific issue TPR Reviews. During the finalisation of this IGT review, the ATO has advised the IGT that it intends to discontinue use of the TPR

²⁰⁸ *ibid.*

²⁰⁹ *ibid.*

²¹⁰ ATO, 'S&ME Risk Management Committee (RMC)' (28 June 2012) Internal ATO Document.

²¹¹ ATO, *2008-9 Compliance Program* (2008).

²¹² ATO, Communication (11 February 2013).

²¹³ In the SME business line, its compliance products also include, Preliminary Risk Reviews and Comprehensive Risk Reviews.

Review product. This will be further explained later in this chapter. Nevertheless, these reviews are conducted by operational case teams in the LB&I and SME business lines.

1.217 Once a transfer pricing risk is identified, a TPR Review must be conducted.²¹⁴ The TPR Review process is outlined in greater detail in the next section. Broadly, the TPR Review involves an evaluation of the quality of taxpayers' documentation used in support of their pricing methodologies and the evaluation of the taxpayer's financial performance over four years to determine the commercial realism of prices set by reference to high level benchmarks using Australian Bureau of Statistics (ABS) data and the LB&I business line's industry knowledge.²¹⁵ The TPR Review does not attempt to specifically identify the area of transfer pricing or establish whether circumstances justify the taxpayer's position.²¹⁶

1.218 It should be noted that there are also specific issue TPR Reviews which focus on a particular transfer pricing risk or risks and are project based in design.²¹⁷ The CRR, on the other hand, may examine a number of different tax risks which may include transfer pricing risks. However, it is unclear whether a separate process or 'product' is commenced or whether case teams conduct the CRR in the same manner as a TPR Review.²¹⁸

1.219 At the conclusion of a TPR Review the ATO will decide on any follow-up action, such as commencing a transfer pricing audit.

1.220 Broadly, when conducting a transfer pricing audit, ATO operational case teams are directed to recreate a taxpayer's transfer prices by following the four steps outlined in *Taxation Ruling TR 98/11*. The audit process is described in greater detail in the next section.

1.221 Where the ATO's adjustments of transfer pricing arrangements occur as a result of audits, the taxpayer may initiate a MAP to minimise any double taxation imposed by any other tax jurisdictions that are a signatory to a tax treaty with Australia.

²¹⁴ ATO, 'TPRR Procedural Manual', above n 145.

²¹⁵ *ibid*; ATO, 'Transfer Pricing Risk Assessment Products – Overview of Procedural Steps' (undated) Internal ATO Document.

²¹⁶ ATO, 'Audit Manual', above n 148, p 6.

²¹⁷ ATO, 'TPRR Procedural Manual', above n 145; ATO, 'Transfer Pricing Risk Assessment Products', above n 215.

²¹⁸ ATO, 'TPRR Procedural Manual', above n 145.

1.222 The ATO's MAP process is outlined in *Taxation Ruling TR 2000/16*. In the conduct of MAPs, ATO officers are directed to follow the OECD's *Manual on Effective Mutual Agreement Procedures*.²¹⁹ The MAP process generally has two stages:

- stage one begins with the presentation of the case by the taxpayer to the CAR of the taxpayer's country of residence. The CAR considers whether the request can be accepted; and
- stage two concerns the dealings between the two countries, with the country of the original request acting as a 'defender' of the claim.²²⁰

1.223 It should be noted that the MAP articles in most Australian tax treaties do not compel the treaty signatory's representative, or CAR, to reach an agreement and resolve tax disputes.²²¹

1.224 Particular to transfer pricing issues, taxpayers may also enter into an APA to reach agreement with the ATO on the method and application of the arm's length principle to their international related party dealings on a prospective basis, thereby resolving any tax uncertainty relating to those dealings. These APAs may either be unilateral, bilateral or multilateral. Bilateral and multilateral APAs are concluded under the MAP article of the relevant tax treaty or treaties. The ATO also has simplified APAs for taxpayers with low value or low risk international related party dealings. The APA process is outlined in *Practice Statement PSLA 2011/1* and has five steps:

- the pre-lodgment step identifies the scope of the APA including, the likely type of APA product and any collateral issues;
- the lodgment step requires taxpayers to lodge their formal APA application and supporting documentation;
- the analysis and evaluation step involves the APA teams evaluating the taxpayer's information, requesting further information and undertaking fieldwork;
- the negotiation and agreement step involves reaching an agreement with the taxpayer or tax treaty partner on the terms of the APA and preparing a draft APA; and
- the concluding step requires finalising the APA terms amongst all the parties.

Specialist unit support during transfer pricing matters

1.225 The following sections describe the role of the special units during various compliance activities.

²¹⁹ ATO, 'E-wiki', above n 166; Centre for Tax Policy and Administration, OECD, 'MEMAP', above n 46.

²²⁰ Centre for Tax Policy and Administration, OECD, 'MEMAP', above n 46, para [25].

²²¹ OECD, 'Model Tax Convention', above n 37, art 25.

TPR Reviews

1.226 The Transfer Pricing Risk Assessment Guide and the TPR Review Procedural Manual outline the role of some of the ‘specialist’ units that may be involved in TPR Reviews.

1.227 Once the TPR Review is allocated, the operational case team is to notify the International Gatekeeper via email that the TPR Review is about to commence.²²² It should be noted that there is inconsistency between the two key documents on this step (see below for details).²²³

1.228 The operational case team then sets up the case in the ATO’s case management system (Siebel).²²⁴

1.229 In the conduct of the substantive TPR Review, operational case teams are directed to email:

- their site PSGG representative to request a TPN member be attached to the case;²²⁵
- a referral form to the Economist Practice to request economic assistance and have an economist attached to the case;²²⁶ and
- a referral form to the PSP where the ‘nature’ of the transfer pricing risk ‘requires assistance’.²²⁷

1.230 It should be noted that the engagement of the Economist Practice and PSP is subject to availability of resources.²²⁸

1.231 The operational case team will be ‘supervised’ by the TPN member who will provide ‘technical support’ to the teams dealing with transfer pricing issues. ‘Ownership’ of the TPR Review remains with the operational case team.²²⁹ No further explanation of the role of the TPN member is provided.

1.232 The role of the PSP is to ‘provide technical advice and assistance... including in technical reviews through the Transfer Pricing Review Panels’.²³⁰ No further explanation is provided.

1.233 The previous step, the referral to the PSP, is contradicted by the Transfer Pricing Risk Assessment Guide which states that it is to occur after the next step being

²²² ATO, ‘TPRR Procedural Manual’, above n 145.

²²³ ATO, ‘Risk Assessment Guide’, above n 175.

²²⁴ ATO, ‘TPRR Procedural Manual’, above n 145.

²²⁵ *ibid*; ATO, ‘Risk Assessment Guide’, above n 175.

²²⁶ ATO, ‘Risk Assessment Guide’, above n 175; ATO, ‘TPRR Procedural Manual’, above n 145.

²²⁷ ATO, ‘Risk Assessment Guide’, above n 175; ATO, ‘TPRR Procedural Manual’, above n 145.

²²⁸ ATO, ‘PS LA 2013/2’, above n 189; ATO, ‘JIP – About us’, above n 161.

²²⁹ ATO, ‘TPN Charter’, above n 168.

²³⁰ ATO, ‘JIP – About us’, above n 161.

operational case teams determining whether there is any transfer pricing risk by seeking answers to what is known as transfer pricing filter questions.²³¹

1.234 Once a TPN member, an economist and a PSP representative (if requested) have been allocated, the operational case team is to discuss with them the timeframe for the TPR Review and then complete the TPR Review plan.²³² Specific responsibilities of each unit are not further explained.

1.235 The next step in TPR Reviews is to:

- evaluate the quality of a taxpayer's transfer pricing documents in line with paragraph 4.26 of *Taxation Ruling TR 98/11* by using the TPR Review 'checklist'; and
- determine the profitability level of the taxpayer as either being commercially realistic, less than commercially realistic, or consistently returns losses.

1.236 To ensure proper evaluation of documentation quality and level of profitability, operational case teams 'should work with' and 'seek advice' from the Economist Practice to 'ensure' that the following analyses are completed:

- summary of findings from the review of documentation (the Transfer Pricing Risk Assessment Guide contradicts this by stating this is to occur after a TPRP is organised);
- calculation of key ratios which are determined in consultation with the Economist Practice, and evaluation against industry standards to assess whether the taxpayer has achieved a commercially realistic outcome; and
- risk assessment based on quality of processes and documentation and profitability level as per the chart at paragraph 4.27 of *Taxation Ruling TR 98/11*.²³³

1.237 Operational case teams are then to conduct a workshop and in certain circumstances, which are further described in Chapter 3, must include 'ATO technical leaders and relevant experts'. These 'experts' may include industry, tax technical, accounting, law, economic, broker, analytical, access, valuation and audit experts and may either be internal or external consultants. The operational case teams should utilise 'expert' lists where available.²³⁴ No further guidance is provided to operational case teams on the specialist units that are available to provide advice, guidance or support. However, other units, such as the LB&I TLG may provide advice on the interpretation of the legislation and participate in risk workshops and risk reviews.²³⁵ Identifying and engaging specialist units is further discussed in Chapter 2.

²³¹ ATO, 'Risk Assessment Guide', above n 175.

²³² ATO, 'TPRR Procedural Manual', above n 145.

²³³ *ibid.*

²³⁴ *ibid.*

²³⁵ ATO, 'Technical Leadership Group', above n 200.

1.238 The operational case team, in ‘conjunction’ with the Economist Practice, should come to an agreed position on the risk rating assigned to a taxpayer and the recommended follow-up strategy.²³⁶

1.239 The Transfer Pricing Risk Assessment Guide states that operational case teams are to set up a TPRP for ‘advice and guidance on the proposed documentation and commercial realism ratings prior to finalising the Preliminary Risk ratings’. The TPR Review Procedural Manual states that the recommendation should be ‘presented’ to the TPRP.²³⁷

1.240 The operational case team is responsible for preparing the TPRP minutes and the TPRP report which concludes with the ‘agreed’ risk rating. The TPRP report is to be emailed to the Internationals unit gatekeeper.²³⁸

1.241 For all cases, where a follow-up audit is proposed, the operational case teams must hold a finalisation interview, following the issuing of a draft finalisation letter, to discuss the risk findings and their implications. Relevant technical ‘experts’ may be involved in particularly ‘complex’ cases. No further guidance is provided. However, the LB&I TLG may be available to explain to taxpayers the technical decisions reached by the ATO.²³⁹

1.242 All finalisation letters ‘should’ be prepared in consultation with a PSP adviser. Following the finalisation letter, the decision as to the appropriate follow-up strategy ‘will be endorsed’ by the TPRP.²⁴⁰

Transfer pricing audits

1.243 The ATO’s audit process for transfer pricing issues is generally to follow the four-step process outlined in *Taxation Ruling TR 98/11*.²⁴¹ Further guidance is provided to operational case teams in the conduct of transfer pricing audits in the ATO’s Streamlined Audit Manual for Transfer Pricing. Operational case teams, with assistance from the PSP and Economist Practice, are to adapt the audit process and prepare a specific audit plan that meets the circumstances of the case. Any economist or PSP adviser allocated to the audit ‘should be consulted’ and will assist the operational case teams to prepare appropriate audit plans and information gathering strategies.²⁴² It should be noted that the approach to be taken in the auditing of a transfer pricing issue, including significant case management decisions related to the planning and conduct of the audit, must be referred to the TPRP for ‘advice and guidance’.²⁴³

²³⁶ ATO, ‘TPRR Procedural Manual’, above n 145.

²³⁷ ATO, ‘Risk Assessment Guide’, above n 175; ATO, ‘PS LA 2004/13’, above n 167.

²³⁸ ATO, ‘TPRR Procedural Manual’, above n 145.

²³⁹ *ibid*; ATO, ‘Technical Leadership Group’, above n 200.

²⁴⁰ ATO, ‘TPRR Procedural Manual’, above n 145.

²⁴¹ ATO, ‘Audit Manual’, above n 148, p 5.

²⁴² *ibid* pp 5, 8.

²⁴³ ATO, ‘PS LA 2004/13’, above n 167.

1.244 Once approval is granted to conduct a transfer pricing audit, there are a number of stages involved.

1.245 The first stage is pre-contact analysis. The pre-contact analysis involves two major tasks:

- conducting a detailed review of the taxpayer's documentation using a number of checklists; and
- obtaining publicly available taxpayer and industry data to assist in undertaking Step 1 of the four-step process in *Taxation Ruling TR 98/11*.

1.246 On the choice and implementation of methodology, if methods other than the Resale Price Method and TNMM are used, operational case teams are directed to obtain advice from their PSP adviser. In relation to evaluating the comparability analysis, it 'should be done in consultation' with the PSP adviser and economist, such as the economist reviewing the taxpayer's comparability search criteria and researching the comparables relied upon by the taxpayer.²⁴⁴ The PSP adviser and economist 'will be able' to supply much of the taxpayer's economic, industry and corporate information with the remainder to be collected as part of the audit plan. The PSP adviser will also assist operational case teams obtain relevant information from a number of sources.²⁴⁵

1.247 The next stage is the first step in the four-step process in *Taxation Ruling TR 98/11*. This first step is the functional analysis which requires accurately characterising the international dealings between the associated enterprises in the context of the taxpayer's business and defining the cross border dealings. This functional analysis generally requires completion of an analysis of the functions performed, assets contributed and risks assumed by the taxpayer.²⁴⁶ The economist and operational case teams prepare a preliminary functional analysis by reviewing:

- public literature on the company;
- the company's documentation; and
- the ATO's notes of interviews with company personnel.²⁴⁷

1.248 The economist and operational case team will then complete the functional analysis report.²⁴⁸

1.249 The second step is to select the most appropriate transfer pricing methodology or methodologies. This step requires documented reasons for the choice of particular methodologies and the rejection of others.²⁴⁹ No further guidance is

²⁴⁴ ATO, 'Audit Manual', above n 148, pp 11, 13-14.

²⁴⁵ *ibid* p 13.

²⁴⁶ *ibid* p 20.

²⁴⁷ *ibid* p 39.

²⁴⁸ *ibid*.

²⁴⁹ *ibid* p 20.

provided on the assistance that may be available to assist the operational case team at this stage.

1.250 The third step is to apply the most appropriate method and determine the arm's length outcome. In using statistical methods to establish arm's length ranges, the operational case team 'will be heavily reliant' on the advice provided by the Economist Practice.²⁵⁰ Operational case teams are also directed to the Economist Practice to help identify accounting differences that may necessitate adjustments to ensure comparability. The economist is to replicate the taxpayer's comparability search, their 'accept and reject' criteria and the integrity of the process.²⁵¹ If the difference in the arm's length outcome is material, operational case teams are directed to go to the TPRP with a submission and gain advice from TPRP to commence drafting of the ATO position paper. In this regard, the operational case team is to 'liaise with PSP advisers and the Economist Practice on inputs to the position paper' and prepare the position paper. Operational case teams must then gain approval from the TPRP to issue the position paper.²⁵²

1.251 The final step is the finalisation of the position paper. The decision to make a transfer pricing determination or apply a corresponding Treaty Article must be referred to the TPRP.²⁵³

1.252 The role of support units other than the Economist Practice and the PSP are not specifically mentioned in the Streamlined Audit Manual for Transfer Pricing. However, other specialist units such as the LB&I TLG may advise on the technical interpretation of a provision of the legislation, attend taxpayer meetings to explain the technical decisions reached by the ATO and review and provide input into audit position papers.²⁵⁴

Advance Pricing Arrangements

1.253 The ATO has advised that under the APA process outlined in *Practice Statement PSLA 2011/1*, three key officers are involved in APAs:

- APA case leaders who are responsible for managing all APAs and approving the terms of unilateral APAs and supported by case officers from the operational areas;²⁵⁵
- economists; and
- CARs who are responsible for negotiating the terms of a bilateral APA with the relevant treaty partner and approving its terms.²⁵⁶

²⁵⁰ *ibid* p 63.

²⁵¹ *ibid* p 70.

²⁵² *ibid* p 71; ATO, 'PS LA 2004/13', above n 167.

²⁵³ ATO, 'PS LA 2004/13', above n 167.

²⁵⁴ ATO, 'Technical Leadership Group', above n 200.

²⁵⁵ ATO, 'Communication (22 March 2013)', above n 166.

1.254 The ATO has advised that the current role of its CARs in terms of the five step bilateral APA process is as follows:

- During the pre-lodgment phase, taxpayers mostly communicate with the APA teams. Taxpayers are not able to engage with the TPRP or the CAR. The ATO considers that this may contribute to stakeholders' perceptions of the back-seat involvement of the CAR.
- During the analysis and evaluation phase, the ATO's Economist Practice leads work on quality assurance or determining taxpayers' functional analyses and identifying comparables. The Economist Practice will produce a report which is included in the ATO's position paper. Any disagreement or tiebreakers between the ATO and taxpayers are dealt with, at first instance, by the APA officer or APA case leader. The CAR normally has the final say.
- During the negotiation and agreement phase, the CAR will review the draft position paper prepared by the APA team.

1.255 Again, other specialist units that are available to provide advice are not specifically outlined.

Resourcing and scope of work

1.256 The ATO receives its funding for transfer pricing work through a combination of general budget allocations and specified government budgeted initiatives, such as the SCI.

General budget allocations

1.257 The total departmental expenditure, or general budget allocation, for the ATO for 2013–14 is \$14.1 billion.²⁵⁶ Internal allocation of departmental expenditure is not allocated to any specific tax risks, such as transfer pricing, as resourcing is generally allocated to different areas within the ATO on a business line or program basis. The budget allocated to transfer pricing work depends on how the varying areas within the ATO allocate their work loads. Therefore, allocations of resourcing within business lines may be quantified as the number of FTE staff allocated to particular matters.

1.258 It should be noted that LB&I operational case teams are not allocated to work on any particular tax risks exclusively. Rather, the business lines select a number of prioritised cases and risks based on the case teams available and the time they need to allocate to differing work. These resources are therefore generally quantified as FTE staff, and not as numbers of actual staff.

²⁵⁶ ATO, 'PS LA 2011/1', above n 148, ch 11.

²⁵⁷ The Treasury, *Portfolio Budget Statements 2013-14: Treasury Portfolio* (2013) p 181.

1.259 The ATO advises that it is unable to readily quantify the results for transfer pricing adjustments outside of the TPSCI Project. However, further details on ATO resourcing are provided in Chapter 2.

Strategic Compliance Initiative — Transfer Pricing

1.260 In May 2009, the Government provided funding of \$323 million to the ATO over four years for its SCI—with \$50.7 million allocated to transfer pricing risks under the specific TPSCI Project. This funding was extended in October 2012 (MYEFO 2012 Funding) with a further \$300 million,²⁵⁸ of which, \$133.6 million (over four years) being allocated by the ATO to address profit shifting risks more broadly.²⁵⁹

1.261 The objectives of the TPSCI Project were influencing the market and ‘levelling the playing field’ by improving the ATO’s transfer pricing capability and providing a return on investment to government.²⁶⁰ The focus of the TPSCI Project was ‘medium’ risk LB&I taxpayers with flow on effects to SME taxpayers.

1.262 The TPSCI Project teams focused on the following transfer pricing risks:

- business restructures (including the transfer of intangible property);
- services to the mining industry;
- related party financing (including intra-group loans and guarantee fees);
- economic/profit performance of companies and the impact of the GFC; and
- foreign bank (profit allocations).²⁶¹

1.263 The specific goal of the TPSCI Project was to collect \$210 million in additional taxes and penalties by having 100 officers conduct 210 risk reviews, starting 7 APAs and 20 audits and finalising 3 APAs and 11 audits in 4 years.

1.264 The ATO advised that the TPSCI Project’s compliance activities were conducted differently to the BAU case teams. In particular, a number of questionnaires, which focused on the project’s particular risk areas such as business restructures, were issued to taxpayers at the commencement of TPR Reviews to assist with the targeting of information gathering and to minimise potential compliance costs. For similar reasons, experienced ATO officers conducted internal workshops early in these TPR Reviews.²⁶²

1.265 The TPSCI Project teams were also able to draw on the same support as the BAU case teams.

²⁵⁸ The Treasury, *Mid-Year Economic and Fiscal Outlook: 2012-13* (2010) pp 10, 46, 181.

²⁵⁹ ATO, ‘Communication 1 (1 November 2013)’, above n 137.

²⁶⁰ ATO, ‘Tier 2 Project Plan: Transfer Pricing Strategic Compliance Initiative Project’ (June 2010) Internal ATO Document.

²⁶¹ *ibid.*

²⁶² ATO, ‘Communication 2 (17 April 2013)’, above n 104.

1.266 As at 31 March 2013, the ATO has advised that the project has spent \$19.5 million and collected \$123 million in tax and penalties. Two-hundred and eleven risk reviews, five APAs and four audits have been completed. Thirty-seven ATO officers were allocated to the project, although this number varied over the life of the project with up to a maximum of 60 officers at any one time.²⁶³

1.267 As at 30 June 2013, the ATO has advised that the project has collected \$134.1 million.²⁶⁴

1.268 Although funding for these objectives was extended in October 2012, the ATO's project-based approach to this type of case work was discontinued on 30 June 2013.

Changes made during the review

1.269 Following the commencement of this IGT review, the ATO has made a number of additional changes to its governance, management and resourcing including in areas dealing with transfer pricing. Although the ATO has maintained focus on profit shifting, some of the ATO's internal arrangements are in a state of flux, presenting a number of challenges for ATO management and underlying a number of stakeholder concerns.

1.270 The areas affected by the additional changes made by the ATO during the review are outlined below.

Changes to the risk management function

1.271 During the review, the ATO made changes to aspects of its risk management function in a number of areas.

Risk managers

1.272 In the LB&I business line, there is no longer a risk manager for transfer pricing. This function has been subsumed, along with other profit shifting risks, into one position—the Profit Shifting Risk Manager.²⁶⁵ Non-profit shifting international risks fall under the responsibility of a separate risk manager.

1.273 The Profit Shifting Risk Manager's responsibility is to coordinate the risk assessment and treatment plans for profit shifting risks with other risk managers in business lines, such as SME and Indirect Tax (ITX).²⁶⁶ Through this coordination, the ATO aims to ensure the business line risk plans are complementary when signed-off by their respective risk committees.

²⁶³ *ibid*; ATO, 'TP SCI Project Update: Governance Meeting' (17 April 2013) Internal ATO Document.

²⁶⁴ ATO, Communication (11 November 2013).

²⁶⁵ ATO, Communication (19 March 2013).

²⁶⁶ ATO, 'Communication (19 July 2013)', above n 146.

1.274 The ATO has advised that the Profit Shifting Risk Manager will be relocated from the PSP to the ISPS unit.

Risk typologies

1.275 The ATO has also started work to develop a form of risk identification compendium. This work involved examining 170 past cases to identify common attributes that could be used as early indicators of a heightened risk of profit shifting.

1.276 Such an approach to develop more mature risk identification methodologies was recommended by the IGT in his *Review into the ATO's use of Benchmarking to Target the Cash Economy*.²⁶⁷ This approach reduces the scope and time taken in those circumstances where the ATO would otherwise conduct wide ranging enquiries. It takes a staged approach to risk identification and compliance verification by using known characteristics that indicate non-compliance.

1.277 As a result of this work in reviewing previous profit shifting cases, the ATO has identified a number of risk 'typologies', or common characteristics, which can be used to focus information gathering activities in future compliance activities.

1.278 The ATO is also making more use of information obtained from natural systems, such as those obtained from information exchange with overseas revenue authorities and other ATO and government activities to more quickly identify emerging issues.

Case selection

1.279 During this review, the LB&I business line modified its risk assessment and case selection process to include 'workshops' to profile lower consequence taxpayers before risk recommendations are made.²⁶⁸

1.280 These workshops are intended to achieve greater involvement of LB&I Operations staff in the:

- development of risk filters;
- case selection process through reviewing risk recommendations to reduce false positive cases; and
- prioritisation of the lower consequence case pool.

1.281 It is also intended that the workshops increase the level of interaction and engagement between LB&I Operations staff and risk managers and increase the effectiveness of feedback loops.²⁶⁹

²⁶⁷ IGT, *Review into the ATO's use of Benchmarking to Target the Cash Economy* (2012) Recommendation 4.1.

²⁶⁸ ATO, 'Communication (24 October 2013)', above n 101; ATO, Communication 4 (1 November 2013).

²⁶⁹ ATO, 'Communication (24 October 2013)', above n 101.

New budget initiative

1.282 As part of the Government's May 2013 budget, the ATO was allocated an additional \$109.1 million over four years, to target restructuring activity that facilitates profit shifting opportunities. The Treasury estimates that this additional funding will allow the ATO to collect additional revenue of approximately \$576.5 million.²⁷⁰

1.283 With the above new funding and the portion of the MYEFO 2012 Funding mentioned earlier, the ATO intends to establish an additional group of 30 FTE staff to form a central team, the ISPS, to work with the LB&I Operations SES group to allocate cases as part of the case selection process and to supervise all cases involving profit shifting and international restructuring risks. However, it is unclear whether the ATO intends to limit this group to only those larger business cases dealt with by the LB&I BAU case teams.

1.284 The group is intended to be headed by a single senior ATO officer and draw on legal, accounting and litigation expertise to ensure that each case dealing with international tax risks has the right focus at the outset by developing case specific plans with the operational case teams.

1.285 The ATO has already recruited two private sector people with experience in international legal issues and transfer pricing. A senior ATO officer will also be recruited to project manage the group's work. The ATO intends to recruit approximately twenty technical specialists.

'Dedicated international' case teams

1.286 Within LB&I Operations, there are a number of operational case teams dealing with large business taxpayers which are not dealt with by the BAU case teams. The ATO advises that after the expiry of the TPSCI Project on 30 June 2013, some of these case teams are now 'dedicated international' case teams.²⁷¹ These teams will be 'available to undertake the international work' that will provide the commitments to Government required under the funding initiatives described previously.

Discontinuing the TPRP and TPR Reviews

1.287 During the finalisation of this review, the ATO has advised that it intends to disband the TPRP.²⁷² Following the LB&I Executive decision to move to the broader profit shifting strategy, an internal review was initiated by the Internationals unit that identified governance and work processes that were only conducted for transfer pricing risks, such as oversight mechanisms (TPRPs) and separate compliance products (TPR Reviews).

²⁷⁰ The Treasury, *Budget Paper No. 2: 2013-14* (2013) p 36.

²⁷¹ ATO, 'Communication (19 July 2013)', above n 146.

²⁷² ATO, 'Communication (24 October 2013)', above n 101.

1.288 Regarding TPR Reviews, the SME business lines will instead use the CRR product but incorporate the TPR Review procedures for review of transfer pricing risks.²⁷³ Similarly, the LB&I business line intends to use a single risk review product for all risks identified through the case selection and profiling process, including transfer pricing. However, at the time of writing, the LB&I business line had not yet determined or established specific review procedures for transfer pricing risks, such as those under the TPR Review product.²⁷⁴

1.289 Regarding the TPRP, the ATO further advised that its ISPS unit currently being implemented as part of its new profit shifting and compliance strategies is a recognition that an early engagement model with specialists may yield better outcomes than a review in later stages of a case, such as those conducted by the TPRP. The ISPS will be involved in the case selection process through participation in the profiling workshops and later case planning workshops.²⁷⁵

²⁷³ ATO, Communication 5 (1 November 2013).

²⁷⁴ ATO, Communication (5 November 2013); ATO, Communication (6 November 2013).

²⁷⁵ ATO, 'Communication (6 November 2013)', above n 274.

CHAPTER 2 — ATO'S STRATEGIC MANAGEMENT APPROACH TO TRANSFER PRICING ISSUES

STAKEHOLDER CONCERNS AND MANAGEMENT CHALLENGES

2.1 Two of the most strongly expressed and broadly held concerns raised by stakeholders related to the Australian Taxation Office's (ATO) strategic approach to identifying and dealing with transfer pricing issues. These concerns were:

- the lack of efficient and effective transfer pricing compliance management. In particular, ATO organisational arrangements, such as providing generalist case teams with decision-making authority on technical issues and ambiguous roles and responsibilities for the various units involved were considered to be major impediments; and
- the ATO selecting 'garden variety' transfer pricing cases for its compliance activities and not tackling the more complex cases that involve the greatest loss to the Government revenue or 'stateless income'.

2.2 These concerns underlie a number of ATO management challenges, which are discussed in the sections that follow.

ATO COMPLIANCE ACTIVITY EFFECTIVENESS AND CHANGE MANAGEMENT

2.3 As outlined in Chapter 1, a number of issues, such as the loss of key transfer pricing staff, have impacted the ATO's management of transfer pricing matters over time. As a result, in October 2010, the ATO made substantial changes to its strategic approach to international tax risks and related organisational arrangements. Of these changes, the most significant were:

- the expansion of the Transfer Pricing Practice's (now called the Profit Shifting Practice or PSP) focus to a broader range of international tax risks, such as non-resident withholding tax and thin capitalisation, and the interaction of these risks with other tax risks, such as capital gains tax and royalty income;
- the removal of the Internationals unit's conduct of certain matters, such as the Advance Pricing Arrangement (APA) program, so that increased focus can be given to risk and strategy issues; and
- a 'decentralised' organisational arrangement whereby generalist operational case teams conduct all compliance activities with advice from specialist units.

2.4 Since that time, the ATO has continued to make changes to respond to international developments in relation to base erosion and profit shifting (BEPS), such as through 'stateless income' and 'tax arbitrage' between different jurisdictions.

2.5 The developments include an Organisation for Economic Co-operation and Development (OECD) 15-point action plan aimed at fostering increased international collaboration and coordination of efforts to address BEPS as well as OECD work on transfer pricing issues involving intangibles. Australia will also play a role in the G20 to harness international cooperation on these issues.

2.6 The Government has provided key support to the ATO's profit shifting strategy by providing substantial funding and amending the existing domestic transfer pricing legislation.²⁷⁶ Other measures include the ATO review of foreign investment review board applications. There are other legislative measures also in train. For example, there is a proposal to repeal section 25-90 of the *Income Tax Assessment Act 1997* (ITAA 1997) and debt dumping via the thin capitalisation rules.

2.7 The ATO's response to these organisational changes, international developments and legislative measures require experienced officers to provide timely and cogent advice to Government as well as to oversee the effective and efficient conduct of risk identification and treatment strategies.

IGT observations

2.8 The initial observations below are directed at the narrow issue of the transfer pricing element within the ATO's new profit shifting strategy given the specific nature of this review. The IGT's broader observations from this review are set out later in this section.

2.9 Historically, the ATO had relied on a number of key ATO officers to provide swift and targeted advice on matters involving transfer pricing issues including the interrelationship with other tax issues. The experience and knowledge of these officers was developed over many years through their direct involvement in a variety of cases and industries with multiple transfer pricing and related tax risks.

2.10 The knowledge and experience of these key officers, however, were not broadly shared or disseminated within the ATO and the ATO's capability in this area was diminished upon their departure. Consequently, in 2010, the ATO found itself in a difficult position where:

- it was expected to respond to the increasing international focus on base erosion and profit shifting in an economic environment of declining sovereign revenues; but
- with reduced levels of experience and technical capability in transfer pricing and its interaction with other tax risks.

²⁷⁶ Replacement of Division 13 of the *Income Tax Assessment Act 1936* with Division 815 of the *Income Tax Assessment Act 1997*.

2.11 As a result, following the ATO's Internationals Review,²⁷⁷ key changes were made to increase the ATO's strategic focus on base erosion and profit shifting, including transfer pricing.

2.12 The team implementing the 2010 changes, however, inherited a challenge to 'corporatise' efficient and effective approaches and processes on a broader range of interrelated tax risks with comparatively reduced experience and technical capability. However, government funding was received in 2013 to increase the ATO's capability to better focus on BEPS risks.

2.13 Developing sufficient organisational capability to effectively and efficiently execute the intended scope of work takes time. Stakeholders have estimated that such capability, in transfer pricing alone, takes between five to ten years to develop as the work requires a mindset that investigates the potential alternative postulates from the perspective of an independent business owner rather than the mindset of a tax practitioner who is merely seeking to evidence whether the components of a statutory provision have been fulfilled. Additionally, this capability is difficult to develop as officers need to frequently undertake different types of transfer pricing work in a variety of industries. The ATO also faces losing such capable officers to the private sector who can offer greater remuneration.

2.14 Notwithstanding these challenges, the ATO may become increasingly efficient and effective in identifying and dealing with these risks over the longer term. Currently, however, stakeholders have highlighted extended timeframes and unwillingness of operational case teams to discuss technical issues on transfer pricing matters and pursuit of unnecessary issues that impose considerable compliance costs for both the ATO and taxpayers. These issues are discussed more fully in the following chapters. The general suggestion is that the ATO currently does not have sufficient specialist resources needed to undertake its current scope of transfer pricing work in an efficient and effective manner.

2.15 The ATO's Internationals Review also initiated a restructure of organisational arrangements that were aimed to better identify international tax risks and deal with an increased number and scope of matters. This restructure has presented a number of challenges and learnings for ATO management. In the new structure the PSP has been removed from conducting case work and also has a much broader range of technical issues to manage. The ATO has also internally reorganised the focus of two key business lines (the Large Business and International (LB&I) and Small and Medium Enterprises (SME) business lines), amongst others, from one of taxpayer turnover to one of taxpayer ownership. The operational teams conducting case work are generalists for all domestic and international tax issues. The ATO will need to exercise tremendous care and attention, as an inability to conduct compliance activities efficiently may compromise the ATO's broader profit shifting strategy.

2.16 By way of contrast, the United States Internal Revenue Service (IRS) recently faced similar problems with its focus and approach to dealing with transfer pricing.

²⁷⁷ ATO, 'International Review', above n 117.

Specifically, the IRS did not have a centralised focus, resulting in ad hoc consideration of transfer pricing and limited risk assessment. This caused some difficulty for the IRS in taking a strategic approach to transfer pricing matters and deciding which cases should be pursued. Due to the significant government revenue at risk and complexity of transfer pricing issues, the IRS restructured its Large Business and International Division in 2012. This restructure involved bringing together international generalists, economists and transfer pricing specialists under a single Deputy Commissioner for International Tax. The IRS considered that creating a national team of international generalists also makes it easier to deploy resources where they are most needed. This was more difficult when relevant personnel were part of regionally defined teams. Another key objective for the new structure was to improve capability. The IRS now seeks to take a more practical and collaborative approach to transfer pricing instead of solely focusing on the strict interpretation of the law.²⁷⁸

2.17 One key difference between the approach of the IRS and the ATO is that the IRS' operational and technical responsibilities for addressing transfer pricing issues are located in one area. The IRS case teams also have a greater degree of international specialisation than those of the ATO.

2.18 Whilst in the current environment, it may no longer be possible to have specialist transfer pricing case teams, the ATO should consider having more specialised case teams, such as those with a particular focus on international issues. Operational case teams with greater international focus will also act as an improved training ground for developing greater international tax capability, including transfer pricing. The current mix of domestic and international tax, i.e. all income tax issues, is too broad particularly when, for example, in a transfer pricing context they are frequently interacting with specialists representing the taxpayer. This imbalance not only causes frustration for taxpayers but also does not serve the best interest of the ATO and Government revenue.

2.19 There is also a need to balance the scope of work with the available resources whilst taking into account available capabilities. The recreation of taxpayers' transfer price is resource intensive, particularly if every transfer pricing risk was to be addressed in this way. The situation is exacerbated when there is a capability deficit. A later section in this chapter will further discuss the issue of case selection and resource allocation.

²⁷⁸ OECD, *Dealing Effectively with the Challenges of Transfer Pricing* (OECD Publishing, 2012) p 61; IGT, Communication with the US IRS (5-6 November 2012).

RECOMMENDATION 2.1

The IGT recommends that the ATO:

- (1) develop case teams that have a particular focus on international tax including transfer pricing issues; and*
- (2) match the scope and scale of compliance activities of transfer pricing risks to the available resources and capability of its generalist and specialist officers to conduct such work efficiently and effectively.*

ATO response

Agree

MAINTAINING SEPARATE RISK AND OPERATIONAL FUNCTIONS

2.20 The separation between the risk function and operational compliance (or 'case work') function is a common feature of many revenue authorities as it allows them to identify the highest priority risks.²⁷⁹ Such a separation involves systematic and strategic management of risk at a national and organisational level, rather than a taxpayer-by-taxpayer basis or auditor discretion basis.²⁸⁰ The IGT has discussed this separation of functions in relation to the ATO's corporate approach in the IGT's *Review into Aspects of the ATO's use of Compliance Risk Assessment Tools*.²⁸¹

Identification and treatment of risk — strategic level

2.21 As explained in Chapter 1, the International Steering Committee (ISC) governs ATO work on transfer pricing and other international tax risks at the enterprise level.²⁸² The ISC is supported by the Profit Shifting Working Group (PSWG), whose role, amongst others, is to evaluate the effectiveness of the ATO's work in managing and addressing these risks.²⁸³ The PSWG is informed by senior ATO officers from the PSP and operational compliance areas of the LB&I and SME business lines, amongst others. It should also be recalled that the ISC is currently reviewing the PSWG. Each business line also has its own risk groups which are considered strategic. These are LB&I's International Risk Strategy and Intelligence Unit (IRSI) (within the 'Internationals unit') and SME's International Strategic Unit (ISU).

²⁷⁹ For example, New Zealand's IRD Compliance Risk Analysts, HMRC's Risk and Intelligence Service, and the ATO's separation in functional focus.

²⁸⁰ Munawer Sultan Khwaja, Rajul Awasthi and Jan Loeprick, World Bank, *Risk Based Tax Audits: Approaches and Country Experiences* (2011) pp 15-16.

²⁸¹ IGT, *Review into Aspects of the ATO's use of Compliance Risk Assessment Tools* (transmitted to the Minister on 21 October 2013).

²⁸² ATO, 'ISC Charter', above n 126.

²⁸³ *ibid.*

2.22 From the documentation maintained by the ATO, it is not clear how these units interact with the ISC and PSWG. The ISC charter only mentions that the PSWG 'work actively' with LB&I's Risk Management Committee (RMC) and Case Selection Sub-Committee (CSSC). It does not mention any SME risk unit, nor does it mention the IRSI. A diagram in the ISC charter, however, does indicate some form of relationship between the PSWG and LB&I Internationals. The nature of this relationship, however, is not described in any detail. The ATO has advised, however, that membership of the ISC includes representatives from the SME business line, which allows input into the management of transfer pricing risk at a business line level.²⁸⁴

2.23 The responsibilities of risk managers do not include overall responsibility for the management of tax risks, such as profit shifting, at the enterprise or operational level as discussed in Chapter 1.²⁸⁵

2.24 Generally, the IRSI and ISU have a role of assessing risks and developing 'treatment plans' to test the risk hypotheses, consistent with the broader ATO approach, but also within the scope of the business line's work. These treatment plans are expected to be endorsed by the relevant business line executive and reviewed annually.

2.25 Risk treatment plans can include conducting compliance activities, amongst others. In respect of such compliance activities, taxpayers are selected as a result of the application of risk filters developed by the risk manager and the business lines' case selection processes.

2.26 Therefore, while the 'strategic risk' is managed by the ISC and PSWG, the risk posed by particular taxpayer arrangements is 'treated' by the risk manager and LB&I Operations case teams. Broadly, similar arrangements for case selection are in place in the SME business line.

2.27 Implicit in developing a treatment plan is the design of a compliance strategy that is achievable with the available operational resources. In this respect, as described in Chapter 1, the LB&I Operations SES Group is responsible for the allocation of LB&I Operations resources to cases and ultimately decides on how many cases will be conducted.

2.28 However, as the business lines are responsible for delivering ATO outcomes, they control their own budgets and allocate their resources according to their own views when faced with competing priorities, such as other tax risks. The result is that a strategic risk management group such as the ISC or PSWG may have difficulty allocating resources to what they consider to be higher risks as they do not control any resources. Although, there is an expectation that the PSWG would 'work actively with the LB&I Risk and Intelligence Committee (RIC) and the LB&I CSSC to ensure risks are properly managed and resourced within the Enterprise Risk Management Framework', it is unclear how these expectations are fulfilled.

²⁸⁴ ATO, 'Communication (24 October 2013)', above n 101.

²⁸⁵ ATO, 'PS CM 2003/02', above n 134.

Identification and treatment of risk — operational level

2.29 The ATO applies risk filters to income tax return and International Dealings Schedule (IDS) data to detect potential compliance risks and their likelihood. The process to design risk filters, involves the risk manager developing a risk hypothesis and determining how the risk will manifest itself in tax returns and associated schedules.²⁸⁶ In the LB&I business line, the risk manager then engages the Risk, Intelligence and Support System (RISS) unit to develop the risk filters. Once the risk filters are developed, the ATO plans to review their effectiveness twice a year by running them against cases with known risks.²⁸⁷ In relation to the risk filters based on IDS data, the ATO has advised that the LB&I risk manager works in collaboration with the SME risk manager in designing the risk filters.²⁸⁸

2.30 During the finalisation of this review, the ATO has advised the IGT that transfer pricing risk filters based on IDS data have now been developed and run over LB&I and SME taxpayers who had lodged their tax return and IDS at the time. The 'risk filter output' for LB&I²⁸⁹ has been analysed by the risk manager to determine 'compliance risks' that should be followed up by operational case teams. Where a 'compliance risk' is determined following a profiling process, it is called a 'risk recommendation'.²⁹⁰

2.31 Although the risk manager is responsible for designing the risk identification and treatment plans, the operational areas are responsible for the conduct of compliance activities in executing the treatment plans as described in Chapter 1. This separation of responsibility presents a management challenge in ensuring that the operational descriptions of risks are effective in detecting non-compliant taxpayers. This challenge includes the need to ensure that:

- there is adequate and timely feedback from operational case teams on the results of cases to effectively refine risk descriptions—for example, if the risk manager is using a certain risk description to recommend cases for review and those risks are ultimately found not to exist, then the description of the risk should be modified to reduce future 'false positives'²⁹¹ and which result in unnecessary administrative and compliance costs;
- there is adequate and timely information from operational case teams on the evolution of risks emerging from new commercial arrangements—for example, although the risk manager is expected to undertake research to better understand how a risk manifests itself in tax returns or otherwise in the

²⁸⁶ ATO, 'LB&I Risk Filter Development - Guide for Risk Managers' (December 2012) Internal ATO Document.

²⁸⁷ ATO, Communication (25 March 2013).

²⁸⁸ ATO, 'Communication (31 October 2013)', above n 139.

²⁸⁹ Due to the changes in the ATO business lines from LB&I and SME to PG&I and PG&H respectively, former SME taxpayers now within PG&I will be reviewed in 2014: ATO, 'Communication 1 (1 November 2013)', above n 137.

²⁹⁰ ATO, Communication 2 (14 March 2013); ATO, Communication 2 (24 October 2013); ATO, 'Communication 1 (1 November 2013)', above n 137.

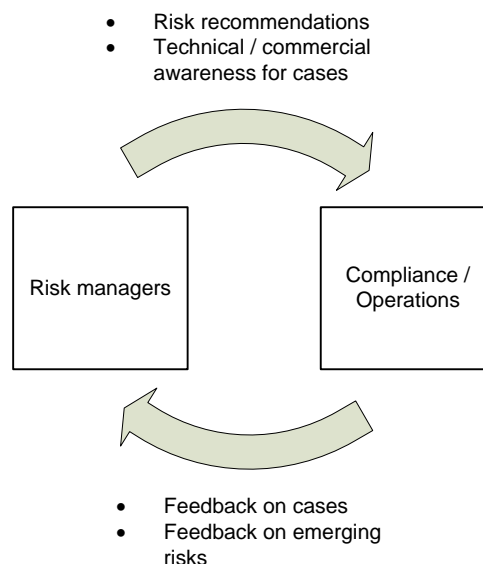
²⁹¹ 'False positive' describes compliance activities that do not result in outcomes. The taxpayer is actually compliant, but the risk method inaccurately detected the taxpayer as being non-compliant.

marketplace, most of the current data is gathered by operational case teams through their regular contact with taxpayers and conduct of commercial research in the course of compliance activities and other matters; and

- the risk manager is sufficiently resourced to support case teams to identify risks—since the risk manager is expected to consult specialists in their risk area and understand how risks manifest themselves in taxpayer circumstances, they are expected to support operational case teams to understand the targeted risk hypothesis underlying a taxpayer's selection for review and audit so that the case teams may undertake targeted enquiries at first instance.

2.32 A visual representation of these interactions between risk managers and operational case teams is provided below in Figure 7.

Figure 7: Interactions between risk managers and operational case teams



Source: IGT.

2.33 The ATO has advised that there are feedback loops from operational case teams to risk managers on the risks that have been identified and the cases nominated for review by the latter.²⁹² However, some senior ATO officers acknowledge that these feedback loops do not work as effectively as intended.²⁹³

2.34 As mentioned in Chapter 1, during the review, the ATO further advised that the International Structuring and Profit Shifting (ISPS) unit to be formed will straddle its risk function and operations function.²⁹⁴ This approach is more consistent with the ATO's broader 'early engagement' of technical specialists approach. Its involvement is intended to provide more refined risk hypotheses leading to more focussed audits

²⁹² ATO, 'Communication (19 March 2013)', above n 265; ATO, 'Communication 2 (17 April 2013)', above n 104.

²⁹³ ATO, 'Communication 2 (17 April 2013)', above n 104.

²⁹⁴ ATO, 'Communication (19 July 2013)', above n 146.

which also consider strategies to obtain information from overseas counterparts. The ATO also intends that this group will perform a role in conducting ongoing callovers and, through a dedicated resource, disseminate the information or 'learnings' obtained more broadly within the ATO to increase organisational knowledge and capability. However, it is unclear what involvement this group will have in profit shifting and international restructuring risk, including transfer pricing, identification and case selection.

IGT observations

2.35 The separation between risk and operational functions highlights the ATO's challenge in maintaining accurate risk identification and effective treatment plans as the information obtained by one function influences the performance of the other.

Ensuring coherence of activities

2.36 As the business lines control their own budgets and allocate their resources according to their own treatment plan priorities, the ISC or PSWG may have difficulty allocating resources to what they consider to be higher risks, since these groups themselves do not, although some of the individual members may, control any resources. This is compounded where generalist case teams deal with the largest taxpayers with considerable influence on what may be reviewed.

2.37 The separation between risk and operational functions, therefore, raises the possibility that:

- the focus may not be on the highest risks;
- inappropriate compliance activity design may be employed, such as using standard business line compliance products rather than tailoring activities to the peculiarities of transfer pricing work; and
- inappropriate treatment strategies may be employed, such as unnecessarily conducting compliance activities and litigation rather than providing greater certainty and guidance.

2.38 The separation of strategic and operational functions is not unique to the ATO. Other revenue authorities, such as the IRS adopts a similar separation. Indeed, the IRS recognised its limited ability to link strategic risk assessment with case work. To address the issue, the IRS implemented a functional restructure which was driven from an external perspective.²⁹⁵

2.39 The IGT considers that a clear line of sight is needed from organisational strategy through to operational measures. This implies a seamless reconciliation between various activities of the various areas.

²⁹⁵ Fyusion, ATO, 'Review of Internationals: Draft Report' (21 May 2012) Internal ATO Document, p 15.

2.40 However, it is not clear how different risk assessments between ATO-wide and business line based groups are reconciled. Whilst the PSWG is expected to 'work actively' with business line groups such as the LB&I business line's RIC and CSSC, no further information is provided in the ISC charter on how this interaction should occur. Furthermore, the general case selection process, which outlines key roles for CSSC and LB&I Operations, does not mention the PSWG or the Profit Shifting Governance Group (PSGG).

2.41 It is also unclear how business line based strategic risk groups, such as the IRSI, RIC and ISU, interact with ATO-wide forums and the business line operational risk forums. The ISC charter only mentions that the PSWG is to work actively with the LB&I business line's RIC and CSSC. It does not mention any SME business line risk unit, nor does it mention the IRSI. A diagram in the ISC charter, however, does indicate a relationship between the PSWG and the Internationals unit. The nature of this relationship, however, is not described in any detail.

2.42 The SME²⁹⁶ and Indirect Tax business (ITX) lines maintain their own risk managers for profit shifting related tax risks, such as transfer pricing. The LB&I Profit Shifting Risk Manager has corporate responsibility for profit shifting risk and the various manifestations. The other business line risk managers ensure that transfer pricing risks are managed appropriately given the particular nuances arising in their respective business lines.²⁹⁷ There is an expectation that the risk managers would liaise closely with the business line's risk committees so that the business lines' risk assessments are coordinated.

2.43 Notwithstanding the above business line arrangements, it is unclear how these processes interact with the work of the LB&I Profit Shifting Risk Manager. For example in the SME business line, senior case leaders are involved in the selection and conduct of transfer pricing cases for review in that business line.²⁹⁸ It is unclear how the ATO ensures that the risk treatment plans are coordinated and the role that the Profit Shifting Risk Manager should play in this regard.

2.44 The ATO's arrangements for the management of transfer pricing risks are complex and difficult to reconcile. There are general statements about the intended focus of different risk committees and their interaction with each other and operational committees. However these are broad statements that do not paint a clear picture.

2.45 The ATO has previously recognised that there are duplicated functions and complex interactions between the various committees. These issues pose a more critical 'risk that commitments will not be delivered or managed because of assumed accountability elsewhere'.²⁹⁹ As part of an ATO commissioned report prepared by Fyusion (Fyusion Report), a survey conducted as part of the report also found that ATO officers tended to be 'undecided' on the effectiveness of risk management in

²⁹⁶ ATO, 'S&ME Risk Rule Development and Case Selection: Part of S&ME's Risk Management Process' (4 June 2012) Internal ATO Document.

²⁹⁷ ATO, 'Communication (19 July 2013)', above n 146.

²⁹⁸ ATO, 'Communication (24 October 2013)', above n 101.

²⁹⁹ ATO, 'LBI Executive Draft Minutes: LBI Management Committee' (25 March 2011) Internal ATO Document.

relation to certain risks and many disagreed or were undecided that there was clear and enforced accountability.³⁰⁰

2.46 The key responsibilities, however, appear to be that of the risk managers, who are to identify risks, develop mitigation strategies and monitor their effectiveness, and the PSGG, who are to identify emerging risks and the patterns that arise from the outcomes of transfer pricing reviews. However, these responsibilities do not appear to be strongly linked to the risk committees and it is unclear whether the PSGG will have a role in the future.

RECOMMENDATION 2.2

The IGT recommends that the ATO rationalise the current complex management and committee structures which deal with transfer pricing risks and operations:

- (1) ensuring that the various ATO transfer pricing risk identification and treatment activities form a coherent strategy with a clear line of sight from organisational strategy through to operational activities; and*
- (2) reconciling the responsibility of all risk committees dealing with transfer pricing issues and clearly explain their relationship with each other.*

ATO response

Agree

Operational risk identification and treatment

2.47 Risk assessment in the ATO is about managing operational tax risks whilst case selection focuses on identifying taxpayers that have engaged in particular behaviour. Both processes, however, also influence the allocation of resources.

2.48 Effective compliance treatment strategies require strong feedback loops at the operational level to inform the broader risk strategy. As the ATO developed transfer pricing risk filters based on IDS data towards the end of the review, it is not possible to comment on the effectiveness of the risk filters. However, the ATO has signalled that it will review their effectiveness twice a year.

2.49 The role of the risk managers responsible for transfer pricing inherently requires an officer with:

- exceptional leadership ability to drive the entire risk assessment, case selection and feedback process;

³⁰⁰ Fyusion, above n 294, pp 19, 27.

- strong project and risk management knowledge and experience to efficiently and effectively drive the abovementioned process, including drawing on relevant expertise when necessary; and
- sufficient knowledge and experience with respect to transfer pricing and related tax risks to credibly lead the abovementioned processes.³⁰¹

2.50 Accordingly, there is a substantial risk to the ATO's risk assessment and case selection processes if its risk managers do not have such abilities and experience. The Fyusion Report made similar observations that risk leaders should be suitably skilled to manage risks.³⁰²

2.51 The IGT is also of the opinion that using the ATO's transfer pricing specialists upfront to select cases and issues for compliance activities will also improve the targeting of appropriate taxpayers and issues for compliance activities and reduce unnecessary compliance costs on compliant taxpayers. Whilst this may have upfront resource impacts for the ATO, more effective case selection will minimise later unnecessary administrative costs and should result in overall cost savings. Indeed, the ATO was implementing the ISPS unit at the time of writing.

2.52 The ATO also acknowledges that case selection has flow-on effects and is, therefore, a critical area for improvement. The ATO has recognised during the course of this review that operational case teams and risk managers needed to work together more collaboratively to improve risk data analyses and case selection.³⁰³

2.53 The IGT is of the view that when recommending cases and issues for compliance activities, risk managers should support operational case teams to understand the underlying risk hypotheses and assist in case planning to resolve those risks. Correspondingly, operational case teams should assist risk managers to refine their risk filters, based on their experiences in compliance activities. Accordingly, the ATO should ensure that this two-way communication between the operational case teams and risk areas operates seamlessly. The Fyusion Report has similarly touched upon the need for greater staff focus on developing risk strategies and improved collaboration within the ATO and broader taxpayer community.³⁰⁴

RECOMMENDATION 2.3

(1) The IGT recommends that the ATO ensure that:

(a) the effectiveness of transfer pricing risk filters are reviewed twice a year as intended;

³⁰¹ ATO, 'Communication 2 (17 April 2013)', above n 104; ATO, 'Communication (19 March 2013)', above n 265; ATO, 'Communication 2 (24 October 2013)', above n 289.

³⁰² Fyusion, above n 294, p 18.

³⁰³ ATO, 'Communication 2 (17 April 2013)', above n 104.

³⁰⁴ Fyusion, above n 294, pp 24-25, 36.

RECOMMENDATION 2.3 (CONTINUED)

- (b) its risk managers responsible for transfer pricing have the necessary attributes required for the efficient and effective functioning of transfer pricing risk assessment, case selection and feedback process; and*
 - (c) transfer pricing 'specialists' are involved in selecting cases for transfer pricing reviews and audits.*
- (2) The IGT recommends that the ATO improve the interaction between the risk and operations functions by requiring:*
- (a) risk managers to assist operational case teams to:*
 - i. understand the underlying risk hypotheses when recommending cases for compliance activities;*
 - ii. develop case planning to resolve those risks; and*
 - (b) operational case teams assist risk managers to refine their risk filters and the associated risk hypotheses, based on their experiences in compliance activities.*

ATO response

Agree

During the course of the Inspector-General's review, the ATO embarked upon an internal re-organisation and refresh of our working arrangements to ensure there is appropriate specialist input into the case selection process and that compliance teams and risk managers have stronger and more direct links at case selection and during casework.

Strategic risk identification and treatment

2.54 The multi-jurisdictional nature of the activities of Multi-National Enterprises (MNE) means that the associated tax risks may not be initially apparent or limited to Australia. Rather, many jurisdictions may be involved. This implies a need for strong and cooperative relationships with the revenue authorities of Australia's major trading partners. Such international cooperation has also been advocated by the OECD particularly with respect to BEPS.

2.55 Given the diversity and complexity of the activities of MNEs, there is also a need to continually monitor the economic environment, industry and individual businesses to identify emerging trends and associated tax risks.

2.56 Whilst compliance activities may provide the most comprehensive information to the ATO for identifying emerging trends and associated tax risks, those activities impose substantial costs for both the ATO and taxpayers and may take many

years to resolve. Long timeframes can also cause perceptions of 'U-turns' as discussed in the IGT's so-called 'U-turn' review.³⁰⁵ The limited ATO resources and capabilities should be applied to instances which pose the highest risk to Government revenue and where the ATO has the strongest grounds for challenging the taxpayer's position. Therefore, great care is required in choosing which cases to pursue. Indeed the Fyusion Report, it was asserted by an interviewee that '[the Internationals unit officers] are spread too thinly, too much work and not necessarily the most important work'.³⁰⁶

2.57 To address the issue above, the IGT considers there is considerable benefit in enhancing the ATO's transfer pricing risk identification process rather than simply 'redoubling effort'.³⁰⁷ By identifying strategic risks, the ATO would be able to conduct targeted projects on the identifiable characteristics of known risks, or 'risk typologies'. Focussing on these typologies may also make it easier for the ATO to agree with taxpayers on the relevant evidence that should be provided and therefore increase efficiencies.

2.58 By using risk typologies the ATO may also better select the scope and scale of its compliance activities based on the resources and capabilities it has available, both at an operational and specialist levels. This will reduce resources allocated to broad reviews and audits for comparatively lower risk cases.

2.59 Therefore, as an immediate measure, the IGT considers that a compliance approach which has a stronger focus on risk typologies may provide the ATO with a more efficient approach to delivering better results expeditiously whilst further developing its transfer pricing capability.

2.60 The IGT is of the view that broad risk reviews are not the best source of identifying emerging risks and should be limited to identifying unknown risks in cases potentially involving the most significant risk to revenue.³⁰⁸ Furthermore, audits should be reserved for verifying identified risks or areas of considerable uncertainty and not the detection of emerging risks.

2.61 There may be exceptions to the above general principle. For example, transfer pricing specialists could be part of operational case teams for a sample of higher consequence taxpayers. Since higher consequence taxpayers are already subject to continuous real time review (such as Pre-lodgment Compliance Reviews (PCR)) and risk reviews are expected to be comprehensive in nature, this would provide a valuable opportunity for transfer pricing specialists to understand the current trends in transfer pricing arrangements and identify emerging risks and their characteristics or typologies. This intelligence, combined with data generated via the IDS, would serve to enhance the ATO's transfer pricing risk identification process.

³⁰⁵ IGT, *Review into Delayed or Changed Australian Taxation Office Views on Significant Issues* (2010) p 11.

³⁰⁶ Fyusion, above n 294, p 28.

³⁰⁷ ATO, 'LBI Executive Minutes' (31 January 2013) Internal ATO Document, p 5.

³⁰⁸ Further discussed in Chapter 3.

2.62 Once emerging risks are identified, there is also a need to develop an appropriate treatment plan. Again, there is danger on placing over-reliance on compliance activities to treat transfer pricing risks. Due to the evidentiary nature of transfer pricing matters, considerable time and resources can be expended in pursuing ultimately fruitless positions. However, compliance activities linked with improved guidance on emerging areas have shown to generate improved longer term compliance. For example, in the ATO's Transfer Pricing Record Review and Improvement project, ATO views were developed and published in public binding advice and a compliance program was rolled out soon after. This compliance program provided graduated ATO administrative responses according to clear objective measures of the ATO's view of compliance. As a result of this project, the amount of tax paid by affected companies increased by 32 per cent, even though the income for these companies fell by 5 per cent.³⁰⁹

2.63 It could be argued that requiring the ATO to issue appropriate guidance on any emerging concerns before it could commence related compliance activities may unduly place the revenue at risk. The IGT considers that, it is generally better for the ATO to notify taxpayers publicly of its concerns and provide incentives for voluntary disclosure. Such public notification can be effected through a number of means, for example, issuing a Taxpayer Alert or offering remission of penalties. It is also appreciated that in limited situations this may not be appropriate – for example, where a particular risk is significant from a revenue perspective and the period for amendment for a taxpayer may be about to close.

2.64 It should be noted that the ATO aims to deliver an appropriate risk treatment plan to ensure the targeting of resources is proportionate to the level of risk and to update this plan on an annual basis. The ATO has not updated its annual treatment plan for transfer pricing since 2011.

RECOMMENDATION 2.4

The IGT recommends the ATO:

- (1) give priority to project-based compliance activity that targets cases which pose the highest risk to Government revenue and where it has the strongest grounds for challenging the taxpayer's position;*
- (2) limit broad-based and resource intensive risk reviews for identifying new transfer pricing trends and hitherto unknown risks to cases potentially involving the most significant risk to revenue with the exception of a sample of risk reviews of taxpayers where transfer pricing specialists may be used to identify emerging risks and their identifiable typologies; and*

³⁰⁹ Braithwaite, above n 99, pp 90-92.

RECOMMENDATION 2.4 (CONTINUED)

(3) update its risk treatment plan for the new profit shifting strategy including a commitment to publish guidance regarding emerging risks.

ATO response

Agree

ALIGN DECISION-MAKING AUTHORITY WITH AREA OF SPECIALISATION OR EXPERTISE

2.65 As stated earlier, the ATO's model for conducting transfer pricing compliance activities relies on generalist operational case teams having the authority to apply the ATO view to particular taxpayers and obtaining advice from the relevant specialist units at the right time. Obtaining this advice is aimed at ensuring that the right technical views are applied to the relevant facts and are supported by the necessary evidence.

2.66 The separation of generalist operational functions and specialists' functions, therefore, presents a key challenge for the ATO to ensure that compliance activities are efficiently and effectively carried out.

2.67 In this respect, stakeholders observe that different ATO units find it difficult to reach consensus and coordinate their resources, which impedes the efficient progress of transfer pricing matters. Stakeholders attribute these difficulties to unclear responsibilities and decision-making authorities of the many units involved in transfer pricing compliance activities.

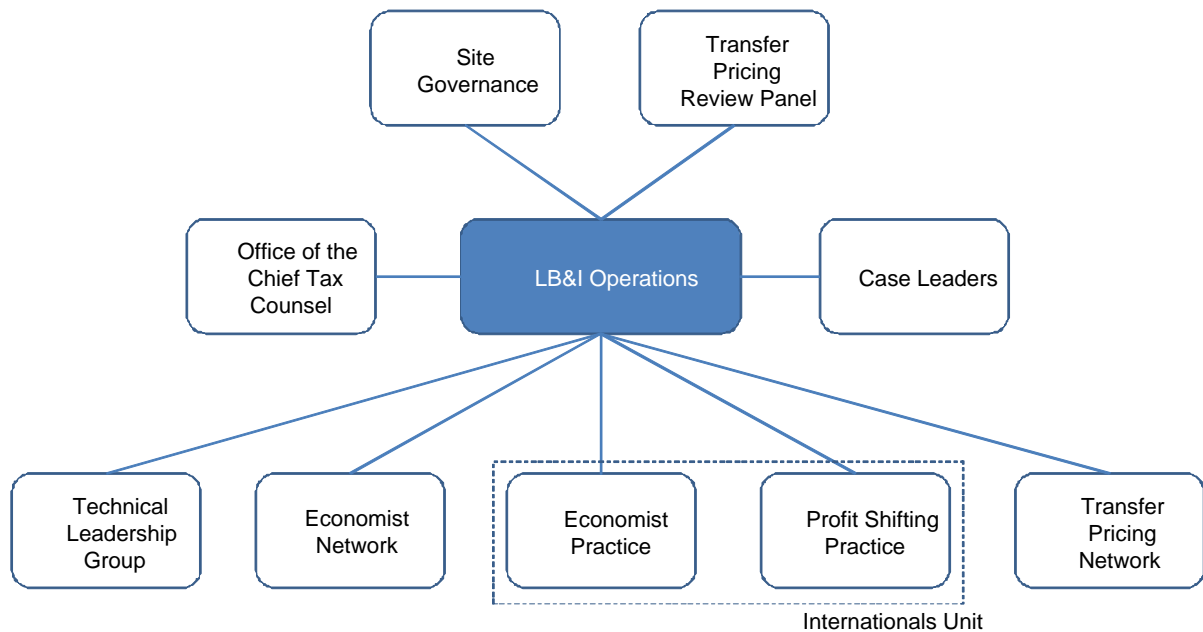
2.68 Indeed, the ATO is aware that delays are caused due to the limited number of decision makers who are also specialists and the lack of clarity of roles, responsibilities, personal incentive and accountability.³¹⁰ In particular, there is 'a perception of diffused responsibility', a need to clarify 'who has authority... to make decisions' and a need for 'clear and measureable Key Performance Indicators (KPI)'.³¹¹

2.69 As outlined previously, the figure below sets out the various units that may assist the LB&I operational case teams with transfer pricing issues.

³¹⁰ ATO, 'LBI Executive Agenda: Agenda Item 2 – Case Callover Report' (21 March 2012) Internal ATO Document; ATO, 'LBI Executive Draft Minutes' (13 December 2012) Internal ATO Document; ATO, 'LBI Executive Minutes: Health of the Performance Management System in LBI' (24 May 2012) Internal ATO Document.

³¹¹ Fyusion, above n 294, pp 13, 28-30, 35.

Figure 5: LB&I operations case teams and specialist areas on international tax



Source: IGT.

2.70 The ATO describes the interaction between the relevant specialist units and operational case teams using a number of different terms. For example, the role of the:

- Economist Practice includes ‘advice’, ‘support’ and ‘assistance’;³¹²
- TPRP includes ‘advice’ and ‘guidance’;³¹³
- Transfer Pricing Network (TPN) includes ‘supervision’, ‘direction’, ‘support’, ‘guidance’ and ‘mentoring’;³¹⁴
- LBI Technical Leadership Group (TLG) includes ‘advice’, ‘guidance’, ‘support’ and ‘work closely’;³¹⁵ and
- PSP includes ‘support’, ‘advice’ and ‘assistance’.³¹⁶

2.71 The IGT will refer to these terms collectively as ‘advice’. Further description of the key roles and functions of the various team and specialist units was described earlier in Chapter 1.

³¹² ATO, ‘PS LA 2013/2’, above n 189.

³¹³ ATO, ‘PS LA 2004/13’, above n 167.

³¹⁴ ATO, ‘TPN Charter’, above n 168.

³¹⁵ ATO, ‘Technical Leadership Group’, above n 200.

³¹⁶ ATO, ‘JIP – About us’, above n 161.

IGT observations

2.72 Maintaining professional independence is of fundamental importance to the function of the special unit. Although operational case teams are charged with the responsibility for decision making, where the capability of these case teams is such that they rely more heavily on specialist units for guidance, a de-facto loss of ownership and leadership of the case may occur.³¹⁷ This outcome is likely to be exacerbated in circumstances where there are difficulties in reaching 'consensus' between units with competing views. Such an outcome invariably leads to protracted decision making, case timeframes and unproductive internal escalations.

2.73 For generalist and specialist units to work together effectively, each must clearly understand their roles and responsibilities, i.e., what they are expected to do, how they are expected to do it and what will enable them to perform their role, as well be accountable for their performance.

2.74 The IGT is of the view that roles, responsibilities and accountabilities are clearer where a number of factors are explicitly identified in terms of engagement for the units. These factors include:

- the scope of role;
- the decision maker for the role;
- the scope of authority is delimited by function or expertise;
- whether a decision is mandatory or advisory in nature — for example, who can direct whom to do what;
- measureable KPIs; and
- what the consequences are if that decision and subsequent escalation processes are not followed.

2.75 To complete transfer pricing compliance activities, there are a number of different functions required, including:

- the interpretation of economic evidence;
- 'commercial acumen', or the ability to stand in the shoes of an independent business owner to determine an arm's length price in light of all of the economic and business factors;
- creating and maintaining productive relationships with the taxpayer and their adviser; and
- supervision of the resolution of technical issues and case management decisions.

³¹⁷ ATO, 'LB&I AC Case Callover Summary: Transfer Pricing November 2012 - C&TL Call-Over' (7 December 2012) Internal ATO Document.

2.76 For example, the role of the LB&I operational case teams are considered by the ATO as 'specialists' in dealing with particular taxpayers in compliance activities. Therefore, the scope of this role appears to be delimited to questions of how to deal with particular taxpayers, such as the conduct of compliance activities. Economists from the Economist Practice are considered 'specialists' for identifying the best evidence to determine an arm's length price as well as the economic interpretation of that evidence.

2.77 The IGT considers that using terms of engagement, such as those set out by the Economist Practice in *Practice Statement PSLA 2013/2*, is a useful means to ensure the roles, responsibilities and accountabilities are clearly understood.

2.78 It should be noted that in fulfilling their role, the specialist units require all information needed to provide independent and accurate advice. The gathering of this information is within the function of the operational case teams. Accordingly, there is a need to ensure that operational case teams gather all necessary information and provide it to the specialist units in a timely manner. However, to provide accurate and sustainable advice, specialists should consider both taxpayers' and operational case teams' positions and evidence.

RECOMMENDATION 2.5

The IGT recommends that for transfer pricing matters, the ATO ensure that:

- (1) for each ATO specialist unit or operational case team, terms of engagement be developed and those terms:*
 - (a) explicitly identify its function, the decision maker for that function, what decision may be made and the consequences if that decision and subsequent escalation processes are not followed;*
 - (b) require operational case teams to gather all information necessary for the specialist unit to provide accurate and independent advice in a timely manner;*
 - (c) ensure the specialist unit considers both taxpayers' and operational case teams' positions and evidence before the ATO position is finalised;*
 - (d) set out measureable Key Performance Indicators; and*
- (2) a clearly designated senior management decision maker be vested with the authority to resolve any internal disagreements that may arise with or between the teams or units.*

ATO response

Agree

Operational case team and economist unit interaction

2.79 Stakeholder comments regarding the Economist Practice unit were generally positive. A number of examples were provided in submissions describing the efficient resolution of transfer pricing matters where experienced economists engaged with taxpayers and their advisers.

2.80 In this respect, stakeholders considered that experienced economists could provide broader economic input in terms of the structure and context of transactions and industry analysis, rather than a narrow role in determining the appropriate transfer price.

2.81 However, stakeholders raised concerns with inexperienced economists and questioned whether they had adequately considered information provided by taxpayers to the case teams and whether their subsequent advice had considered that information.

ATO materials and information

2.82 The Economist Practice provides economist advice through a 'service provider model' to 'support' international and non-international compliance work across the ATO.³¹⁸ During the review, the ATO published *Practice Statement PSLA 2013/2* which states that Economist Practice provides 'operational advice on cases including active compliance, [advice] and litigation, particularly in relation to multinational taxpayers'.³¹⁹

2.83 The Economist Practice comprises 60 officers with 52 allocated to compliance and research activities. Of these officers, 27 are allocated to transfer pricing matters.³²⁰ The attrition rate in Economist Practice is 15 per cent compared to 3 – 5 per cent for other ATO units. This may at least partly explain why over 40 per cent of the economists have less than two years' experience and why the work of the Economist Practice is flexible and moves between advice and research.³²¹

2.84 In Transfer Pricing Record Reviews (TPR Reviews), when determining the realism of a taxpayer's commercial outcomes (taking into account the functions performed, assets used and risks undertaken) and review their benchmarking study, operational case teams are directed to 'seek advice' from the Economist Practice and 'should discuss difficulties' with the Economist Practice. The operational case teams are also directed to 'consult' with the Economist Practice in selecting the most appropriate ratio to be used. The operational case teams, in 'conjunction' with the

³¹⁸ ATO, 'Economists', above n 188; ATO, 'PS LA 2013/2', above n 189, para [10].

³¹⁹ ATO, 'PS LA 2013/2', above n 189, para [10].

³²⁰ ATO, 'Communication (11 February 2013)', above n 212.

³²¹ ATO, 'Communication 1 (14 March 2013)', above n 149; ATO, 'Organisation Chart', above n 188; ATO, 'LBI Executive Agenda' (18 December 2012) Internal ATO Document; ATO, 'LBI Executive Minutes' (25 October 2012) Internal ATO Document; ATO, 'Economics Capability Strategy' (November 2012) Internal ATO Document.

Economist Practice, 'should' also come to an agreed position on the risk rating assigned to taxpayers and the recommended follow-up strategy.³²²

2.85 The ATO documentation sets out that the operations teams are required to consult with the Economist Practice in the conduct of audits and in doing so, the Economist Practice should:

- assist with the preparation of audit plans and information gathering tasks for the resolution of economic issues;
- supply much of the general economic, industry and corporate information;
- complete the functional analysis;
- assist with the comparability analysis;
- provide advice on statistical methods to determine arm's length ranges and address the impact of accounting differences on comparability; and
- provide input to the audit position paper.³²³

2.86 Operational case teams are required to engage the Economist Practice through the International and Economist Gateway (IEG). The IEG allocates economists based on the following criteria:

- availability of economists;
- materiality and revenue impact;
- risk to the ATO reputation and the integrity of the system;
- technical complexity and precedential value; and
- Compliance Program and ATO objectives.³²⁴

2.87 *Practice Statement PSLA 2013/2* also provides the following guidance with respect to how economists are allocated:

26. Accepted referrals will be allocated to an economist who will work collaboratively with the referring area to develop a plan, outline the scope and action required. This includes participating in taxpayer meetings and resolving the issues. In order to resolve matters efficiently and effectively:

(a) the type of assistance and the timeframes will be negotiated on a case-by-case basis and will be dependent upon the factors listed at paragraph 24 of this practice statement.

³²² ATO, 'TPRR Procedural Manual', above n 145; ATO, 'PS LA 2005/14', above n 148.

³²³ ATO, 'Audit Manual', above n 148; ATO, 'PS LA 2013/2', above n 189.

³²⁴ ATO, 'PS LA 2013/2', above n 189, para [24].

(b) the economist will determine the economic issues to be examined with the referring area, and will outline the approach to analysing and resolving the economic issues. In a case advice setting, this may include determining:

- (i) the information required;
- (ii) characterisation of issues including functional analysis;
- (iii) analytical approach;
- (iv) choice of method; and
- (v) benchmarking and arm's length range (where applicable).

(c) the referring area needs to provide support throughout the process to allow the economist to form an appropriate view in a timely manner. This includes:

- (i) including the economist in case planning;
- (ii) gathering and documenting facts and evidence;
- (iii) collecting the information and data requested by the economist;
- (iv) liaising with the taxpayer;
- (v) providing the economist with the opportunity to attend relevant meetings;
- (vi) providing regular updates and timely notification of material changes in the case; and
- (vii) taking into account the economic advice when making decisions on the case.³²⁵

2.88 Within the ATO, there are economists who are not part of the Economist Practice but who are, nevertheless, part of the Economist Network which is managed by the Economist Practice. The Economist Network provides a bigger pool of economic expertise to the whole of the ATO.³²⁶

2.89 Generally, the work done by both the Economist Practice and Economist Network is reviewed, for quality assurance purposes, by a senior economist from another state to ensure objectivity and consistency.³²⁷

2.90 In situations requiring highly specialised expertise or knowledge which is not available within the Economist Practice or Economist Network, external economic advice may be obtained subject to approval by the Assistant Commissioner of Economist Practice and the business line budget holder.³²⁸

³²⁵ *ibid* para [26].

³²⁶ *ibid* paras [15]-[16].

³²⁷ *ibid* paras [28]-[30].

³²⁸ *ibid* paras [31]-[33].

IGT observations

2.91 The ability to quickly draw appropriate inferences from an extensive amount of economic, business, management and accounting information is essential for sustainable and timely decision making in matters involving transfer pricing issues. These inferences establish the characterisation of the function of the taxpayer for determining the appropriate comparables.

2.92 Therefore, the effective interaction between operational case teams and the Economist Practice is critical in determining a transfer price which is both appropriate and sustainable. In the conduct of compliance activities, the operational teams are the decision makers. However, much of the processing and analysing of information for determining the arm's length price requires economic expertise which is the domain of the Economist Practice.

2.93 Although operational case teams are responsible for the resolution of technical issues through collaborative processes with other ATO units³²⁹, they need only to 'take into account'³³⁰ the advice provided by the Economist Practice. There is no explanation of the consequences if that advice is not followed in ATO materials.

2.94 Arrangements, such as the above involving the operational case teams and the Economist Practice, also exists in the private sector. However, in the private sector, there are external pressures, such as competition for advice work and accountabilities to the client, which strongly direct internal teams to work within the scope of their expertise. However, the ATO is a monopoly administrator and cannot be sued for incorrectly applying adjustments unless done in bad faith. Therefore, stronger internal controls may be needed to ensure that interactions between internal units are operating as intended.

2.95 Whilst the ATO's procedural documents set out the roles of the operational case teams and the Economist Practice, the interaction between them is uncertain where views differ or confidence in each other is not established.

2.96 One of the difficulties is that the decisions of operational case teams may not reflect the advice from the Economist Practice or other 'specialist' units. This can arise, for example, where the operational case team is much more experienced than the junior economist with whom they interact. Providing directions for the resolution of such matters is important, especially where organisational or cultural issues may need to be overcome, such as where the economist is relatively new to the ATO and the operational case team leader is not.

2.97 The IGT considers that the publication of *Practice Statement PSLA 2013/2* is a step in the right direction in clarifying the role and responsibilities of the Economist Practice and the scope of its function in relevant matters. The IGT observes, however, that officers in the Economist Practice are not provided with documented work

³²⁹ ATO, 'Communication (18 April 2013)' above n 154.

³³⁰ ATO, 'PS LA 2013/2', above n 189, para [26]; ATO, 'TPRR Procedural Manual', above n 145; ATO, 'Audit Manual', above n 148.

processes or guidelines on the conduct of their work. The IGT considers that such guidelines may also assist to further clarify the interaction between economists and operational case teams.

2.98 Another aspect of the interaction between the two units is that the operational case team has to provide all relevant information to the Economist Practice and the latter, then, has to independently assess that information and provide its advice. This is akin to the engagement of external advisers. The ATO has observed that, in some cases, operational case teams have taken a long time to provide information to the Economist Practice.³³¹ Compliance with the newly published *Practice Statement PSLA 2013/2* should minimise these occurrences. The IGT also considers that implementing Recommendation 2.5 will result in further improvements in this regard.

ATO supervision of transfer pricing compliance activities

2.99 Stakeholders have raised a number of concerns with the supervision of technical issues in transfer pricing matters.

2.100 First, stakeholders consider that practical oversight of operational case teams by transfer pricing 'experts' is necessary. However, they also appreciate that there is insufficient senior transfer pricing 'expertise' to effectively oversee technical and case management decision making. Stakeholders believe that many of these 'experts' have either left the ATO or are performing other functions such as management roles.

2.101 Secondly, stakeholders assert that there is a dispersion of authority that makes it difficult for the ATO to resolve conflicting internal technical views. Stakeholders also observe that the ATO's key panel for overseeing transfer pricing matters, the TPRP, does not effectively oversee or influence operational case teams' technical and case management decisions. Further, as there are no formal escalation processes from the TPRP, stakeholders comment that they must use informal networks or relationships above case teams to resolve disputes.

2.102 Thirdly, stakeholders are of the view that the TPRP does not meet often enough to provide timely advice and guidance to operational case teams. Stakeholders attribute this to the number of transfer pricing cases that the ATO has on hand.

2.103 Fourthly, stakeholders have raised concerns that the TPRP is not independent. Stakeholders observe that the members of the TPRP are closely linked to the compliance activities being reviewed and consider that the Economist Practice heavily influences the TPRP.

2.104 Lastly, stakeholders observe that they do not have an opportunity to ensure that the TPRP is considering all relevant information or test auditors' conclusions of fact or evidence and respond to any auditor's incorrect understanding of the taxpayer's business operations. They claim that they can only engage with case teams

³³¹ ATO, 'Case Callover Summary', above n 316.

that appear to have little power or are reluctant to make decisions. Stakeholders comment that this results in incorrect decisions being made, such as moving a case to audit as a result of incorrect inferences or conclusions being made by the TPRP. This in turn, results in further misdirection of case teams' enquiries.

2.105 The above concerns were said by stakeholders to result in:

- untargeted information requests and operational case teams not being able to understand information provided by taxpayers and resolve concerns;
- inconsistent advice on similar arrangements within the same industry or taxpayers with similar fact patterns;
- procedural inconsistencies, such as not using the documentation checklist in TPR Reviews or not following the four-step process in *Taxation Ruling TR 98/11*; and
- protracted timeframes and increased compliance costs.

2.106 Stakeholders considered that the ATO's compliance activities would improve if the TPRP was properly resourced to obtain a detailed knowledge and understanding of the cases and the difficulties case teams were encountering. Stakeholders also considered that if taxpayers were represented at the TPRP, the ATO's transfer pricing compliance activities would improve. Stakeholders suggest that any presentation to the TPRP could be conducted at the same time with the ATO case team as this would ensure transparency of the decision-making process. Stakeholders point to the ATO's General Anti-Avoidance Rules (GAAR) Panel as an example.

ATO materials and information

2.107 As set out in Chapter 1, the ATO supervises the resolution of transfer pricing issues encountered in compliance activities through its operational case team leaders, call over processes, such as LB&I site governance, and technical panels, such as the TPRP. It should also be recalled that the ATO has signalled its intention to disband the TPRP and implement the ISPS unit which may take over some functions of the TPRP.

2.108 The role of the TPRP is to maintain a high standard of technical and case management decision making in all transfer pricing compliance activities by providing advice on the planning of work, quality reviewing transfer pricing compliance activities and providing advice to facilitate the making of transfer pricing determinations.³³²

2.109 The ATO advises that the TPRP maintains a list of 33 officers that the ATO considers are transfer pricing 'specialists' and 15 'intermediate' level officers that may form a TPRP. The intermediate level officers possess important characteristics that make them suitable to be a member of a TPRP, such as industry specialisation.³³³ The

³³² ATO, 'PS LA 2004/13', above n 167, paras [1], [4].

³³³ ATO, 'TPRP List' (June 2012) Internal ATO Document.

ATO further advises that the membership of a TPRP as a whole should provide the collective skills and experience necessary.³³⁴

2.110 The Compliance Audit Directors in operational case teams are responsible for the resolution of issues³³⁵ for particular taxpayers. Where operational case teams conduct TPR Reviews or transfer pricing audits, they are directed to refer compliance activities to the TPRP for 'endorsement' or 'advice'.³³⁶ The advice given by the TPRP 'should be followed'³³⁷ by operational case teams.³³⁸ However, there is no explanation of the consequences if that advice is not followed.

2.111 Whilst there are other specialist units, such as the Economist Practice, that may also provide advice to operational case teams, these units do not have an oversight function.

2.112 In the conduct of TPR Reviews, the TPRP either:

- 'endorses' the recommendation of the operational case team (that was agreed in conjunction with Economist Practice);³³⁹ or
- provides 'advice and guidance on the proposed documentation and commercial realism ratings'.³⁴⁰

2.113 The TPRP will also endorse the operational case team's follow-up strategy.³⁴¹

2.114 As set out in Chapter 1, at various stages of an audit, the TPRP may be called upon to 'sign-off' on case plans where appropriate, assist in developing draft position papers where material transfer pricing risks are identified and endorse the final position paper. However, the ATO has acknowledged that in some instances, the TPRP may not have appropriately assisted case officers resulting in protracted case timeframes.³⁴²

2.115 In *Practice Statement PSLA 2004/13*, the ATO states that TPRP meeting days will be 'scheduled' on a regular basis in Sydney, Melbourne and Brisbane and as required, in other locations.³⁴³ However, during the review, the ATO advised that TPRP meetings are held on an 'as needs' basis, with at least one meeting held every fortnight on average.³⁴⁴

³³⁴ ATO, 'Communication 2 (15 March 2013)', above n 104.

³³⁵ ATO, 'Communication (18 April 2013)' above n 154.

³³⁶ ATO, 'TPRR Procedural Manual', above n 145; ATO, 'Audit Manual', above n 148; ATO, 'PS LA 2004/13', above n 167.

³³⁷ ATO, 'PS LA 2004/13', above n 167, para [5].

³³⁸ *ibid.*

³³⁹ ATO, 'TPRR Procedural Manual', above n 145.

³⁴⁰ ATO, 'Risk Assessment Guide', above n 175.

³⁴¹ ATO, 'TPRR Procedural Manual', above n 145.

³⁴² ATO, 'Communication 2 (13 March 2013)', above n 200.

³⁴³ ATO, 'PS LA 2004/13', above n 167, para [20].

³⁴⁴ ATO, Communication (17 June 2013).

2.116 The ATO has also advised that the TPRP is not specifically resourced in terms of dedicated funding or travel budget. Rather, the TPRPs draw resources from the Internationals unit and from the business lines according to the case needs.³⁴⁵

2.117 The ATO has advised that independence of the TPRP is maintained by ensuring that all TPRP members are not directly involved in the particular case being considered.³⁴⁶ This requirement, however, is not contained in formal documentation.

2.118 In relation to taxpayer access to the panel, the ATO's *Practice Statement PSLA 2004/13* states,

The TPRP is a part of the Tax Office's internal quality assurance processes [in addition to other mechanisms such as, the IQF] and is not accessible by taxpayers and their advisers. Taxpayers do not have a right to representation at TPRP meetings. In exceptional circumstances a taxpayer may be given the opportunity to liaise with the TPRP through access to a member or members where the Chairperson in consultation with the case owner regards this as appropriate. This may, for instance, be the case if it is necessary to assist the TPRP's consideration of the case or it is necessary to assist the taxpayer in understanding the outcome of the TPRP's consideration of the case. A taxpayer may be given the opportunity to review and comment upon the factual accuracy of materials prepared for consideration by the TPRP, at the case owner's discretion.³⁴⁷

2.119 It is not clear from the Practice Statement why taxpayers are not generally permitted to access the TPRP.

2.120 The ATO advises that TPRPs are not 'locally formed' as 'generally consistent' members can 'dial-in'. The ATO also advises that the various TPRPs convene quarterly to discuss common and emerging issues to ensure national consistency.³⁴⁸ These quarterly meetings involve the ATO Profit Shifting Risk Manager.

2.121 The ATO advises that whilst there may be departures from its expected procedures, such as regional practices, most departures are not of substance as the case outcomes and decisions remain appropriate. Additionally, where there are 'substantial departures', officers are required to justify them to the quality assurance forums.³⁴⁹ It is uncertain whether these 'quality assurance forums' register and report on 'substantial departures'. For example, the ATO has advised that the TPRP does not maintain a centralised repository of the cases it reviews. TPRP advice is 'attached' in Siebel on a case-by-case basis. Furthermore, it is not possible for the ATO to consolidate the TPRP advice in Siebel.³⁵⁰

³⁴⁵ *ibid.*

³⁴⁶ *ibid.*

³⁴⁷ ATO, 'PS LA 2004/13', above n 167, para [25].

³⁴⁸ ATO, 'Communication 2 (15 March 2013)', above n 104; ATO, 'Communication (19 March 2013)', above n 265; ATO, Communication (14 June 2013); ATO, Communication 2 (1 July 2013).

³⁴⁹ ATO, 'Communication 1 (19 March 2013)', above n 200; ATO, 'Communication 1 (14 March 2013)', above n 149.

³⁵⁰ ATO, 'Communication 2 (1 July 2013)', above n 347.

IGT observations

2.122 The IGT observes that the ATO expected that its Transfer Pricing Management System (TPMS), which was implemented in 2007, would resolve many issues, including those identified by PricewaterhouseCoopers (PWC) Legal in its 2008 APA Review. However, many of the issues identified by PWC Legal in 2008 still remain. Indeed, PWC Legal warned that if the TPMS was not fully implemented on a timely basis, the impact of current issues experienced by external stakeholders will increase, causing further frustration and uncertainty within the ATO.³⁵¹

2.123 As stated earlier, generalist operational case teams are responsible for the conduct of all matters involving transfer pricing issues as well as all other international and domestic tax issues. Improving the links between the risk and operational functions of the ATO and assurance of the resourcing of specialist units should help to address 'bottom up', or case team initiated, avenues for advice.

2.124 Generalist case teams may not fully appreciate what specific information is needed to quickly conclude the ATO's view on transfer pricing issues, or not appreciate the information that they already possess. As a result considerable unproductive time and resources may be expended by both case teams and specialist units in the absence of early and sufficient guidance. Therefore, there is a need for effective 'top-down' supervision of technical issues. To some extent the existing site governance and aged case call over processes allow the ATO to identify those cases languishing, but will not help to provide preventative measures. It is important to ensure that generalist operational case teams are able to quickly identify when specialist advice may be beneficial.

2.125 The IGT is of the view that the scope of the operational case team's decision-making authority may extend beyond their level of expertise. TPR Reviews and transfer pricing audits involve technical and case management decision making, requiring specialist technical skills that are within the scope of the TPRP's function. Without an oversight body that has the authority to resolve such issues, case teams may not agree or fully appreciate the advice provided. This may lead to inefficient or inappropriate outcomes. Additionally, the IGT observes that no detailed guidance exists for taxpayers or the ATO's operational case teams outlining how issues or inconsistent advice from the specialist units can be resolved, such as avenues for escalation.

2.126 Ultimately, a binding decision must be made that is consistent and based on a strong understanding of transfer pricing issues. In this respect, the TPRP appears to have been set up by the ATO as an important step in the transfer pricing compliance process to ensure a high standard of technical and case management decisions. Such supervision also influences the extent to which operational case teams develop their own knowledge and experience. A failure to adequately transfer or nurture more advanced knowledge and experience to the operational case teams will propagate

³⁵¹ PWC Legal, above n 109, p 26.

their dependence on specialist units, contributing to the demands on the specialist units.

2.127 As operational case teams improve their transfer pricing 'capability' and experience, the need for such supervision reduces. Accordingly, a type of graduated licensing system may permit more experienced operational case teams to conduct transfer pricing compliance activities with less intervention of supervisory units. The IGT notes that PWC Legal, in its 2008 APA Review, similarly recommended that 'all key transfer pricing decisions should be made by a transfer pricing specialist' and the use of a 'transfer pricing accreditation system'.³⁵²

2.128 The effective resolution of transfer pricing matters involves both the ATO and taxpayers having a strong understanding of the facts, the functional analysis and the legal interpretation. To come to this understanding and determine a position requires a consideration of large amounts of information with an understanding of their relevance to resolving transfer pricing issues. This requires time.

2.129 Accordingly, it is important that the TPRP is promptly provided with all relevant facts when providing guidance to case teams. However, as stated earlier, the TPRP meetings are no longer regularly scheduled and there is no dedicated funding or budget for the TPRP. It is, therefore, foreseeable that such unplanned budgetary pressure may adversely impact the frequency of the TPRP meeting resulting in bottlenecks and protracted case timeframes.

2.130 Furthermore, in an attempt to adequately manage congested transfer pricing matters within the limited time available, the TPRPs may be forced to heavily rely on operational case teams' interpretation of facts and conclusions. As a result, there is no means to ensure that all relevant information is considered in providing direction.

2.131 Similar potential congestion problems and reliance on case team's interpretation of facts may also arise with respect to the specialist units that also provide advice and guidance.

2.132 The above pressures on the TPRP and specialist units may lead to inconsistent advice that may require escalation to resolve creating further congestion and adversely impact on the TPRP's independence.

2.133 As transfer pricing issues can, and do, involve considerable amounts of information, efficiencies can be achieved by allowing taxpayers and their advisers to present their views on the relevant evidence and comment on the case teams' position and evidence. Furthermore, such a forum may also provide a useful means for developing the capability of operational case teams with respect to resolution of technical and case management issues.

2.134 The IGT is of the view that there is a potential for inadequately supervised work to drain ATO resources and result in significant frustration and unnecessary compliance costs for taxpayers. The supervisory function needs to also be properly

³⁵² *ibid* p 3, 48.

resourced to direct operational case teams on the conduct of the compliance activities, and make decisions on key technical and management issues. In this respect, the Commissioner of Taxation may reconsider his delegated or authorised powers to ensure the supervisory function has appropriate decision-making authority.

2.135 Furthermore, the IGT notes that currently, the TPRP does not maintain a central repository of the transfer pricing matters considered. Instead the details of the TPRPs, including minutes, are attached to the relevant case in Siebel. It is also not possible to search for all attachments or events in Siebel to extract information on all TPRP minutes.³⁵³ The IGT considers that there are significant benefits of maintaining a central repository of the advice provided by the TPRP as it would be a particularly useful tool for the operational case teams and risk managers.

2.136 The ISPS, mentioned earlier, is also likely to take over the function of the TPRP. It is important that the ISPS maintains some of the attributes of the TPRP, however, some changes are needed to address the issues identified above.

RECOMMENDATION 2.6

The IGT recommends that the ATO:

- (1) maintain an overseeing body, which consists of transfer pricing 'specialists' and those with experience in key industries;*
- (2) the overseeing body to consider transfer pricing issues at key stages during compliance activities, including formulating risk hypotheses, case planning, information requests, and (after receiving new taxpayer information) refining risk hypotheses, discussions with taxpayers on technical issues and preparation of the position paper; and*
- (3) ensure that the overseeing body:*
 - (a) members are authorised to challenge officers on the conduct of transfer pricing work and, where necessary, escalate key technical and management issues for senior management resolution;*
 - (b) is sufficiently resourced and provided with enough time to consider the facts and evidence underlying case teams' positions;*
 - (c) maintains a central repository of the transfer pricing matters considered by the body, advice provided by them and the outcome of the case; and*

³⁵³ ATO, 'Communication (17 June 2013)', above n 343.

RECOMMENDATION 2.6 (CONTINUED)

(d) provides an opportunity for taxpayers to present their position to the body and test the position of the case team.

ATO response**Disagree**

Under our new profit shifting strategy, the ATO is seeking to enhance the capability of compliance officers as well as provide additional access to specialists to assist compliance officers in the conduct of their casework. This is consistent with the ATO's model for compliance work, where compliance officers are accountable for decision making in a case and the role of specialists is to provide expert advice. We do not support the creation of a separate body which oversees the work of compliance officers and takes on a formal review function. This would be contrary to the fundamental principle of compliance officers being accountable for decisions.

RESOURCING OF KEY SPECIALIST FUNCTIONS

2.137 Although risks may be identified and advice provided by the TPRP or ISPS, a case can only be successfully completed if there are also enough resources at the case team and specialist unit levels.

2.138 The following data summarises ATO information provided on the Full Time Equivalent (FTE) staff allocated for all transfer pricing work across the ATO. It includes the FTE staff allocated to the Transfer Pricing Strategic Compliance Initiative (TPSCI).

Table 1: ATO resources allocated to transfer pricing matters, as at 19 February 2013

		Risk	Audit	MAP	APAs	Other	Total
LB&I BAU	Staff	0.00	0.00	0.00	0.00	0.00	143.00
	FTE	17.65	44.05	1.30	27.30	0.65	90.95
LB&I TPSCI	Staff	0.00	0.00	0.00	0.00	0.00	29.00
	FTE	1.50	23.50	0.00	1.00	0.00	26.00
SME	Staff						22.00
	FTE	6.00	6.00		8.00	2.00	22.00
PSP	Staff	2.00		5.00	5.00		12.00
	FTE	1.00		1.00	3.00	3.00	8.00
Economist Practice	Staff						30.00
	FTE	9.10	10.70	2.00	5.20		27.00
TOTAL	Staff						236.00
	FTE	35.25	84.25	4.30	44.50	5.65	173.95

Source: ATO, Communication (29 February 2013).

2.139 The data above shows that the total FTE staff allocated to transfer pricing matters in the ATO is 173.95 (but includes 236 officers) across LB&I operational case teams, SME General Compliance case teams and the specialist units, the Economist Practice and the PSP.

Planned transfer pricing matters and staff allocations

2.140 The ATO's LB&I and SME business lines also plan for the numbers of different transfer pricing matters undertaken during a given year which is compared with the actual numbers of these matters undertaken.

2.141 The table below compares the planned LB&I Operations transfer pricing matters to actual performance.

Table 2: LB&I Operations transfer pricing matters — planned and actual

Product	Planned Completions 2012/13	Planned new Starts 2012/13	WIP 1/7/12	Commenced in 2013 FY	Finalised in 2013 FY	On Hand to 20/11/2012
TP focussed audits	24	8	28	0	2	26
Risk Reviews	40	27	13	12	6	19
APAs	30	20	33	9	2	40
Annual Compliance Reports	100	93	7	35	25	17
Mutual Agreement Procedures	8	5	15	1	0	16

Source: ATO, Communication (14 December 2012).

2.142 The above table suggests that the LB&I case teams planned to complete far more transfer pricing activities for the 2012-13 financial year than they actually finalised.

2.143 Using the data in two tables above, it appears LB&I Operations requires: 44.05 FTE staff to undertake 28 audits (2 finalised and 26 on hand); 17.65 FTE staff to undertake 25 risk reviews (6 finalised and 19 on hand); 27.3 FTE staff to undertake 42 APAs (2 finalised and 40 on hand); and 1.3 FTE staff to undertake 16 Mutual Agreement Procedures (MAP) (0 finalised and 16 on hand).

2.144 The ATO's timeframes for transfer pricing compliance activities will be described in greater detail in Chapter 3. At a broader level, however, it should be noted that in the past six years, in LB&I Operations, approximately 31 per cent of all transfer pricing reviews, 41 per cent of all audit products, 19 per cent of all APA products and 30 per cent of MAPs exceed the ATO's service standards.³⁵⁴

2.145 The table below compares the planned SME General Compliance transfer pricing matters to actual performance.

³⁵⁴ ATO, Communication: Level 4 Report (14 December 2012) Internal ATO Document.

Table 3: SME General Compliance transfer pricing matters — planned and actual

Product	Planned Completions 2012/13	Planned new Starts 2012/13	WIP 1/7/12	Commenced in 2013 FY	Finalised in 2013 FY	On Hand to 20/11/2012
TP focussed audits	8	8	9	4	3	10
Risk Reviews	40	11	14	6	14	6
APAs	20	15	30	11	11	30
Annual Compliance Reports	60	47	6	32	23	15
Mutual Agreement Procedures	0	0	0	0	0	0

Source: ATO, Communication (14 December 2012).

2.146 The above table suggests that the SME General Compliance case teams also planned to complete far more transfer pricing compliance activities in the 2012-13 financial year than were actually finalised.

2.147 Using the data in Tables 1 and 3 above, it appears that SME General Compliance would require: six FTE staff to undertake 13 audits (three finalised and 10 on hand); six FTE staff to undertake 20 risk reviews (14 finalised and six on hand); and eight FTE staff to undertake 41 APAs (11 finalised and 30 on hand). No staff in the SME business line were allocated to MAPs in the 2012-13 financial year.

2.148 At a high level, for SME transfer pricing matters, in the past six years, approximately 41 per cent of all risk review products, 20 per cent of all audit products, 15 per cent of all APA products and 100 per cent of MAPs exceeded the ATO's service standards.³⁵⁵

2.149 It is clear that both in the LB&I and SME business lines, the ATO does not have sufficient resources available to resolve matters it has undertaken within the timeframes it predicted.³⁵⁶

2.150 From the data maintained by the ATO, it is possible to estimate the number of FTE staff required to complete all transfer pricing matters within their respective service standards.³⁵⁷ Resourcing will be further discussed in the IGT observations section later.

Internationals unit

2.151 As described earlier, the funding for the Internationals unit is determined by the LB&I executive as it plans what the Internationals unit delivers.³⁵⁸

2.152 The February 2013 meeting of the Internationals Leadership Team (ILT) (comprising the Internationals unit executive) outlined the current budget situation for

³⁵⁵ *ibid.*

³⁵⁶ ATO, 'Communication 2 (13 March 2013)', above n 200.

³⁵⁷ Note: the IGT could also estimate the number, but would require better quality data from the ATO.

³⁵⁸ ATO, 'Communication 1 (19 March 2013)', above n 200.

the Internationals unit. The Internationals unit has budgeted for 136 FTE staff (including the Economist Practice) but currently has 119.12 FTE staff. Although the area is under-staffed, the budget is under pressure due to the higher job classification of officers.

2.153 The inadequate number of higher paid ATO officers is particularly acute in the PSP. As described above, the PSP provides advice to case teams, such as staffing the TPRP amongst others, subject to available capacity.

2.154 The FTE staff for the PSP was 26 and 35 in 2010 and 2013 respectively. Although there appears to be substantial increase from 2010 to 2013, the figures for 2013 include an additional unit, the International Risk, Strategy and Intelligence (IRSI) unit, that was separately accounted for in 2010. In 2010, the IRSI area had 7 FTE staff. Accordingly, the increase may not have materially affected the level of advice provided to case teams. Indeed, one ILT meeting in 2012 noted that the PSP actually lost 15 FTE staff.³⁵⁹ It is unclear whether these staff members left the ATO or were simply allocated to a different unit. As set out in Table 1 above, the PSP has only allocated 8 FTE staff to assist with transfer pricing matters.

2.155 The ATO has advised that the reduction in positions is generally a result of a number of factors, including accommodating salary increases, agency efficiency dividends and management decisions³⁶⁰ that implement measures to rationalise its budget.

Risk managers resourcing

2.156 As discussed in Chapter 1, one officer in the LB&I business line and another officer in the SME business line were allocated to perform their respective roles of transfer pricing risk manager. The ATO has advised that the LB&I transfer pricing risk manager had other roles, including performing the role of Secretariat to the PSWG. The SME business line previously merged the role of its transfer pricing risk manager into a single role for all international tax risks. Similarly, during this review, the LB&I business line subsumed the role of a number of its risk managers, including the transfer pricing risk manager, into one risk manager for all manifestations of profit shifting risk.³⁶¹

2.157 Senior ATO officers have expressed concerns that the role of the transfer pricing risk manager is critical to the effectiveness of the transfer pricing compliance program, that the role should not be shared and requires a full time focus.³⁶²

³⁵⁹ ATO, 'Internationals Leadership Team Meeting Minutes' (17 April 2012) Internal ATO Document.

³⁶⁰ ATO, Communication: Internationals Budget History (12 April 2013).

³⁶¹ ATO, 'Communication (19 March 2013)', above n 265; ATO, 'Communication (24 October 2013)', above n 101; ATO, 'Communication (31 October 2013)', above n 139.

³⁶² ATO, 'Communication (19 March 2013)', above n 265.

Transfer Pricing Review Panel resourcing

2.158 As discussed earlier in this chapter, there is no specific overall budget for TPRPs. The TPRPs are held on an as needs basis and resourced according to case needs and availability of suitable officers from the Internationals unit and the business lines.³⁶³

2.159 Some submissions to this review observe that the TPRPs are under a great deal of pressure in terms of resourcing the number of cases in which they are expected to provide advice.

Economist Practice

2.160 As also mentioned earlier in this chapter, the Economist Practice has suffered from relatively high turnover with a considerable number of newer personnel moving through the unit. Stakeholders have experienced cases in which the Economist Practice declined to provide an economist to advise the case team or be present at taxpayer presentations. As a result, protracted delays were experienced because the case team had to repeatedly seek piecemeal advice from the Economist Practice.

2.161 The Economist Practice also allocates its economists to research tasks.³⁶⁴ Stakeholders observe that this diversion of resources reduces the support for transfer pricing matters and has resulted in a deterioration of the ATO's overall capability in relation to case work.

2.162 The impacts of the above resourcing issues for the Economist Practice have been noted in ATO internal callover processes. In particular, it was identified that there are 'systemic issues' with a significant amount of Economist Practice work outstanding, requiring a rearrangement of economist work schedules to bring forward delivery timeframes. These impacts were observed to highlight elements of a 'capability need' which is more acute in some particular sites.³⁶⁵

2.163 The Economist Practice's resourcing constraints have also been discussed at senior levels in a number of ILT meetings. The ILT meetings have raised awareness of the increased demand for economic advice, high workloads and the relatively high attrition rate. In response to these challenges, the ILT has discussed the need to increase the Economist Practice's FTE at both the junior and senior levels and prioritise transfer pricing matters.³⁶⁶

³⁶³ ATO, 'Communication (17 June 2013)', above n 343; ATO, 'TPRP List', above n 332.

³⁶⁴ ATO, 'Internationals Leadership Team Meeting Minutes' (12 November 2012) Internal ATO Document.

³⁶⁵ ATO, 'Case Callover Summary', above n 316; ATO, 'LB&I AC Case Callover Summary: Perth 24 August 2012' (29 October 2012) Internal ATO Document; ATO, 'LB&I AC Case Callover Summary Parramatta 31 August 2012 (29 October 2012) Internal ATO Document.

³⁶⁶ ATO, 'Internationals Leadership Team Meeting Minutes' (31 March 2011) Internal ATO Document; ATO, 'Internationals Leadership Team Meeting Minutes' (2 May 2011) Internal ATO Document; ATO, 'Internationals Leadership Team Meeting Minutes' (21 June 2011) Internal ATO Document; ATO, 'Internationals Leadership Team Meeting Minutes' (25 August 2011) Internal ATO Document; ATO, 'Internationals Leadership Team Meeting Minutes' (28 November 2011) Internal ATO Document; ATO, 'ILT

2.164 As discussed previously, to help address the above challenges, the Economist Practice has developed a Practice Statement which sets out the priorities for its work. The Economist Practice area also trialled a new structure by locating economists in the operational areas of the business lines. However, the trial was discontinued as it did not provide the desired outcome.³⁶⁷

2.165 The table below sets out the workload for Economist Practice during February 2013.

Table 4: Economist Practice workload for February 2013

Work type description	1 February 13 — 28 February 13			
	Opening stock	Received	Finalised	Closing stock
3.4.3 Audit casework	50	5	5	50
3.4.3 Litigation	1			1
3.4.9 CRR (TP & other)	8	1		9
3.4.9 TPRR	22	3	5	20
3.4.13 APA	56	4	5	55
3.4.13 MAP	10			10
3.4.13 ACA	1			1
3.4 Other case advice	8			8
3.5.1 Research project work	7	9	4	12
3.5.1 Economist network	1			1
3.5.5 CEM	2			2
3.5 Other research	17			17
Total	183	22	19	186

Source: ATO, Communication (14 March 2013).

Minutes (17 April 2012)', above n 358; ATO, 'Internationals Leadership Team Meeting Minutes' (25 October 2012) Internal ATO Document; ATO, 'Internationals Leadership Team Meeting Minutes' (20 November 2012) Internal ATO Document; ATO, 'Internationals Leadership Team Meeting Minutes' (18 December 2012) Internal ATO Document.

³⁶⁷ ATO, 'Economics Capability Strategy', above n 320; ATO, 'Communication 1 (14 March 2013)', above n 149.

2.166 The table below sets out the workload for Economist Practice over the 1 July 2012 to February 2013 period.

Table 5: Economist Practice workload 1 July 2012–February 2013

Work type description	YTD													
	Opening stock	Received	Finalised						Closing stock					
	Total	Total	LB&I	SME	SCI	RRT	Others	Total	LB&I	SME	SCI	RRT	Others	Total
3.4.3 Audit casework	55	13	12	3	2		1	18	39	4	7			50
3.4.3 Litigation	1												1	1
3.4.9 CRR (TP & other)	7	8	4	2				6	5	4				9
3.4.9 TPRR	33	18	22	7	2			31	16	4				20
3.4.13 APA	62	22	13	16				29	29	24	2			55
3.4.13 MAP	14		2	2				4	6	3			1	10
3.4.13 ACA	1	1	1					1	1					1
3.4 Other case advice	4	11	6	1				7	6	1			1	8
3.5.1 Research project work	6	30	19				5	24	10	1			1	12
3.5.1 Economist network	2	1	2					2	1					1
3.5.5 CEM	2	2	1	1				2	1				1	2
3.5 Other research	13	11	3			4		7		1		15	1	17
Total	200	117	85	32	4	4	6	131	114	42	9	15	6	186
Percentage total			65%	24%	3%	3%	5%	100%	61%	23%	5%	8%	3%	100%

Source: ATO, Communication (14 March 2013).

2.167 As indicated earlier, as for the other ATO units involved in transfer pricing matters, the workloads for the Economist Practice, its FTE and case timeframes could be used to predict the resourcing needed for transfer pricing matters.

IGT observations

2.168 Operational planning should consider whether the matters can be completed on time with the available resources including specialist as well as operational case staff.

2.169 Since the specialist units are outside the business lines' operational units, the operational units do not have control over the specialist units' resources. Conversely, while the specialist units are able to control the level of advice they provide to case teams, they do not have control over the number and scope of matters selected.

2.170 Whilst the LB&I business line's CSSC must consult with the LB&I Operations SES Group about resources, the latter is not in a position to determine or predict the availability of specialist resources which may be required to effectively carry a transfer pricing case to completion. This may cause competing demands on limited resources where multiple LB&I operational case teams call upon the resources of the specialist units. For example, approximately one-third of the Economist Practice's work is unplanned work, responding to operational case teams' requests for advice.³⁶⁸ The IGT considers that whilst the ATO's broader 'profit shifting' strategy is laudable, the practicalities of its implementation heighten the need for the appropriate planning of resources.

2.171 Further to Recommendation 2.1(2) above, the ATO should examine all of its finalised and current transfer pricing matters conducted over the last few years to determine not only the actual FTE staff of operational units in the matters, but also that of all the relevant specialist units to better predict the level of resourcing needed to conduct such matters. That is, the ATO can use historical data to identify the relationship between the number and type of specialists needed to finalise different types of transfer pricing matters within benchmark cycle times. This will allow the ATO to better estimate the resources needed to complete transfer pricing matters within service standards. Such work was similarly conducted by the SME business in 2009, in relation to the objection's function resourcing needed on average, for each compliance activity selected.

2.172 The ATO should also ensure that where the availability of specialist resources will be less than originally planned or agreed, the operational case teams and the SES group supporting these teams can quickly reprioritise case work. This may involve reducing the scope of planned cases, their number or managing expectations on planned timeframes. The IGT has observed in other reviews the consequences of inadequately responding to circumstances which deviated from original plans for compliance activities.³⁶⁹

RECOMMENDATION 2.7

The IGT recommends that the ATO improve its planning of compliance activities by:

- (1) requiring business line executives to seek assurance from specialist units that sufficient support resources will be available for the planned number and scope of compliance activities to be undertaken;*
- (2) identifying the type and level of the specialist units' resources that were provided in past and current cases as an evidentiary basis for this assurance; and*

³⁶⁸ ATO, Communication (25 February 2013).

³⁶⁹ IGT, *Review into the Income Tax Refund Integrity Program* (transmitted to the Minister on 18 September 2013); IGT, *Review into Aspects of the ATO's use of Compliance Risk Assessment Tools* (transmitted to the Minister on 21 October 2013) in relation to the importance of the ATO adopting a project-management approach to compliance strategies.

RECOMMENDATION 2.7 (CONTINUED)

(3) limiting the number of compliance activities based on resources available, past history and emerging risks.

ATO response

Agree

With respect to part 1, we consider this to be an expectation of all planning and management of compliance work and will continue to reinforce this expectation with staff.

CHAPTER 3 — ATO'S COMPLIANCE APPROACHES AND PROCESSES

SUMMARY OF STAKEHOLDER CONCERNS

3.1 Stakeholders raised a number of concerns with aspects of the Australian Taxation Office's (ATO) compliance approaches and processes, including the following:

- compliance costs;
- timeframes for transfer pricing compliance activities;
- taxpayer access to ATO specialists;
- Transfer Pricing Record Reviews (TPR Reviews);
- transfer pricing audits; and
- the International Dealings Schedule (IDS).

3.2 These stakeholder concerns are discussed in more detail below.

COMPLIANCE COSTS

3.3 Interwoven with stakeholders concerns regarding the ATO's compliance activities is that compliance with transfer pricing is inherently costly and may be disproportionate to potential revenue risks, particularly for Small and Medium Enterprise (SME) taxpayers. Stakeholders have suggested a number of methods that the ATO should employ to reduce the compliance burden on taxpayers associated with transfer pricing.

3.4 First, stakeholders suggest that SME taxpayers should be carved out from the transfer pricing regime. Stakeholders say that these taxpayers' international related party dealings pose a comparatively lesser revenue risk. The compliance burden for these taxpayers is said, however, to be disproportionately large.

3.5 Secondly, stakeholders suggest that the ATO should increase its use of safe harbours starting with certain low value or common transactions, such as interest payments. These safe harbours could be based on the size of the taxpayer, the quantum of international related party transactions or the type of transaction.

3.6 Thirdly, stakeholders suggest the ATO should implement a *de minimis* documentation rule that exempts smaller taxpayers with low value transactions from having to comply with the ATO's transfer pricing documentation requirements.

Stakeholders consider that only the larger taxpayers, such as taxpayers with over \$20 million in international related party dealings, should prepare a full transfer pricing analysis in accordance with *Taxation Ruling TR 98/11*. Stakeholders have stated that, in addition to the ATO's publications aimed at lowering the compliance burden on SME taxpayers (SME Publications),³⁷⁰ more rigor regarding the actual process and what is required would greatly assist smaller taxpayers in ensuring compliance with the arm's length principle.

3.7 Lastly, stakeholders suggest the ATO publish its transfer pricing industry and comparables data to produce an arm's length range of results. Stakeholders say the ATO's willingness to accept results falling within an arm's length range derived from such a comparable set would greatly simplify compliance particularly for smaller taxpayers.

ATO materials and information

3.8 Although all taxpayers with international related party dealings are required to comply with the transfer pricing provisions, the ATO has advised that the *de minimis* disclosure exemption (in the tax return and IDS) effectively carves out taxpayers with less than \$2 million in relevant transactions.³⁷¹

3.9 In respect of transfer pricing safe harbours, the ATO has advised that it is currently considering safe harbours for SME taxpayers in relation to penalties where taxpayers have made reasonable efforts to comply. The ATO notes that any potential safe harbour provided will involve multiple jurisdictions. Therefore, there is a need for harmonisation with other treaty partners. This is difficult as different jurisdictions have a different appetite for risk which will influence the safe harbour. The ATO is also concerned that safe harbours might set a precedent that larger taxpayers might argue by analogy that they should also fit within the safe harbour.³⁷²

3.10 The ATO's simplified approach to transfer pricing documentation and risk assessment for SME taxpayers applies to businesses with an annual turnover of less than \$100 million, unless they are:

- part of a multinational group that is listed on any stock exchange; or
- part of a private group with any international subsidiary or other offshore related party that has the resources to deal with global transfer pricing issues.³⁷³

³⁷⁰ ATO, *International Transfer Pricing – A Simplified Approach to Documentation and Risk Assessment for Small to Medium Businesses* (13 November 2012) <www.ato.gov.au>.

³⁷¹ ATO, 'Communication 1 (19 March 2013)', above n 200.

³⁷² ATO, 'Communication (22 March 2013)', above n 166.

³⁷³ ATO, 'Simplified Approach to Documentation', above n 369.

3.11 The ATO view on the extent to which SME taxpayers should prepare documentation is set out in *Taxation Ruling TR 98/11* which states:

Small business taxpayers and taxpayers with relatively low levels of international dealings with associated enterprises... need not create documents beyond the minimum necessary to arrive at arm's length outcomes in the context of their business... However, this usually involves the creation of some documentation, in addition to that which would otherwise be created in the ordinary course of business ... The circumstances in which a taxpayer does not require at least some level of analysis of external data upon which to base any comparison of its international dealings with associated enterprises may be very limited in the Australian context. Even in cases where reliable internal benchmarks... exist, a less detailed functional analysis combined with an assessment of any external data available about price and/or performance, provides a greater degree of certainty and a reduced risk of adjustment by the ATO.

The various possible situations arising in business do not lend themselves to a code of practice or formal process being spelt out for small business taxpayers. The wide range of situations give rise to different judgments about what to do, or not do, with no consistent line of reasoning emerging. Small business taxpayers need to exercise good commercial judgment in determining the level of documentation they think appropriate for their international dealings with associated enterprises.³⁷⁴

3.12 Three basic questions are also included to 'help' taxpayers judge what documentation they should prepare to be satisfied that the arm's length principle has been applied.³⁷⁵

3.13 In respect of publishing comparable data, the ATO states in *Taxation Ruling TR 98/11* that it will not publish such data:

Consideration has been given to the relative merits of the ATO maintaining a database and publishing pricing and profit data as a means of enabling taxpayers to comply with their statutory obligations. However, it is felt that the concerns raised, particularly in relation to the historic nature of data available and secrecy and confidentiality concerns, preclude the ATO from providing such a database, excepting those reports which are currently presented to Parliament and consequently published for public information (TAXSTATS).³⁷⁶

3.14 The ATO current safe harbours or exemptions with respect to transfer pricing are:

- low value adding intra-group services – non-core services: safe harbour arm's length range;³⁷⁷

³⁷⁴ ATO, *Income Tax: Documentation and Practical Issues Associated with Setting and Reviewing Transfer Pricing in International Dealings*, TR 98/11, 24 June 1998, paras [6.1]-[6.2].

³⁷⁵ *ibid* para [6.5].

³⁷⁶ *ibid* para [10.2].

³⁷⁷ ATO, *Income Tax: International Transfer Pricing for Intra-Group Services*, TR 1999/1, 20 January 1999.

- small transactions — *de minimis* services not more than \$500,000: safe harbour arm's length range;³⁷⁸
- small transactions — aggregate international related party dealings is not more than \$2 million: exemption from disclosure requirement;³⁷⁹
- SMEs — low levels of international related party dealings;³⁸⁰ and
- SMEs — gross income is less than \$250 million, or greater than \$250 million and international related party dealings involving goods not exceeding \$150 million, routine services not exceeding \$50 million and intangible property not exceeding \$10 million.³⁸¹

IGT observations

3.15 The difficulties in minimising compliance costs for transfer pricing arise from the nature and volume of information needed to satisfy the ATO of compliance. In contrast to normal tax liability issues, there is no conclusive evidence of compliance, only a range of economic, business management and accounting information from which inferences can be drawn.

3.16 To minimise costs for both taxpayers and administrator, the ATO should strive to provide certainty to taxpayers and ensure the costs imposed are proportionate to the risks. Administrative carve outs, safe harbours, simplified documentation and accepted industry standards are means to achieve these aims. Some of these cost efficient means to minimise double taxation were previously recommended in the context of Advance Pricing Arrangements (APAs) by PricewaterhouseCoopers (PWC) Legal in its 2008 APA Review.³⁸²

3.17 The costs of compliance particularly for smaller taxpayers are regressive. Taxpayer experience indicates that, despite the guidance in the SME Publications, currently all taxpayers are effectively required to prepare the same nature and level of documentation. This issue is accentuated now that a 25 per cent penalty for no reasonably arguable position will be applied where documentation is inadequate.³⁸³

3.18 The IGT observes that the United Kingdom's (UK) Her Majesty's Revenue and Customs (HMRC), by contrast, provides an exemption from transfer pricing rules for the vast majority of transactions carried out by a business that is a SME. HMRC regards small enterprises as having up to 50 staff and either its annual turnover or balance sheet being less than €10 million. A medium enterprise has up to 250 staff and either its annual turnover is less than €50 million or balance sheet is less than €43 million. There are, however, a few exceptions where HMRC's SME exemption

³⁷⁸ *ibid.*

³⁷⁹ Threshold requirements for completion: ATO, *International Dealings Schedule* (2012).

³⁸⁰ ATO, 'TR 98/11', above n 373.

³⁸¹ Simplified APA procedures: ATO, 'PS LA 2011/1', above n 148.

³⁸² PWC Legal, above n 109, p 5.

³⁸³ *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013.*

does not apply, such as where the SME has international related party transactions with countries with which the UK does not have a tax treaty.³⁸⁴ Such thresholds may be relative to others in the UK economy. However, such thresholds do provide guidance to the ATO in setting similar relative thresholds, for example \$15 million, for simplified documentation requirements.

3.19 The IGT observes that on 16 May 2013, the Organisation for Economic Co-operation and Development (OECD) Council approved the revision of Section E on safe harbours in Chapter IV of the OECD Guidelines. New OECD guidance on safe harbours provides opportunities for countries to relieve some compliance burdens and to provide greater certainty for cases involving smaller taxpayers or less complex transactions. With that, the revised Section E provides a basis for countries to design a transfer pricing compliance environment that makes optimal use of the limited resources available.³⁸⁵

3.20 The IGT also notes that draft Practice Statement PSLA 3187 which was released on 16 December 2009, outlined a 'practical rule of thumb' approach for the transfer pricing of interest payable by a taxpayer on a cross-border related party loan. Specifically, the ATO undertook not to challenge an interest rate paid by a subsidiary on a related party debt where the interest rate applied to the transaction equated to the ultimate parent's weighted average cost of debt (calculated on an annual basis). The draft Practice Statement was subsequently withdrawn because the ATO considered that the 'practical rule of thumb' approach was no longer necessary with the release of *Taxation Ruling TR 2010/7*.³⁸⁶

3.21 The IGT is of the opinion that the ATO should consider increasing its use of safe harbours starting with low value or common transactions similar to those contained in *Taxation Ruling TR 1999/1*. One area that is worth exploring for application of such an approach is international related party loans and interest.

3.22 The ATO should perhaps go a step further and investigate a 'margin approach' to transfer pricing similar to that contained in Brazilian regulations (which may effectively be seen as safe harbours).³⁸⁷ Whilst this may be departing too far away from the OECD's arm's length approach, all options should be explored and at least aspects of them with appropriate modification may prove to be useful. Concepts such as arm's length price and market value are based on sound economic principles, however, compliance with them on a practical level is costly, can lead to uncertainty, disputes and litigation the outcome of which can be highly unpredictable.

³⁸⁴ HMRC, *INTM - International Manual* (27 August 2013) INTM412070 - *Transfer Pricing: Legislation: Rules: Exemptions: Small and Medium Sized Enterprises* <<http://www.hmrc.gov.uk>>.

³⁸⁵ OECD, 'OECD Approves the Revision of the Section on Safe Harbours in the Transfer Pricing Guidelines' (Media Release, 21 May 2013) <<http://www.oecd.org>>.

³⁸⁶ Thomson Reuters, *Income Tax Assessment Act 1997*, para [820.1100]; KPMG, *Transfer Pricing Update: Analysis of ATO Ruling on the Interaction between the Transfer Pricing and Thin Capitalisation Rules* (1 November 2010); ATO, 'NTLG Minutes' (March 2010) Internal ATO Document; ATO, 'NTLG Minutes' (November 2012) Internal ATO Document, p 26; ATO, *Income Tax: The Interaction of Division 820 of the Income Tax Assessment Act 1997 and the Transfer Pricing Provisions*, TR 2010/7, 27 October 2010, para [49].

³⁸⁷ Normative Instruction No. 243/2002 (Brazil).

3.23 It could be argued that some taxpayers may 'push the boundaries' if safe harbours are offered. However, it could be argued that safe harbours may also save government revenue as more taxpayers will achieve a minimum level of compliance with less impact on ATO resources.

3.24 In addition to safe harbours, the ATO should also consider the use of 'simplified' transfer pricing methods in appropriate circumstances. The IGT notes that a number of OECD countries have such measures.

3.25 Whilst providing documentation exemptions for smaller taxpayers may create difficulties for the ATO to verify compliance, there is opportunity for the ATO to reduce costs for smaller taxpayers by providing greater certainty on the nature and level of required documentation. This could be done, for example, by outlining specifically the ATO's documentation requirements in the SME Publications.

3.26 In respect of publishing industry comparable data, the IGT is aware that some countries, such as Chile, publish anonymised APA data for the benefit of other taxpayers. The relevant provision states:

Those taxpayers authorising the Chilean Tax Authority to publish the criteria and the economic, financial and commercial/business reasons, among others, and the methods by which the advance pricing agreements were entered into pursuant to this provision, will be included, if they so agree, in a list of taxpayers socially responsible, which is to be managed by said tax authority. Even when taxpayers have not authorised their inclusion in said list, no sanctions and/or fines based on violations of their tax liabilities ascertained during the period in which the APA is in force shall be levied against them, unless these sanctions are punishable by imprisonment. If this is the case, said taxpayers will be immediately excluded from the list [unofficial translation].³⁸⁸

3.27 The IGT is of the opinion that, without breaching any secrecy and privacy requirements, the ATO should consider providing as much industry data as possible to help taxpayers determine the appropriate arm's length price. This has potential to greatly reduce taxpayers' compliance costs.

3.28 Additionally, the significant number of APAs entered into between the ATO and taxpayers has led to a number of 'accepted practices and principles' which have developed over time that are not immediately apparent upon a reading of the transfer pricing legislation. These accepted practices and principles can also provide public guidance to taxpayers and minimise their costs of compliance.

³⁸⁸ *Law on Income Tax, Decree Law No. 824 of 1974, Article 41-E, Number 7 (Chile).*

RECOMMENDATION 3.1

The IGT recommends the ATO:

- (1) increase its use of safe harbours starting with low value or common transactions such as those with international related party loans and those in the services industry;*
- (2) provide simplified transfer pricing documentation requirements for taxpayers with international transactions valued below for example \$15 million; and*
- (3) without breaching any secrecy or privacy laws, publish as much industry information as possible relating to pricing of related party transactions including the relevant functions, assets and risks.*

ATO response

Agree

The ATO agrees with this recommendation and is currently considering the options listed but notes that we cannot act on these initiatives unilaterally, so we are also in dialogue with domestic and international stakeholders.

TIMEFRAMES FOR TRANSFER PRICING COMPLIANCE ACTIVITIES

3.29 This section focuses on timeframes for transfer pricing compliance activities such as risk reviews and audits. Timeframes for APAs and Mutual Agreement Procedures (MAPs) are considered in Chapter 4 along with other matters.

3.30 Stakeholders observed that the ATO's resolution of transfer pricing matters took too long, unnecessarily increasing compliance costs. Stakeholders considered the ATO could reduce timeframes and their costs in a number of areas.

3.31 First, stakeholders commented that protracted timeframes for TPR Reviews and transfer pricing audits were due to a lack of effective project management and inadequate communication of mutual expectations.

3.32 Stakeholders have provided examples such as the ATO changing case plans unilaterally and without communicating with taxpayers. Such changes result in considerable difficulties in marshalling the required resources to respond to the ATO's enquiries while at the same time fulfilling other tax, statutory and commercial obligations. Stakeholders comment that committing to agreed timelines upfront would enable taxpayers to plan their resourcing for responding to information requests in a timely manner.

3.33 Comparisons were made by stakeholders between the ATO's approach to case planning and other revenue authorities, such as the United States (US) Internal

Revenue Service (IRS), where taxpayers are provided clearly defined timelines and processes for the resolution of transfer pricing cases. Stakeholders comment that these IRS timelines were clearly communicated and updated throughout the dispute.

3.34 Secondly, stakeholders raised concerns with the disparity between the timeliness of taxpayer and ATO responses. Stakeholders consider that the case teams efficiently manage the time granted to the taxpayer to respond to information requests and position papers but the case teams are not efficient at managing their own timeframes to resolve transfer pricing issues.

3.35 Stakeholders observe that the operational case teams generally:

- take a long time to process taxpayer information and are slow to respond to taxpayer queries;
- do not engage sufficiently or frequently enough with taxpayers to communicate outstanding issues or issues on which ATO officers want to gain a better understanding; and
- require written responses to lengthy position papers within unreasonably short deadlines, such as within 30 days over the December-January holiday period.

3.36 Stakeholders commented that the disparity between the time taken for the ATO to process information and the time allowed for the taxpayer to prepare a response results in significant time pressure being placed on the taxpayer and limits the extent of data and analysis provided to the ATO. Stakeholders mentioned that long ATO timeframes were acceptable if there was ongoing and meaningful exchange of information and communication which is targeted and dynamic. In practice, however, there are long periods where there is no communication.

3.37 Thirdly, stakeholders raised concerns with the lack of remission of interest charges for ATO delays in formulating its technical position. Stakeholders have commented that where a technical issue is subject to ongoing uncertainty from a broader perspective, taxpayers should not be penalised by way of ongoing interest charges whilst the ATO formulates its position. Where such uncertainty exists, stakeholders also suggest that the uncertainty should be acknowledged by the ATO when assessing penalties.

3.38 Lastly, stakeholders raised concerns with the unlimited period of review for transfer pricing matters. Stakeholders said that the unlimited amendment period for transfer pricing acts as a disincentive for the ATO's timely resolution of transfer pricing cases, which can impact tax treaty partners with shorter period of amendment.

3.39 The IGT has previously called for a limit to be placed on the amendment period for transfer pricing matters in his *Review into Improving the Self Assessment System*.³⁸⁹ Following this recommendation, on 29 June 2013, the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* introduced an

³⁸⁹ IGT, *Review into Improving the Self Assessment System* (2012) Recommendation 3.10.

amendment period of 7 years for the Commissioner of Taxation to make transfer pricing adjustments.

ATO material and information

3.40 Publicly, the ATO manages the community's expectation on timeframes through its service standards which are published in its annual reports and other publications. The expectation is that large business audits and complex APAs are to be completed within two years.³⁹⁰ The ATO has advised the IGT that it is currently in the process of updating its service standards.³⁹¹

3.41 There are additional unpublished internal service standards on the expected duration of other compliance products, including TPR Reviews, Client Risk Reviews (CRR) and non-complex APAs. There are also some internal 'expectations' on the timeframes for internal specialist advice units. These expectations do not quantify timeframes but expect the specialist unit 'to work with case teams to meet the ATO's service standards'.

3.42 Although the service standards set general expectations, more accurate timeframes for reviews and audits are outlined in their respective case plans which are developed at the commencement of compliance activities.³⁹²

3.43 In developing case plans, the ATO's Large Business and Tax Compliance booklet (LBTC Booklet) outlines that Large Business and International (LB&I) operational case teams are to have ongoing, open and frank discussions and agree on a case plan upfront with taxpayers in both risk reviews and audits. During audits the ATO expects its officers to regularly review and update the audit plan and inform taxpayers of their progress and explore ways with taxpayers on how completion may be expedited.³⁹³ The Tax Compliance for Small-to-Medium Enterprises and Wealthy Individuals publication (Tax Compliance Publication) makes similar comments to the LBTC Booklet.³⁹⁴

3.44 The ATO records and internally reports data on the timeframes for completing transfer pricing compliance activities. The timeframes commence from the date of case allocation through to finalisation. Each type of activity may have a different expected service standard.

3.45 Table 6 below sets out the LB&I business line timeframe data compiled from the business-as-usual (BAU) Operations case teams as well as the LB&I Transfer

³⁹⁰ For example: ATO, *Annual Report 2011-12* (2012) p 18; ATO, *Large Business and Tax Compliance* (2012) p 30; ATO, 'PS LA 2011/1', above n 148, para [16].

³⁹¹ ATO, Communication (30 July 2013).

³⁹² Service standards: ATO, 'Level 4 Report', above n 353; case plans in TPR Reviews and transfer pricing audits: ATO, 'TPRR Procedural Manual', above n 145; ATO, 'Audit Manual', above n 148.

³⁹³ ATO, 'LBTC', above n 389.

³⁹⁴ ATO, *Tax Compliance for Small-to-Medium Enterprises and Wealthy Individuals* (26 October 2012) <www.ato.gov.au>.

Pricing Strategic Compliance Initiative (TPSCI) project case teams. The ATO has not provided a break-up of data between those two areas.

Table 6: LB&I compliance activities timeframes between 2006 and 2012

Activity	Number of cases	Service standard	Number exceeding service standard	% exceeding service standard	Max. time (days)	Min. time (days)	Avg. time (days)
IT audit comp LBA large	1	730	0	0%	36	36	36
IT large business comp audit	27	730	16	59%	2244	60	919
IT large business spec audit	5	730	0	0%	462	48	196
Transfer pricing audit	7	730	1	14%	1038	29	340
IT large business specific audit — 365	4	365	1	25%	505	2	282
Transfer pricing record review	196	180	55	28%	437	0	128
Transfer pricing record review	20	180	13	65%	680	82	220
IT large client risk review	210	240	110	52%	1035	17	271
IT large project risk review — HV	4	120	4	100%	327	133	255
IT large specific review	115	180	34	30%	1267	1	157
IT innovations specific review	3	90	1	33%	232	4	105
IT specific enquiry	238	30	92	39%	363	2	45
IT transfer pricing	1	90	1	100%	266	266	266
IT compliance assurance review	32	365	9	28%	986	28	249
IT large ACA review	2	730	0	0%	484	218	351
IT large simplified SE — HV	13	45	0	0%	44	3	29
IT specific enquiry — 180	1	180	1	100%	420	420	420
IT large pre-lodgment comp review	6	549	1	17%	599	1	324
Total activities	885		339	38%			

Source: IGT analysis of ATO data.

3.46 The data³⁹⁵ in the table above indicates that, over the last six years, the LB&I business line has exceeded its benchmark service standards in 38 per cent of all compliance activity cases (339 of 885 cases), including;

- 41 per cent of audit cases (18 of 44 cases); and
- 31 per cent of TPR Review cases (68 of 216 cases).

3.47 The table below sets out the timeframes for completing transfer pricing compliance activities in the SME business line.³⁹⁶

Table 7: SME compliance activities timeframes between 2006 and 2012

Activity	Number of cases	Service standard	Number exceeding service standard	% exceeding service standard	Max. time (days)	Min. time (days)	Avg. time (days)
GST specific audit field HV	1	120	0	0%	45	45	45
IT audit spec SME office	6	180	0	0%	45	16	31
IT SME office spec audit	2	180	0	0%	115	43	79
IT SME office spec audit esc	1	120	0	0%	56	56	56
IT SME specific audit	2	540	0	0%	159	72	116
IT SME specific audit esc	7	420	3	43%	617	15	313
IT SME 1 specific audit	1	540	0	0%	190	190	190
IT SME 1 specific audit esc	1	420	0	0%	27	27	27
IT SME 2 comprehensive audit	14	540	6	43%	2001	77	681
IT SME 2 office spec audit	1	180	0	0%	32	32	32
IT SME 2 specific audit	1	540	0	0%	99	99	99
IT SME 2 specific audit esc	1	180	1	100%	576	576	576
IT SME 3 comprehensive audit	6	540	2	33%	819	307	522
IT SME 3 office spec audit	1	180	0	0%	100	100	100
IT SME 3 office spec audit esc	1	120	0	0%	30	30	30
IT SME 3 specific audit	1	540	0	0%	42	42	42
IT SME audit comprehensive	4	540	0	0%	162	14	95

³⁹⁵ As identified earlier in the IQF reports, the quality of Siebel data varies.

³⁹⁶ ATO, 'Level 4 Report', above n 353.

Table 7: SME compliance activities timeframes between 2006 and 2012 (continued)

Activity	Number of cases	Service standard	Number exceeding service standard	% exceeding service standard	Max. time (days)	Min. time (days)	Avg. time (days)
IT SME comprehensive audit	30	540	3	10%	762	19	294
IT SME 1 comprehensive audit	1	540	1	100%	940	940	940
IT SME 1 office spec audit	1	180	1	100%	687	687	687
IT HWI Comprehensive risk revw	1	240	1	100%	364	364	364
IT Ind tax haven review HV	12	90	1	8%	91	1	36
IT internal review	118	10	114	97%	354	1	114
IT review comp SME CRR	1	180	0	0%	118	118	118
IT review spec internal HV	36	40	1	3%	53	9	31
IT review spec SME PRR	41	60	9	22%	112	9	56
IT SME comprehensive review	195	120	145	74%	591	24	193
IT SME Comprehensive risk revw	88	120	50	57%	531	14	166
IT SME field specific review	5	60	3	60%	314	1	118
IT SME PRA	6	60	0	0%	60	50	58
IT SME preliminary risk review	12	60	8	67%	171	57	87
IT SME PRR	264	60	85	32%	340	2	63
Transf pricing record review	1	180	0	0%	13	13	13
IT internal review — 40	429	40	91	21%	231	1	37
IT SME Comprehensive risk revw — 180	67	180	23	34%	503	15	189
IT SME comprehensive review — 240	15	240	6	40%	365	142	229
All compliance campaign	14	40	0	0%	40	0	13
Total	1388		554	40%			

Source: IGT analysis of ATO data.

3.48 The data³⁹⁷ in the table above indicates that, over the last 6 years, the SME business line has exceeded its service standards in 40 per cent of all compliance activity cases (560 of 1404 cases), including:

- 20 per cent of audit cases (17 of 83 cases); and
- 41 per cent of transfer pricing record review cases (537 of 1305 cases).

3.49 In relation to the reasons for extended timeframes in some cases, an internal report identified a number of systemic issues including:

Teams generally had in place work plans for delivery. However, although the teams were aware of the urgency around delivery times, the work plans or contingency planning did not necessarily reflect this urgency...

A significant amount of Economist Practice work was outstanding leading to a rearrangement of economist work schedules to bring forward delivery timeframes...

More generally, while some case teams had clearly considered and prioritised the technical issues and approaches on the back of a thorough audit and forensic process, in other cases it was less clear that the same rigor had been applied to the technical analysis, forensic process, or in the development of the ATO position...³⁹⁸

3.50 In one case, it was noted that the specific operational case team had 'lost all control and accountability'.³⁹⁹

3.51 The report identified that the main focus for improvement work included:

Performing tasks in parallel (eg, starting the engagement of TCN in conjunction [with] the drafting of position papers).

Early engagement of key stakeholders well before the scheduled task (eg, setting the path for independent reviews).⁴⁰⁰

3.52 The LB&I business line's site-based callovers also found timeframes could be improved by better case planning.

3.53 The ATO's procedural guides for TPR Reviews and transfer pricing audits require case teams to prepare case plans at the commencement of transfer pricing matters. These case plans should direct their work and outline timeframes for the completion of the compliance activity. Case team leaders are responsible for approving the case plan. The ATO further advises that it is the responsibility of the operational

³⁹⁷ As identified earlier in the IQF reports, the quality of Siebel data varies.

³⁹⁸ ATO, 'Case Callover Summary', above n 316.

³⁹⁹ ATO, 'Callover Summary: Perth', above n 364; ATO, 'Callover Summary: Parramatta', above n 364; ATO, 'LB&I AC Case Callover Summary Melbourne: 6 and 7 September 2012' (29 October 2012) Internal ATO Document; ATO, 'LB&I AC Case Callover Summary Brisbane 27 and 28 August 2012' (29 October 2012) Internal ATO Document.

⁴⁰⁰ ATO, 'Case Callover Summary', above n 316.

case teams to actively manage cases, provide explanations for why case timeframes may extend and what they are doing to address the causes of delays.⁴⁰¹

3.54 In TPR Reviews and transfer pricing audits, ATO officers are assisted in developing case plans by the Economist Practice and where necessary, the Profit Shifting Practice (PSP). In TPR Reviews, officers may also be assisted by a Transfer Pricing Network (TPN) member in developing case plans. In audits, the Transfer Pricing Review Panel (TPRP) may also endorse the case plan where appropriate.⁴⁰²

3.55 In 2010, the LB&I business line also trialled a 'plan and manage network' of officers experienced in managing complex cases to assist staff with planning and managing their cases. The ATO has advised that training materials for mentors are being designed and are likely to be based on, and linked to, the LB&I end-to-end program.⁴⁰³

3.56 Operational case teams are expected to actively manage their cases and apply the relevant project management principles and techniques.⁴⁰⁴ This is tested through the ATO's Manager Assurance Program and mandatory LB&I Checklists at mid-year and annual performance appraisal.

3.57 In the LB&I business line, its Site Governance callover process monitors aged cases and seeks to ensure that case plans are followed. Previously, there were separate callover processes run by LB&I Case and Topic Leadership (CTL) Case Leadership and the Profit Shifting Governance Group (PSGG).⁴⁰⁵

3.58 Where LB&I Operations case teams have exceeded the internal benchmark timeframes, or are likely to exceed those times, in compliance activities, the LB&I CTL Case Leadership unit becomes involved. This unit assists LB&I Operations case teams by providing oversight and strategic direction on key compliance cases and technical leadership on more complex issues. The LB&I CTL Case Leadership unit provides guidance, counsel and leadership in managing the technical issues and/or the case to ensure it is progressing appropriately.⁴⁰⁶ Similarly, the SME Technical and Case Leaders (TCL) Case Leadership unit assists SME General Compliance case teams with the resolution of complex tax technical issues and includes, conducting callovers of significant and potential aged or blocked cases. Further, the engagement of the SME TCL Case Leadership unit is mandatory where cases exceed or are likely to exceed benchmark timeframes.⁴⁰⁷

3.59 The ATO currently has a 28 day service standard to respond to taxpayers' general correspondence and other requests. If taxpayers have not provided all the information needed to make a decision, the ATO aims to contact taxpayers within

⁴⁰¹ ATO, 'Communication (10 May 2013)', above n 152.

⁴⁰² ATO, 'TPRR Procedural Manual', above n 145; ATO, 'Audit Manual', above n 148.

⁴⁰³ ATO, Communication: LMAC Response to Request for Information No. 2 (Learning & Development in LBI) (14 November 2012).

⁴⁰⁴ ATO, *Project and Program Management*, PS CM 2003/05, 26 July 2012.

⁴⁰⁵ ATO, 'Communication (10 May 2013)', above n 152; ATO, 'Communication (19 March 2013)', above n 265.

⁴⁰⁶ ATO, 'Case and Topic Leaders', above n 197.

⁴⁰⁷ ATO, 'Technical and Case Leadership', above n 205.

14 days to ask for the information. If the request raises particularly complex matters that will take more than 28 days to resolve after receiving all the required information, the ATO aims to contact taxpayers within 14 calendar days to negotiate an extended reply date.⁴⁰⁸

3.60 The LBTC Booklet also states that the ATO will ensure information requests are satisfied in a timely manner and coordinate its requirements to accommodate taxpayers' business cycles and any important demands on key people. The Tax Compliance Publication also states that when the ATO requests information they will give taxpayers adequate time to respond. After taxpayers supply the information the ATO expects its officers to advise taxpayers how long it will take for the ATO to review and respond to taxpayers.

3.61 The LBTC Booklet and Tax Compliance Publication generally outline that taxpayers will be provided an opportunity to respond to the ATO's position paper before a final position paper is issued. The ATO's Streamlined Audit Manual for Transfer Pricing includes steps relating to the drafting of position papers, such as ensuring that taxpayers are given an opportunity to respond.

3.62 Following the IGT's 2004 announcement of his *Review into Tax Office Audit Timeframes*⁴⁰⁹ (Audit Timeframes Review), the then Commissioner of Taxation announced in September 2004 that he had appointed Mr Kevin Burges to get a picture of private experiences and concerns about ATO audits. This report was issued in April 2005. One of the initiatives ultimately flowing from this report was remission of the Shortfall Interest Charge (SIC) and General Interest Charge (GIC) for the period that audits went beyond two years. Only in exceptional cases involving blatant obstruction would this remission not apply. Such cases would need to be agreed by the Deputy Commissioner following discussion with executives of the relevant large business taxpayer.

3.63 *Practice Statement PSLA 2006/8* sets out the ATO's policy on the remission of SIC and GIC and incorporates the Commissioner's initiative by remitting interest to the base rate for audits exceeding their predetermined cycle time. The practice statement also provides additional grounds for remission, including:

- delay in commencing audit;
- expected audit completion date exceeded;
- unreasonable delay;
- delay in obtaining information from a third party; and
- longer resolution times due to complexity of issues.

⁴⁰⁸ ATO, *Our Commitments to Service* (30 June 2013) <www.ato.gov.au>.

⁴⁰⁹ IGT, *Review into Tax Office Audit Timeframes* (2005).

3.64 Additionally, the IGT Audit Timeframes Review recommended that the ATO implement appropriate governance processes to ensure that the GIC attributable to significant periods of ATO-caused audit delay is remitted. The ATO agreed with this recommendation.⁴¹⁰

IGT observations

3.65 Realistic case planning is based on an understanding of the steps and timeframes involved in identifying and verifying tax risk, as well as the steps needed to quickly arrive at a common understanding of each party's position including their views on the law, facts and evidence.

3.66 The ATO's data in Tables 6 and 7 shows that over the last 6 years, between 38 to 40 per cent of compliance activities have exceeded the ATO's expected timeframes for completion. This may explain why the ATO has been unable to complete the number of compliance activities it plans, as observed in Chapter 2.

3.67 These protracted timeframes for the resolution of transfer pricing compliance activities suggest a need to re-examine expected timeframes for compliance activity completion, the nature of taxpayer engagement and the governance of case timeframes.

3.68 Senior ATO officers have stated that international tax audits are generally complex and the two year audit timeframe is optimistic.⁴¹¹ Accordingly, the ATO should consider whether its timeframes for compliance activities involving international tax issues should be differentiated.⁴¹² The ATO has also advised that it will consider the appropriateness of its internal service standards within 18 months of its Review of Service Standards project.⁴¹³

3.69 Great care should be exercised in merely setting an overall case timeframe as an expectation. The impact of the ATO's two-year audit timeframe was reviewed by the IGT in the *Report into the Australian Taxation Office's Large Business Risk Review and Audit Policies, Procedures and Practices*⁴¹⁴ (LB&I Review). In that review, the IGT considered stakeholder submissions which claimed that the ATO was stipulating amended assessments by the end of the two years even though there had been little time for taxpayers to respond to the position papers. Where taxpayers managed to respond in the short time available to them, there was little or no time to debate the merits of competing positions. Taxpayers felt forced to prepare and lodge objections to protect their position, notwithstanding that the ATO position was still being formulated.

⁴¹⁰ ATO, *Remission of Shortfall Interest Charge and General Interest Charge for Shortfall Periods*, PS LA 2006/8, 11 July 2012.

⁴¹¹ ATO, 'Communication (19 March 2013)', above n 265.

⁴¹² *ibid.*

⁴¹³ ATO, 'Communication (30 July 2013)', above n 390.

⁴¹⁴ IGT, *Report into the Australian Taxation Office's Large Business Risk Review and Audit Policies, Procedures and Practices* (2011).

3.70 In the above review, the IGT found that there was a need for clearer milestone events including timeframes and expectations around these milestone events. It is noted, however, that the ATO disagreed with the relevant recommendation.⁴¹⁵ The IGT reasserts these recommendations in the context of transfer pricing matters explored in this review.

3.71 In relation to how timeframes can be minimised, it should be noted that whilst operational case teams are responsible for the management of all aspects of reviews and audits, they may be assisted by a number of other specialist units within the ATO. However, these case teams have no authority to require the other areas to provide advice within certain timeframes. General expectations, such as 'endeavour to work with case officers to ensure that overall service standards are met' and 'cases will be prioritised depending on the case's risk and available resources' are not sufficiently definitive. Specialist units providing advice to operational case teams should be required to meet their own benchmark timeframes to ensure they also have accountability for their involvement in transfer pricing issues.

3.72 Although the ATO publishes some timeframes for the completion of transfer pricing compliance activities, there are a number of internal expectations relating to the completion of other transfer pricing products (such as TPR Reviews, CRRs and non-complex APAs) which are not published. The IGT considers that greater transparency and accountability would be promoted by publishing these timeframes and service standards.⁴¹⁶

3.73 The IGT also considers that asymmetries in response timeframes as between the ATO and the taxpayer adversely impact the relationship between the two parties and the efficient and effective resolution of issues. The ATO should ensure the expectations it sets are achievable and reasonable with response timeframes falling within the overarching timeframe for the compliance activity. Accordingly, the ATO in consultation with taxpayers, should plan an accurate as possible timeline at the outset of compliance activities and ensure that it is closely followed.

3.74 It would be desirable for case teams to submit their case plans, including any proposed amendments, for review by transfer pricing experts particularly if their assistance is to be sought during the compliance activity. Further, the transparency and efficiency of the management of transfer pricing compliance activities could be improved where the views of taxpayers on the ATO's case planning were considered by these experts.

3.75 In relation to timeframes imposed on taxpayers, although general timing standards, such as 28 days, are an important project management tool, there are a number of factors that should be considered in each case when setting response times. These factors include the complexity of the matters, the amount and type of information sought, key staff availability and seasonal considerations. Accordingly, ATO officers could be made aware more explicitly of considerations that may impact

⁴¹⁵ *ibid* Recommendation 8.3.

⁴¹⁶ The ATO consulted a range of taxpayers on what service standards they wanted to be reported. This was not one of them: ATO, 'Communication (30 July 2013)', above n 390.

upon taxpayers' ability to respond to the ATO by engaging with the taxpayer during the case planning stage and whenever information is requested.

3.76 Executive monitoring of overall case timeframes and internal cycle times is essential to appropriately manage cases. Over reliance on bottom-up escalation processes in circumstances where generalist case teams rely on specialist advice can result in unnecessary delays. Therefore, top-down intervention should be initiated where internal cycle times are exceeded.

3.77 The issue of remitting interest due to ATO delays was considered in the IGT's abovementioned Audit Timeframes and LB&I Reviews. The IGT considers that *Practice Statement PSLA 2006/8* should be clarified to include such delays.⁴¹⁷

RECOMMENDATION 3.2

To establish more accurate timeframes for transfer pricing compliance activities and improve adherence to them, the IGT recommends that the ATO:

- (1) review and update its existing benchmarks for timeframes relating to transfer pricing compliance activities to better reflect ATO and taxpayer resources and complexity of matters being considered;*
- (2) establish and publish benchmarks for timeframes required by the ATO's specialist units to provide advice to the case teams;*
- (3) develop a mechanism for top-down intervention by the specialist units where it is expected that case timeframes may be exceeded;*
- (4) require case teams to consult with specialist units and taxpayers when preparing and/or amending case plans;*
- (5) ensure taxpayers are provided with adequate time to consider and respond to information requests and that time be commensurate to the complexity and volume of information sought; and*
- (6) remit interest attributable to ATO delays.*

ATO response

Agree in part

The ATO agrees with parts 1 and 3 to 6.

⁴¹⁷ '[W]here there is complexity involved in the issues underlying a shortfall, it may take some time to come to a view as to the proper operation of the law. So there may be a hiatus between the commencement of the audit and the amendment of the assessment': ATO, 'PS LA 2006/8', above n 409, para [63].

With respect to part 2, the ATO disagrees with separately publishing benchmark timeframes for specialist advice as the time required is dependent on the facts and circumstances of the individual case.

Regarding part 6, in exercising the discretion to remit interest, the criteria outlined in PS LA 2006/8 will be applied.

TAXPAYER ACCESS TO ATO SPECIALISTS

3.78 Stakeholders believe that the lack of access to ATO specialists and external consultants (such as third party economists engaged by the ATO) causes unnecessary delays, frustrations and extra costs. Their specific concerns are:

- unclear processes for stakeholders to escalate transfer pricing issues, including gaining access to the ATO's transfer pricing specialists. Stakeholders also observe that any requests to speak with the ATO's experts appear to cause angst with the case teams and in some cases have been explicitly denied. Paradoxically, the case teams are believed to be reluctant to engage in meaningful taxpayer discussions without the ATO's transfer pricing specialists; and
- the ATO's transfer pricing specialists and some external consultants not consistently or sufficiently engaging with taxpayers and their advisers to discuss commercial factors underlying their pricing and other transfer pricing issues. Stakeholders comment that this is particularly important where they consider that the ATO case teams have made incorrect assumptions about their businesses and transfer pricing arrangements.

ATO materials and information

3.79 The ATO's LBTC Booklet and Tax Compliance Publication provide that where taxpayers and their advisers have any issues they wish to raise with the ATO, contact should first occur with the delegated case officer. The details of the delegated contact officer are provided to taxpayers and their advisers at the commencement of compliance activities.⁴¹⁸ Where taxpayers and their advisers consider the case officer's response unsatisfactory, they are permitted to contact the case officer's team leader. Where the response continues to be unsatisfactory, taxpayers and their advisers may request that the team leader escalate the issue to their immediate manager.⁴¹⁹ In this regard, the LBTC Booklet and the Tax Compliance Publication state that access will be granted to the ATO's 'decision makers.' In transfer pricing compliance activities, the decision makers are the operational case teams.⁴²⁰

3.80 The ATO has advised that taxpayers and their advisers are also able to meet with LB&I Technical Leadership Group (TLG) and Economist Practice officers to

⁴¹⁸ ATO, 'LBTC', above n 389, p 30.

⁴¹⁹ ATO, 'LBTC', above n 389; ATO, 'TCSME' above n 393.

⁴²⁰ ATO, 'LBTC', above n 389, pp 16, 30-31.

discuss their concerns.⁴²¹ Similarly, operational case teams in the SME business line will facilitate access to specialists in transfer pricing compliance activities.⁴²²

3.81 In regards to the TPRP, as mentioned in Chapter 2, *Practice Statement PSLA 2004/13* outlines that taxpayers do not have a right of access to, or representation at TPRP meetings. Only in exceptional circumstances may taxpayers be given an opportunity to liaise with the TPRP members where the chairperson, in consultation with the case owner, regards this as appropriate. For example, where it is necessary to assist the TPRP's consideration of the case or it is necessary to assist the taxpayer in understanding the outcome of the TPRP's consideration of the case.⁴²³

3.82 Taxpayers, however, may be given the opportunity to review and comment upon the factual accuracy of materials prepared for consideration by the TPRP, at the case owner's discretion.⁴²⁴

IGT observations

3.83 The efficient resolution of complex taxation issues requires the timely interaction between ATO specialist units and operational case teams as well as taxpayers and their advisers to quickly define and narrow the issues and understand the basis for each party's position.

3.84 Currently, there is no explicit ATO direction to its officers that taxpayers and their advisers should be granted access to the supporting specialist units or the circumstances where such access should be granted, other than in respect of the TPRP. Directing operational case teams to facilitate access to supporting specialist units and the circumstances in which specialist units should be required to meet taxpayers, will help ensure that issues are quickly identified, narrowed and resolved based on relevant information. This is particularly important while operational case teams are developing long term capability. It can also assist the ATO's specialists to develop their capability in dealing with taxpayers and their advisers on technical issues.

3.85 Similarly, there is no guidance provided to taxpayers and their advisers on how they may access the ATO's specialist units. The LBTC Booklet and the Tax Compliance Publication are limited in that access is to the operational case teams only. Whilst it is important to maintain a single point of entry for discussion with the ATO, it is similarly important that taxpayers should be made aware of the circumstances in which they may access the ATO's specialist units to discuss specialist issues such as economic issues or legal issues. This may include for example, providing relevant escalation methods to taxpayers at the outset of compliance activities.

⁴²¹ ATO, 'Communication (10 May 2013)', above n 152; ATO, 'Communication 1 (14 March 2013)', above n 149.

⁴²² ATO, Communication 1 (15 March 2013).

⁴²³ ATO, 'PS LA 2004/13', above n 167, para [25].

⁴²⁴ *ibid.*

RECOMMENDATION 3.3

The IGT recommends that with respect to transfer pricing compliance activities, the ATO ensures:

- (1) specialist units engage with taxpayers and their advisers where requested and appropriate; and*
- (2) at the outset, taxpayers and their advisers are made aware that they are able to, and how they may request, access to the various specialist units.*

ATO response

Agree

TRANSFER PRICING RECORD REVIEWS

3.86 Stakeholders support the ATO's risk review processes where they are able to exclude compliant cases from unproductive compliance activity. However, stakeholders raised a number of concerns with the TPR Review approach.

3.87 First, stakeholders raised concerns with the ATO's documentation checklist used in TPR Reviews. Stakeholders observe that ATO officers can use the documentation checklist to simply assess the documentation, with a 'failing score' leading to audit. This approach has the potential to be manipulated as it entices taxpayers to 'tick the boxes' without necessarily obtaining information that assists in understanding the related party dealings or why these were carried out.

3.88 Secondly, stakeholders consider that the commercial realism test in TPR Reviews is based on high level benchmarks that have low data integrity and are not fit for the purpose of identifying transfer pricing risks.

3.89 They comment that the reliability of comparables ultimately depends on the similarity in functions, assets and risks. However, the Australian Bureau of Statistics (ABS) and other forms of publicly available data that the ATO uses in TPR Reviews, is anonymised and is not granular enough to accommodate for reasonable commercial factors, such as the life cycle of the business. The benchmarks developed from the LB&I business line's industry knowledge were also raised as a concern by stakeholders as they may not be representative or current.

3.90 Stakeholders further comment that data relied upon for TPR Review benchmarks are not consistently transparent. The benchmarks, therefore, are said to create an uneven playing field and perceptions of the use of 'secret' comparables. Stakeholders consider that if the commercial realism analysis undertaken by ATO case teams was public, it would create a level playing field in the taxpayer community and advisory community, giving an understanding of when a tax audit could be undertaken and improving the benchmarks and its inputs. It was also suggested that

the major accounting firms and others already maintain their own databases and benchmarking across the globe. Therefore, making such analysis public was not expected to give rise to undue compliance risk assessment concerns.

3.91 Lastly, stakeholders raised concerns that the commercial realism test in TPR Reviews results in cases being unnecessarily selected for an audit. Although high level benchmarks may be useful to identify taxpayers with profit outcomes departing from a broad average, benchmarks do not assist ATO officers to understand the basis for the taxpayer's reported profit outcomes or appropriately consider the technical integrity or quality of commercial reasons for the taxpayer's position. Accordingly, stakeholders mention that ATO officers' focus on profit outcomes could negate any transactional benchmarking the taxpayer has relied upon in its transfer pricing documentation.

3.92 Stakeholders comment that such an approach encourages ATO officers to 'chase the bottom line' and establish a bias towards confirming the profit outcomes indicated by the high level benchmarks without adequately understanding the commercial drivers or factors underpinning taxpayers' positions. For example, stakeholders have observed that ATO officers appeared to have pre-conceived ideas as to what the financial performance of taxpayers should be prior to gaining any understanding of their business, its functions, assets or risks.

3.93 Stakeholders commented that the ATO's profit outcomes approach in TPR Reviews wasted considerable time, imposed unproductive expenses and that ATO views only became more entrenched. For example, the ATO issued a number of information requests to taxpayers and undertook their own analysis to determine an arm's length outcome without engaging in meaningful discussions with the taxpayer or their professional advisers as to how the ATO and the taxpayer might work together to understand each parties' position.

3.94 Given the cost of undertaking benchmarking analyses and to prepare supporting materials for both parties, stakeholders comment that a more meaningful consideration of taxpayers' positions is required at the TPR Review stage. Detailed analysis of taxpayers' transfer pricing materials was usually left until the audit process was well in motion. Stakeholders comment that the alternative for TPR Reviews is a low cost transfer pricing documentation requirement to 'get passed the scoring process' which adds little information or depth to assist the reader.

3.95 Stakeholders argue that given the time and costs involved in an audit, a more robust initial risk review process is required that better considers the merits of the commercial case and technical position taken by taxpayers. Stakeholders also comment that the current TPR Review process is unfair as taxpayers have provided significant financial data and analysis to the ATO and should be provided with the opportunity to dispute the ATO's TPR Review decision.

ATO materials and information

3.96 As described in Chapter 2, the ATO TPR Review process starts with an initial interview with the taxpayer. The operational case teams are expected to give taxpayers an opportunity to present any helpful information.

3.97 The ATO has also used questionnaires to target information gathering on particular transfer pricing risks, such as business restructures, profitability and financing during the TPSCI project. These questionnaires were issued at the commencement of TPR Reviews to assist with profiling and risk identification. The questionnaires also intended to minimise compliance costs and disclose to taxpayers the areas of interest to the ATO.

3.98 The ATO's *Taxation Ruling TR 98/11* guides taxpayers in preparing transfer pricing documentation in terms of the coverage and depth of documents.⁴²⁵ One of the main focuses of the TPR Review is the quality of documentation. The operational case teams are instructed to spend a few days, at most, understanding the taxpayer. This may include understanding taxpayers' group structure, international and Australian operations and international related party dealings. Operational case teams are also directed to review the taxpayer's tax return and IDS.⁴²⁶

3.99 In evaluating the quality of documentation, ATO case teams use a checklist to compare taxpayers' transfer pricing documentation with the responses in their IDS. Operational case teams also use this checklist to assess taxpayers' documentation in line with the four steps in *Taxation Ruling TR 98/11* as either low, low to medium, medium, medium to high, and high quality.⁴²⁷ The ATO advises that this checklist essentially asks whether the topics covered by the items disclosed in the IDS have been adequately addressed in the taxpayer's documentation. The checklist does not ask whether ATO officers agree with the analysis presented in the reports provided.⁴²⁸

3.100 The TPR Review also involves evaluation of the taxpayer's financial performance over four years to determine the commercial realism of their transfer pricing. According to ATO procedures, this involves the comparison of the taxpayer's financial ratios, such as income/sales ratios⁴²⁹ or asset based ratios⁴³⁰ against other companies' in specific segments, taking into account the functions performed, assets used and risks undertaken. The financial performance of these comparable companies' is extracted from:

- publicly available data, such as ABS data;
- the LB&I business line's industry knowledge obtained as a result of prior work; or
- other sources identified by the Economist Practice, such as accounting firm surveys or Tax Statistics.⁴³¹

3.101 The publically available data also includes public accounts of taxpayers and interest rate data where relevant.⁴³²

⁴²⁵ ATO, 'TR 98/11', above n 373.

⁴²⁶ ATO, 'TPRR Procedural Manual', above n 145.

⁴²⁷ *ibid.*

⁴²⁸ *ibid.*

⁴²⁹ Such as Profit margin, EBIT/total income or EBIT/sales.

⁴³⁰ Such as Return on Assets, Return on Net Worth or EBIT/assets.

⁴³¹ ATO, 'TPRR Procedural Manual', above n 145.

3.102 In relation to the data developed on the basis of LB&I industry knowledge, the ATO advises that although it had used these benchmarks previously, it has not used these for a number of years. However, the ATO is considering reinvigorating this approach.⁴³³ The ATO's staff instruction also considers that although 'secret' comparables may be used, they will generally not be used at the TPR Review stage.⁴³⁴

3.103 The ATO instructs operational case teams in its TPR Review Procedural Manual to, in 'consultation' with the Economist Practice, exercise judgment in determining the most appropriate ratios to be used.⁴³⁵

3.104 The Economist Practice unit is then expected to work with the case teams to determine whether the taxpayer's profitability is:

- 'commercially realistic';
- less than 'commercially realistic'; or
- consistently returns losses.⁴³⁶

3.105 The ATO advises that there is no specific instruction material for economists in relation to TPR Reviews and transfer pricing audits as it is expected that they will rely on their professional judgment.⁴³⁷

3.106 The ATO considers that, although this profit outcome and simplified ratios approach may not of itself indicate potential transfer pricing risks, it does provide a sound basis for determining a commercially realistic outcome for risk assessment purposes.⁴³⁸

3.107 All TPR Reviews must have a workshop with operational case teams and relevant 'specialists' to discuss all risks arising from a TPR Review that are likely to lead to an audit. The focus of these workshops is on clarity of the tax risks, technical issues and the consideration of any response from the taxpayer. These workshops must include 'specialists' prior to finalisation where the TPR Review:

- involve the top 30 taxpayers;
- have potential risks over \$100 million in potential income or reduction in losses;

⁴³² ATO, Communication (9 April 2013).

⁴³³ ATO, 'Communication 1 (14 March 2013)', above n 149.

⁴³⁴ ATO, 'TPRR Procedural Manual', above n 145.

⁴³⁵ *ibid.*

⁴³⁶ *ibid.*

⁴³⁷ ATO, 'Communication 1 (14 March 2013)', above n 149.

⁴³⁸ ATO, 'TPRR Procedural Manual', above n 145.

- have potentially systemic risks; and
- have complex or ambiguous arrangements or require specialist industry experts.⁴³⁹

3.108 The operational case teams are directed to work 'in conjunction with' the Economist Practice to come to 'agreed' positions on taxpayers' risk ratings and a 'follow-up strategy', such as an audit. The TPR Review is then referred to the TPRP to 'endorse' operational case teams' recommendations prior to taxpayers being notified of the outcome of TPR Reviews.⁴⁴⁰

3.109 Where the TPR Review is of a top 30 taxpayer, operational case teams must hold a finalisation interview with the taxpayer at the conclusion of the TPR Review to discuss the risk findings and their implications.

3.110 The TPR Review finalisation interview is not mandatory where the taxpayer is not a top 30 taxpayer or where the risks are considered 'low' or 'trivial'.

3.111 Where a finalisation interview is conducted, a 'senior tax officer' will facilitate the interview and relevant technical 'experts' may be involved in particularly complex cases. This interview must include discussion about the tax risks, the reasons why the operational case team believe the risks exist, the implications for the taxpayer from these findings and what the taxpayer can do to mitigate the risks.⁴⁴¹

3.112 In the ATO's International Leadership Team (ILT) meeting minutes, it is implied that the ATO intended to review and improve the TPR Review process, including the documentation checklist. During this review, the ATO advised that the process was stopped due to budgetary constraints.⁴⁴² However, as mentioned in Chapter 1, the ATO advised during the finalisation of this review that it intends to discontinue TPR Reviews and use a single comprehensive risk review product to review all material risks, including transfer pricing, that are identified through the case selection and profiling process.⁴⁴³

IGT observations

3.113 The TPR Review was first introduced by the ATO in 1998.⁴⁴⁴ At the time, the TPR Review fulfilled a means to exclude lower risk transfer pricing taxpayers on the basis of documentation and overall profit. As business practices have evolved and tax compliance matured in this area, identification of potential non-compliance has increasingly required more refined processes.

⁴³⁹ *ibid.*

⁴⁴⁰ *ibid.*

⁴⁴¹ *ibid.*

⁴⁴² ATO, 'Communication (19 March 2013)', above n 265.

⁴⁴³ ATO, 'Communication (6 November 2013)', above n 274.

⁴⁴⁴ As a result of: ATO, 'TR 98/11', above n 373; ATO, 'TPRR Procedural Manual', above n 145.

3.114 The TPR Review indicates the degree of transfer pricing risk by analysing the 'quality' of documentation and the financial performance of a taxpayer against the industry norms. However, the design of the TPR Review does not encourage operational case teams to establish the purported reasons for the taxpayer's departure from the accepted range of financial ratios or a more refined risk hypothesis or 'typology' which can be tested in subsequent audit. This work appears to only occur during audits, by which time it may be too late to avoid unproductive compliance costs.

3.115 The IGT considers that TPR Reviews provide an opportunity for the ATO to better understand taxpayers' transfer pricing methodologies and the reasons underpinning commercial performance before considering whether to invest both parties' time and resources in an audit. The ATO's TPR Review approach could be complimented by using a less resource intensive process designed to focus on key issues to quickly eliminate comparatively lower risk cases. This process should comprise a risk assessment process that focuses on articulating specific hypotheses to the taxpayer. The hypothesis and the reasoning need to be explained in clear terms.

3.116 Issues or concerns, such as the taxpayer being outside the high level ratios used by the ATO, aspects of related party dealings, business operating model and key factors that impact on a group's profitability should be shared. Such a process would better inform the ATO, allow consideration of the taxpayer's explanation prior to a risk rating being determined and potentially facilitate an early exit from the process avoiding a costly and unnecessary audit. It also affords the taxpayer the opportunity to be heard.

3.117 Indeed, one example of the above approach was provided in stakeholder submissions to this review, where a decision to commence an audit was reversed after the ATO considered the reasons for the taxpayer's level of profitability. It has been observed that such scenarios are often due to the involvement of a more experienced officer.

3.118 The above approach seems to be closely aligned with the ATO's public statements in the design of risk review processes generally:⁴⁴⁵ a risk review seeks to establish a risk hypothesis, whereas an audit verifies the existence of that risk.⁴⁴⁶ This approach would enable the ATO to merge the TPR Review process with other risk review products already used by the ATO. Indeed, the ATO has indicated its intent to 'fold in' transfer pricing risks into its ordinary risk review process, the CRR.

3.119 Additionally, allowing the taxpayer an opportunity to address the case team's concerns before the matter is conveyed to the TPRP for consideration, or the International Structuring and Profit Shifting (ISPS) unit as the case may be in future, would again ensure that the information put before TPRP or ISPS is more accurate.

⁴⁴⁵ ATO, 'LBTC', above n 389.

⁴⁴⁶ *ibid.*

3.120 The ATO has also advised the IGT of its desire to update its industry benchmarks based on data collected by the LB&I business line.⁴⁴⁷ The IGT also considers that the substantial amounts of information collected by the ATO via the IDS could be used to improve the ATO's internal indicators of commercial realism in TPR Reviews to better target compliance activities. As recommended earlier in this Chapter, publication of these benchmarks would promote transparency and improve compliance where they include the functions, assets and risks on which the benchmarks are based.

3.121 By improving the accuracy of risk reviews involving transfer pricing, audit activity will be targeted towards more appropriate cases. This would have the effect of freeing administrative resources and reducing the unproductive compliance burden on compliant taxpayers.

RECOMMENDATION 3.4

The IGT recommends that the ATO improve its risk review processes involving transfer pricing by:

- (1) ensuring that operational case teams establish the purported reasons for the taxpayer's departure from the accepted range of financial ratios;*
- (2) providing taxpayers an opportunity to address the ATO's concerns prior to the TPR Review being referred to the TPRP or ISPS; and*
- (3) developing more refined internal comparables for use in risk reviews.*

ATO response

Agree in part

The ATO agrees with parts 1 and 3

The ATO disagrees with part 2. We are discontinuing the separate TPRP process and the resolution of technical issues in transfer pricing cases will be aligned with the ATO's broader model for compliance work, where compliance officers are accountable for decision making in a case and the role of specialists is to provide expert advice. Consistent with the co-operative approach outlined in the Large business and tax compliance booklet, taxpayers are afforded an opportunity to present their concerns to case teams and, where appropriate, specialists advising on the case will be brought into those discussions.

⁴⁴⁷ ATO, 'Communication (9 April 2013)', above n 431.

TRANSFER PRICING AUDITS

3.122 First, stakeholders raised concerns that some case teams gather an excessive amount of unnecessary information on a broad range of matters. This unfocused information gathering by operational case teams occurs primarily during the functional analysis stage of transfer pricing audits. They consider that there does not appear to be a way to shortcut this information gathering process once commenced. Stakeholders' frustrations are exacerbated as operational case teams are said not to communicate the reasons why such information is requested during this stage.

3.123 Stakeholders' observations on the ATO's information gathering during audits include that case teams' information requests:

- often relate to information previously supplied;
- are outside the statutory retention period; and
- expect the same level of documentation for SMEs as they do for large businesses, despite the reduced documentation requirements for SMEs.

3.124 The ATO's approach to information gathering is said by stakeholders, to significantly add to taxpayers' compliance costs, unnecessarily creating a burden both to the ATO and business across their organisations.

3.125 Generally, stakeholders questioned the nature and level of information requested by ATO operational case teams. Stakeholders appreciate that with transfer pricing matters, no one piece of information will address concerns, as it is a process of analysis based on inferences to determine what an independent business owner would have done in the circumstances. However, stakeholders consider experience and skill is required to guide operational case teams to know what is required to inform them to ask targeted questions and help transfer pricing audits move forward.

3.126 Stakeholders consider that if ATO operational case teams communicated their concerns to taxpayers, in a manner that allowed them to engage and address those concerns, the ATO would have better targeted and more relevant information. Stakeholders consider that such an approach would be more efficient for both the ATO in gathering information and for taxpayers as their compliance burden would be minimised.

3.127 Secondly, stakeholders observe that the ATO operational case teams are generally not amenable to reconciling their position to that of the taxpayer but readily and cursorily dismiss a taxpayer's analyses without due consideration of the relevant technical aspects. For example, stakeholders have noted that ATO officers do not demonstrate an understanding of taxpayers' positions. Stakeholders also observe that although the ATO conducts fieldwork to test its view, facts or materials that do not support the ATO position are disregarded or given no weight by the ATO.

3.128 Thirdly, stakeholders raised concerns that operational case teams do not always communicate their concerns until a position paper is issued. Stakeholders have noted positive examples where the ATO had actively engaged with taxpayers to explain how particular information assists the ATO to determine the allocation of the

taxpayer's functions, assets and risks. However, stakeholders observe that some case teams were not consistently willing or able to communicate or discuss:

- their risk hypothesis;
- their technical concerns with specific transactions and opinions on the economic or functional analysis issues unless the ATO's transfer pricing specialists were present;
- the relevance between the information requested and the issues being reviewed—accordingly, stakeholders had no touchstone of relevance prior to a position paper being issued; or
- the reasons and analysis supporting the quantum of adjustment.

3.129 Stakeholders have also said that meetings with ATO case teams are generally rare and difficult to arrange. Stakeholders consider the lack of communication to be unacceptable causing taxpayers to devote additional resources, both internal and external, to respond to ATO concerns when there was little evidence of the ATO basing its position on researched and technical arguments. Stakeholders say this unnecessarily prolongs case timeframes and increases their compliance costs.

3.130 There have often been substantial delays and long periods without any feedback from ATO officers. This gave rise to significant uncertainty for taxpayers, particularly where senior management did not understand the reason for the ATO's actions.

3.131 Stakeholders also consider that it is critical for the ATO to ensure that robust OECD-based analyses are conducted, documented and made available to taxpayers on a timely basis in order to assist with prompt and appropriate resolution of transfer pricing audit cases.

3.132 Lastly, stakeholders raised a number of concerns regarding the ATO's use of comparables in transfer pricing audits. They prefer a tailored, OECD-based approach that considers which point in the identified arms' length range of prices is most reflective of the facts and circumstances of the taxpayer, having regard to the available local and international guidance and the large amounts of information, financial analyses and data that had been supplied by taxpayers.

3.133 Stakeholders, however, observe that the ATO does not use appropriate comparables and question whether sufficient analyses are undertaken to ensure benchmarks are sufficiently comparable considering the nature of taxpayers' businesses. Even when the ATO has undertaken a more significant analysis of the taxpayer's business and profitability, taxpayers have identified errors and discrepancies which should not have been made. With earlier engagement of transfer pricing experts, stakeholders considered that many such errors may have been avoided.

3.134 Stakeholders also consider that the ATO places excessive reliance on profit methods, such as the Transaction Net Margin Method (TNMM) despite the relevant comparables being too broad and inaccurate and therefore, less reliable.

3.135 On occasions the ATO has used a high level analysis of broad industry benchmarks, such as ABS data or cost base plus an uplift to determine commercial outcomes and a transfer pricing adjustment based on the median arm's length range. Stakeholders consider that such an approach inappropriately overrides taxpayers' transactional benchmarking and commercial explanations for the pricing. Further, it is suggested that such benchmarks are only meant to be used for risk assessment purposes and not for any adjustments.

3.136 Stakeholders also point out the difficulties in selecting appropriate comparables, such as different revenue authorities taking different perspectives of data and using different data sets. Stakeholders note that taxpayers may use a range of different databases to establish comparables. This increases the difficulties in resolving issues of double taxation.

ATO materials and information

3.137 Aspects of the ATO's processes for transfer pricing audits were previously described in Chapter 2. It is important to recall that when conducting a transfer pricing audit, operational case teams are directed to reconstruct the taxpayer's transfer prices by following the four steps outlined in *Taxation Ruling TR 98/11*.⁴⁴⁸ Operational case teams are warned not to work backwards from taxpayers' transfer prices as this may cause potential bias.⁴⁴⁹

3.138 Further guidance on the transfer pricing audit process is set out in the ATO's Streamlined Audit Manual for Transfer Pricing. This manual was designed for use by officers undertaking the audit of companies whose primary function is to import and distribute products acquired from foreign related parties. However, the ATO considers that the approach outlined in this manual can be used as a template for the transfer pricing audits of other types of businesses with 'suitable modifications'.⁴⁵⁰

3.139 The ATO's general approach to information gathering has been influenced by previous IGT reviews⁴⁵¹ and is outlined in a number of its publications including the:

- LBTC Booklet;
- *Large Business Active Compliance Manual – Income Tax* (LBACM) publication; and
- Tax Compliance Publication.

3.140 The LBTC Booklet outlines the ATO's approach to understanding taxpayers' businesses and information gathering in the large business market. For example, the use of the 'BISEP Model' which considers business, industry, sociological, economic and psychological factors that influence taxpayer behaviour. The LBTC Booklet states

⁴⁴⁸ ATO, 'Audit Manual', above n 148

⁴⁴⁹ *ibid.*

⁴⁵⁰ *ibid* p 5.

⁴⁵¹ IGT, 'Large Business Review', above n 413; IGT, *Review into the ATO's Compliance Approaches to Small and Medium Enterprises with Annual Turnovers between \$100 million and \$250 million and High Wealth Individuals* (2011).

that the ATO will collect substantial amounts of information and evidence when examining complex compliance matters to get 'full facts'.⁴⁵²

3.141 The ATO acknowledges that taxpayers should have a clear understanding of the ATO's requests, why that information was requested and how it relates to the matter under review. However, the ATO has advised that the scope and relevance of its requirements are matters for them to determine.⁴⁵³ Notwithstanding this approach the ATO has advised that it will develop timeframes and protocols concerning provision of information as part of the audit plan agreed with the taxpayer.⁴⁵⁴

3.142 The LBACM and the Tax Compliance Publication make similar comments as the LBTC Booklet.

3.143 In respect of transfer pricing specifically, the ATO's approach to information gathering is outlined in *Taxation Ruling TR 98/11*, which states generally:

It can be expected that the ATO would acquire a good knowledge of the business of the enterprise to assist in taking a realistic view of the issues involved. The enquiries may need to cover industry and economic cycles and a number of relevant businesses and years and may include:

- examining the worldwide operations, strategies and structure of the [Multi-National Enterprise] MNE group to which the taxpayer belongs to establish the roles played by the taxpayer and the associated enterprise(s);
- examining the market structure and dynamics, the enterprise's strategic direction, financial position, marketing strategies, pricing documentation, assets employed and risks borne and examining the documentation for specific international transactions, where necessary. This also includes an examination of all arrangements with associated enterprises and the interrelationship of those arrangements. Performance reports may also be examined to isolate any products or services that warrant particular attention;
- examining budgets, business plans and financial projections;
- interviewing a selection of the taxpayer's staff to establish the skills base and to understand the functions performed and the decision making processes adopted. Staff interviewed normally include relevant operational, managerial, finance and accounting staff;
- reviewing the taxpayer's pricing processes; and
- ascertaining in broad terms any comparable uncontrolled dealings, the assets employed and risks borne by any comparable uncontrolled enterprises. This would normally be refined as part of a comparability analysis.

⁴⁵² ATO, 'LBTC', above n 389.

⁴⁵³ *ibid*; ATO, 'LBI Executive Minutes: Disputes Management Advisory Panel July 2012 - Recommendations for Improved Litigation Outcomes' (7 September 2012) Internal ATO Document.

⁴⁵⁴ ATO, 'LBTC', above n 389.

The demand for this information depends on the ATO's progress through the four steps. Requests for information should be framed having regard to the specific information needs of the case.

Every effort should be made to ensure that necessary information is collected only once, subject to the need to verify information or amplify explanations from time to time and subject to cases where it may be more convenient to the taxpayer to provide information that overlaps.⁴⁵⁵

3.144 *Taxation Ruling TR 98/11* further outlines details of particular aspects of the ATO's approach to information gathering:

- chapter 5 – outlines the (contemporaneous) documentation requirements to substantiate the arm's length nature of a taxpayer's transfer prices;
- chapter 6 – discusses documentation for small business taxpayers and taxpayers with low levels of international dealings;
- chapter 7 – discusses documentation relevant to the selection and application of particular transfer pricing methodologies;
- chapter 8 – outlines documentation for certain business strategies;
- chapter 9 – discusses collection, use of, and access to third party data in the context of a transfer pricing review or audit and addresses a number of issues related to the ATO's powers to access information and documentation and taxpayers' right of access to information collected by the ATO; and
- chapter 10 – outlines the use of publically available sources of data.⁴⁵⁶

3.145 The overview above regarding the ATO's information gathering materials for transfer pricing is directed at gaining an understanding of the taxpayer's business and arrangements of concern, consistent with steps one and two of the four-step process specified in *Taxation Ruling TR 98/11*.⁴⁵⁷

3.146 As stated earlier, operational case teams are supported by the Economist Practice to assist in preparation of audit plans and information gathering tasks to ensure that the plan is appropriate, for example, identifying additional information to assist with critiquing taxpayers' functional analyses. Where necessary, an adviser from the Internationals unit may also provide this advice.⁴⁵⁸

3.147 The ATO's Streamlined Audit Manual for Transfer Pricing informs operational case teams that, '[y]our Internationals advisor and economist will be able

⁴⁵⁵ ATO, 'TR 98/11', above n 373, paras [4.33]–[4.37].

⁴⁵⁶ ATO, 'TR 98/11', above n 373.

⁴⁵⁷ ATO, 'Audit Manual', above n 148.

⁴⁵⁸ *ibid.*

to supply much of the information [during transfer pricing audits] and the remainder should be included in your audit [information gathering] plan'.⁴⁵⁹

3.148 There are other ATO areas that may have input during the information gathering phase for example, in workshopping documents with operational case teams and identifying information gaps. However, the operational case team is responsible for requesting the information from the taxpayer and managing the relationship.⁴⁶⁰

3.149 In guiding how much information is needed, the ATO expects its officers to exercise judgment in determining the nature and extent of documentation appropriate to taxpayers' circumstances. However, there is also an emphasis on ensuring that the 'full facts' are obtained and that the ATO is 'litigation ready'.⁴⁶¹

3.150 The LBACM and the Tax Compliance Publication also address ATO communication with taxpayers—information will be shared with taxpayers. In the LBTC Booklet, it is stated, with reference to the *Taxpayers' Charter*, the ATO will maintain open and frank dialogue, including agreeing case plans upfront, informing taxpayers regularly of the progress of any compliance activity and aim to make information requests clear and unambiguous. The LBTC Booklet further states that the ATO's risk hypothesis will be shared with taxpayers as it evolves at various stages of reviews and audits.⁴⁶² Both the LBACM and Tax Compliance Publication also make similar statements.⁴⁶³

3.151 The avenues for taxpayers and their advisers to escalate issues were previously described in this chapter.

3.152 Internally, the ATO has identified the factors outlining best practice on communicating with taxpayers:

- ensure there are two-way communication/feedback channels between taxpayer and teams for dealings with issues and concerns;
- [conduct] early and frequent communication about review or audit enables taxpayer availability to be factored into case plans and information requests;
- [organise] meetings — lock in and schedule in advance regular meetings helps keep everyone focussed and committed;

⁴⁵⁹ *ibid.*

⁴⁶⁰ ATO, 'Communication 1 (14 March 2013)', above n 149.

⁴⁶¹ ATO, 'Audit Manual', above n 148; ATO, 'LBTC', above n 389; ATO, 'LBI Executive: Callover', above n 309.

⁴⁶² ATO, 'LBTC', above n 389, pp 8, 29, 47.

⁴⁶³ *ibid* pp 29, 30, 47, 49; ATO, *Large Business Active Compliance Manual – Income Tax* (undated) <www.ato.gov.au>; ATO, 'TCSME' above n 393.

- [maintain] taxpayer relationships – [by] discussing issues and information needs early; and
- [conduct] communication from a confident and knowledgeable position.⁴⁶⁴

3.153 The ATO's Streamlined Audit Manual for Transfer Pricing, however, suggests that communication with taxpayers is limited to information gathering during the functional analysis stage of the transfer pricing audit:

The audit meetings and interviews should fall into two completely separate stages. The first stage is data and information gathering and understanding the cross-border transactions the company is involved in. This is not a time for debate, friction, expression of opinions or negotiation. At the data and information gathering stage the audit process is at its most vulnerable. Specific knowledge is limited and it is easy to follow lines of investigation that are fruitless; to make statements that are demonstrably at odds with the facts and to create a level of hostility that curtails the flow of data and information specific to the company under audit. The best approach to the initial meetings is to genuinely seek knowledge and be interested in the functions, assets and risks of the company and the activities of the staff interviewed...

The second stage of taxpayer meetings is a negotiation stage. Whilst no position paper would have issued or formal negotiations commenced, the fact is that by this stage the audit team will be informed about the company and the industry and would have identified some issues. When issues involving potential adjustments are identified and discussed, it is essential to understand that an implicit negotiation is in progress. If the taxpayer believes that the team doesn't understand the issue their attitude to the negotiation may be adversely affected.⁴⁶⁵

3.154 Another concern for the ATO is the determination of appropriate comparables along with identifying the most reliable transfer pricing method. The available comparables influence the selection of the most appropriate transfer pricing method.⁴⁶⁶

3.155 The ATO's Streamlined Audit Manual for Transfer Pricing recognises,

As TR 97/20 (paragraph 2.2) says, the concept of comparability is central to the arm's length principle. The purpose of comparability analysis is to identify an arm's length price or margin by ensuring that uncontrolled transactions used as benchmarks are sufficiently closely comparable to the controlled transaction to be so used, with adjustments made for relevant differences, if any.⁴⁶⁷

⁴⁶⁴ ATO, 'LB&I Better Teams Better Practices Information and Checklist' (December 2012) Internal ATO Document.

⁴⁶⁵ ATO, 'Audit Manual', above n 148, pp 17-18.

⁴⁶⁶ ATO, 'Communication (9 April 2013)', above n 431; ATO, 'TR 98/11', above n 373; ATO, 'TR 97/20', above n 53.

⁴⁶⁷ ATO, 'Audit Manual', above n 148, p 53.

3.156 The ATO's Streamlined Audit Manual for Transfer Pricing also goes on to describe in greater detail the factors relevant to comparability including:

- the nature of the goods or service;
- intangibles;
- contractual terms;
- economic and market circumstances;
- business strategies; and
- reliability of data concerning comparability.

3.157 The ATO acknowledges that taxpayer's transfer prices are unique. The objective is to determine an arm's length 'range' of prices. Therefore, the ATO seeks to explain any key divergences based on different methods used.⁴⁶⁸ Accordingly, a functional analysis is critical.⁴⁶⁹ The ATO advises that broad industry benchmarks should not be used in audits to make adjustments, rather 'actual' comparables should be used based on the taxpayer's business and operating model.⁴⁷⁰

3.158 The ATO advises that the Economist Practice uses a range of external subscription databases to determine appropriate comparables for the purpose of transfer pricing audits. These databases provide a range of information including data on MNEs (structures, dividends, earnings, shareholder and accounting data, credit ratings, royalties/licenses), industries, financial markets, countries and market research data, such as merger and acquisition activity.⁴⁷¹

3.159 The ATO acknowledges that materially similar comparables are difficult to find especially as some markets have shrunk significantly over time. Other difficulties include where companies have consistent losses or have particular marketing strategies, such as market penetration. The ATO advises that other countries have similar problems.⁴⁷² Where appropriate comparable uncontrolled prices cannot be found, the Economist Practice will look for comparables as close to the taxpayer's functions, assets, risks and the product/service under audit. In some cases the Economist Practice may need to consider comparables from other industries and countries.⁴⁷³

⁴⁶⁸ ATO, 'Communication (9 April 2013)', above n 431; ATO, 'TR 98/11', above n 373; ATO, 'TR 97/20', above n 53.

⁴⁶⁹ ATO, 'Communication (9 April 2013)', above n 431.

⁴⁷⁰ *ibid.*

⁴⁷¹ *ibid.*

⁴⁷² *ibid.*

⁴⁷³ *ibid.*

3.160 The use of arm's length ranges is also discussed in the ATO's Streamlined Audit Manual for Transfer Pricing:

... transfer pricing analysis is not an exact science, so there will be many occasions when the application of the most appropriate method or methods produces a range of outcomes...

It must also be observed that all of the observations in a range of outcomes may not be equally reliable so care is required, particularly where the maximum and minimum values are so disparate that at least one of them is likely to be wrong...

In estimating "the" arm's length price from data which is dispersed in ranges, team members should have regard to the advice set out in "Judgements", above. In particular, a description of the process by which the final estimate was arrived at should be set out in the relevant report, including considerations taken into account, how and why adjustments were made, what matters were considered and why and what matters were disregarded and why.⁴⁷⁴

IGT observations

3.161 The ATO's current approach to conducting transfer pricing audits is to conduct functional analyses in all cases before issues are identified and discussed with the taxpayer. This approach imposes a significant base line cost on the ATO and the taxpayer.

3.162 Functional analyses are inherently labour intensive and time consuming processes. Similar to undertaking market valuations, a thorough understanding of the various economic factors affecting pricing is needed. In addition to these complexities, transfer pricing also involves consideration of a range of material business factors to determine what an independent business owner would have done in the circumstances in an international context. Ultimately, it is a process of analysis based on inferences and determined through accepted methodologies. As a result, although assertions could easily be made, it is inherently difficult to conclusively prove.

3.163 Implementation of Recommendation 2.4, set out in Chapter 2, should reduce the number of such resource intensive activities to the highest risk cases. Improved risk identification flowing from Recommendations 2.4 and 3.5 (below) will also facilitate a differentiated approach to information gathering in audits to reduce the compliance burden on taxpayers. This may be achieved through a combination of project work conducted on known risks, as well as generating more focused risk hypotheses at the conclusion of risk reviews.

3.164 Furthermore, implementation of Recommendations 2.6 and 3.2 should improve the progress and timeliness of audits as a result of increased supervision and improved project management. In addition to these recommendations, the IGT has

⁴⁷⁴ ATO, 'Audit Manual', above n 148, pp 60-62.

previously made recommendation that benchmarks be set for key events during large business audits.⁴⁷⁵

3.165 As discussed in Chapter 5 of the IGT's LBI review, a key factor in the efficient and effective conduct of audits is the refinement of the risk hypotheses through ongoing transparent communication with the taxpayer. Information requests should be explained, discussed and referenced to these hypotheses in the absence of any fraud or evasion.

3.166 The ATO's current approach to information gathering in transfer pricing audits is to complete its functional analysis before entering into any discussions with the taxpayer –indeed there seems to be little discussion on technical issues until the position paper stage. This may have led to the stakeholder's view that the operational case teams are prone to 'confirmation bias'.

3.167 The IGT appreciates that the ATO should arrive at an independently reasoned position. However, ignoring taxpayer explanations increases the risk of unsustainable outcomes or at the very least causes a deterioration in the relationship between the two parties.

3.168 The IGT also considers that ongoing communication, aimed at refinement of the risk hypothesis, provides opportunity to expedite the audit process by leveraging off the work already undertaken by taxpayers and testing the taxpayer's approach based on a sound understanding of the factors that impact on profitability. In support of such a process, an example has been provided to the IGT which illustrates that a taxpayer was able to resolve ATO concerns, without undergoing a full audit, by engaging in discussions with the ATO specialist.

3.169 To ensure appropriate communication with taxpayers during the transfer pricing audit process, operational case teams should seek to facilitate the understanding of the strengths and weaknesses of each party's arguments at key stages. The ATO should also ensure that 'specialists' assisting operational case teams are available for discussions with taxpayers.

3.170 The IGT considers that such an approach will assist the ATO's relationship with taxpayers by building trust. It will also provide taxpayers with an opportunity to correct any misunderstandings of circumstances prior to finalising decisions. More targeted information gathering and reduced compliance costs will also likely result from such an approach, including more timely and appropriate resolution of transfer pricing audit cases.

3.171 Having established the functions, assets and risk, choice of methodology and comparables comes into focus. Once again communication with the taxpayer is the key. Understanding the taxpayer's choice of methodology and comparables may be a good starting point.

⁴⁷⁵ IGT, 'Large Business Review', above n 413, Recommendation 8.3.

3.172 Furthermore, having conducted many transfer pricing compliance activities in the past, the ATO has at its disposal a large amount of data which may prove to be useful in identifying comparables. A database, containing such data, may be developed with an appropriate search function which may assist operational case teams and specialist units to more rapidly determine comparables.

3.173 Another source for assistance in developing comparables for the ATO is other revenue authorities to harmonise databases used.

3.174 The IGT acknowledges that there are inherent difficulties with finding comparables, however, the above are some helpful means of simplifying the task.

RECOMMENDATION 3.5

The IGT recommends that the ATO:

- (1) develop benchmark timeframes for key events during transfer pricing audits as a guide to operational case teams to ensure that audits progress as expeditiously as possible;*
- (2) require operational case teams to discuss their information requests with the taxpayer providing reasons for such requests and how they would assist in refining the risk hypothesis; and*
- (3) improve and expedite the process of adopting and identifying appropriate methodologies and comparables by:*
 - (a) developing a searchable database of outcomes from previous compliance activities;*
 - (b) consulting other revenue agencies; and*
 - (c) seeking to understand the taxpayer's choice of methodologies and comparables.*

ATO response

The ATO agrees to parts 1, 2, 3b and c.

Regarding part 2, we acknowledge that our information gathering approaches are not always consistently applied by all case officers in all cases. We have recently updated guidance for ATO staff and taxpayers in our booklet, *Our Approach to Information Gathering*, published on 31 October 2013, which includes requirements in line with this recommendation. We will continue to reinforce with our staff the requirement that they adhere to the processes in that publication.

In respect of part 3a, the ATO agrees in principle, noting we would need to consider this in the context of our broader corporate IT strategy and priorities.

THE INTERNATIONAL DEALINGS SCHEDULE

3.175 Stakeholders raised a number of concerns with the IDS including:

- 1) Increased compliance costs, arising from the increased level and specificity of information required to be provided at lodgment time. Stakeholders have estimated the costs to be \$3,000-\$10,000 for smaller taxpayers and up to \$100,000 or more for larger taxpayers, taking between two to three months for an experienced person to collate the necessary material. In some cases, additional compliance costs have been incurred in upgrading business systems due to the requirement to provide information that is not captured by natural business systems and only produced for compliance purposes—for example, the IDS question on interest requires a quarterly balance rather than a closing balance.
- 2) The effect of compliance costs on SME taxpayers, as they do not have the same economies of scope and scale of resources as large businesses to capture, collate and provide the required type and amount of information.
- 3) The costs being disproportionate to the taxpayer's level of risk. Stakeholders consider much of the 'granularity' of information requested from all taxpayers completing the IDS is more akin to information collected from the 'riskiest' of taxpayers during a compliance activity. There is also uncertainty as to whether some of the information required to be provided in the IDS assists the ATO to identify tax risks—for example, the question on non-deductible expenses and derivatives, which requires taxpayers to provide large amounts of information—or whether the ATO is merely collecting it on behalf of another government department.
- 4) Better and broader consultation on the purpose and reason behind IDS disclosures would have likely minimised overall costs, particularly those disproportionately borne by SME taxpayers⁴⁷⁶ and those taxpayers of comparatively lower risk. They consider a differentiated information gathering approach based on a taxpayer's risk, size and natural business systems is more appropriate.
- 5) Uncertainty in making IDS disclosures due to unclear or incomplete instructions and terminology applicable on key issues.

ATO materials and information

3.176 The consultation process for the development of the IDS was described in Chapter 1 whilst the role of the IDS in developing risk filters was described in Chapter 2. This section provides further information on the IDS.

⁴⁷⁶ ATO, 'NTLG Internationals Minutes (July 2012)', above n 128.

3.177 The ATO maintains that the information collected in the IDS is important for the overall integrity of the tax system. The ATO intends to use this information to improve its:

- identification of international tax risks by enhancing the risk filters, which are also expected to decrease taxpayers' compliance costs arising from improved case selection;⁴⁷⁷
- timeliness and transparency of information gathering, by obtaining this information earlier in the compliance interaction cycle;⁴⁷⁸ and
- provide a greater focus on key compliance risk areas,⁴⁷⁹ through understanding the relevant market and industry wide patterns and trends to identify emerging and hitherto unknown risks—for example, where taxpayers' data significantly diverges from the industry norms⁴⁸⁰—and thereby facilitate the strategic management of international compliance risks.⁴⁸¹

3.178 The ATO acknowledges the concerns raised with the increase in costs on lodgment. However, the ATO considers that the information gathered under previous schedules was not effective in indicating comparative levels of compliance. Previously, the information had to be gathered from relatively few taxpayers during compliance activities. Without the IDS, the ATO considers that there would still be a need for multiple methods of information gathering.⁴⁸²

3.179 The ATO acknowledges that although it may not appear to be the case now, benefits will be realised as taxpayers adjust to the new reporting and lodgment requirements of the IDS.⁴⁸³ As 2012 was the first year for the compulsory lodgment of IDS by all relevant taxpayers, the ATO has sought to minimise some of the costs by accepting IDSs that have been prepared on a taxpayer's 'best efforts':

We understand that for some taxpayers there may not have been enough time to change your accounting systems to collect all the information required to complete this schedule for the first year. If this is the case, complete as much of this schedule as possible using your current systems and make a best effort to estimate figures where you do not have records of the actual data. Include in a covering letter with your International dealings schedule:

- what you needed to estimate and for which questions
- what data you used to make this estimate.⁴⁸⁴

⁴⁷⁷ ATO, 'Communication 2 (14 March 2013)', above n 289.

⁴⁷⁸ ATO, 'NTLG Internationals Minutes (July 2012)', above n 128.

⁴⁷⁹ *ibid.*

⁴⁸⁰ ATO, 'Communication (25 March 2013)', above n 286.

⁴⁸¹ ATO, 'Communication (25 February 2013)', above n 367; ATO, 'NTLG Internationals Minutes (July 2012)', above n 128.

⁴⁸² ATO, National Tax Liaison Group (NTLG) Internationals Sub-group Minutes (July 2011).

⁴⁸³ ATO, 'NTLG Internationals Minutes (July 2012)', above n 128.

⁴⁸⁴ ATO, International Dealings Schedule Instructions (2012) <www.ato.gov.au>.

3.180 Importantly, it should be noted that one of the ATO's objectives of implementing the IDS was to reduce taxpayer compliance costs by aligning the data requirements with normal business systems.⁴⁸⁵ The ATO advises that it is developing plans to analyse the data collected to ensure any possible improvements to the IDS and its instructions are identified and actioned. At a later stage, the ATO intends to conduct a post-implementation review to determine whether the objectives of the IDS have been achieved.⁴⁸⁶

3.181 The ATO's website stated that,

You can also provide feedback on any difficulties you have in completing the questions in the schedule. We will use this information for future versions of the schedule. Provide this feedback by... emailing the IDS project team at idsproject@ato.gov.au.⁴⁸⁷

3.182 At the time of writing, the ATO has advised that most submissions to the mailbox were questions on technical aspects of the IDS.⁴⁸⁸

IGT observations

3.183 The stakeholder feedback set out above indicates a need for greater consultation, education and understanding regarding the information needs of the ATO.

3.184 The IGT appreciates that the compliance costs should be proportionate to the relevant risks and that SMEs, particularly, should not be exposed to unnecessary compliance cost. In this respect a differentiated approach may be justified to achieve the underlying objective and yet minimise the impact upon smaller taxpayers or those that pose little or no risk. However, such differentiation needs to be balanced by the ATO's need for industry data and more general information to develop and refine its risk filters and better target its compliance activities. In the long run, such refinement of risk filters should minimise compliance costs for these very taxpayers.

3.185 Stakeholders' concerns with the proportionality of costs to the perceived risks and the consultation process to develop the IDS were considered in the IGT's *Review into Improving the Self Assessment System*⁴⁸⁹ and a recommendation has already been made:

(a) The ATO should consult with taxpayers, tax practitioners and/or their representative bodies every five years on information it seeks in company returns (as well as associated pre-assessment and expanded lodgement disclosure, such as ... the international dealing schedule...).⁴⁹⁰

⁴⁸⁵ ATO, National Tax Liaison Group (NTLG) Minutes (December 2009).

⁴⁸⁶ ATO, 'NTLG Internationals Minutes (July 2012)', above n 128.

⁴⁸⁷ ATO, International Dealings Schedule Instructions (2013) <www.ato.gov.au>.

⁴⁸⁸ ATO, 'Communication (25 March 2013)', above n 286; ATO, 'Communication 1 (19 March 2013)', above n 200.

⁴⁸⁹ IGT, 'Self Assessment Review', above n 388, paras [3.190]-[3.201].

⁴⁹⁰ *ibid* p 66.

3.186 In response the ATO agreed to:

...develop and implement procedures to periodically consult with relevant consultative forums and the community to review the information required on company and individual income tax returns and associated schedules...⁴⁹¹

3.187 The ATO intends to implement this recommendation by developing a plan by November 2013 'for ongoing review and consultation with relevant consultative forums on information required on company returns and associated schedules'.

3.188 The ATO has also indicated that it will conduct a post-implementation review of the IDS and assess, amongst other things, whether its objectives of reduced overall compliance costs, better understanding of the environment and identification of known and unknown risks have been achieved.

3.189 The IGT considers that the post-implementation review of the IDS provides an opportunity for the ATO to not only consider whether the aims of the IDS have been achieved, but to consult relevant taxpayers and their advisers to better understand the overall compliance burden that the IDS has necessitated.

3.190 A large majority of SME cases are said to involve less complex technical issues than larger business cases. However, in these instances there is less public information. The transfer pricing issues of SMEs also tend to involve simpler arrangements, such as marketing and distributing arrangements, rather than the more complex arrangements involving marketing hubs and attribution of intellectual property. Therefore, the ATO's concerns in the SME market segment have tended to focus on understanding the reasons for taxpayers' particular economic performance, rather than identifying emerging risks through patterns and trends. This suggests that there is an opportunity to tailor the information sought in the IDS to SME taxpayers in a manner that minimises compliance costs.

3.191 SME taxpayers comprise the vast majority of IDS lodgments. In this respect, it should be noted that the ATO requires the same data from these taxpayers as it does from large businesses. SME taxpayers, however, tend to have more difficulty with time and cost of transfer pricing documentation requirements, in relative terms, associated with the engagement of specialist advisers in this regard.

3.192 During this review, the ATO has indicated that it could, as part of the IDS post implementation review, consider whether the IDS completion threshold is appropriate for smaller taxpayers and whether it could be increased.⁴⁹²

3.193 The IGT considers, in addition to reconsidering the IDS completion threshold, differentiated forms could be developed for SME taxpayers. The IGT acknowledges that this may impose some additional administrative costs on the ATO to refine its information technology systems. However, consultations with SMEs would help the

⁴⁹¹ *ibid* p 66.

⁴⁹² ATO, 'Communication (25 February 2013)', above n 367; ATO, 'Communication (25 March 2013)', above n 286; ATO, 'International Leadership Team Minutes' (26 June 2012) Internal ATO Document.

ATO to better identify information required through the IDS to select risk reviews. The IGT also notes early indications that the ATO may be moving towards a differentiated tax return for businesses in the near future.⁴⁹³

3.194 The IGT also considers that the ATO instructions on the completion of the IDS on a 'best efforts basis' are limited. Due to the recent implementation of the IDS and substantial changes in reporting for taxpayers, the ATO should consider penalty remission for 'incorrect' completion of the IDS unless there is evidence of intentional omission or misinformation provided by taxpayers for the purpose of reducing tax. Such a remission policy is consistent with the implementation of new regimes.

RECOMMENDATION 3.6

The IGT recommends that the ATO:

- (1) with respect to its post implementation review of the IDS:
 - (a) examine the impact of the IDS on both large and SME taxpayers and their advisers through consultation with them;*
 - (b) determine the extent to which its intended aims of reduced compliance costs through, amongst other things, more industry data and improved risk filters has been achieved;*
 - (c) publish the findings of the review;**
- (2) consider a simplified IDS that reduces compliance costs for SME taxpayers and those that pose a low risk to Government revenue; and*
- (3) remit penalties where taxpayers have completed the 2012 IDS on a 'best effort basis'.*

ATO response

Agree

Regarding part 1, the ATO agrees but notes it is anticipated the review will be undertaken 3-5 years after the introduction of the IDS to enable an effective review.

Regarding part 2, the ATO agrees to consider a simplified IDS and we will undertake consultation as appropriate to explore this. However, we do note that the current thresholds have been designed to exclude taxpayers with international dealings of less than \$2 million and the schedule is structured such that smaller taxpayers are less likely to have to complete the entire schedule.

⁴⁹³ Chris Jordan, 'It's About Time' (speech delivered at the National Small Business Summit, Brisbane, 25 July 2013).

CHAPTER 4 — ATO'S ADVANCE PRICING ARRANGEMENTS AND MUTUAL AGREEMENT PROCEDURES

4.1 This Chapter considers the main stakeholder concerns with the Australian Taxation Office's (ATO) Advance Pricing Arrangements (APAs) and Mutual Agreement Procedures (MAPs). These stakeholder concerns are described immediately below, followed by a description of the relevant ATO material. The Inspector-General of Taxation's (IGT) observations are provided at the end of this chapter together with relevant recommendations.

STAKEHOLDER CONCERNS

4.2 Overall, stakeholders supported APAs and preferred them over transfer pricing audits as they view APAs as potentially limiting the adverse impact on taxpayer resources and associated costs involved in dealing with ATO compliance activities. Stakeholders also support the aims of the MAPs to reduce double taxation.

4.3 Stakeholders positively commented on the co-design process for APAs following PricewaterhouseCoopers' (PWC) *Review of the Advance Pricing Arrangement Program* in 2008 (2008 APA Review). However, notwithstanding the changes arising from this co-design process, they considered a number of concerns remain which have increased financial and business opportunity costs due to the time and resources expended, particularly in relation to bilateral cases.

4.4 Stakeholders commented that the ATO concludes simpler APAs cooperatively and relatively efficiently. However, they considered that ATO officers appeared to treat the APA process as a quasi-audit for many large business unilateral and bilateral APAs. Fundamentally, they considered for these large business APAs:

- the intensity of information gathering was more akin to that experienced in an audit and disproportionate to taxpayers' risk profiles, including uncertain relevance; and
- ATO officers were less willing to discuss their concerns and work with the taxpayer to identify the information that could resolve those concerns.

4.5 Stakeholders commented that the above approach tended to dissuade taxpayers from entering into APAs as the process imposes considerable compliance costs and extended timeframes. In fact, some overseas tax directors and tax managers consider the United States' (US) Inland Revenue Service (IRS) and ATO as the most

difficult revenue authorities in terms of APA negotiations, due to their 'micro approach to checks and approving APAs'.⁴⁹⁴

4.6 Stakeholders consider that the streamlined APA approach for Small and Medium Enterprises (SME) has shortened timeframes and reduced compliance costs for these taxpayers. However, they observe that the overall timeframes for concluding APAs have significantly increased over the last five years with some taking up to six years, leading some taxpayers to abandon the process. Stakeholders observe that although the process of the ATO analysing APA proposals and their terms is generally efficient, substantial delays can occur after substantive agreement has been reached on key points.

4.7 Stakeholders noted that the 2008 APA Review had made a number of recommendations to improve timeframes, amongst other things. Although they consider the ATO's subsequent redesign of the APA framework in *Practice Statement PSLA 2011/1* was a resulting improvement, they are concerned that other APA review recommendations have not been appropriately addressed, such as centralisation of the APA function and implementation of the 'stage and gate' approach for APAs. Whilst the ATO provided an update to the Large Business Advisory Group (LBAG), stakeholders consider that it was not a comprehensive briefing update on the APA program.

4.8 In relation to MAPs, stakeholders were concerned with the extended timeframes for negotiations between Competent Authority Representatives (CAR), and the subsequent enquiries that those discussions generated. They also questioned the need for the ATO to obtain further detailed information during MAPs, as the ATO had already obtained considerable information during the earlier audit or APA process.

4.9 Stakeholders also raised concerns with independence of the ATO's CARs who appear to have taken a less active role in the APA and MAP processes. Stakeholders attribute this to the ATO reducing the number of its CARs to three in number and drawing on its operational case officers who may be less independent. Accordingly, stakeholders consider it highly likely that the effectiveness and efficiency of bilateral negotiations is likely to substantially decrease and risk Australia's good record in relieving double taxation.

4.10 Some stakeholders raised particular concerns that recent reductions in the ATO's travel budget has also delayed the resolution of APAs and MAPs. Although alternative communication channels are available, meetings in person are more effective particularly when dealing with some jurisdictions.

⁴⁹⁴ Michael Walpole and Nadine Riedel, *The Role of Tax in Choice of Location of Intellectual Property: Report for the Oxford University Centre for Business Taxation* (2011).

Other issues

4.11 A number of other issues were raised that related to the clarity of the roles and responsibilities of different units, resourcing and budgetary constraints, and ATO officers' capability. These issues have been considered in Chapters 2 and 5.

ATO MATERIALS AND INFORMATION

4.12 The ATO's staff instructions, *Practice Statement PSLA 2011/1*, indicate that a 'cooperative approach' should be taken in the APA process.⁴⁹⁵ However, the ATO advises that where APAs are complex, involve novel arrangements or large sums of money, it needs to examine the underlying transactions and their tax consequences before the terms of an APA can be agreed. This is due to the administratively binding nature of APAs.⁴⁹⁶ In this respect, the ATO's expectation is that its officers will undertake a 'critical analysis of the APA application rather than undertaking original work to establish the arm's length outcome'. However, the ATO indicates that officers 'may choose to undertake original work in some circumstances'.⁴⁹⁷

4.13 The ATO recognises the need for judgment in certain cases with regard to the scope of APAs. While there is a preference for APAs to cover all of an entity's international related party transactions, the ATO understands the need for flexibility in its approach. Further, the ATO recognises that an all-encompassing approach may be considered inconsistent with its Risk Differentiation Framework.⁴⁹⁸

4.14 For complex APAs, the ATO expects the taxpayer to 'provide information/documentation commensurate with the complexity of the arrangement and the level of risk' and that 'some topics may require detailed examination'.⁴⁹⁹ However, in this event, the ATO expects its officers to 'explain the relevance of additional information requested and how it relates to the APA application' so that the taxpayer understands the purpose and reasons for the requests.⁵⁰⁰

4.15 The ATO's *Practice Statement PSLA 2011/1* also outlines what information the ATO may gather during the APA process such as:

- related parties involved in the APA;
- the term of the APA;
- covered international related party dealings;
- functional analysis;

⁴⁹⁵ ATO, 'PS LA 2011/1', above n 148, para [17].

⁴⁹⁶ *ibid* para [13].

⁴⁹⁷ *ibid* para [85].

⁴⁹⁸ ATO, National Tax Liaison Group (NTLG) Transfer Pricing Sub-Group Minutes (March 2011); ATO, National Tax Liaison Group (NTLG) Transfer Pricing Sub-Group Minutes (14 November 2012) p 5.

⁴⁹⁹ ATO, 'PS LA 2011/1', above n 148, paras [17(b)(viii)], [98].

⁵⁰⁰ *ibid* paras [96], [97].

- industry analysis; and
- selection and application of the transfer pricing methodology.⁵⁰¹

4.16 The ATO's expected timeframes for completing the different types of APAs are set out in the following table:

Table 8: ATO's expected timeframes for APAs

	Simplified	Standard		Complex
Types of APA products	Unilateral	Unilateral	Bilateral	Unilateral/ Bilateral
Target cycle time for a typical APA from pre-lodgment to finalisation (months)	9	12	18 — 24	24

Source: ATO, *ATO's Advance Pricing Arrangement Program*, PS LA 2011/1, 7 May 2012, para [16].

4.17 In addition to the above timeframes, the ATO expects that the pre-lodgment phase will take between one to three months depending on the type of APA product.

4.18 Further, the ATO can agree with the taxpayer to a different timeframe for the APA upfront, based on the issues that need to be resolved and the information required to come to an agreement.⁵⁰²

4.19 Data provided by the ATO in respect of APAs completed in the Large Business and International (LB&I) business line between the 2006 and 2012 calendar years is:

Table 9: APA data for LB&I between 2006 and 2012

Activity	Number of cases	Service standard	Number exceeding service standard	% exceeding service standard	Max. time (days)	Min. time (days)	Avg. Time (days)
IT APA ACR HV	255	60	45	18%	268	1	48
IT complex APA	6	720	0	0%	617	17	208
IT Large APA pre-lodgment	43	365	6	14%	707	1	205
IT simplified APA	2	270	1	50%	404	200	302
IT standard bilateral APA	7	720	0	0%	622	43	383
IT standard unilateral APA	16	360	6	38%	493	36	261

⁵⁰¹ ibid para [95].

⁵⁰² ATO, 'NTLG Transfer Pricing (March 2011)', above n 497; ATO, 'NTLG Transfer Pricing (14 November 2012)', above n 497, p 5.

Table 9: APA data for LB&I between 2006 and 2012 (continued)

Activity	Number of cases	Service standard	Number exceeding service standard	% exceeding service standard	Max. time (days)	Min. time (days)	Avg. Time (days)
Large APA	93	730	26	28%	2140	2	532
Large APA rollover	35	730	4	11%	1154	5	447

Source: IGT analysis of ATO data.

4.20 It should be noted that the ATO estimates that between 1 July 2011 to February 2013, 20 APAs have been abandoned in the large market.

4.21 The data⁵⁰³ in the table above, indicates that over the last six years, the LBI business line has exceeded its benchmark service standards in 19 per cent of all APA cases (89 of 458 cases), including:

- 38 per cent of standard unilateral APA cases (6 of 16 cases); and
- 28 per cent of large APA cases (26 of 93 cases).

4.22 It should also be noted that whilst the ATO's APA Program update indicates that the pre-lodgment phase should take up to three months, it appears that the ATO's internal service standard is one year.

4.23 Similarly, the data for the SME business lines is:

Table 10: APA data for SME between 2006 and 2012

Activity	Number of cases	Service standard	Number exceeding service standard	% exceeding service standard	Max. timeframe (days)	Min. timeframe (days)	Avg. Time (days)
IT APA ACR HV	183	60	14	8%	286	0	29
IT Large APA pre-lodgment	36	365	3	8%	750	0	193
IT simplified APA	25	270	4	16%	394	1	186
IT standard bilateral APA	6	720	0	0%	444	108	282
IT standard unilateral APA	10	360	2	20%	451	74	200

⁵⁰³ As identified earlier in the IQF reports, the quality of Siebel data varies.

Table 10: APA data for SME between 2006 and 2012 (continued)

Activity	Number of cases	Service standard	Number exceeding service standard	% exceeding service standard	Max. timeframe (days)	Min. timeframe (days)	Avg. Time (days)
Large APA	28	730	1	4%	1022	0	218
Large APA rollover	15	730	1	7%	857	39	256
SME APA rollover	158	60	31	20%	352	0	48
SME APA	45	180	19	42%	1140	0	244

Source: IGT analysis of ATO data.

4.24 It should be noted that the ATO estimates that between 1 July 2011 to February 2013, three APAs have been abandoned in the SME market.

4.25 The data⁵⁰⁴ in the table above indicates that, over the last six years, the SME business line has exceeded its benchmark service standards in 15 per cent of all APA cases (75 of 506 cases), including:

- 42 per cent of SME APA cases (19 of 45 cases); and
- 20 per cent of SME APA rollover cases (31 of 158 cases).

4.26 A more in-depth ATO analysis of a sample of APAs shows:

- There can be ATO and taxpayer delays in commencing work on APAs. For example, there can be periods of up to 6.5 months from when a taxpayer first notifies the ATO of its intention to enter into an APA (beginning of the pre-lodgment phase) and when the ATO commences action, such as meeting with the taxpayer or requesting further information. In one case, the initial APA meeting was held 6 months after the taxpayer first notified the ATO of its intention to enter into an APA, with an additional 6.8 months before the ATO issued its first information request.
- The pre-lodgment step in APAs can take up to 750 days, but is sometimes followed by a short application phase.
- The APA teams' timeframes in which it gathers information can vary, from 8.3 months to over 44 months. The latter case, however, required the engagement of external consultants.

⁵⁰⁴ As identified earlier in the IQF reports, the quality of Siebel data varies.

- There can be a wide variation in the timeframes for engagement and output of reports from the Economist Practice. For example, in one case, teams received the Economist Practice Report after 18.7 months. In another example, however, the Economist Practice was engaged in the first week of the taxpayers' initial notification of their intention to enter into an APA.
- There can be delays in the finalisation of APAs once the formal APA application is submitted to the ATO. For example, there can be a period of a further 9.6 months in finalising the APA once the formal APA application is received.⁵⁰⁵

4.27 The ATO has advised that it seeks to ensure the timeliness of APAs by giving APA case leaders responsibility for actively managing the case and by ensuring milestones and timeframes are met within the case plan. The case plan has a structured timeline and work plan. It is a 'live' document that can be modified as needed in consultation with the taxpayer. The ATO expects the APA case leader and the Transfer Pricing Review Panel (TPRP) to ensure case plans are adhered to at key milestones in the APA process.⁵⁰⁶ If timeframes are slipping, the APA case leader has authority to escalate any significant blockers and delays to senior officers for resolution.⁵⁰⁷

4.28 Additionally, collateral issues are expected to be processed in parallel with the APA where possible and dealt with under the case plan. If the collateral issue is not being dealt with directly by the APA team, the APA case leader is expected to liaise directly with the officer responsible for resolving the collateral issue to ensure that they are aware of the agreed timeframe and endeavour to meet it.⁵⁰⁸

4.29 The ATO has previously expressed reluctance to certain recommendations aimed at closing off issues at various stages in the APA process, such as a 'stage and gate' process.⁵⁰⁹ It considers that such a process 'cannot be so rigid' and 'that it would undermine the integrity of the APA Program'.⁵¹⁰ It advises that its main concern is that the community would not expect the ATO to be precluded from reviewing prior matters where it later obtained a greater understanding of taxpayers' arrangements and their tax effect.

4.30 However, where there are delays, the ATO advises that it has extended the APA period to ensure that the taxpayer receives certainty for several years in advance. However, this flexibility may be constrained where agreement is also required from another revenue authority.

⁵⁰⁵ ATO, Communication (7 May 2013).

⁵⁰⁶ ATO, Communication 1 (13 March 2013).

⁵⁰⁷ ATO, 'IGT Review of Transfer Pricing – Management of the APA Program' (February 2013) Internal ATO Document.

⁵⁰⁸ *ibid.*

⁵⁰⁹ ATO, 'Response to PwC Legal Report', above n 108; ATO, 'Communication 1 (13 March 2013)', above n 105.

⁵¹⁰ ATO, 'Response to PwC Legal Report', above n 108.

4.31 In relation to the timeframes for MAPs, the ATO aims to complete these processes within two years.⁵¹¹

4.32 The ATO's data for MAPs completed between the 2006 and 2012 calendar years is:⁵¹²

Table 11: ATO MAP data between 2006 and 2012

Business line	Activity	Number of cases	Service standard	Number exceeding service standard	% exceeding service standard	Max. time (days)	Min. time (days)	Avg. Time (days)
LB&I	Mutual agreement procedures	40	730	12	30%	1754	23	559
SME	Mutual agreement procedures	1	730	1	100%	804	804	804

Source: IGT analysis of ATO data.

4.33 As shown in the above table, most MAPs are in the LB&I business line. Almost one-third of LB&I MAPs exceeded the ATO's service standard and there can be significant variation in completion times (between 23 to 1754 days).

4.34 It should be noted that between 2004-05 and 2011-12, the Organisation for Economic Co-operation and Development (OECD) data shows that six ATO MAPs have resulted in double taxation during this time.⁵¹³

4.35 The ATO has advised that it also plans to introduce MAP case plans which are agreed with taxpayers and the other revenue authorities. These case plans are intended to include timelines for key stages of the MAP process and some form of senior revenue official call-over process if agreed timelines are not met.⁵¹⁴

4.36 Bilateral and multilateral APAs involve other revenue authorities. Whilst the ATO generally uses its best endeavours to achieve the planned timeframes, it cannot dictate precise timeframes to the other revenue authority who have their own processes, resource constraints and priorities. In this respect, the ATO is involved with the OECD Forum on Tax Administration's (FTA) project on MAPs, which is seeking to improve the effectiveness of the process.⁵¹⁵

4.37 Bilateral APAs and MAPs require the ATO's CARs to negotiate with their overseas counterparts to relieve double taxation in a manner that looks for

⁵¹¹ ATO, 'Communication (22 March 2013)', above n 166; ATO, *Income Tax: International Transfer Pricing - Transfer Pricing and Profit Reallocation Adjustments, Relief From Double Taxation and the Mutual Agreement Procedure*, TR 2000/16A, 24 July 2002, para [4.53].

⁵¹² ATO, 'Level 4 Report', above n 353.

⁵¹³ OECD, *Mutual Agreement Procedure Statistics* (2006) <<http://www.oecd.org>>; OECD, *Mutual Agreement Procedure Statistics* (2009) <<http://www.oecd.org>>; OECD, *Mutual Agreement Procedure Statistics* (2010) <<http://www.oecd.org>>.

⁵¹⁴ ATO, 'Office Minute: International MAP (Competent Authority) Strategy' (16 April 2013) Internal ATO Document, p 5.

⁵¹⁵ ATO, 'Management of the APA Program', above n 506; ATO, 'MAP Strategy', above n 513.

'appropriate opportunities to compromise' and 'reach satisfactory resolution of the issues'.⁵¹⁶

4.38 The ATO has advised that up until 2011, a CAR's role involved a substantial amount of time to understand and test each party's position, such as the evidence of the key profit drivers underlying taxpayers' international related party dealings.⁵¹⁷ The time spent depended on the complexity of each case and the experience of the CAR. By way of example, potentially half of the more senior CAR's time could be taken up on the most complex cases for a period between one to two years.⁵¹⁸

4.39 The ATO's review of the Internationals unit in 2010, however, found that the CAR should take more of a supervisory role and build the capabilities of operational officers. As a result, the ATO is currently considering an internal proposal to centralise the APA and MAP leadership function in Brisbane. Case work will be completed at a number of sites by officers from operational areas and the Economist Practice, with CAR oversight.⁵¹⁹

4.40 The ATO has stated publicly in its former National Tax Liaison Group (NTLG) Transfer Pricing Sub-group that it will ensure the most suitable people with the appropriate skills and experience are placed on each APA and ensure all case leaders assigned to an APA are accredited.⁵²⁰

4.41 The ATO is aware that these changes raise concerns with the potential impacts on the Competent Authority function. However, it maintains that independence will not be affected and is further maintained through:

- the processes outlined in *Practice Statement PSLA 2011/1* and the various ATO taxation rulings on transfer pricing and the application of the arm's length principle;
- the role of the Economist Practice to ensure that the appropriate arm's length methodologies are both chosen and applied; and
- its quality assurance processes, such as the role of the TPRP.⁵²¹

4.42 In terms of the staff resourcing required to resolve bilateral APAs and MAPs with overseas CARs, the ATO estimates the following are required during 2013:

- CARs – 3 FTE staff – \$360,000; and
- Operations/Economist Staff – 12 part-time staff – \$500,000.⁵²²

⁵¹⁶ Centre for Tax Policy and Administration, OECD, 'MEMAP', above n 46, para [1.3.1].

⁵¹⁷ ATO, 'Communication (22 March 2013)', above n 166.

⁵¹⁸ *ibid.*

⁵¹⁹ *ibid.*; ATO, 'MAP Strategy', above n 513; ATO, 'Internationals Health of the System Assessment (HOTSA) 2012 (undated) Internal ATO Document.

⁵²⁰ ATO, 'NTLG Transfer Pricing (March 2011)', above n 497; ATO, 'NTLG Transfer Pricing (14 November 2012)', above n 497, p 5.

⁵²¹ ATO, 'Management of the APA Program', above n 506.

4.43 The ATO has advised that CARs travel for a few purposes. There is a need to maintain productive relationships with the overseas counterparts, as well as establish new relationships when there are personnel changes. Bilateral APAs are discretionary and therefore substantially affect travel priorities. The ATO advises that the current priorities are Japan, US, China, Singapore and Korea. The travel plans for the current year involve all five of the above countries. Trade with Canada and Europe are both relatively small so the ATO cannot justify a face-to-face meeting at this point in time.

4.44 The ATO's 2012 cases involving CARs, including bilateral APAs and MAPs is:

Table 12: Competent Authority work by jurisdiction

Jurisdiction	Cases on hand 1 Jan 2012	Cases on hand 31 Dec 2012	Cases Completed 2012
NZ	4	3	2
UK	3	3	1
USA	15	17	2
Singapore	7	9	
Indonesia	1	1	
Canada	2	2	
Rep. of Korea	5	4	2
France	2	2	
Japan	9	8	6
Ireland	2	2	
PR China	2	2	
India	-	1	

Source: ATO Draft Map Strategy 2013.

4.45 The ATO's proposed CAR travel program for 2013 is:

Table 13: ATO Competent Authority travel funding

Jurisdiction	Last visit to Australia	Last visit by Australia	Proposed next visit to Australia	Proposed next visit by Australia	No. of Delegates	Indicative Cost
Japan	October 2012	June 2011	June 2013	April 2013	2	\$20,000 for both Japan and Korea
Korea	December 2011	July 2011	Not agreed	April 2013	2	
China	No previous visits		Feb/March 2013	October 2013	2	\$20,000 for both China and Singapore
Singapore	No previous visits		Not agreed	October 2013	2	
US	September 2012	> 3 Years	Not agreed	May/June 2013	3	\$36,000
TOTAL						\$76,000

Source: ATO Draft MAP Strategy 2013.

⁵²² ATO, 'MAP Strategy', above n 513.

4.46 The ATO has acknowledged stakeholder concerns with the limited travel over the last couple of years. It explains that CAR negotiations with a number of countries were originally scheduled to take place in June 2012. However, senior ATO management decided to postpone the travel until April 2013 and use alternative methods of progressing the relevant cases due to the early stage of the negotiations and that the ATO was still formulating its negotiation options.⁵²³ During this period, staff changed within one of the foreign revenue authorities and new relationships needed to be established.

4.47 During the finalisation of this review, the ATO has advised the IGT that it intended to review its APA program, including the patterns and numbers of APA applications, to improve its effectiveness and efficiency. Any amendments that may be required to *Practice Statement PSLA 2011/1* will also be made.⁵²⁴

IGT OBSERVATIONS

4.48 APAs are an important vehicle to resolve transfer pricing issues. For taxpayers, APAs may provide a more flexible and cheaper process to obtain certainty on the application of the transfer pricing law. For the ATO, APAs may provide a level of assurance that the arm's length principle is being appropriately applied and provide an invaluable source of intelligence on emerging business and industry practices.

4.49 However, a significant impediment for taxpayers to seek an APA is the lengthy timeframe that may be involved. As stated earlier, a substantial proportion of APA and MAP cases exceed the ATO's expected timeframes. The ATO's APA program update also indicates a general trend of increasing average timeframes for APAs. For example, there was a substantial increase in duration of bilateral APAs in 2009 averaging 12 months, to averaging 25 months in 2010, with some improvement in 2011.⁵²⁵ At the time of this review, the ATO's APA program update was not available for the 2011-12 and 2012-13 years.

4.50 By comparison, the ATO's average bilateral APA timeframes are faster than those of the IRS which averages 44 months.⁵²⁶ However, as stated earlier, some observers have ranked both the IRS and ATO poorly in terms of their performance in APA management including timeframes. The ATO's timeframes used to be similar to those of the United Kingdom's (UK) Her Majesty's Revenue and Customs (HMRC) but HMRC has significantly improved its average bilateral timeframes in 2011-12 to 16.9 months.⁵²⁷

⁵²³ ATO, Communication (15 April 2013); ATO, 'Communication 2 (17 April 2013)', above n 104; ATO, 'Communication (22 March 2013)', above n 166; ATO, Communication (25 November 2013).

⁵²⁴ ATO, 'Communication (31 October 2013)', above n 139.

⁵²⁵ The last APA Program report was 2010-11; ATO, 'Communication (19 March 2013)', above n 265.

⁵²⁶ IRS, *Announcement and Report Concerning Advance Pricing Agreements* (27 March 2009) <www.irs.gov>; IRS, *Announcement and Report Concerning Advance Pricing Agreements* (29 March 2010) <www.irs.gov>; IRS, *Announcement and Report Concerning Advance Pricing Agreements* (29 March 2011) <www.irs.gov>.

⁵²⁷ HMRC, *Transfer Pricing Statistics* (undated) <www.hmrc.gov.uk>.

4.51 A number of reasons contribute to extended timeframes , including:

- the type of APA and complexity of issues requiring further information;
- the capability of the ATO's APA teams to quickly refine and resolve issues;
- taxpayers' responsiveness to the ATO's engagement; and
- the high case load and lack of resources available within the Competent Authority area of the ATO.

4.52 In relation to bilateral APAs and MAPs, a proportion of elapsed timeframes is attributable to the engagement between the ATO and overseas revenue authorities. Improving case planning and streamlining processes between the authorities may assist in improving timeframes. In this respect, the IGT notes that the US is also considering streamlined MAPs with its trading partners.⁵²⁸

4.53 Further, a number of studies have been undertaken into improving such bilateral processes, including the use of international tax arbitration for 'aged' MAPs.⁵²⁹ However, as arbitration of international tax disputes is not an established practice, various complications may arise. Therefore, including third parties in such bilateral approaches may be better approached in an incremental fashion to engender broader support.⁵³⁰ In this respect, the ATO could explore the options for early neutral evaluation, in appropriate circumstances, as it can provide a more flexible process than arbitration without the requirement to commit any party to a binding determination.

4.54 In addition to external factors, such as bilateral negotiations, the data on the ATO's internal cycle times for APAs indicate extended timeframes are encountered in all stages of APAs in a substantial number of cases. This data strongly indicates a need for more robust project management of APA cases, particularly; as it appears that the pre-lodgment phase of APAs is not consistently reported. Indeed, ATO IQF reports have raised concerns with the prevalence of ATO activities occurring before commencement of the matters in Siebel.

4.55 In this respect, PWC Legal had previously conducted a detailed review of the ATO's APA program and made specific recommendations in relation to improving project management, as amongst others, which are reproduced in Appendix 3.⁵³¹ The ATO agreed with most of the aims of the recommendations, however, it did not agree with all of the recommended actions. Given that extended timeframes for APAs continue to be experienced, the IGT is of the view that the ATO should reconsider the project management issues identified by PWC Legal's review and its responses to the recommended actions, including:

- promoting and using the APA program;

⁵²⁸ ATO, 'Communication (22 March 2013)', above n 166.

⁵²⁹ For example: Chloe Burnett, 'International Tax Arbitration' (2007) 36 *Australian Tax Review* 173, p 173.

⁵³⁰ Burnett, above n 528, p 173.

⁵³¹ PWC Legal, above n 109, p 3.

- providing clarity on the types of APAs that will be accepted into the program;
- ensuring that taxpayers are made aware, at the outset of APA processes, that they may initiate independent internal review processes; and
- establishing clear criteria where the ATO will withdraw from APA negotiations.

4.56 The IGT is of the view that project management of APAs could be improved, compliance burden on taxpayers reduced and lengthy disputes avoided if the ATO adopted a 'stage and gate' approach to reach a common understanding of the facts and evidence and to ensure each party appreciates the view of the other. As stated in previous IGT reviews, such an approach should not preclude the ATO from revisiting its views where, through no fault of its own, material facts come to light after, for example, agreement has been reached on the facts.

4.57 Additionally, allocated resourcing for expected caseloads is needed. Rejecting APA applications on resourcing grounds should be avoided as it would be contrary to the objective of the APA program to promote a more effective and efficient means to resolve transfer pricing issues. Reducing caseloads by providing alternative means for taxpayer certainty, such as providing safe harbours, would achieve that objective.

4.58 Although the ATO generally has little notice of APA applications, it is possible for the ATO to estimate the number of bilateral APA applications directly and indirectly generated by its compliance activities, as is done in the SME business line to estimate the number of objections. The IGT considers that an estimation of potential bilateral APAs and MAPs may provide the ATO with an indication of the funding required to allow their efficient negotiation.

4.59 However, a smaller proportion of cases which cannot be predicted will remain. This nature of APA applications indicates a need for a source of variable funding, such as an application fee. Whilst the 2008 APA Review found that stakeholders appreciated that there was no fee,⁵³² in this review stakeholders preferred a fee where it assists the efficient resolution of bilateral APAs. It has also been suggested that implementing such a fee may be difficult for the ATO as it would need to appropriately manage taxpayers' expectations of timely progress towards favourable results, which may be outside of the ATO's control. However, the IGT considers that such fees, if judiciously spent and couched in appropriate terms that do not set inappropriate taxpayer expectations of the ATO, may be an effective remedy.

4.60 The ATO's efficient and effective handling of bilateral APAs and MAPs depends upon, amongst other things, the ATO's capability. The need for specialists in bilateral APAs and MAPs is greater than transfer pricing compliance activities as the former require independent negotiation with corresponding overseas competent authorities, amongst other things. The ATO has recently moved to develop the capability of operational staff by providing a greater role for them in bilateral APA and MAP work. From a development perspective this is understandable. However, there is a real risk that such a move will compromise the independence of the

⁵³² *ibid* p 2.

negotiation function where there is insufficient resourcing for CARs to provide sufficient supervision and test the evidence on which operational case teams rely. Such a position is implicit in the OECD's guidance:

In order to enhance the independence of a subsequent review of a case by a Competent Authority, it is recommended that Competent Authorities maintain a level of autonomy from the audit function of a tax administration...

The guiding principle should be that the Competent Authority's function is to ensure a fair and appropriate application of the convention, not to seek to uphold all adjustments proposed by the tax authorities of its country.

Independent and sufficient funding will also enhance the Competent Authorities' autonomy and enable it to carry out its mandate without becoming overly reliant upon other areas of a tax administration which do not share the Competent Authorities' primary objective, namely relieving double taxation. Tax administrations should ensure that the Competent Authority function is given sufficient resources, including qualified personnel, funding, training, and other program needs, to be able to carry out MAP responsibilities in a timely, effective, and efficient manner.⁵³³

4.61 Transfer pricing disputes involve large amounts of information from which inferences are drawn to evidence economic outcomes, such as prices and profit. This takes significant periods of time to properly consider and develop cogent positions. If CARs were to be inadequately resourced to perform this function, they may not be able to effectively determine strengths and weaknesses of overseas counterparts' positions as they would be forced to rely on operational staff's evidentiary material, without objective review. The IGT considers it likely that the effectiveness and efficiency of CAR negotiations is likely to decrease substantially as a result.⁵³⁴ As Australia is heavily trade exposed, these negotiations involve significant reductions of other revenue authorities' adjustments. An inability to test operational case teams' evidence may risk revenue and reputation.

4.62 The CAR role is not a discretionary function and is required under Australia's tax treaties. Given the increasing workload and complexity at this level, the IGT considers that it is inadequate to only have three CARs. There is also potential for that number to decrease if the current position holders retire or leave the ATO.

4.63 Further, it appears that reduced funding and restructuring within the ATO has contributed to an increase in the time taken to conclude bilateral APAs and MAPs. These delays appear to be compounded where overseas CARs are replaced with new staff that will need to get across the work done by their predecessors before moving forward with negotiations – essentially starting the case again.

4.64 The IGT considers that the ATO's draft MAP strategy is a step in the right direction in an attempt to schedule face-to-face meetings with Australia's primary

⁵³³ Centre for Tax Policy and Administration, OECD, 'MEMAP', above n 46, p 41.

⁵³⁴ ATO, 'Communication (12 March 2013)', above n 104; ATO, 'Tier 2 Project Status Report: Transfer Pricing – Strategic Compliance Initiative' (12 March 2013) Internal ATO Document.

trading partners. The strategy currently outlines the best way for the ATO to manage bilateral APAs and MAPs which is to accumulate those cases and prioritise trading partner jurisdictions in terms of travel.

4.65 An important aspect promoting overall transparency of the APA program is the publication of a report, the APA Program Update, which provides information indicating the ATO's performance. The ATO advises that this report has not been published since 2011 due to lack of sufficient resources. Publication of such data promotes increased accountability and management responsiveness to issues as they emerge.

RECOMMENDATION 4.1

The IGT recommends that the ATO:

- (1) promote and use the APA program;*
- (2) identify the types of arrangements that will be accepted into the APA program;*
- (3) set out the criteria that would lead the ATO to withdraw from APA negotiations;*
- (4) require ATO officers, at the outset of APA negotiations, to make taxpayers aware of the ATO's independent internal review process and the circumstances in which it can be initiated by the taxpayer;*
- (5) implement a 'stage and gate' process in relation to APAs, such that closed stages may only be reopened where material new information becomes available to the ATO;*
- (6) explore options for reducing the timeframes for bilateral negotiations, such as mutual case planning, streamlined processes and early neutral evaluations, in appropriate circumstances;*
- (7) estimate the number of bilateral APA applications by examining the causes of the applications, including the extent to which previous applications were directly or indirectly generated by compliance activities;*
- (8) consider an appropriate administration fee for complex bilateral APAs;*

RECOMMENDATION 4.1 (CONTINUED)

(9) better resource the Competent Authority function and draw in expertise to enable it to appropriately test the evidence supporting position of operational case teams with respect to bilateral APAs and MAPs; and

(10) re-introduce the public reporting of the information on its APA program and implement similar reporting for MAPs.

ATO response

Agree in part

The ATO agrees with parts 1 to 4, 6, 7 and 10.

The ATO disagrees with part 5. An APA should be subject to a project plan and that project plan should include clearly defined stages. However, the plan must allow for flexibility as factual analysis, issue identification, and application of law and policy are not linear processes that can be subject to a “closed gate” or to a limitation placed on reopening a stage based on material new information becoming available.

The ATO disagrees with part 8 and does not consider it appropriate to charge an administrative fee for any APA applications. Any such charge may also require legislative or policy change and would therefore also be subject to the views of Government.

The ATO also disagrees with part 9 and believes there are sufficient competent authority resources available, having regard to: process improvements; the number and complexity of MAP matters; and the fact the majority of the work is undertaken by compliance teams. In the context of the relatively small number of cases, to the extent there is a need to build capacity, we consider the focus of that activity is more likely to be on better developing the capability for MAP cases in our audit teams and we will be addressing this through the implementation of the new profit shifting strategy.

4.66 There are APA cases in which the level of complexity and risk are so high that the community would expect the ATO to critically assess the facts supporting the taxpayers' arrangements. The ATO's staff instructions envisage 'original work' to be conducted in these instances. However, if the ATO were to require taxpayers to provide a similar level of evidence to that expected in an audit, there is risk that the APA program would not attract the more complex APAs, particularly given the 'voluntary nature' of APAs as noted in PWC Legal's 2008 APA Review.⁵³⁵

⁵³⁵ PWC Legal, above n 109, p 3.

4.67 Further, if such a resource intensive approach were to continue, a significant reduction in the effectiveness of the APA program may ensue as the ATO may be using some of its scarce resources on arrangements of lesser risk when they may be better utilised on more complex arrangements. Indeed, the 2008 APA review identified that the APA Program 'struggles with... new, complex transfer pricing issues and in some cases, the process appears to break down for taxpayers and the ATO'.⁵³⁶

4.68 A similar issue of balancing information needs with compliance costs arises in relation to private rulings. This issue has been raised in the private ruling context in the IGT's *Review into Improving the Self Assessment System*.⁵³⁷ If assumptions materially differ to the actual facts, they effectively invalidate the protection of the ruling or the APA. In relation to APAs, *Practice Statement PSLA 2011/1* provides for the use of 'critical assumptions'. However, their use appears to be limited to the occurrence of material future events.

4.69 The IGT is of the view that the ATO could reduce overall administrative and compliance costs by allowing ATO officers to make critical assumptions of facts in a broader range of circumstances, than stipulated in *Practice Statement PSLA 2011/1*, where taxpayers provide written assurances that the relevant facts are correct. Such taxpayer assurances would, however, need to acknowledge that the APA may be vitiated, in whole or in part, in any subsequent ATO compliance activities where such assumptions are material and cannot be supported by evidence.

4.70 It should be noted, however, that there may be some situations where the ATO's concerns may only be allayed through intensive information gathering, such as concerns with the characterisation of the tested entity or 'commercial reality' of arrangements. Additionally, there are cases which cause ATO officers such concern that they may be considering withdrawing from the APA process or commencing an audit. In this respect, the ATO's staff instructions do not clearly set out what is expected to be communicated to taxpayers in these circumstances.

4.71 The IGT considers that the ATO's engagement with taxpayers on issues of concern is critical to maintaining taxpayer and broader perceptions of the APA program's utility. Providing clearer directions to ATO staff on what and how such concerns should be communicated to taxpayers in these circumstances would provide greater transparency on the reasons for 'audit-like' approaches in APA processes. Additionally, a cooperative approach entails reasonable opportunity for taxpayers to address those concerns if they arise.

4.72 In the IGT's view, in such circumstances, ATO officers should be required to communicate to taxpayers any concerns with their arrangements and related tax effects in APA applications and provide reasonable opportunity to address those concerns. These communications should clearly describe the concerns, the information

⁵³⁶ *ibid* p 2.

⁵³⁷ IGT, 'Self Assessment Review', above n 388.

required to address them and the consequences if those concerns persist. The IGT notes that the 2008 APA Review made similar recommendations.⁵³⁸

RECOMMENDATION 4.2

The IGT recommends that the ATO amend PSLA 2011/1 to:

- (1) allow ATO officers to make critical assumptions of facts in APAs in a broader range of circumstances where taxpayers provide written assurances that the relevant facts are correct and that they bear the risk arising from any material inaccuracies; and*
- (2) require ATO officers communicate to taxpayers any concerns with their arrangements and related tax effects in APA applications and provide reasonable opportunity to address those concerns. These communications should describe the concerns, what information would allay those concerns and what the consequences will be if those concerns are not allayed.*

ATO response

Agree

The ATO will consider these as part of the broader review of the APA program and PSLA 2011/1.

⁵³⁸ PWC Legal, above n 109, p 30.

CHAPTER 5 — INDIVIDUAL ATO OFFICER CAPABILITY

STAKEHOLDER CONCERNS

5.1 The key concern raised by stakeholders in this review related to individual ATO officers' capability in an increasingly complex and dynamic global business environment. Stakeholders submitted that the lack of capability is a fundamental cause of the significant delays and substantial unproductive compliance costs for taxpayers. This is particularly so where the decision maker does not possess the requisite experience and capability.

5.2 Stakeholders supported the ATO's training and development of its officers. However, they believe that such activities have not resulted in the relevant officers acquiring a number of key skills.

5.3 First, stakeholders commented that ATO officers are unable to practically apply transfer pricing to taxpayers' organisations within particular industries. ATO officers were said to have limited understanding of broader economic influences, particular industries or the commercial drivers for particular businesses. ATO officers appear not to undertake sufficient research, do not closely consider the information provided by taxpayers and are slow to understand the arrangements they are investigating. Their decisions were believed to be based on imprecise and high level analysis. These issues adversely impact the functional analysis required in transfer pricing and are exacerbated in more complex matters.

5.4 Stakeholders also commented that ATO officers do not know when enough information has been gathered to form a view. ATO officers were said to continuously make untargeted and onerous information requests which lacked an identifiable objective and make no reference to taxpayers' businesses or specific related party transactions. Stakeholders further commented that with transfer pricing, no one piece of information will answer questions as it is a process of analysis. However, experience will guide officers in knowing when they have enough information.

5.5 Lastly, stakeholders commented that ATO officers do not clearly communicate their risk hypothesis, the relevance of information requested, technical concerns or the views of ATO specialists, such as economists. ATO officers were said to rarely communicate, so taxpayers and their advisers have no touchstone of relevance prior to a position paper being issued.

5.6 Understanding the causes for stakeholders concerns relating to ATO officer capability is difficult as no one particular activity or ATO process can be said to directly impact on capability levels. In examining the detail of these concerns, the IGT has observed the following key underlying causes:

- attracting and retaining staff; and
- identifying the required capability of transfer pricing 'specialists' and focusing training and development to promote that capability.

5.7 These underlying causes are discussed below, together with relevant ATO information and the IGT's observations.

ATTRACTING AND RETAINING STAFF

5.8 Stakeholders have identified the diminution of ATO officers' overall 'capability' over the last 7 to 10 years as a key cause underlying many of their concerns with the ATO's management of transfer pricing matters. Stakeholders have commented that, previously, many ATO officers were highly experienced, industry aware and technically proficient. Now, stakeholders consider that few of those officers remain in the relevant roles.

ATO materials and information

5.9 As mentioned in earlier chapters, over the years the Large Business and International (LB&I) business line has lost many of its skilled transfer pricing experts (including economists, where the attrition rate is particularly high) due to retirement and movement into the private sector and other areas of the ATO. This is due to the skill set required for transfer pricing being highly transportable to other aspects of taxation, such as Part IVA and other international tax risks. Current transfer pricing experts are also approaching retirement.⁵³⁹ A critical area appears to be the Competent Authority Representatives (CARs), as there are only three.

5.10 The LB&I business line acknowledges the many difficulties it faces including:

- a high percentage of officers performing 'front line' activities that are new to the business line;
- the loss of 'specialist' officers within the business line who have no clear successors;
- difficulty in recruiting expertise in a competitive labour market;

⁵³⁹ ATO, Communication (11 March 2013); ATO, 'Communication (12 March 2013)', above n 104; ATO, 'Communication (19 March 2013)', above n 265; ATO, 'Communication 1 (14 March 2013)', above n 149; ATO, 'LMAC Response', above n 402; ATO, 'International Leadership Team Agenda' (February 2011) Internal ATO Document, Item 3.

- the complexity of transfer pricing work which requires a lengthy lead time to meet the expected market capability;
- limitations in the ‘intermediate’ to ‘advanced’ skilling program; and
- significant demands both on team leaders and capability development programs to support the ongoing learning requirements of new officers and difficulties in keeping officers’ knowledge up-to-date.⁵⁴⁰

5.11 Accordingly, the LB&I business line has developed a Transfer Pricing Capability Strategy (TPCS) for the ATO.⁵⁴¹ This strategy focusses on building a highly skilled workforce through:

- recruiting and retaining skilled staff with transfer pricing and commercial knowledge;
- building a cross business line ‘core’ of professional expertise;
- mentoring of junior officers by transfer pricing specialists;
- succession planning to transfer the skills and knowledge of key officers;
- the Transfer Pricing Network (TPN) building transfer pricing capability;
- career paths within the ATO for those with a transfer pricing focus in order to make specialisation worthwhile;
- performance management by including transfer pricing learning objectives in personal development agreements with officers; and
- the use of capability survey results to design and plan capability strategies.⁵⁴²

5.12 One of the key strategies above is the TPN. It seeks to build the transfer pricing capability of its members through a range of activities such as monthly phone hook-ups, audit forums and video workshops.⁵⁴³ The TPN’s members provide feedback to others of any new learnings and share best practice. Specialist members also mentor more junior officers.⁵⁴⁴

5.13 Previously the LB&I business line had ‘industry segments’, such as financial services and insurance and energy and resources, which facilitated the development of

⁵⁴⁰ ATO, ‘Transfer Pricing Capability Strategy 2012-13’ (undated) Internal ATO Document; ATO, ‘ILT Agenda (February 2011)’, above n 538, Item 3; ATO, ‘International Leadership Team Agenda’ (March 2011) Internal ATO Document, Item 4; ATO, ‘International Leadership Team Minutes’ (April 2012) Internal ATO Document; ATO, ‘LBI Executive Minutes: LBI Tenure and Attrition Data’ (27 July 2011) Internal ATO Document; ATO, ‘Communication (12 March 2013)’, above n 104.

⁵⁴¹ The SME business line has also adopted the TPCS: ATO, ‘Communication 1 (15 March 2013)’, above n 421; ATO, ‘Communication (11 March 2013)’, above n 538.

⁵⁴² ATO, ‘TP Capability Strategy’, above n 539, Strategy 1.

⁵⁴³ ATO, ‘TP Capability Strategy’, above n 539.

⁵⁴⁴ *ibid.*

industry knowledge and capability of its officers. However, these industry segments were dissolved with the new site strategy. Instead, the LB&I business line has implemented 'communities of practice' to support industry knowledge and capability. The ATO advises that these 'communities' are similar to the compliance technical networks that previously existed but are less formal.⁵⁴⁵ The ATO currently has two 'communities of practice', being 'banking and finance' and 'energy and resources'.

5.14 The ATO has advised that in 2011 it redesigned its transfer pricing 'E-Wiki'. The ATO intends to use this 'E-Wiki' which is accessible by all ATO officers, and the delivery of a profit shifting bulletin to TPN members issued every two months, to communicate updates on the latest developments in transfer pricing.

5.15 The ATO also aims to target recruitment of skilled staff with transfer pricing and commercial knowledge from outside the ATO. The ATO's recruitment statistics for the entire LB&I business line (and not just transfer pricing) show that:

- in 2008-09, 31 per cent (96) of new officers were recruited externally, and of those, 72 per cent were from the ATO's graduate program; and
- in 2009-10, 21 per cent (101) of new LB&I officers were recruited externally – the proportion of ATO graduates is not shown for this year.⁵⁴⁶

5.16 Overall, the ATO aims to measure the success of the TPCS via:

- its ability to retain and recruit quality people within budget;
- an increase in capability due to support from case leaders, good processes, training programs and use of 'specialists'; and
- internal feedback from officers.⁵⁴⁷

5.17 It should be noted, however, that during the latter half of 2012, the LB&I business line offered staff voluntary redundancies. Within the leadership team of the Internationals unit, it was discussed that if the focus of the Internationals unit was shifted to building capability, then there may be a need to retain some of their senior officers for that purpose.⁵⁴⁸ Concerns were also raised within the leadership team on the timing and reduction of senior level officers and the impact of under-resourcing and capacity to undertake work. The leadership team acknowledged that under-resourcing may lead to a reduction in case outcomes.⁵⁴⁹

⁵⁴⁵ ATO, 'Communication (24 October 2013)', above n 101.

⁵⁴⁶ ATO, 'LMAC Response', above n 402.

⁵⁴⁷ ATO, 'TP Capability Strategy', above n 539.

⁵⁴⁸ ATO, 'International Leadership Team Minutes' (July 2012) Internal ATO Document.

⁵⁴⁹ ATO, 'International Leadership Team Minutes' (August 2012) Internal ATO Document.

IGT observations

5.18 The IGT believes that improving overall ATO officer capability will resolve many of the issues observed in this review. However, there are lead times required in developing capability and there is a need to maintain that capability once developed.

5.19 The ATO is seeking to build its capability via a number of means including the targeted recruitment of practitioners with transfer pricing and commercial knowledge. It is not clear as to how many transfer pricing specialists have been recruited. However, the ATO's recruitment statistics for the LB&I business line suggest that the majority of the staff recruited externally were from the graduate program.

5.20 The ATO faced similar difficulties when recruiting people for its Transfer Pricing Strategic Compliance Initiative (TPSCI) Project. The ATO considered that it could attract a significant number of experienced staff due to market conditions at the time. However, when the ATO's recruitment activities for the TPSCI commenced, the market improved and the ATO did not attract the level of capability it expected.

5.21 Generally, the quantum of salary is a key driver for attracting experienced staff. The Australian private sector may offer considerably higher salaries than the ATO can provide. Transfer pricing specialists can seek even higher remuneration if prepared to go overseas.

5.22 Accordingly, it is not unexpected that the ATO may have difficulties in attracting experienced staff, unless economic conditions are unfavourable for private sector recruitment. However, the ATO can provide other aspects that potential recruits may find attractive. As a result, the ATO should promote other features of working for the public sector, such as quality and variety of work, development opportunities, public and community interest, ability to work in a number of locations around the country as well as a work-life balance.

5.23 Notwithstanding recruitment of external expertise, reliance on these new recruits, of its own, will not address the underlying cause for the position that the ATO currently faces.

5.24 The loss of valuable 'specialist' knowledge is a fundamental reason why the ATO is currently facing difficulties with efficiently and effectively managing its transfer pricing program. This knowledge was individually gained and held by a number of key officers and had been developed over a number of years of practical application and experience. Many of these officers drew on specific information gained from prior activities to quickly narrow and resolve issues.

5.25 A failure to implement a robust system to capture and more broadly disseminate any gained knowledge will result in further decrease in capability in the future. It is inevitable that officers will move to other areas of the ATO or leave the ATO altogether to pursue other opportunities or retire.

5.26 The IGT notes that the PWC Legal 2008 APA Review made recommendations to improve knowledge sharing and succession planning including a central online

repository of transfer pricing experience and identifying future transfer pricing leaders and planning for their career development amongst others.⁵⁵⁰ The Fyusion Report in 2012 also made similar comments.⁵⁵¹

5.27 The ATO's TPCS is attempting to address the loss of knowledge through capturing and disseminating information via a number of means including the TPN and on-the-job training with more experienced officers. Whilst this is commendable, over-reliance on informal discussions in networks or 'communities of practice' and mentoring activities lacks a systematic approach for ensuring efficient and effective dissemination and retention of knowledge and experience. Furthermore, the current informal approach is too dependent on the individual officers to impart their knowledge and experience without providing them with a direct motivation for doing so.

5.28 The ATO has shown that it can capture and disseminate insights and knowledge with its training for the oil and gas and life insurance industries. This training has captured observations of other officers and disseminated that knowledge to new officers on industry participants' financial arrangements, operations and interactions with other regulatory bodies. The ATO's E-Wiki is also an effective means to capture and access specialist knowledge.

5.29 Although these are positive examples, it is noted that the oil and gas training has not been held for over a year and the E-Wiki requires resourcing to ensure that the information is relevant and up-to-date by officers continually contributing their insights.

5.30 The IGT is of the view that the ATO needs a systematic strategy to capture and disseminate knowledge and experience gained from transfer pricing matters. Such strategy should encompass a range of subject matters and channels. Any resulting systems should be appropriately resourced with officers being required to input any learnings or findings into the system at the conclusion of all transfer pricing matters. Similarly, officers should be required to use the system to help them progress cases.

5.31 As a crucial first step, the ATO should identify the key officers with specialist industry and transfer pricing knowledge who are at risk of leaving the ATO. The ATO should then ensure that their knowledge is captured, particularly with the demise of the ATO's industry networks.

5.32 Once capability is developed, it must be maintained. Given the considerable resources and time invested in developing officers to a level that they can independently operate, a career path should be established to encourage staff to stay.

5.33 At present it is not clear how an officer conducting generalist work may progress to specialising in transfer pricing. The IGT believes that officers with the ability and interest in transfer pricing should be identified and fast-tracked by

⁵⁵⁰ PWC Legal, above n 109, p 4.

⁵⁵¹ Fyusion, above n 294, pp 16, 18, 38.

exposing them to a range of transfer pricing matters including exposure to more complex cases and CAR negotiations.

RECOMMENDATION 5.1

The IGT recommends that the ATO:

- (1) systematically capture and disseminate knowledge and experience gained from transfer pricing matters with relevant officers being required to input any learnings or findings at the conclusion of cases and/or to use it to progress cases;*
- (2) continue to recruit transfer pricing specialists externally emphasising aspects of the role such as quality and variety of work, development opportunities, public and community interest, ability to work in a number of locations around the country as well as work-life balance; and*
- (3) establish a career pathway for generalist officers to progress through to specialising in transfer pricing.*

ATO response

Agree

With respect to part 2, we note that Government requirements for external recruitment may, at times, limit our ability to recruit external specialists.

CAPABILITY, TRAINING AND DEVELOPMENT

5.34 Stakeholders are concerned with how the ATO assesses the capability of its staff. They observe some inexperienced junior ATO officers have the job title of ‘Transfer Pricing Specialist’⁵⁵² and the ATO appears to use the terms ‘experts’ and ‘specialists’ interchangeably.

5.35 As a corollary, stakeholders are concerned that the ATO may not be sufficiently targeting its training activities to develop the abilities of its officers that are needed to effectively address transfer pricing issues.

5.36 Most stakeholders, and some senior ATO officers agree, that ‘capable’ transfer pricing officers should have strong ‘technical’ and ‘soft’ skills, which include the ability to:

- identify the facts and conditions that affect price and attribution so as to understand business and commercial drivers in the context of the relevant

⁵⁵² ATO, ‘TPSCI Project Staff List’ (6 December 2012) Internal ATO Document.

industry and broader economic influences that impact on the transfer pricing functional analysis and on taxpayers' profitability;

- quickly analyse and synthesise large amounts of commercial data and determine the amount of information needed to understand these business and commercial drivers;
- make a judgment on how an independent business owner would have determined prices;
- apply knowledge of transfer pricing, both the technical aspects, such as Taxation Rulings and domestic law, and the broader OECD models and guidance that overlay transfer pricing matters; and
- willingly communicate their concerns and reasoning including the underlying technical aspects.

5.37 Stakeholders and some ATO officers agree that 'expert' transfer pricing officers have the above capabilities in addition to the following:

- experience and confidence across a range of industries and transfer pricing methodologies and the processes for risk reviews, audits, APAs and Mutual Agreement Procedures (MAPs);
- experience and understanding of the interaction between transfer pricing provisions and other areas of the tax law, such as permanent establishments, capital gains and thin capitalisation;
- appreciate taxpayers' worldwide commercial arrangements, the drivers for commercial arrangements and profits in the industry, how taxpayers' individual characteristics influence these arrangements and their profits and what information is needed to test taxpayers' assertions and identify the appropriate entity to test;⁵⁵³
- ability to understand economic arguments and issues, make complex issues simple in a cogent way and explain important facts and conditions affecting prices;⁵⁵⁴
- in circumstances, where more than one conclusion is possible and an arm's length price can only be inferred from large body of evidence, appreciate the strengths and weaknesses of competing arguments and adapt their position and

⁵⁵³ ATO, 'Communication (12 March 2013)', above n 104.

⁵⁵⁴ ATO, 'Communication (11 March 2013)', above n 538; ATO, 'Communication (12 March 2013)', above n 104; ATO, 'Communication 1 (13 March 2013)', above n 166; ATO, 'Communication 2 (13 March 2013)', above n 200; ATO, 'Communication 2 (15 March 2013)', above n 104; ATO, 'Communication (22 March 2013)', above n 166.

reasoning to persuade taxpayers, their advisers, overseas revenue authorities and the courts to their view of the facts;⁵⁵⁵ and

- perceived as an expert in their field by peers in revenue authorities and the private sector.

5.38 Stakeholders supported the ATO's training and development of its officers. However, they were concerned that these activities were not equipping ATO officers with key skills, such as conducting functional analyses accurately and, in particular, steps one and two of the four-step process outlined in *Taxation Ruling TR 98/11*.

ATO concerns with capability

5.39 The LB&I Executive,⁵⁵⁶ leadership team in the Internationals unit,⁵⁵⁷ case callovers⁵⁵⁸ and other quality assurance processes⁵⁵⁹ have all identified concerns with ATO officers' transfer pricing capability. Indeed the leadership team of the Internationals unit acknowledged that the ATO's aspirations are not fully met, including a breakdown in outputs of cases⁵⁶⁰ with capability being an impediment to achieving sustainable decisions⁵⁶¹ and raising concerns with the validity of risk assessments and audits.⁵⁶² The concerns identified include:

- inappropriate questions asked in transfer pricing questionnaires, processes not being followed, not asking taxpayers which transfer pricing methodologies were used, lack of clear direction and mentoring of junior officers, not consulting experts, not communicating change in the ATO's risk hypotheses and overall concerns about the validity of the risk assessments and audits;⁵⁶³

⁵⁵⁵ ATO, 'Communication (12 March 2013)', above n 104; ATO, 'Communication 2 (13 March 2013)', above n 200.

⁵⁵⁶ ATO, 'LB&I Executive Minutes' (28 September 2011) Internal ATO Document; ATO, 'LB&I Executive Minutes' (24 May 2012) Internal ATO Document; ATO, 'LB&I Executive Minutes' (23 August 2012) Internal ATO Document; ATO, 'LB&I Executive Minutes' (21 September 2012) Internal ATO Document; ATO, 'LB&I Executive Minutes' (24 October 2012) Internal ATO Document; ATO, 'LB&I Executive Minutes' (22 November 2012) Internal ATO Document; ATO, 'LB&I Executive Minutes' (13 December 2012) Internal ATO Document; ATO, 'LB&I Executive Minutes' (21 February 2013) Internal ATO Document.

⁵⁵⁷ ATO, 'ILT Agenda (February 2011)', above n 538; ATO, 'International Leadership Team Minutes' (May 2011) Internal ATO Document; ATO, 'International Leadership Team Minutes' (July 2011) Internal ATO Document; ATO, 'International Leadership Team Minutes: Notes' (November 2011) Internal ATO Document; ATO, 'International Leadership Team Minutes' (March 2012) Internal ATO Document; ATO, 'ILT Minutes (April 2012)', above n 539; ATO, 'HOTSAs 2012', above n 518; ATO, Communication (6 March 2013).

⁵⁵⁸ ATO, 'Case Callover Summary', above n 316.

⁵⁵⁹ ATO, 'Integrated Quality Framework Results 1 August 2009 to 30 June 2010' (undated) Internal ATO Document; ATO, 'Integrated Quality Framework Results 1 July 2010 to 30 June 2011' (undated) Internal ATO Document.

⁵⁶⁰ ATO, 'ILT Minutes (July 2012)', above n 547.

⁵⁶¹ ATO, 'International Leadership Team Minutes' (November 2011) Internal ATO Document; ATO, 'International Leadership Team Minutes: Notes' (October 2010) Internal ATO Document.

⁵⁶² ATO, 'IQF Results 2009 to 2010', above n 558; ATO, 'IQF Results 2010 to 2011', above n 558.

⁵⁶³ ATO, 'IQF Results 2009 to 2010', above n 558; ATO, 'IQF Results 2010 to 2011', above n 558.

- some case teams relying on specialists to apply the ATO view in cases, indicating a lack of capability of the team, a lack of empowerment or issues with approval or escalation processes;⁵⁶⁴
- some case teams not understanding the facts or the source material — for example, how the transaction documents could be used to create legal structure and cash flow charts for arrangements;⁵⁶⁵ and
- in some cases, a lack of awareness of the commercial, corporate, accounting and legal aspects that evidence a transaction.⁵⁶⁶

Levels of capability

5.40 The ATO defines the following levels of officers' transfer pricing abilities:

- new to job officers have a general awareness of transfer pricing issues;
- foundation level officers recognise and understand:
 - transfer pricing conceptually;
 - the arm's length principle;
 - transfer pricing issues;
 - transfer pricing compliance products, such as APAs, Transfer Pricing Record Reviews (TPR Reviews), audits and MAPs;
 - have some knowledge of case law, Taxation Rulings and tax treaties; and
 - the interaction with other aspects of income tax;
- intermediate level officers can understand, apply and articulate:
 - a transfer pricing issue under review in workshops, transfer pricing callovers and tax technical forums;
 - how tax treaties can affect structures;
 - exchange of information;
 - the interaction between transfer pricing, source and residency;

⁵⁶⁴ ATO, 'LB&I Executive Agenda: Case Callover Submission' (21 September 2012) Internal ATO Document.

⁵⁶⁵ *ibid.*

⁵⁶⁶ *ibid.*

- advanced level officers can take a lead role in:
 - Transfer Pricing Review Panel (TPRP) meetings on specific cases, industries or issues;
 - MAPs and their preparation; and
 - preparation of position papers for transfer pricing issues;
- expert level officers advise, lead and mentor:
 - on all aspects of transfer pricing legislation including, case law, exchange of information, making determinations on a proper basis and liaising with Treasury on law changes;
 - on transfer pricing cases, MAPs, and chairing TPRPs across all topics, issues and industries; and
 - by being an effective member of a Competent Authority team or Joint International Tax Shelter Information Centre.⁵⁶⁷

5.41 The LB&I Executive in March 2009 considered how team capability or ‘better practices’ may be achieved and referred the matter to the LB&I Compliance Assurance and Governance (CAG) unit for action. As part of its review, the LB&I CAG unit interviewed eight ‘higher performing’ large business teams across six sites. The aim of the exercise was to identify better practices and approaches that could have application more widely across LB&I. The LB&I, ‘Better Teams Better Practices Information and Checklist’ (Better Teams Report) summarises the key attributes of high performing teams as:

- having a clear set of deliverables with standards of quality;
- setting dates to achieve deliverables; and
- working together to regularly review and adjust work commitments as necessary.

5.42 Attached to the Better Teams Report is a checklist for teams to consider incorporating into their team plans and individual officers’ performance agreements. This checklist is reproduced in Appendix 6.

5.43 The ATO assesses the transfer pricing capability of ATO officers through a number of means, including LB&I capability assessments which the SME business line have recently adopted. Officers are assessed on a graduated scale according to their knowledge of transfer pricing, ability to apply that knowledge to case work and ability to lead others in the conduct of case work as either ‘limited’, ‘low’, ‘medium’, ‘high’ or ‘expert’.

⁵⁶⁷ ATO, ‘LB&I Master Learning Pathway’ (26 February 2013) Internal ATO Document; ATO, ‘Communication (12 March 2013)’, above n 104.

LB&I capability assessments

5.44 In 2010, the LB&I business line started measuring its officers' capability through voluntary capability assessments during officers' performance reviews. These assessments asked officers to self-assess their current level of proficiency against a number of capabilities, including transfer pricing. A copy of the assessment questions for 2013 is reproduced in Appendix 7. The assessments had been tailored to officers' position levels and job profiles, including an option for staff directly involved in transfer pricing work.⁵⁶⁸

5.45 The capability assessments are used to:

- match each capability assessed to learning products and provide evidence to support demand for learning product delivery;
- assist ATO site leadership in matching work to staff capability;
- provide evidence twice a year of change in capability against strategies implemented; and
- match with other supporting data to provide analysis of challenges for the business line, such as demographics, tenure and age data and case callover data in comparison with some of the key capabilities.⁵⁶⁹

5.46 For example, the Capability Assessments were used to identify the Internationals strategy as one of the LB&I business line's priority capability risk gaps, with further intermediate level products being designed at the time of writing.⁵⁷⁰

5.47 All capability assessments are self-assessed by officers. However, more recently, these assessments have also been moderated by their team leader.

⁵⁶⁸ ATO, 'LB&I Executive Minutes: LB&I Capability Report 2011 Part 1' (6 July 2011) Internal ATO Document; ATO, 'LB&I Capability Snapshot' (May 2010) Internal ATO Document; ATO, 'LB&I Capability Assessment' (5 May 2011) Internal ATO Document; ATO, 'LB&I Capability Assessment' (2012) Internal ATO Document; ATO, 'Communication (11 March 2013)', above n 538.

⁵⁶⁹ ATO, 'Capability Assessment 2012', above n 567.

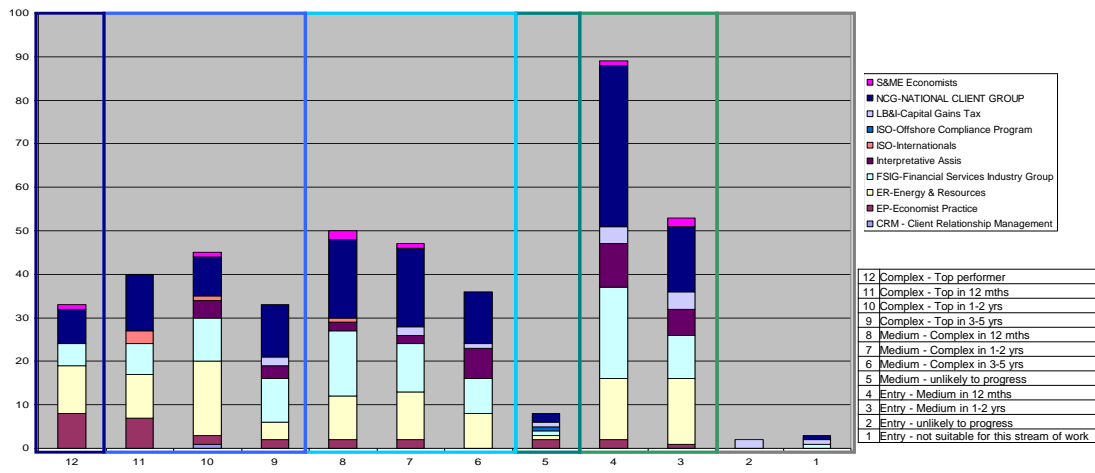
⁵⁷⁰ ATO, 'LB&I Integrated Capability Development Framework 2010-13' (2 November 2010) Internal ATO Document; ATO, 'Communication (11 March 2013)', above n 538; ATO, 'Communication 1 (15 March 2013)', above n 421; ATO, 'Communication 2 (15 March 2013)', above n 104; ATO, 'LB&I Capability Assessment 2012 – Preliminary Assessment' (undated) Internal ATO Document; ATO, 'LB&I Capability and Learning Pathways Strategy 2012-13' (undated) Internal ATO Document; ATO, 'ATO International Tax Capability Report for the Year Ending 30 June 2012' (June 2012) Internal ATO Document.

5.48 The completion rates by LB&I officers for these capability assessments are between 87 per cent and 89 per cent. The transfer pricing capability of LB&I officers in 2010 is reproduced in Figure 8 below:

Figure 8: 2010 LB&I transfer pricing capability

LB&I capability snapshot

Staff who undertake Transfer Pricing work in each capability category across cost centres



➔ Of 439 staff who undertake Transfer Pricing work, the breakdown of staff across cost centres is as follows:

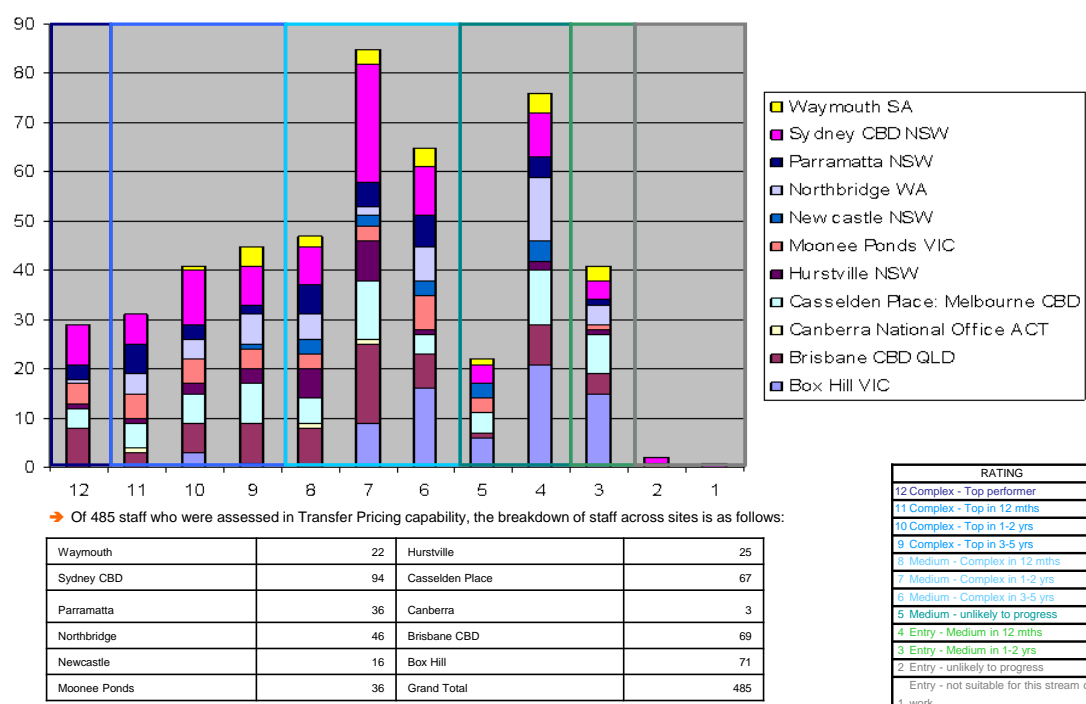
S&ME Economists	8	FSIG-Financial Services Industry Group	99
NCG-NATIONAL CLIENT GROUP	145	ER-Energy & Resources	101
LB&I-Capital Gains Tax	17	EP-Economist Practice	28
ISO-Offshore Compliance Program	1	CRM - Client Relationship Management	1
ISO-Internationals	5		
Interpretative Assistance	34	Grand Total	439

Source: ATO LB&I Capability Snapshot 2010.

5.49 The figure above shows that there were a large number of officers that were considered 'entry' level and expected to progress to 'medium' within one to two years. This is reflective of the recruitment of officers for the TPSCI Project. The results also show that 33 officers were considered top performers and 181 staff were expected to be other top performers within five years.

5.50 The results for 2011 were:

Figure 9: 2011 LB&I transfer pricing capability



Source: ATO LB&I Capability Assessment 2011.

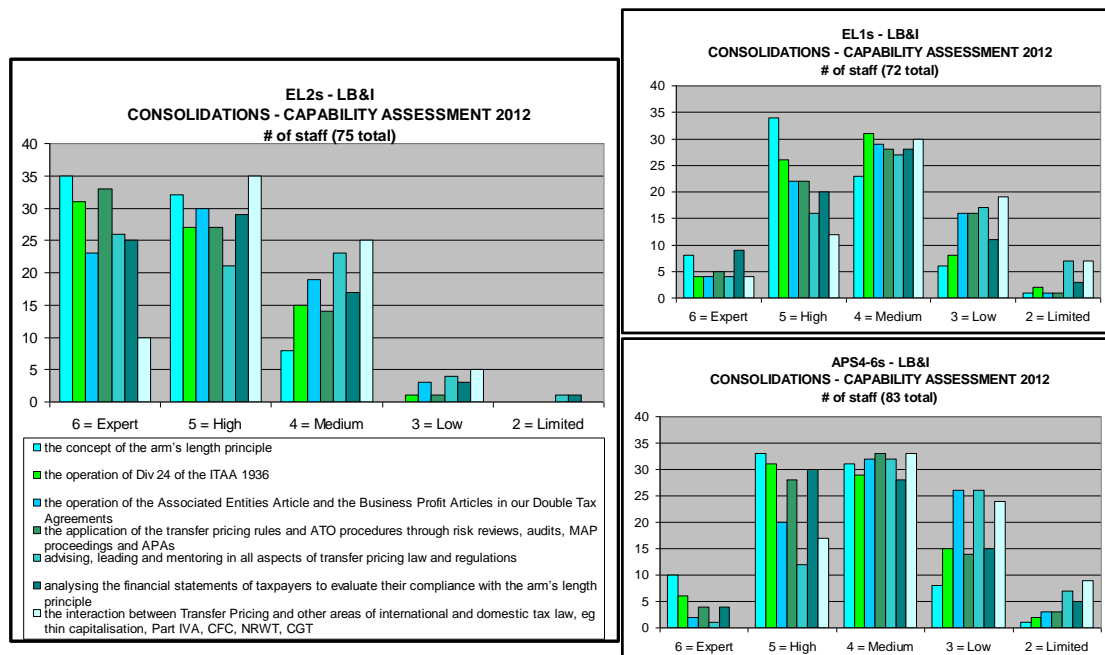
5.51 The 2011 results continue to show a significant number of entry level staff but also a higher number of staff at the 'medium' level that are expected to progress to the 'complex' level within one to five years. The number of top performers slightly decreased from 33 officers in 2010 to 29 officers in 2009.⁵⁷¹ The ATO acknowledges that how well officers are researching and improving their technical skills is unclear from this capability assessment.⁵⁷²

⁵⁷¹ ATO, 'Capability Report 2011 Part 1', above n 567.

⁵⁷² *ibid.*

5.52 The results for officers in 2012 were:

Figure 10: 2012 LB&I transfer pricing capability



Source: LB&I Capability Assessment 2012.

Note: the ATO's reference to 'consolidations' is an error. The data relates to transfer pricing.

5.53 In 2012, most officers are rated as either at the 'medium' and 'expert' levels.⁵⁷³ Notably, the number of officers completing the survey part on transfer pricing reduced from 485 in 2011 to 230 in 2012.

5.54 It should also be noted that the rating scale for the 2012 results was reduced from 1-12 to 2-6. Additionally, the criteria for the rating scale appears to have changed from an assessment by reference to the degree of support received in case work to levels of personal confidence in knowledge and skill. These rating scales are reproduced in Appendix 8.

5.55 Therefore, direct comparison with previous years' results is not possible. Although the results potentially show an increase in the number of officers rated as 'experts', it is not known whether this is due to the natural progression of officers' capability or simply due to the change in reporting. The assessments for officers' industry, finance and accounting, relationship management and communication capabilities are reproduced in Appendix 9.

⁵⁷³ ATO, 'Capability Snapshot 2010', above n 567; ATO, 'Capability Assessment 2011', above n 567; ATO, 'Capability Assessment 2012', above n 567; ATO, 'Communication (11 March 2013)', above n 538; ATO, 'Communication 2 (15 March 2013)', above n 104.

5.56 As the SME business line was in the process of implementing capability assessments for its staff in line with previous IGT review recommendations, no data is currently available for the SME business line.⁵⁷⁴

Transfer Pricing Network's list of specialists

5.57 The TPN also compiles its own list of transfer pricing 'specialists' within the ATO⁵⁷⁵ which indicates a type of peer assessment of capability. The number of transfer pricing specialists over time are as follows:

Figure 11: Numbers of transfer pricing specialists in the Transfer Pricing Network's list

Date	Number
March 2010	35
May 2010	38
July 2010	36
September 2010	37
March 2011	38
May 2011	40
November 2011	38
December 2011	48
2012	-
February 2013	47

Source: ATO Transfer Pricing Network History

Transfer pricing training and development

5.58 In addition to the capability assessments conducted, the ATO has a number of cascading strategies and plans aimed at the training and development of its officers, amongst other things. A key component of these training and development strategies is the ATO's Integrated Capability Development Framework (ICDF) which aims, amongst other things, to help officers build professional capability as a compliance officer. It also aims to align staff learning and development with corporate outcomes by providing a training curriculum that supports the development of skills and knowledge which the ATO expects of officers according to the time spent in the role. The ICDF is supported by a number of strategies with the delivery of its outcomes based on a concept that formal learning comprises approximately 10 per cent is developed through formal training, 20 per cent is developed through support

⁵⁷⁴ IGT, 'SME Review', above n 450, Recommendation 2.3; ATO, Communication (19 April 2013); ATO, 'Communication 1 (15 March 2013)', above n 421.

⁵⁷⁵ ATO, 'Communication (12 March 2013)', above n 104; ATO, 'Communication (19 March 2013)', above n 265; ATO, 'Communication (11 March 2013)', above n 538.

relationships and 70 per cent is developed from on the job experiences (the ‘70/20/10 learning concept’).⁵⁷⁶

5.59 There are a number of formal and informal transfer pricing and related training available to officers on such areas as transfer pricing generally, accounting, economics, industry and communication.

5.60 The ATO acknowledges that not having adequate training material could result in insufficient staff capability to conduct transfer pricing matters which could result in revenue leakages.⁵⁷⁷ ATO officer capability is therefore critical to the efficient and effective treatment of international tax risks, such as transfer pricing.⁵⁷⁸

The ATO’s Transfer Pricing Capability Strategy

5.61 The ATO’s TPCS comprises a number of objectives in contributing to six broader corporate strategies which are reproduced in Appendix 10. These strategies are specifically aimed at building transfer pricing capability across the ATO in a timely and cost effective manner, providing a mix of suitably qualified staff to allow for succession planning and for the efficient operations of the transfer pricing program, and implementing the transfer pricing capability aspects of the Transfer Pricing Management System (TPMS).⁵⁷⁹

5.62 The strategy is supported by, amongst other things, a delivery framework and a tailored learning curriculum, and exists within the ATO’s corporate framework for learning and development, which is outlined in Appendix 11.

5.63 The figure below shows the TPCS is designed to align with the delivery of a number of broader cascading ATO strategies, with line of sight to the ATO’s Strategic Statement and supported by the Learning Pathway for developing officers’ capability.

⁵⁷⁶ ATO, ‘ICDF’, above n 569; ATO, ‘LMAC Response’, above n 402; ATO, ‘Communication 1 (13 March 2013)’, above n 105; ATO, Communication (8 April 2013); ATO, Communication (1 May 2013).

⁵⁷⁷ ATO, ‘ICDF’, above n 569; ATO, ‘Communication (11 March 2013)’, above n 538; ATO, ‘Communication 1 (15 March 2013)’, above n 421; ATO, ‘Communication 2 (15 March 2013)’, above n 104; ATO, ‘Preliminary Assessment 2012’, above n 569; ATO, ‘Learning Pathways Strategy’, above n 569; ATO, ‘International Tax Capability Report’, above n 569.

⁵⁷⁸ ATO, ‘International Capability Strategy 2013’ (7 September 2012) Internal ATO Document.

⁵⁷⁹ ATO, ‘TP Capability Strategy’, above n 539; ATO, ‘Learning Pathways Strategy’, above n 569.

Figure 12: ATO's cascading strategies



Source: IGT reproduction of ATO Capability Strategy 2012–13.

5.64 Through the TPCS, the ATO aims to continue to develop a structured skilling program that encompasses theory (formal training), application (case studies), learning (including self-directed learning and informal training), case work (on the job) and mentoring at the foundation, intermediate and specialist levels.

5.65 The formal training program includes the transfer pricing curriculum, relevant aspects of the LB&I end-to-end skilling program, the international curriculum, the financial analysis training program, external training courses and seminars, and use of external experts where appropriate;

5.66 Informal training includes monthly TPN technical discussion, telephone hook-ups, provision to the TPN of resources, materials, guides, publications and tools, and on the job opportunities, such as attendance at TPRPs and working with international experts.

5.67 The ATO plans to monitor the level of formal and informal training, learning and level of achievement by, amongst others:

- including in officers' performance agreements, a commitment to increasing transfer pricing capability through a combination of formal skilling and allocation of transfer pricing work;

- maintaining TPN capability stocktakes and identifying transfer pricing training needs;
- ensuring that transfer pricing issues receive appropriate priority in skilling programs; and
- using the results from its Capability Assessments in planning the transfer pricing capability program.⁵⁸⁰

5.68 Certain capability strategies are supported by the Learning Pathways. The Learning Pathways outline the development of officers in a number of technical areas, such as income tax (including international tax, transfer pricing, capital gains and consolidation), finance and accounting, and leadership. The Learning Pathways set out the expected timeframes for their capability progression from ‘new to job’ to ‘expert’, expected proficiencies at each capability level including, industry awareness and communication, and matches formal training courses to each capability level. It is expected that officers advance through all capability levels in five to eight years, with fast-tracking of more capable officers left to individual managers.⁵⁸¹

Transfer Pricing Learning Pathway

5.69 The Transfer Pricing Learning Pathway outlines the formal training products for transfer pricing. It was developed in consultation with Economist Practice, the former Transfer Pricing Risk Manager, whose role included identifying capability gaps, and the LB&I Capability Manager. The Transfer Pricing Learning Pathway is reproduced in Appendix 11.

5.70 No transfer pricing training is mandatory for ATO officers unless they were allocated to the TPSCI Project. There is also no formal accreditation process for movement through the differing levels of proficiency outlined in the Transfer Pricing Learning Pathway.⁵⁸² However, officers are expected to know enough to identify transfer pricing risks and seek advice.

5.71 The Transfer Pricing Learning Pathway also aimed to develop TPSCI officers from foundation level, with no or minimal previous transfer pricing knowledge or experience, to ‘specialist’ level after three years. ‘Specialists’ in this context means:

- officers that have completed the ATO’s internal advanced transfer pricing course;
- completed ongoing CPD in relation to transfer pricing;

⁵⁸⁰ ATO, ‘TP Capability Strategy’, above n 539.

⁵⁸¹ ATO, ‘Communication (11 March 2013)’, above n 538; ATO, ‘Communication 2 (15 March 2013)’, above n 104.

⁵⁸² ATO, ‘Communication (11 March 2013)’, above n 538; ATO, ‘Communication 2 (15 March 2013)’, above n 104.

- capable of leading transfer pricing cases, chairing TPRPs, making transfer pricing determinations; and
- capable of being an effective member of a Competent Authority team.

5.72 To assist in building the capability of TPSCI officers, external consultants were engaged to help develop and roll out training to officers.⁵⁸³

Transfer pricing learning plan

5.73 A draft learning plan for transfer pricing was also developed by the ATO which allows officers to track their proficiency on various topics, including:

- the relevant legislation, explanatory memoranda, tax treaties and the OECD guidelines and discussion papers;
- Taxation Rulings, Interpretative Decisions, Taxation Determinations, Practice Statements and ATO's published transfer pricing booklets;
- ATO compliance activities as well as the four-step process in *Taxation Ruling TR 98/11* specifically; and
- transfer pricing issues.

5.74 The draft transfer pricing learning plan is reproduced in Appendix 12.

Formal training on transfer pricing

5.75 'New to job' and 'foundation' transfer pricing courses are aimed at giving officers a basic awareness of international tax and transfer pricing. The relevant training courses are self-directed and amongst other things, outline:

- international tax, transfer pricing and transfer pricing manipulation techniques and methods;
- the relevant legislation, case law and ATO rulings;
- the arm's length principle, comparability and the four-step process; and
- the relevant ATO compliance activities.

5.76 'Intermediate' level training focuses on the process for ATO risk reviews, audits and APAs and how to apply transfer pricing methodologies. There is also training on specific technical subjects, such as the interaction between thin capitalisation and transfer pricing.

⁵⁸³ ATO, 'Communication (12 March 2013)', above n 104.

5.77 ‘Advanced’ level topics focus on issues related to transfer pricing, such as double tax agreements and international tax avoidance. An additional training course for TPRP members is being developed.⁵⁸⁴

5.78 ‘Expert’ level training focuses on leading International Network discussions and authoring risk mitigation strategies for the network.

5.79 The most recent transfer pricing training schedule is set out in the table below.⁵⁸⁵

Table 14: ATO’s transfer pricing training schedule for 2013

Training to take place in week commencing	VIC		NSW		QLD		WA
	Docklands	M Ponds	Sydney	Parramatta	Hurstville	Brisbane	Perth
TP — New to Subject (NTS)	20 Aug	27 Aug		3 Sep	10 Sep	20 Aug	10 Sep
TP — Risk	8 Oct	15 Oct	17 Sep	8 Oct		22 Oct	29 Oct
TP — Audit		12 Nov	6 May			19 Nov	3 Dec
TP — APA	4 Feb		18 Feb		4 Mar	11 Feb	25 Feb
TP — Business Restructures (BR)	11 Mar	18 Mar		26 Nov	19 Nov	15 Apr	6 May
TP — Interaction with Div 820 (Thin Cap)	22 Apr	13 May	22 Oct	29 Oct		13 May	27 May

Source: ATO International Capability Strategy 2013.

5.80 As part of another learning pathway, the Income Tax Learning Pathway, the LB&I business line runs a generic foundation level training course for its officers on end-to-end active compliance (E2E Course). The E2E Course runs for 11 days and includes, risk reviews, audits and interpretative assistance with a focus on understanding how the LB&I business line approaches its work, why the LB&I business line approaches its work in that manner and how the approach fits with its overall organisational goals and strategies. Specific modules which are part of the E2E Course include:

- risk and compliance management;
- planning and managing a case, identifying risks and escalating reviews to audit;
- understanding business; and
- interviews, negotiation, information gathering, evidence and audit decision making.⁵⁸⁶

⁵⁸⁴ ATO, ‘Communication 2 (15 March 2013)’, above n 104; ATO, ‘E-wiki’, above n 166, Course Synopsis; ATO, ‘Capability Report 2011 Part 1’, above n 567.

⁵⁸⁵ The ATO has advised that the training schedule provided does not include training to LB&I officers in November 2012 on Subdivision 815-A of the ITAA 1997 and the ATO’s approach to transfer pricing compliance. The schedule also does not include foundation level training on Division 815 of the ITAA 1997 which is scheduled for November 2013: ATO, ‘Communication (24 October 2013)’, above n 101.

⁵⁸⁶ ATO, ‘End to End Active Compliance Program for Large Business’ (undated) Internal ATO Document.

5.81 The ATO also has formal training to improve the commercial awareness of the economic influences on business, the characteristics of particular industries and how business operates.⁵⁸⁷ This formal training includes:

- Oil and Gas, which is a course directed at officers who have been identified as requiring an intermediate knowledge of the oil and gas industry on such issues as the mineral development regime, financial arrangements, contracting and how it applies to Australia and its tax system;
- Life Insurance – Introduction, which is a self-directed course that explains the operations of a life insurance company within Australia, highlights the key regulatory bodies, describes their main functions and also discusses the features of common products sold by the life insurance companies within Australia; and
- the E2E Course, which includes a module on understanding business that contains 12 high level questions which officers can use, in combination with undertaking general research about taxpayers' businesses at an early stage in the case, to obtain an understanding of taxpayers, their industry and their business practices.⁵⁸⁸

Self-directed learning and on the job application

5.82 The ATO provides self-directed learning on transfer pricing issues and on the job application through:

- Continuing Professional Development (CPD) updates, which were developed in partnership with external providers and partially outsourced the delivery of those modules to external presenters from professional firms who are able to give officers insights into the practical implications of the law for businesses;
- access to:
 - publications, such as journals, media, industry specific reports, subscription services and an internal transfer pricing newsletter issued bi-monthly;
 - ATO intelligence and economist teams and the TPN and Economist Network;
 - technical conferences and site forums; and
 - the transfer pricing E-Wiki, which includes procedural documents for the conduct of TPR Reviews and transfer pricing audits amongst other things.⁵⁸⁹

⁵⁸⁷ ATO, 'Communication 2 (15 March 2013)', above n 104; ATO, 'Communication (8 April 2013)', above n 575.

⁵⁸⁸ ATO, 'Communication (11 March 2013)', above n 538; ATO, 'Communication (12 March 2013)', above n 104; ATO, 'Communication (8 April 2013)', above n 575; ATO, 'International Tax Capability Report', above n 569.

⁵⁸⁹ ATO, 'LMAC Response', above n 402; ATO, 'IGT-TP-TOR6-REQ1' (November 2012) Internal ATO Document.

- Large Business Advisory Group meetings, messages and learnings that are cascaded from senior ATO representatives to operational case teams;⁵⁹⁰ and
- the activities of the TPRP.⁵⁹¹

Finance and accounting skilling and development

5.83 A Learning Pathway also exists for officers for finance and accounting skills, which is reproduced in Appendix 13.

5.84 This Learning Pathway outlines training and a number of accounting courses, some of which are being developed by external professional bodies, that are recommended for each capability level. This training includes:

- ‘foundation’ level training, which focuses on basic accounting and financial reports and understanding basic financial information (a further course on the International Financial Reporting Standards (IFRS) is also being developed);
- ‘intermediate’ level training, which focuses on the Australian equivalents to the IFRS, forensic accounting and accounting for income taxes in relation to key accounting standards and analysis of income tax returns;
- ‘advanced’ level training, which takes an in-depth analysis of income tax returns, for example around consolidations, capital gains, international tax and losses; and
- ‘expert’ level training, which comprises attending seminars through the ATO’s Accounting network that has a primary objective to build capability and share knowledge in accounting and tax interactions.⁵⁹²

5.85 The LB&I E2E Course also has specific modules that assist its officers with knowledge and application of accounting and audit techniques such as:

- the identifying tax risks module, which include analysis of income tax returns, considering known tax risks, reading a tax return and understanding the tax effect on accounting to identify tax risks; and
- the audit closure and debrief module, which includes technical and analytical skills.⁵⁹³

Relationship and communication skilling and development

5.86 Officers’ proficiency around relationship management and communication also features within the Income Tax Learning Pathway.

⁵⁹⁰ ATO, ‘LMAC Response’, above n 402.

⁵⁹¹ ATO, ‘IGT-TP-TOR6-REQ1’, above n 588.

⁵⁹² ATO, ‘Master Learning Pathway’, above n 566, p 8 (finance and accounting).

⁵⁹³ ATO, ‘End to End Program’, above n 585, Modules 5 and 8.

5.87 This learning pathway includes two training courses for auditors at the intermediate level that focus on developing negotiation and influencing skills and client relationship management. The latter course is aimed at SME officers. At the expert level, the ATO provides a negotiation and influencing course, however, at the time of writing, this course was not found on the ATO's Learning Management System.⁵⁹⁴ The LB&I area also has its E2E Course which has a module on interviews and negotiation.⁵⁹⁵

5.88 The negotiation and influencing skills course aims to increase participants' awareness of the opportunities for effectively negotiating and influencing in order to enhance business, professional and personal outcomes and improve employee engagement. It also provides an opportunity to practice and integrate these skills in a supportive learning environment. This course is targeted towards ATO officers who are currently in a role that requires the business application of negotiation and influencing skills at the intermediate level. At the time of writing, the course was scheduled to be run once in four different ATO sites within 365 days.

5.89 The client relationship management course aims to assist SME officers build confidence and effectiveness in dealing with top tier accounting and law firms. In particular, an emphasis is placed on developing skills for officers to 'think on their feet' that is respond effectively to questions or issues raised at the client meetings. The desired outcome is that officers are confident, professional and effective at a variety of meeting situations with taxpayers and their representatives in the upper end of the SME market. At the time of writing, no courses were scheduled for the next 365 days.

5.90 The LB&I E2E Course's interviews and negotiation module aims to:

- develop officers' ability to refine risk hypotheses and plan the information gathering process required to obtain sufficient information to test hypotheses;
- understand the attributes of a good interviewer, as well as questioning and listening techniques that should be followed during an interview;
- identify emotional reactions to other points of view and maintain objectivity; and
- understand the impact of behavioural and psychological issues on the interview process.

5.91 Although during the review no E2E Course modules were scheduled to be delivered for the next 365 days, during the finalisation of the review the ATO advised that three sessions in two ATO sites had been conducted over July to August 2013 and further sessions were to be scheduled in five additional sites from October 2013 to early 2014.⁵⁹⁶

⁵⁹⁴ ATO, 'Master Learning Pathway', above n 566.

⁵⁹⁵ ATO, 'Communication (11 March 2013)', above n 538; ATO, 'Communication (8 April 2013)', above n 575; ATO, 'End to End Program', above n 585, Module 6.

⁵⁹⁶ ATO, 'Communication 1 (1 November 2013)', above n 137.

5.92 There are also negotiation skills courses offered by the ATO Learning and Development unit. The ATO reports that places in the negotiation skills courses are limited and demand always exceeds supply, as the courses at the advanced level are expensive. Prior to 2010, the LB&I business line organised this training for its officers at the executive level and usually ran between two to four sessions per year. This training was externally sourced.⁵⁹⁷

APA training

5.93 The ATO has also advised they are involving less experienced officers more in Competent Authority work such as meetings and providing them cases to work on. These officers have mentioned that it takes them two years to understand the role and work of CARs. The ATO have also taken officers from their graduate program as this is a good use of resourcing and is less intrusive on the other business lines, since the CARs are not taking expertise away from the case managers in operations.⁵⁹⁸

Training and development on functional analyses and transfer pricing methodologies

5.94 The training and support specifically to improve officers' ability to undertake a functional analysis include:

- the LB&I's E2E Course;
- transfer pricing specific training for the foundation and intermediate levels; and
- training on specific industries.⁵⁹⁹

5.95 These are outlined in more detail below.

LB&I E2E Course

5.96 Part of the LB&I E2E Course is a 96 page module to assist officers with understanding business. Specifically, this module aims to assist LB&I officers to:

- identify and work through critical areas of understanding a taxpayer's business through the use of a number of models, approaches and concepts; and
- identify ATO systems to help officers understand the business and run related internal workshops.

⁵⁹⁷ ATO, 'Communication (21 May 2013)', above n 173.

⁵⁹⁸ ATO, 'Communication (22 March 2013)', above n 166.

⁵⁹⁹ ATO, 'Communication (11 March 2013)', above n 538; ATO, 'Communication (8 April 2013)', above n 575; ATO, 'International Tax Capability Report', above n 569; ATO, 'Communication (12 March 2013)', above n 104.

5.97 The module outlines a number of model approaches and concepts – for example, the Bullseye Model, the Business Industry Sociological Economic Psychological (BISEP) Model, Porter's Five Forces, functional analyses, value chain analyses and LB&I's 12 high level questions.

Transfer pricing specific training

5.98 The foundational level 'transfer pricing awareness' training, amongst other things, gives participants a basic outline of the four-step process in *Taxation Ruling TR 98/11* and the transfer pricing methods. The relevant learning outcome is to be able to explain the four-step process and the different transfer pricing methodologies.⁶⁰⁰

5.99 The foundation level 'new to subject' transfer pricing training includes a more detailed look at the four-step process in *Taxation Ruling TR 98/11*. In respect of step one, it is acknowledged that accurately characterising the dealings requires the dealings be looked at in the context of the taxpayer's industry. The module outlines Porter's 'five forces', the Bullseye Model, value chain analysis and the 12 high level questions, amongst others, to assist officers understand the business of the taxpayer and the broader industry and economy. A case study is also included on understanding the business and developing a preliminary functional analysis. The learning outcomes of this course include officers being able to explain transfer pricing risks, identify the main types of international related party dealings, describe how the arm's length principle operates and understand the application of the four-step process.⁶⁰¹ This course is similar to the LB&I business line's E2E Course on understanding business. The E2E Course however goes into further detail on functional analyses and its use to allocate profit to reflect the value added in the production and selling process.

5.100 The 'new to subject' course also includes a more detailed look at each of the main transfer pricing methods and selecting the most appropriate transfer pricing methodology, including by determining the reliability of available comparables and difficulties with each transfer pricing method. The learning objectives include officers being able to identify major transfer pricing methodologies and their use and to understand the application of the four-step process.⁶⁰²

5.101 At the intermediate level, the ATO's training for transfer pricing audits outlines the audit process in testing the arm's length outcome including steps 1 and 2 of *Taxation Ruling TR 98/11*. The training module recognises that step 1 is the most time consuming and critical step. A number of broad questions are framed to assist officers to properly characterise a taxpayer's dealings in the context of their business. Again, it is stated that the objective of step 1 and associated information gathering is to understand the taxpayer's business, identify international related party dealings and

⁶⁰⁰ ATO, 'Transfer Pricing: Basic Awareness' (undated) Internal ATO Document.

⁶⁰¹ ATO, 'Transfer Pricing: New to Subject' (undated) Internal ATO Document.

⁶⁰² *ibid.*

understand the industry in which the taxpayer operates. The learning outcomes of this training include officers being able to undertake the various audit steps.⁶⁰³

5.102 This training also looks at the selection of the most appropriate transfer pricing method by assessing the reliability and availability of comparables. Again, there is an outline of the main transfer pricing methods and the factors that affect their comparability and adjustments. This training module also contains two case studies on applying the Comparable Uncontrolled Price (CUP) method and Transactional Net Margin Method (TNMM). The learning outcomes of this training include officers being able to undertake the various audit steps.⁶⁰⁴

Specific industry training

5.103 The ATO also has two specific industry training courses mentioned earlier for the oil and gas industry and the life insurance industry.

5.104 Those stakeholders who were aware of the ATO's formal training on this area commented favourably and considered that it, under direct supervision of a transfer pricing expert, should deliver the skills needed to conduct functional analyses with confidence.

Support relationships and on-the-job application

5.105 The ATO also establishes support relationships on the conduct of functional analyses during transfer pricing work.

5.106 As recognised in the ATO's adoption of the 70/20/10 approach to learning and development, formal skilling needs to be built upon through application in the workplace and through the guidance and mentoring of more experienced officers.

5.107 At present, officers are generally supported and trained through mentoring by senior members of their team, case workshops with specialists, site technical forums, technical networks and access to guidance material (such as the compliance manual, procedural documents and risk guides).⁶⁰⁵

5.108 While team leaders and technical leaders play an important role, networks of officers experienced in particular areas of tax law and accounting are also an integral part of the capability strategy to develop the profile of officers so that more officers are confident and competent to undertake complex work.⁶⁰⁶ This strategy also aims to provide a coordinated approach to networks, while recognising that there are a number of core specialisations in which expertise needs to be developed.⁶⁰⁷

⁶⁰³ ATO, 'Transfer Pricing: Audit' (October 2011) Internal ATO Document.

⁶⁰⁴ *ibid.*

⁶⁰⁵ ATO, 'LMAC Response', above n 402.

⁶⁰⁶ ATO, 'TP Capability Strategy', above n 539.

⁶⁰⁷ ATO, 'LMAC Response', above n 402.

5.109 As mentioned in Chapter 1, in relation to transfer pricing, support is available through the TPN.⁶⁰⁸ The purpose of the TPN is to provide a cross business line forum for transfer pricing specialists and case officers to build transfer pricing capability through a number of activities.⁶⁰⁹ Officers are also able to nominate one or two industry specialities as part of the formal TPN.

5.110 Furthermore, the LB&I business line has two 'communities of practice' to facilitate industry knowledge and capability, as mentioned earlier in this chapter.

5.111 Support with undertaking functional analyses and benchmarking taxpayers is also provided through the Economist Practice or Profit Shifting Practice (PSP) as described in Chapter 2 previously.⁶¹⁰

5.112 Additionally, the ATO provides its officers with a range of support materials to assist in developing general commercial awareness as mentioned earlier in this chapter, such as quarterly CPD updates, journals and media reports, industry specific reports and industry and technical conferences.⁶¹¹

Training and development on information gathering

LB&I E2E Course

5.113 The LB&I E2E Course also contains a module on information gathering during audits. This module assists officers in understanding the principles of information gathering in compliance work (e.g. informal approaches versus formal), determining the information needed to test the risk hypothesis, considering and resolving a range of competing complications that occur in the large market and understanding how to escalate information gathering approaches in a complex audit. The module encourages officers to get 'full facts' quickly, along with the relevant supporting evidence.

5.114 The training module recognises that successful information gathering results in timely, full, complete and relevant information to enable good decision making, early and ongoing dialogue, and for the case to be actively managed. Additionally, evidence gathering should be focussed and directed.

5.115 The level of information required to establish facts is also discussed in the context of agreed facts, facts in dispute and alternative facts.

5.116 The training material also acknowledges that officers should disclose what they are asking for and why, be timely in dealings, ready to discuss requirements (planned and prepared), have regular communication with the taxpayer and reduce costs to all parties.

⁶⁰⁸ ATO, 'Communication (21 May 2013)', above n 173.

⁶⁰⁹ ATO, 'TPN Charter', above n 168.

⁶¹⁰ ATO, 'Communication 1 (14 March 2013)', above n 149.

⁶¹¹ ATO, 'LMAC Response', above n 402.

5.117 The learning module also includes three case studies which focus on three skilling areas, namely, preparing for a formal interview, the process, protocols and procedures associated with a formal interview and interview techniques.

5.118 The course emphasises that information gathered during a risk review may be used in any subsequent audit activity and possible litigation. Therefore care should be taken in how records are managed.⁶¹²

5.119 The LB&I E2E Course on interviews and negotiation includes a section on knowing how much information is needed. The relevant part of the module states:

Information gathering starts with the understanding of why the case has been selected. Irrespective of how wide or narrow is the reason; it provides a focus for the information gathering strategy, and a guide as to the level of information required. The depth of the information gathering process should be tailored depending on the product you are using and the hypothesis you are testing.

It is important to understand the difference between:

- the amount and nature of information gathered during a review as compared to that gathered during an audit and
- information gathering during a risk review should be directed to obtaining sufficient information to allow a proper assessment of the risk rather than seeking certainty that an issue exists and a precise value of the issue.

Module 4 of the End to End program looked at understanding the business. You need to be able to see the tax issues in the context of the taxpayer's business affairs, then compare that to what you are seeing on the tax side. Combining the two sets of analyses whilst considering the whole of the tax legislation allows you to identify tax risks and analyse their potential impact.

As you develop a hypothesis for the activity you start to form a picture of the issues that might be relevant. You are then in a position to have a conversation with the taxpayer and use that hypothesis to drive your information gathering strategy. The information to be gathered must be relevant to the hypothesis.⁶¹³

Intermediate

5.120 At the intermediate level, the transfer pricing audit training contains a section on information gathering and states the objectives to include understanding the taxpayer's business, identifying international related party dealings and understanding the industry in which the taxpayer operates. The module also discusses sources of contemporaneous documentation and other evidence from taxpayers or

⁶¹² ATO, 'End to End Program', above n 585, Module 6.

⁶¹³ *ibid.*

external sources via interviews with relevant personnel, industry experts or consultants.

5.121 The module states that officers should be able to explain the relevance of information sought and outlines that:

- The ATO will follow the principles and practices detailed in *Taxation Ruling TR 98/11* which provides guidance on the types of documentation that the ATO will expect to see.
- Officers need to exercise commercial judgment in determining the nature and extent of documentation appropriate to taxpayers' circumstances and will vary with the transfer pricing methodology employed. However, the greater the significance and complexity of the dealings, the greater the ATO's expectation that documents will be created/obtained. Documentation issues are also discussed around low levels of international dealings and particular business strategies.
- There are no compulsory lists of documents which a taxpayer must keep, appropriate documentation will depend on the facts and circumstances.

5.122 This training also suggests documentation that taxpayers should retain for each step of the four-step process outlined in *Taxation Ruling TR 98/11*.

Effectiveness of capability development

5.123 In respect of formal training, at the time of writing this report, a framework was being developed by the corporate ATO Learning and Development unit to evaluate such training's effectiveness. Specific effectiveness measures however, are yet to be designed.⁶¹⁴ This work is at an early stage and will be seeking business line input. The ATO advises that core questions of the framework will include whether:

- the learning intervention correctly identified and met the needs of business;
- the learning solution was timely and of high quality; and
- the solution made a difference in the workplace.

5.124 The ATO commissioned a researcher, Inside Story, to provide insights into, and guidance on, accelerating the development of expertise in less experienced compliance officers in the SME business line. The research drew from common themes in literature, opinions of experienced ATO officers and observations of a number of expert and less experienced compliance officers. The research examined SME officers' dealings in compliance cases to identify and capture the characteristics of expert officers' thinking, decision making and processes and the difference in these characteristics to those of less experienced officers. In July 2010, Inside Story presented its report, *S&ME Compliance Officer Research*, which identified the characteristics of

⁶¹⁴ ATO, 'Communication (11 March 2013)', above n 538.

expert compliance officers in five core areas and created an 'Expertise Assessment Tool' from these areas:

1. strategic thinking, including investigative ability, critical thinking and diagnostic ability;
2. draws from previous experience, including the application of knowledge of an industry;
3. confidence, including being able to maintain momentum on a case when faced with uncertainty;
4. productive working relationships, including the ability to seek cooperative solutions and avoid confrontation, and communicate processes and keep taxpayers informed of progress; and
5. negotiation skills.⁶¹⁵

5.125 The full extract of these characteristics is reproduced in Appendix 14.

5.126 In relation to Learning and development, the researcher recommended:

Strengthen relevant existing learning pathway disciplines which align more closely to the competencies in the Expertise Assessment Tool. For example, Communications and Relationship Management, Commercial Industry and Client Knowledge and Case Management and Work Practice;

Develop learning modules to address strategic thinking sub component competencies in Expertise Assessment Tool. Use a staged learning approach appropriate to experience and competency level to fast track development of these skills from the beginning;

Develop a new learning module with a basis in Creative Problem Solving techniques to bring together competencies in Strategic Thinking competency. This could form a capstone learning module once a solid grounding from the Strategic Thinking modules has been achieved;

A grid analysis can be utilised to plot expertise competencies on axes of 'Extent of expertise gap' and 'Importance of expertise gap to outcomes' to establish an order of priority for the program of works to adapt and develop new learning modules for compliance officers.⁶¹⁶

⁶¹⁵ ATO, 'S&ME Compliance Officer Research' (July 2010) Internal ATO Document.

⁶¹⁶ *ibid.*

IGT OBSERVATIONS

5.127 There is a substantial risk that international tax issues, including transfer pricing, will not be effectively and efficiently addressed unless there is a strong individual ATO officer capability:

These risks cannot be addressed unless we have suitably skilled and capable staff... unless we have an effective professional workforce skilled with international capabilities, which can operate effectively in the highly technical sophisticated international market, the ATO will not be able to collect the fair share of international profit/income that is subject to Australian tax.⁶¹⁷

5.128 Similar comments were made by PWC Legal in its 2008 APA Review.⁶¹⁸

5.129 The IGT observes that the ATO expects its officers to be able to identify transfer pricing revenue risks and seek advice. In this respect, 'intermediate' level transfer pricing training and related development through undertaking transfer pricing risk matters appear to satisfy this expectation. Accordingly, the IGT considers that decision making with respect to transfer pricing matters should be allocated to officers who have a minimum 'intermediate' level of proficiency.

5.130 If the ATO is to invest in developing the abilities of its officers to effectively and efficiently resolve transfer pricing matters, it should clearly identify those abilities that are critical and seek to focus on developing those abilities in its officers. The ATO has previously done similar work in this regard. For example, the Inside Story research commissioned by the ATO provides that the first step should be to observe and identify in tangible terms what an 'expert' does to effectively and efficiently resolve transfer pricing issues that are different to what an inexperienced officer would do.

5.131 The ATO's commitment to learning and development is evident from its skilling and development strategies which are supported by the Learning Pathways and compliance technical networks. It should also be noted that the Economist Practice is in the process of developing its own capability strategy for its officers.

5.132 The IGT observes that whilst the Transfer Pricing Learning Pathway is comprehensive in respect of technical aspects of taxation, there are a number of limitations in the training that is aimed to improve the commercial awareness of officers. For example:

- there are training courses on only two industries, both appear to be aimed at officers in the LB&I business line;

⁶¹⁷ ATO, 'International Capability Strategy', above n 577.

⁶¹⁸ PWC Legal, above n 109, p 48.

- the E2E Course, which includes a high level module on understanding business, is restricted to LB&I officers only;⁶¹⁹ and
- the Transfer Pricing Learning Pathway expects officers to develop proficiency in understanding industries, however, the formal training courses on developing awareness of specific industries are not included within any Learning Pathway.

5.133 Further, the IGT observes a number of training products have not been scheduled to run for the next 365 days at the time of writing. These training products include one of the ATO's two industry training products and one of the two relationship management and communication training products. The ATO commissioned Fyusion Report also found that while many staff took up on-the-job and self-paced training (85 per cent and 76 per cent respectively), other methods, such as mentoring (50 per cent) and formal training, particularly at the advanced level could be improved (between 15 per cent for advanced level and 30 per cent for 'other').⁶²⁰ It is insufficient to simply have these training products listed. The products must be made available sufficiently frequently and relevant ATO officers be required to attend them.

5.134 The IGT considers that improving an officer's ability to conduct a robust functional analysis is a critical factor in improving their ability to successfully resolve transfer pricing issues. Many agree that the E2E Course provides the foundation for developing a functional analysis. However, this is a general induction course for all new LB&I officers without direct relevance to transfer pricing issues. The ATO, therefore, should develop a program of development activities that are focussed on quickly instilling the core abilities involved in successfully conducting a robust functional analysis in a transfer pricing context.

5.135 The knowledge of conducting a functional analysis in and of itself is insufficient. What is needed is confidence in correctly applying that knowledge in practical situations. This requires regular transfer pricing case work and direct supervision by a 'specialist' including feedback on the officer's application of that knowledge. At present, this supervision is provided by team leaders who may not have the requisite level of transfer pricing skills and experience, economists many of which have less than two years' experience and the TPRP which is convened on an ad hoc basis.

5.136 In this respect, it is acknowledged within the ATO that it is important to develop transfer pricing capability with CARs in preference to operational units. The ATO has advised that it is involving junior officers more in Competent Authority work and believes it will take these officers two years to understand that work.⁶²¹

5.137 The IGT considers that the establishment of a capability building framework, including measuring its effectiveness, will assist the ATO in evaluating and improving its training products. Whilst the implementation and refinement of the capability

⁶¹⁹ ATO, 'SAP: End to End Active Compliance Program for Large Business' (undated) Internal ATO Document.

⁶²⁰ Fyusion, above n 294, p 26.

⁶²¹ ATO, 'Communication (22 March 2013)', above n 166.

assessments in this respect are commendable, the reliability and usefulness of the capability assessments require improvement. This is evidenced from what appears to be differing results of capability between the capability assessments on one hand, and the case callovers and the observations of the Internationals Unit leadership team and LB&I Executive on the other.

5.138 Accordingly, the ATO should seek to improve the robustness of its capability assessments, particularly as they are largely a self-rating by officers. The capability assessment questions should be designed to elicit more objective responses by testing officers' actual knowledge and requiring demonstrated application of that knowledge in case work. These improvements may also improve the accuracy of identifying further learning opportunities.

5.139 The capability assessment should be expanded to consider external stakeholder views of ATO officers' capability as recommended in previous IGT reviews. As discussed in those reviews, the ATO could take more proactive measures to obtain such views in addition to using its Client Feedback Questionnaires.⁶²²

RECOMMENDATION 5.2

The IGT recommends that the ATO:

- (1) allocate transfer pricing decision-making authority to officers who have a solid grounding in transfer pricing;*
- (2) supplement foundation and intermediate level transfer pricing officers' training programs with on-the-job direct supervision by transfer pricing 'specialists' in a range of key activities;*
- (3) identify the key abilities of 'specialist' transfer pricing officers (including the economist) and develop activities to accelerate the development of expertise such as conducting robust functional analyses; and*
- (4) develop more rigorous tools for measuring staff capability including obtaining the views of externals and their advisers.*

ATO response

Agree in part

The ATO agrees with parts 2 to 4.

The ATO disagrees with part 1. In cases where the transfer pricing risk is not the main risk under examination we would, as we do now, have an officer who is an experienced case officer managing the case and accountable for making decisions.

⁶²² IGT, 'SME Review', above n 450.

This officer would take expert advice, as appropriate, on specific risks, including transfer pricing, from relevantly skilled specialists. That case officer may not necessarily be one with a ‘solid grounding’ in transfer pricing.

CHAPTER 6 — ATO ADVICE AND GUIDANCE

STAKEHOLDER CONCERNS

6.1 Stakeholders were concerned that the recent changes to the transfer pricing law, including the enactment of Division 815 of the *Income Tax Assessment Act 1997* (ITAA 1997), may increase the risk of retrospective application of ATO views and cause considerable uncertainty for taxpayers. Stakeholders were of the view that additional ATO advice and guidance should be provided quickly to avoid this risk. They identified the following issues as priorities for ATO advice:

- The ATO's reconstruction power under subdivision 815-A of the ITAA 1997 and the circumstances in which it will be used. Stakeholders were concerned that the ATO may impose unrealistic administrative requirements and that double taxation may occur where the competent authorities do not agree on what is a reconstruction or when a transaction should be reconstructed.
- A 'restructuring event' for the purpose of completing Question 17 of the IDS. Stakeholders comment that at present, the question and the related instructions do not clearly indicate the extent to which a transfer of functions, assets and risks would be needed to constitute such an event. SMEs were concerned that this lack of clarity was imposing an unnecessary compliance burden.
- The reasonably arguable position penalties under Subdivision 284-E of the ITAA 1997. Stakeholders were concerned that the existing *Taxation Ruling TR 98/11* does not provide sufficient practical advice on what transfer pricing documentation would be accepted by the ATO.

6.2 Stakeholders also considered that the ATO's advice and guidance on transfer pricing issues were in need of updating, as they:

- did not adequately consider recent changes in international dealings and commerce, such as the use of the London Interbank Offered Rate (LIBOR) in the mining industry, the movement of SMEs' intellectual property into tax havens, the deferral of MNEs' dividends to their domestic countries and the combined use of debt and guarantee fees;
- had not been provided on areas foreshadowed in previous rulings, such as those in *Taxation Ruling TR 2001/11* paragraph 6, *Taxation Ruling TR 94/14* paragraphs 4, 5 and 408 and *Taxation Ruling TR 97/20* paragraph 1.10;

- did not consider the interaction of the transfer pricing provisions with other areas of legislation, such as *Taxation Ruling TR 2011/1* that does not consider capital gains, attribution or anti-avoidance issues; and
- did not fit seamlessly together as many older rulings appeared inconsistent in some ways with later public advice.

6.3 In addition to the content of the ATO's advice and guidance, stakeholders were concerned that a key forum to surface emerging transfer pricing issues, the NTLG International Sub-group, was ineffective in this respect. Stakeholders consider that the NTLG International Sub-group does not have the necessary degree of specialisation to discuss transfer pricing issues or the necessary middle market representation. Although the ATO has advised that such specialists and representatives may attend the sub-group's meetings in certain circumstances, stakeholders have questioned the logistics of doing so.

6.4 Lastly, stakeholders raised concerns that the ATO has, or will, change its approach to current transfer pricing cases or cases previously 'thought to be settled' as a result of the enactment of the new transfer pricing provisions.⁶²³

ATO MATERIALS AND INFORMATION

6.5 The ATO sets out its administration of transfer pricing laws in numerous binding advice and non-binding guidance products.⁶²⁴ Since 1992, the ATO has released a total of 39 advice products on transfer pricing issues. A non-exhaustive list of this advice and guidance is set out in Appendix 5.

6.6 The ATO considers that public rulings, a form of binding advice, are generally designed to cover a specific issue or area of law, but for practicality reasons of managing length and complexity, it can never cover every associated issue or matter that may intersect with the identified specific issue or area of law.⁶²⁵ Other advice or guidance must be used where this occurs. For example, in relation to paragraph 5 of *Taxation Ruling TR 2011/1*, relevant capital gains tax issues are the subject of other public rulings which can be applied widely, including the transactions described in *Taxation Ruling TR 2011/1*. Similarly, attribution is the subject of existing ATO advice and guidance.⁶²⁶ Overall, the ATO considers that its advice and guidance is comprised of a number of products on a number of different issues, which together are intended to be applied to taxpayer arrangements.

6.7 During the review, the ATO advised that it has commenced planning for the review and update of its transfer pricing advice and guidance.⁶²⁷ It aims to afford

⁶²³ ATO, 'Draft Transfer Pricing Working Group Minutes' (29 August 2012) Internal ATO Document, p 3.

⁶²⁴ ATO, 'IGT-TP-TOR2-REQ1' (8 November 2012) Internal ATO Document.

⁶²⁵ ATO, 'Public Rulings Manual' (7 August 2013) Internal ATO Document.

⁶²⁶ ATO, Communication (7 June 2013).

⁶²⁷ ATO, Communication (13 December 2012).

priority in delivering advice and guidance on the following list of topics with certain timeframes:

- reconstruction (no prior ruling), public ruling to be issued by September 2014;
- penalties (*Taxation Ruling TR 98/16*), practice statement to be issued by September 2014;
- documentation (*Taxation Ruling TR 98/11*), practice statement to be issued by September 2014;
- transfer pricing methods (*Taxation Ruling TR 97/20*), updated public ruling to be issued by September 2015;
- relief from double taxation (*Taxation Ruling TR 2000/16*), updated public ruling to be issued by September 2015;
- transfer pricing determinations (*Taxation Ruling TR 2007/1*), updated public ruling to be issued by September 2015;
- transfer pricing review work (*Practice Statement PSLA 2005/14*), revised practice statement to be issued by September 2014;
- Transfer Pricing Review Panel (*Practice Statement PSLA 2004/13*), revised practice statement to be issued by September 2014;
- Advance Pricing Arrangements (*Practice Statement PSLA 2011/1*), revised practice statement to be issued by September 2014; and
- referral of work to the International unit (*Practice Statement PSLA 2006/9*), revised practice statement to be issued by September 2014.⁶²⁸

6.8 The ATO advises that it has engaged with tax professionals to obtain input into the scoping of guidance products⁶²⁹ and to issue more detailed scoping documents for the Taxation Rulings on the application of section 815-130 and transfer pricing documentation requirements and the practice statement on penalties for transfer pricing.⁶³⁰

6.9 In respect of providing further advice and guidance on what constitutes 'restructuring events', the IDS 2012 instructions indicate that the IDS adopts a wider meaning of the term 'restructuring' which goes beyond the generally accepted

⁶²⁸ ATO, 'Tier 3 Project Outline: Division 815 ITAA 1997 Implementation Project' (5 August 2013) Internal ATO Document.

⁶²⁹ *ibid* p 13.

⁶³⁰ ATO, 'NTLG TPWG – Scoping Document: Taxation Ruling: Income Tax – Transfer Pricing – Application of Section 815-130 of ITAA 1997' (3 September 2013) Internal ATO Document; ATO, 'NTLG TPWG – Scoping Document: Taxation Ruling: Income Tax – Transfer Pricing – Documentation' (3 September 2013) Internal ATO Document; ATO, 'NTLG TPWG – Scoping Document: PS LA: Income Tax - International Transfer Pricing – Penalty Tax Guidelines' (3 September 2013) Internal ATO Document.

financial definition.⁶³¹ The instructions outline that 'restructuring events' for the purposes of the IDS is consistent with the definition of *Taxation Ruling TR 2011/1*⁶³² and,

refers to arrangements whereby assets, functions and/or risks of a business are transferred between you and international related parties, or your branch operations.

This may include:

- reorganisation of your structure resulting in the disposal or acquisition of entities or the change in ownership of entities;
- establishing, expanding, downsizing, liquidating or relocating business operations or business lines, resulting in:
 - the acquisition and/or the disposal of assets or liabilities (tangible or intangible);
 - the transfer of functions or the significant modification of service arrangements between yourself and international related parties (for example, this may include transfer of agency, distribution, finance, information technology, insurance, logistics, marketing, sales, shared services, shipping, trading, transport and treasury functions);
 - the transfer of risks between yourself and international related parties;
 - the increase or decrease of rights or obligations; and
- where there has been a change in the nature of the business carried on through your branch operations – for example, you have commenced or ceased to use your property in your branch operations or you have commenced or ceased to perform functions or services through your branch operations.⁶³³

6.10 Division 815 of the ITAA 1997 explicitly incorporates the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* and the OECD's *Model Tax Convention on Income and on Capital*, and its commentaries as extrinsic material for the interpretation of the Division.⁶³⁴ In respect of reconstructing transactions, the OECD guidelines state:

A tax administration's examination of a controlled transaction ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them, using the methods applied by the taxpayer insofar as these are consistent with the methods described in Chapter II [of the OECD Transfer Pricing Guidelines]. In other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them. Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of

⁶³¹ ATO, 'IDS Instructions 2012', above n 483, Question 17.

⁶³² ATO, *Income Tax: Application of the Transfer Pricing Provisions to Business Restructuring by Multinational Enterprises*, TR 2011/1, 9 February 2011.

⁶³³ ATO, 'IDS Instructions 2012', above n 483.

⁶³⁴ *Income Tax Assessment Act 1997* s 815-20.

which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.⁶³⁵

6.11 In relation to ‘exceptional cases’ the OECD outlines two situations where it may be appropriate for revenue authorities to reconstruct taxpayers’ transactions.

6.12 The first is where the economic substance of a transaction differs from its form. In such circumstances, revenue authorities may disregard the parties’ characterisation of the transaction and reconstruct it in accordance with its substance.

6.13 The second situation is where the form and substance of the transaction are the same, however the arrangements made in relation to the transaction when viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the revenue authority from determining an appropriate transfer price. In this case, while it may be proper to respect the structure and form of the transaction, it would nonetheless be appropriate for a revenue authority to reconstruct the terms of that transfer in its entirety. The reconstruction of the transfer should not be simply by reference to pricing that might reasonably have been expected had the transfer been the subject of a transaction involving independent enterprises.⁶³⁶

6.14 Other than the above, currently there is no further advice or guidance on what constitutes a reconstruction of a transaction, what are ‘exceptional circumstances’ necessitating a reconstruction⁶³⁷ and how the ATO’s reconstruction powers should be applied.⁶³⁸

6.15 These issues were raised with the ATO by members of the Transfer Pricing Working Group (TPWG) in August 2012. During the meeting, the Chair of the TPWG indicated that from the ATO’s point of view, with respect to the specific issue of reconstruction, Subdivision 815-A of the ITAA 1997 does not represent a change to the ATO view that the power to reconstruct a transaction was available under Division 13 of the ITAA 1936. Other members of the TPWG did not agree with this view of the law and indicated they would prefer guidance provided on the subject.⁶³⁹ Members raised the matter again during the October 2012 meeting of the TPWG.⁶⁴⁰

6.16 In respect of providing advice and guidance of what transfer pricing documentation taxpayers should prepare, *Taxation Ruling TR 98/11* outlines the process of documenting the arm’s length nature of transfer prices and generally, the nature and type of documentation that is relevant to supporting transfer prices between international related parties.

⁶³⁵ OECD, ‘Transfer Pricing Guidelines’, above n 2, para [1.64].

⁶³⁶ *ibid* para [1.65].

⁶³⁷ ATO, ‘TPWG Draft Minutes (29 August 2012)’, above n 622, p 3.

⁶³⁸ ATO, ‘IGT-TP-TOR2-REQ1’, above n 623; ATO, ‘Draft Transfer Pricing Working Group Minutes’ (10 October 2012) Internal ATO Document; ATO, ‘Draft Transfer Pricing Working Group Minutes’ (14 November 2012) p 3.

⁶³⁹ ATO, ‘TPWG Draft Minutes (29 August 2012)’, above n 622, p 3.

⁶⁴⁰ ATO, ‘TPWG Draft Minutes (10 October 2012)’, above n 637, Item 4.

6.17 *Taxation Ruling TR 98/11* also considers documentation issues for small business taxpayers and entities with low levels of international dealings in chapter 6, documentation relevant to the selection and application of particular pricing methodologies in chapter 7 and documentation issues for certain business strategies in chapter 8.

6.18 From 1999 until March 2011 the NTLG Transfer Pricing Sub-group (Transfer Pricing Sub-group) was a forum through which the ATO sought and obtained the views of professional advisers and industry groups on issues related to the administration of tax legislation on transfer pricing, particularly issues to be covered in future rulings or determinations.

6.19 Membership of the Transfer Pricing Sub-group comprised representatives from peak professional associations, industry groups and accounting firms involved in transfer pricing, representatives from the Department of Treasury and key ATO staff involved in transfer pricing strategy and casework. Other ATO staff attended as required.⁶⁴¹

6.20 Membership from the accounting firms was limited to the top six Schedule 25A lodgers to keep membership numbers to a manageable level. Due to this limitation, the ATO stressed that it was important that representatives of the professional associations circulate information from the NTLG Transfer Pricing Sub-group meetings to their members to ensure that it is disseminated amongst the accounting firms who undertake transfer pricing work.⁶⁴²

6.21 During the ATO's reorganisation of its governance and coordination of international issues in 2010, the ATO considered that international tax issues can be complex and it is often not possible or desirable to deal with transfer pricing issues discretely. The ATO felt that a change in the NTLG sub-group arrangements would better cover the range of international issues. The ATO consulted various stakeholders in November and December of 2010. A decision at the NTLG was made on 14 December 2010 to trial the new International Sub-group by combining the then Transfer Pricing Sub-group and the Foreign Source Income Sub-group.⁶⁴³

6.22 Some early concerns were raised by the Transfer Pricing Sub-group members around adequately addressing such a wide ranging subject as international tax as firms are generally established with differentiation between international issues and transfer pricing issues.⁶⁴⁴

6.23 The ATO proposed that once the members have considered the agenda items, they will be free to invite an additional person as subject matter experts or market segment representatives that they consider will be more suited to dealing with or

⁶⁴¹ ATO, *NTLG Minutes* (31 March 2010); ATO, *NTLG Minutes* (14 November 2012) p 25.

⁶⁴² ATO, 'NTLG Minutes (31 March 2010)', above n 640; ATO, 'NTLG Minutes (14 November 2012)', above n 640, p 25.

⁶⁴³ ATO, 'NTLG Minutes (31 March 2010)', above n 640; ATO, 'NTLG Minutes (14 November 2012)', above n 640, pp 24-25; ATO, *NTLG Transfer Pricing Sub-Group Minutes* (29 March 2011) pp 2-4.

⁶⁴⁴ ATO, *NTLG Internationals Sub-group Minutes* (16 May 2011) p 5.

discussing a particular issue.⁶⁴⁵ The IGT notes that since the change in March 2011, no transfer pricing issues have been discussed in the NTLG Internationals Sub-group at the time of writing.

6.24 Further, the ATO stated that should a particular issue be considered significant or where ongoing consultation is required, a working group may be set up. This working group will be chaired by an appropriate ATO representative, and consist of appropriately experienced professionals and/or relevant industry body representatives as nominated by the members.⁶⁴⁶

6.25 Such a working group was set up in April 2012 to examine issues in relation to the administration and operation of Subdivision 815-A of the ITAA 1997 – the TPWG. However, the TPWG would not consider issues or activities requiring resolution by way of legislative or policy change. Where such issues are identified in the course of this working group's deliberations, the issues will be escalated to the Technical Issues Management Sub-group of the NTLG via the Internationals Sub-group.⁶⁴⁷

6.26 The ATO also advised members that while the TPWG was open to discussing many issues concerning implementation, the ATO could not provide advice or guidance on law prior to its enactment. Members were instead directed to *Practice Statement PSLA 2004/6*.⁶⁴⁸

6.27 The ATO has also acknowledged concerns that the new arrangements may exclude some transfer pricing practitioners from engaging in dialogue with the ATO in these forums. The ATO responded to this by stating that the NTLG Internationals Sub-group had undertaken to publish the minutes as soon as possible and that there should be no disadvantage to anyone who is not included in the meeting.⁶⁴⁹

6.28 However, the ATO has advised the timeframe for publishing the NTLG Internationals Sub-group minutes can take between 99 to 335 days. The IGT notes that details of the first meeting in August 2012 are unavailable.⁶⁵⁰

6.29 The ATO has advised that most delays can be attributed to either publishing congestion and backlogs, or lags in receiving comments and feedback from ATO members and external attendees. Members had copies of the draft minutes prior to the following meeting.

6.30 Previously, minutes were presented at the subsequent meeting for endorsement prior to being sent for publishing. In response to requests for more timely publishing of minutes by externals, the new Secretariat is trialling sending the draft minutes to members for review, updating these based on feedback then sending

⁶⁴⁵ *ibid.*

⁶⁴⁶ *ibid.*

⁶⁴⁷ ATO, 'Draft Transfer Pricing Working Group Charter' (undated) Internal ATO Document, pp 1-3.

⁶⁴⁸ ATO, 'TPWG Draft Minutes (29 August 2012)', above n 622; ATO, 'TPWG Draft Minutes (14 November 2012)', above n 637, p 2.

⁶⁴⁹ ATO, *NTLG Internationals Sub-Group Minutes* (19 July 2011).

⁶⁵⁰ ATO, 'Communication (21 May 2013)', above n 173.

them for approval by the Chair ahead of submitting for publishing. The aim is to have the minutes published within six weeks of a meeting but this will be dependent on timely review of the minutes by members and ATO Publishing, which can take an additional two to three weeks.

6.31 Towards the finalisation of this review, the ATO has advised the IGT that it has disbanded both the NTLG International Sub-group and the TPWG as of 1 July 2013. Consultation in respect of the public rulings and advice being prepared by the ATO on Division 815 of the ITAA 1997 will occur through a newly proposed Division 815 Technical Working Group.⁶⁵¹

6.32 ATO documentation describes the new intended consultation framework as follows:

The review is complete and we have agreed to implement a new consultation framework from 1 July 2013 which consists of:

- eight forums representing key relationships and systems, they are:
 - tax professionals (NTLG)
 - large business
 - small/medium business
 - individuals
 - ATO tax practitioner forum
 - GST
 - superannuation
 - charities/not for profit
- a model where participants, methodology and timeframe are determined by the nature of the issue, and
- a corporate consultative intelligence hub. The hub will not perform a secretariat function but will add value by sharing best practice advice, facilitate a two-way clearing house for issues, and develop a 'pool of experts' with the relevant business areas.⁶⁵²

6.33 The intended operation of how the consultative intelligence hub will operate is reproduced in Appendix 15.

⁶⁵¹ ATO, 'Communication (24 October 2013)', above n 101.

⁶⁵² ATO, 'Office Minute: Review of ATO Consultative Arrangements – New Arrangements to Commence from 1 July 2013' (30 May 2013) Internal ATO Document.

6.34 In relation to the issue of whether the ATO will change its approach to cases as a result of the new law, the Second Commissioner, Compliance, has publicly stated that the ATO will not reopen any cases settled by deed, any concluded advance pricing arrangements and also any settled mutual agreement procedure cases.⁶⁵³ It is important to note, however, that there is a distinction between cases settled by deed compared with cases where ‘no further action’ was taken. In this respect, the ATO has advised that it is not possible to be definitive that years previously looked at by the ATO will not be re-examined, but the ATO has advised that cases will not be started or re-examined due to the introduction of Subdivision 815-A of the ITAA 1997.⁶⁵⁴

IGT OBSERVATIONS

6.35 Since the ATO’s first public ruling in 1992, there have been major changes in MNE structures and arrangements, the global economic environment and the associated taxing regime. Australia’s focus has also moved to a broader profit shifting approach as has those of its trading partners, such as the United States⁶⁵⁵ and United Kingdom (UK).⁶⁵⁶ It is therefore necessary to reconsider the currency of ATO’s existing advice and guidance.

6.36 The IGT is of the view that the ATO now has an ideal opportunity to also ensure its advice and guidance are sufficient and provide practical advice that is integrated with other areas of law, updated and released in a timely manner.

6.37 The IGT notes that the ATO has commenced a process to revise and update its existing advice and guidance. Broadly, the topics raised by stakeholders, which require guidance as a result of the new laws, appear to have been incorporated into the scope of the ATO’s plans. The ATO is seeking input from tax practitioners on the scope of the ATO’s work. Furthermore, input from others can be provided during the ATO’s consultation process for issuing public rulings and practice statements.

6.38 The ATO has also consulted on the timeframes for the release of its intended advice and guidance, which generally accord with its existing advice development processes.

6.39 As part of these processes, the IGT considers that consolidating the ATO’s international tax advice and guidance, including all relevant Taxation Rulings, Taxation Determinations, Practice Statements, transfer pricing booklets and relevant speeches, into a single document will have many efficiency benefits as well as ensuring coherence. The IGT notes that other revenue authorities such as, the UK Her

⁶⁵³ Commonwealth, *Parliamentary Debates*, Senate, 26 July 2012, pp 53-62 (Bruce Quigley); Quigley, above n 10.

⁶⁵⁴ ATO, ‘TPWG Draft Minutes (10 October 2012)’, above n 637, p 4.

⁶⁵⁵ US Office of Management and Budget, *Living Within Our Means and Investing in the Future: The President’s Plan for Economic Growth and Deficit Reduction* (September 2011) pp 50-51; US Department of the Treasury, *General Explanations of the Administration’s Fiscal Year 2013 Revenue Proposals* (February 2013) pp 88-90.

⁶⁵⁶ David Cameron, ‘David Cameron Sets Out the Main Priorities for the UK’s Presidency of the G8: Trade, Tax and Transparency’ (speech delivered at the World Economic Forum, Davos, 24 January 2013).

Majesty's Revenue and Customs⁶⁵⁷ and the New Zealand Inland Revenue Department⁶⁵⁸ have issued consolidated international tax or transfer pricing advice.

6.40 The TPWG previously comprised transfer pricing specialists for the purpose of consulting on the issues arising from Subdivision 815-A of the ITAA 1997. In this respect, with the restructure of the ATO's external consultation forums and the limited scope of the proposed Division 815 Technical Working Group, the IGT considers that it is important to maintain the TPWG for at least five years, with its membership reviewable every one to two years, as not all issues come to the surface immediately and some may be best considered after a passage of time.

6.41 Furthermore, transfer pricing issues that fell outside the scope of the TPWG previously may have been raised in the NTLG International Sub-group. Again, as a result of the restructure of the ATO's external consultation forums, many different domestic and international tax issues may be discussed at the restructured forum and there may not be sufficient time and resources to address all major transfer pricing issues. For example, when the ATO previously moved from the specialised NTLG Transfer Pricing Sub-group to the broader NTLG International Sub-group, the ATO did not appear to have communicated developments arising from the OECD Working Party 6⁶⁵⁹ as regularly.

6.42 As many revenue authorities believe that transfer pricing may be a key risk to sovereign revenues, the IGT considers that it is critical to maintain appropriate and focused consultation between the ATO and private sector transfer pricing specialists. The TPWG should be maintained and its scope widened to also consider existing issues that arise from Division 13 of the ITAA 1936 and the second tranche of the modernised transfer pricing rules.

6.43 Furthermore, recent administrative changes have brought approximately 11,000 SME taxpayers within direct focus of the ATO's transfer pricing compliance activities, such as through the IDS.⁶⁶⁰ The transfer pricing issues they encounter are likely to be dissimilar to those of large business. Therefore, the expanded TPWG should also ensure appropriate middle market representation.

RECOMMENDATION 6.1

The IGT recommends the ATO:

- (1) update and consolidate its advice and guidance on transfer pricing matters;*
- (2) issue future advice and guidance on transfer pricing issues in a timely manner; and*

⁶⁵⁷ HMRC, 'International Manual', above n 383.

⁶⁵⁸ IRD, *Transfer Pricing Guidelines: A Guide to the Application of Section GD 13 of New Zealand's Income Tax Act 1994* (October 2000) <<http://www.ird.govt.nz>>.

⁶⁵⁹ OECD, *Recommendation of the Council C (95)126/Final* (1973) <www.oecd.org>.

⁶⁶⁰ ATO, 'SME Communicator', above n 131.

RECOMMENDATION 6.1 (CONTINUED)

(3) maintain the Transfer Pricing Working Group for another 5 years to assist the ATO in the application of the new and existing law and, in particular, ensure the views of SMEs are appropriately considered.

ATO response

Agree in part

The ATO agrees with parts 1 and 2.

The ATO disagrees with part 3 as this would not be consistent with the streamlined approach to consultation that we have recently implemented at a corporate level. That approach is designed to ensure that we are consulting appropriately with the right stakeholders at the right time and on the right issues. We further note that a working party has been established, under our new consultation approach, to support stakeholder engagement during the drafting of rulings relevant to the administration of Division 815.

APPENDIX 1 — TERMS OF REFERENCE



Australian Government

Inspector-General of Taxation

Review into the ATO's management of transfer pricing matters

**Terms of reference &
submission guidelines**

25 October 2012

BACKGROUND

Revenue authorities have long-held concerns that multinational enterprises may use transfer pricing to inappropriately reduce their tax liabilities by either shifting profits offshore or by shifting losses/outgoings onshore. The revenue impact of transfer pricing is perceived as one of the most important tax issues by revenue authorities. Its importance is increasing due to integration of national economies and technological progress that has allowed Small and Medium Enterprises (SMEs) to join large business in expanding internationally.⁶⁶¹

Australia's transfer pricing regime has been primarily contained in Division 13 of the *Income Tax Assessment Act 1936*,⁶⁶² which provides the Commissioner of Taxation with a discretion to reset the value of such prices for tax purposes.⁶⁶³

Submissions to the Inspector-General of Taxation (IGT), in relation to his 2012-13 work program, by larger SMEs and large business taxpayers, their advisers and representative bodies, raised concerns with aspects of the Australian Taxation Office's (ATO) management of transfer pricing matters. These stakeholder concerns could be broadly summarised as follows:

- **ATO advice and guidance** – The need for clearer, more consistent ATO advice and for significant areas of uncertainty to be addressed was raised. A comprehensive review was called for in order to update, revise and consolidate, the ATO advice and guidance materials through an appropriate transparent consultation process;
- **ATO compliance approach, processes and practices** (including risk reviews, audits, Advance Pricing Arrangements (APAs) and Mutual Agreement Procedures (MAPs)) – The ATO processes are claimed to be inefficient and very costly. The specific concerns include the nature and extent of the ATO's information requests, extended timeframes, lack of transparency and communication more generally; and
- **ATO's capability** – The ATO officers engaged in transfer pricing matters are believed to have varied levels of capability regarding knowledge of the transfer pricing regime, economic expertise as well as industry and business knowledge.

⁶⁶¹ Giammarco Cottani, *IBFD: Transfer Pricing* (2011) pp 10, 12, 15-18; Thomson Reuters, *Australia and New Zealand Tax Survey* (2012).

⁶⁶² Subdivision 815-A of the *Income Tax Assessment Act 1997* was recently enacted to confirm that the internationally consistent transfer pricing rules contained in Australia's tax treaties and incorporated into Australia's domestic law provide assessment authority to address treaty related transfer pricing: Explanatory Memorandum, House of Representatives, Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012, p 3.

⁶⁶³ Section 136AD of the *Income Tax Assessment Act 1936* provides discretion to deem the consideration for supply or acquisition of property under an international agreement to be equal to the arm's length consideration in respect of that supply or acquisition where the Commissioner is satisfied that the parties to the agreement are not dealing at arm's length in relation to the supply or acquisition and either the consideration received for the supply was less than the arm's length consideration, or the consideration given for acquisition was in excess.

Concerns were also expressed with the ATO's organisational arrangements for dealing with transfer pricing matters in the large business segment.

Stakeholders also raised a number of concerns around international competitiveness issues given the manner in which businesses operate in a global environment with increasing cross-border flows of goods and services. These concerns have direct and indirect interaction with business decisions, including internal and external price setting in this context.

The IGT seeks to establish through this review the underlying reasons or causes for these concerns, their systemic impacts and to identify opportunities for improvement.

TERMS OF REFERENCE

In accordance with subsection 8(1) of the Inspector-General of Taxation Act 2003 ('IGT Act'), the IGT on his own initiative will conduct a review into the ATO's management of transfer pricing matters with a focus on:

The ATO's advice and guidance

- 1. The accuracy, adequacy and timeliness of the ATO's transfer pricing advice and guidance 'products' in providing certainty to taxpayers including the community consultation processes through which they are developed.*
- 2. The need to update and rationalise the ATO's transfer pricing advice and guidance products to provide certainty, clarity and consistency given changes in international dealings and commerce since these products were originally issued.*

The ATO's compliance approach, processes and practices

- 3. The effectiveness of the ATO's compliance approach, processes and practices to appropriately deal with transfer pricing matters in a manner that minimises timeframes and compliance costs, including those relating to risk reviews, audits, APAs and MAPs.*
- 4. The transparency of the ATO's compliance approach, processes and practices, such as the identification of specific ATO concerns, third-party data used for comparison purposes and benchmarking, methodology for case selection and reasons for information requests.*
- 5. Opportunities to reduce the compliance burden, such as provision of safe harbours, and the use of targeted and staged approaches to information gathering to identify risks.*

The ATO's capability

- 6. The ATO's transfer pricing capability development and maintenance, such as skilling, succession planning and retention of corporate knowledge and experience.*
- 7. The ATO's organisational structure in dealing with transfer pricing matters, including the ATO's ability to quickly access and draw on sufficient transfer pricing and economic expertise as well as its ability to maintain consistent compliance approaches.*

8. *ATO officers' industry and business knowledge, particularly in respect of the relevant transactions and their commercial context.*

Other issues including international business and competitiveness interactions

9. *Broader business issues, including the cross border or global environment that interacts directly or indirectly with transfer pricing actions of revenue authorities.*
10. *International experiences or comparisons with the ATO's approach and that taken by other revenue authorities.*

SUBMISSION GUIDELINES

We envisage that, broadly, your submission will be divided into two parts:

- a detailed account of your experience with the ATO on transfer pricing matters; and
- any opportunities to improve the ATO's management of transfer pricing matters.

Your experience in dealing with the ATO on transfer pricing matters

In the first part of your submission, it is important to provide a detailed account of specific ATO practices and behaviours that, in your view, impact upon the timely, efficient and effective resolution of transfer pricing matters. As far as possible, these practices should address the terms of reference above.

In investigating the ATO's management of transfer pricing matters, it would be useful to provide a timeline of events outlining your key interactions with the ATO including information requests, key meetings, the issuing of position papers, ATO amended assessments, APAs and dispute resolution activities, such as MAPs (if relevant).

Any adverse or detrimental impacts of the ATO's management of transfer pricing matters should then be set out and, if possible, the costs quantified. These might include unanticipated tax liabilities raised in amended assessments (including tax, penalties and interest) for prior years, increased compliance costs in dealing with the ATO during the activities or increased ongoing compliance costs thereafter and potential restructuring of significant commercial arrangements.

The IGT is also seeking examples of positive ATO practices and behaviours that contributed to the timely resolution of transfer pricing matters as well as those that minimised your costs. Relevant examples may also be drawn from your experiences in dealing with other revenue authorities.

Opportunities for improvement

In the second part of your submission, we invite you to identify opportunities to improve the ATO's management of transfer pricing matters.

These opportunities could include alternative actions, practices or behaviours which, in your view, could at the very least minimise the adverse effects of ATO practices of concern, and ideally lead to optimal outcomes for all parties.

Such alternatives may range from such specific issues as transparency and consultation relating to information requests to broad issues such as use of safe harbours to reduce overall compliance costs.

Set out below are questions to help your submission to address the broad areas covered by this review.

QUESTIONS FOR CONSIDERATION

General

- What is your experience in dealing with the ATO on transfer pricing matters?
- What compliance costs do the ATO's transfer pricing requirements place on taxpayers? What impacts do these costs have on businesses? Are these costs and impacts different for different sized businesses? Are there significant opportunity costs that should be taken into account? Can these costs be measured?
- Are there opportunities to reduce compliance costs and timeframes arising from the ATO's management of transfer pricing matters? If so, how could these opportunities be realised without materially affecting the ATO's ability to assess the risk to revenue?
- Is the ATO's management of transfer pricing matters sufficiently transparent? If not, in what specific areas should transparency be improved and what effect would this have on the timely and efficient resolution of transfer pricing matters?

The ATO's advice and guidance

- Do you consider that the ATO publishes sufficient advice and guidance to provide practical certainty on transfer pricing matters? If not, in what specific areas should more advice and guidance be provided?
- In your view, how well does the law, OECD transfer pricing guidelines and the ATO's approach to transfer pricing fit together and are consistent?
- Do you consider the ATO's advice and guidance products have kept pace with changes in law, business and international developments over time? If

not, what are the specific changes and in what areas could this advice and guidance be updated?

- Are the timeframes for provision of ATO advice and guidance sufficient to minimise the adverse effects of delay on taxpayers? If not, what changes could be made to ensure that such advice and guidance is provided in a more timely manner?
- Do the avenues for community consultation enable transfer pricing matters to be appropriately considered and addressed? Please explain your views and provide examples as necessary.

The ATO's compliance approach, processes and practices

Information requests

- Describe the type of information that you provide in income tax returns and the related International Dealings Schedules. What has been the impact of collating and reporting this information? Do you consider this level of information to be appropriate? Should less information be gathered upfront and, if so, what would be an appropriate trade-off for the associated reduction in up-front compliance costs? Should the ATO take a differentiated approach depending on the size of the taxpayer?
- Do you believe that the ATO's information requests are well-targeted and relevant to the issues under consideration? Please provide examples.
- Does the ATO make it clear how requested information or documents relate to the transfer pricing risks and issues? Would a greater understanding of the ATO's specific concerns assist you in the timely and efficient resolution of transfer pricing matters? If so, why would this be the case and how could this be achieved?
- Did you specifically create information for the ATO for transfer pricing purposes – that is, information not readily available from existing business systems? What was the nature and scale of this information? Did you provide it directly or did the ATO ask for it?
- How can the ATO reduce the compliance burden of its information needs without materially affecting its ability to assess the risk to revenue? Could the ATO take a more staged approach to information gathering? Could documentation requirements for transfer pricing matters be limited?

ATO interaction and case management

- How did the ATO interact with you during the transfer pricing matter? Was it in a manner that promoted the timely and efficient resolution of that matter? If so, what characteristics assisted in that aim? If not, what was it about the ATO's interaction that hindered this aim and how could the ATO interact differently without materially affecting its ability to assess the risk

to revenue?

- Did the ATO's case management facilitate the timely progression of cases with minimal compliance costs? If so, what specific aspects of its case management promoted that aim? If not, what specific processes or actions hindered this aim? What alternative action could the ATO have taken? For example, you may wish to comment on the merits of a stage and gate approach.
- Did you experience open expression of opinion from ATO audit staff and other ATO specialist staff (for example, economists)? Were points of ATO uncertainty or disagreement shared with you?
- Was an alternative dispute resolution (ADR) process suggested or appropriate in this context?

Valuation

- How does the ATO's approach to transfer pricing consider taxpayers' setting of prices and industry benchmarks? How does the ATO resolve any inconsistencies between the two? In this respect, are there opportunities for the ATO to reduce taxpayers' compliance burdens without materially affecting the ATO's ability to assess the risks?
- What were the valuation issues at the core of your transfer pricing dispute? What was your experience and do you consider that there are opportunities for such disputes to be resolved in a more timely and efficient manner? If so, what are these? Could this include a mutually appointed valuer or economist?

APAs

- Have you considered entering into an APA or have you been involved in one? Did you consider the costs and benefits? Please specify these and describe how it influenced your decision to enter or not enter into an APA.
- How long did it take to conclude an APA with the ATO? Were these timeframes sufficiently communicated to you at the outset? Do you consider these timeframes appropriate? Please provide your reasons.
- Are there opportunities for the ATO to improve its administration of the APA program? If so, what are these and what would be the trade-offs in implementing such improvements? How would they improve both taxpayer willingness to enter APAs and the ATO's confidence in compliance with the transfer pricing requirements?

Risk reviews/audits

- Have you been involved in a transfer pricing risk review or audit? What was the ATO's approach in assessing the transfer pricing risk? What aspects of the current transfer pricing risk review and audit processes worked well? Why did those processes work well and how did they contribute to the

timely resolution of the audit or risk review? What aspects did not work well? Why and how might these be improved?

- How did the ATO demonstrate that it has sufficiently considered your information in forming views on transfer pricing risks?
- Do you consider there are opportunities for the ATO to more accurately assess risks before escalating to audits without increasing taxpayers' compliance costs?

Position papers

- Have you received position papers? What period of time did the ATO allow to respond to its position papers? Do you believe that this was sufficient time and did you seek an extension?
- Do you believe that the ATO adequately considered your responses to its position papers? Please explain your views.

MAPs

- Do you consider that MAPs appropriately minimise the potential for double taxation with respect to Australia's treaty partners? If not, why?
- Have you been involved in a MAP? What were the timeframes involved? What were the impacts on your business?
- Please outline any alternative approaches that you believe would result in improvements. Do you consider that there are any overseas practices that the ATO could adopt to further reduce MAP timeframes? If so, what are these practices?

The ATO's capability

- Do you consider the ATO has sufficient overall 'collective capability' to efficiently resolve transfer pricing matters? If so, what specific skills, experience and organisational response leads you to this conclusion? If not, what are the specific areas for improvement?
- How might the ATO maintain and disseminate its transfer pricing expertise?
- Are the roles and responsibilities of the different areas within the ATO sufficiently clear to enable consistent, timely and efficient resolution of transfer pricing matters?
- *Are there any particular organisational arrangements that contribute to the efficient resolution of transfer pricing matters? What are these arrangements and how do they assist?*

Alternative models

- Is there potential to remove lower risk taxpayers from the ATO's transfer

pricing requirements? For example, through the provision of safe harbours, de minimis thresholds and carve-outs for smaller taxpayers?

Other

- Are there any other areas on which you would like to make submissions? *For example, you may wish to cite international experiences or comparisons which you believe would lead to improvements.*

LODGEMENT

The closing date for submissions is 23 November 2012. Submissions can be sent by:

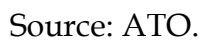
Post to: Inspector-General of Taxation
 GPO Box 551
 SYDNEY NSW 2001

Email to: [for enquiries regarding this review, please email
 enquiries@igt.gov.au]

CONFIDENTIALITY

Submissions provided to the IGT are in strict confidence (unless you specify otherwise). This means that the identity of the taxpayer, the identity of the adviser and any information contained in such submissions will not be made available to any other person, including the ATO. Sections 23, 26 and 37 of the IGT Act 2003 safeguard the confidentiality and secrecy of such information provided to the IGT – for example, the IGT cannot disclose the information as a result of an FOI request, or as a result of a court order generally. Furthermore, if such information is the subject of client legal privilege (or legal professional privilege), disclosing that information to the IGT will not result in a waiver of that privilege.

A.2.1 The following diagram outlines the ATO's transfer pricing management system in 2007.



APPENDIX 3 — DETAILED RECOMMENDATIONS FROM PWC LEGAL'S APA REVIEW

A.3.1 The following table lists PWC Legal's detailed recommendations outlined in their review of the ATO's APA Program in 2008.

No.	Aim of recommendation	Recommendations
1	ATO to continue to promote and use APA Program as a tool for cooperative compliance with taxpayers	<ul style="list-style-type: none"> Continue to promote and use APA program. Focus on areas for improvement outlined in Section 5 – Facts and recommendations of the Australian Taxation Office Review of Advance Pricing Arrangement Program report (report) to ensure sustainability of the APA Program and continuing support by all stakeholders.
2	Ensure full implementation of enhanced transfer pricing management system introduced mid 2007	<ul style="list-style-type: none"> Ensure full implementation of the enhanced transfer pricing management system on a timely basis. To facilitate full implementation, ensure the new system is understood, embraced and supported by all divisions/personnel involved. This can be facilitated by the TPOG. Monitor implementation of enhanced transfer pricing management system. Adapt and improve new system to account for further recommendations outlined in the report. Communicate changes with external stakeholders to foster the relationship of increased transparency as well as evidencing to the wider stakeholder community that the ATO is focussed on developing and improving the APA Program.
3	Continue promoting the stated purpose and benefits as published in the ATO's APA Program 2004-05 update. Update and ensure they are 'experienced' by all stakeholders	<ul style="list-style-type: none"> Retain the present stated purpose and benefits. Continue to promote the stated purpose and benefits. Focus on areas of key importance to stakeholders identified in the surveys to ensure continued ATO and external stakeholder support. Consider other recommendations outlined in the report to ensure these purposes and benefits are "experienced" by all stakeholders and that disadvantages are reduced (in particular a reduction in time and cost of completing an APA).

No.	Aim of recommendation	Recommendations
4	Further promotion/relaunch of specific guidance to taxpayer community surrounding admission criteria and acceptance into the APA Program	<ul style="list-style-type: none"> Promote/relaunch detailed public guidance addressing the types of APAs that will be accepted into the program and the ATO's position on rollovers. Consider including in the public guidance case study examples on the types of APAs that will be accepted and the treatment of rollovers. As outlined in Section 5, recommendation 12, use a 'co-design' approach with external stakeholders (e.g. NTLG) to agree with the type of APAs that should be accepted. On application for an APA by a taxpayer, the ATO and taxpayer should jointly consider whether any other compliance products (such as a priority binding ruling) may be appropriate for certain aspects of an APA. The application of other compliance products to aspects of APAs should be further discussed with external stakeholders as part of the co-design approach as per Recommendation 12. On each APA application/negotiation, keep taxpayers well informed of the ATO's priorities and decisions and manage expectations in relation to rollovers.
5	Consistency and certainty in ATO's APA five step process	<p>A) Certainty and consistency in the application of the five step process:</p> <ul style="list-style-type: none"> ATO to formally adhere to 5 step process and ensure processes follow intended order (per APA process maps set out in Appendix D of report). Use key signposts visible to the taxpayer at each step. ATO to issue formal confirmation early in the pre-lodgement phase that the taxpayer is 'accepted' into the APA negotiation process and stating commitment by the ATO to work with the taxpayer to agree an APA. Provide formal acceptance in writing. ATO to regularly communicate with the taxpayer regarding status of negotiations and application. For complex APAs, agree "small gains" with the taxpayer (e.g. TP methodology) and then move on to the next step. This will assist in developing mutual trust and cooperation. <p>B) Recognition of Dual Purpose of APAs:</p> <ul style="list-style-type: none"> There needs to be common understanding by all divisions within the ATO that an APA is a voluntary process for the taxpayer and that the dual purposes of help and compliance are not mutually exclusive and, in fact, need to be delivered as one. A 'service experience' should be experienced by both the ATO and the taxpayer for all APAs. To facilitate this, it is recommended that:

No.	Aim of recommendation	Recommendations
		<ul style="list-style-type: none"> All personnel in the Segments involved in APAs are members of the TP Network; and Members of the Segments and the TPP work together on individual APAs to ensure a greater understanding by all of the service approach to this voluntary product. <p>C) Establishment of review process / clear exit protocols:</p> <ul style="list-style-type: none"> Establishment of a circuit breaker/ review mechanism to be used if the negotiation reaches a stand still. To be effective, any circuit breaker/review mechanism would need to be independent of the APA program. In the course of consultation with LB&I Deputy Commissioner, Paul Duffus, the suggestion was made that the Chief Tax Counsel may be the appropriate mechanism in such cases, for example to obtain confirmation that the ATO corporate view was being expressed. It is recommended that such a mechanism is discussed further with external stakeholders as part of the co-design approach as per Recommendation 12. Establish clear exit criteria/ protocols for abandoning the APA. If the ATO withdraws from an APA negotiation clear reasons and justification should be provided. Establish an independent internal review/ appeals process which can be requested by the taxpayer if the ATO decides to withdraw from APA negotiations.
6	Definition, clarification of relevance, certainty and timeliness of the sharing of information	<ul style="list-style-type: none"> ATO to openly share output from its external advisors at the earliest opportunity so as to provide taxpayers with greater clarity regarding the ATO’s thought processes and demonstrate the ATO’s commitment to a cooperative approach. ATO to distinguish between information required for the APA to be agreed and information that can be tested as a critical assumption as part of the annual compliance report review process. Taxpayer and ATO to agree timing of regular project management discussions to monitor progress of APA (including progress on reviewing of information) against the agreed project plan. Increase use of email, video links and computer files to improve the speed and ease of information sharing.
7	Consistent and appropriate APA teams with decision makers determined at the outset	<p>Overall ownership and coordination:</p> <ul style="list-style-type: none"> Oversight of the APA program and administration of all APAs to be owned and managed by a Dedicated Team (e.g. TPOG). Dedicated Team (e.g. TPOG) to monitor progress on all APAs and escalate any significant blockers/

No.	Aim of recommendation	Recommendations
		<p>delays to a senior committee (e.g. TPSC).</p> <p>Team:</p> <ul style="list-style-type: none"> • In the initial planning/ discussion/ mobilisation, Dedicated Team to determine/ review the allocation of the APA team and ensure that the most "appropriate" person leads each APA. The most "appropriate" person/ team must be selected from the TP Network (from the enhanced TP management system) and have sufficient technical transfer pricing capabilities to run the APA. • It is recommended that the competency requirements to qualify as the most "appropriate" person to lead an APA should be discussed further and agreed as part of the co-design approach set out in Recommendation 12. • Consider determining makeup of ATO APA team using a combination of personnel with different "TP Accreditations" as discussed in Recommendation 11. • Unilateral APAs should not automatically be led by the Segments — the decision should be made based on capabilities required to lead an APA including transfer pricing experience, expertise and objectivity. • Where possible, the ATO APA team should not change over the life of the APA. • APA program to be adequately resourced in line with the enhanced transfer pricing management system detailed in Section 4 of this report. • Consider adopting a process for creating APA teams similar to the Priority Binding Rulings process. • In the case of an APA which has been initiated as a result of an audit, the Dedicated Team to determine the most appropriate ATO APA team taking into account transfer pricing experience, expertise and objectivity to ensure a genuine APA process and not continuation of an audit under another name. <p>Decision makers:</p> <ul style="list-style-type: none"> • Dedicated Team to agree on/ review the selected APA decision makers up front. Those decision makers should not change throughout the life of the APA. • All transfer pricing related decisions in an APA must be made by a person with sufficient technical transfer pricing knowledge and experience, including the transfer pricing decision makers as part of the Stage and Gate review process as outlined in Recommendation 10.

No.	Aim of recommendation	Recommendations
		<ul style="list-style-type: none"> Currently, members of the TPP are organisationally recognised as having this knowledge, as are some officers in LB&I segments, but there is also recognition that the APA program requires a broader and self-sustaining base of expertise recognised within and outside the ATO. Going forward, once the proposed training/ accreditation as part of the TP Network is fully implemented, it is recommend that all key transfer pricing decisions should be made by a specialist within the TP Network. Decision makers should be involved in all significant meetings/ stages of the APA process. The selection of transfer pricing decision makers should be further discussed and agreed with external stakeholders as part of the co-design process outlined in Recommendation 12.
8	Scope of APA should be agreed upfront including the timing and role of Deputy Commissioner, LB&I (Case Leadership)	<p>Once the ATO has an initial understanding of the taxpayers APA request, agree the scope and threshold of the APA upfront with the taxpayer, including:</p> <ul style="list-style-type: none"> What issues are going to be covered within the scope of the APA (including other non transfer pricing specific collateral issues). The order and timing in which issues will be addressed. The information required to deal with identified issues. For bilateral/ multilateral APAs, the mechanism to deal with changes in scope of an APA as a result of discussions with overseas tax authorities. The scope and involvement of CCL . Specific parameters/ guidelines should be set to identify what issues CCL can become involved in as part of the APA process. The timing of any CCL involvement. CCL must commit to be involved at specific identified stages of the APA process only to ensure progression of the application. A clear exit strategy for any CCL involvement. At the end of each step of the APA process, the Stage and Gate review panel should be involved in the determination of scope and work plan for the next step of the APA. Please refer to Section 5, Recommendation 10, for further details. If the scope changes (i.e. new issues arise) firstly consider whether the issue should be dealt with as part of the APA. If the issue is inherent within the APA, determine when this issue should be dealt with, who will be involved and how. Where possible, do not delay the APA when dealing with collateral issues. Where appropriate, use parallel processing (i.e. continue progression of the APA whilst dealing with a collateral issue at

No.	Aim of recommendation	Recommendations
		the same time).
9	Establish a detailed project plan with the taxpayer that is adhered to and amended where necessary	<p>Once the initial scope and thresholds of the APA are agreed, a detailed project plan should be agreed between the taxpayer and the ATO including:</p> <ul style="list-style-type: none"> • Roles; • Responsibilities; • Decision makers; • Dependencies; • Key steps; • Key milestones; • Timeframes for each phase (including pre-lodgement); • Maximum time thresholds that then result in escalation or exit from APA; • Protocols for escalation or exit from an APA; • Timing and involvement of LB&I Complex Case Leadership; • What information is required by when; • Timing for responses to information requests; • Timing of project management discussions to formally monitor progress of APA against project plan. <p>At the end of each step of the APA process, the Stage and Gate Review team should be involved in the determination of scope and work plan for the next step of the APA. Please refer to Section 5, Recommendation 10, for further details.</p> <p>This project plan should be committed to by both parties and amended where necessary. It is important to note, that in developing and implementing the project plan a balance of flexibility and consistency is required, given that all parameters will not be known at the outset of the process. As part of the project plan, protocols should be established to deal with unforeseen issues. For example:</p> <p>a) Review issue.</p> <p>b) Agree approach including who will be involved and timing for addressing the issue.</p> <p>c) Amend project plan using parallel processing where possible.</p> <p>In addition to the project plan:</p> <ul style="list-style-type: none"> • The ATO needs to 'own and run' all steps of the APA with assistance from the taxpayer, including pre-lodgement. • Pre-lodgement should not be the sole

No.	Aim of recommendation	Recommendations
		<p>responsibility of the taxpayer.</p> <ul style="list-style-type: none"> The ATO should also measure and publish the length of their APAs to include pre-lodgement to ensure accountability.
10	Use a Stage and Gate process to progress through an APA	<p>Use a Stage and Gate review process to progress through an APA.</p> <p>At the end of each step within the APA process, an interim stage and gate review panel should:</p> <p>a) Review and agree on what has been undertaken and achieved during the previous step; and</p> <p>b) Agree a detailed scope and work plan for the next step.</p> <ul style="list-style-type: none"> The capability of the members of the review panel must match the nature of the issues being reviewed and is likely to include all key decisions makers (refer to Recommendation 7). In particular, all transfer pricing issues must be reviewed and scoped by an individual with sufficient transfer pricing knowledge. Currently, members of the TPP are organisationally recognised as having this knowledge, as are some officers in LB&I segments, but there is also recognition that the APA program requires a broader and self-sustaining base of expertise recognised within and outside the ATO. Going forward, once the proposed training as part of the TP Network is fully implemented, it is recommended that all key transfer pricing decisions should be made by a specialist within the TP Network. Once the stage and gate review panel has reviewed the previous step, the “door closes”. I.e. Issues raised during that step cannot be revisited during a future step of the APA process except within a process agreed upfront with the taxpayer as part of the project plan. For bilateral/ multilateral APAs, any issues that arise during negotiation with overseas tax authorities need to be discussed with the taxpayer. To the extent possible, joint agreement should be reached as to how such issues should be dealt with. Any changes to scope arising as a result of the stage and gate review should be agreed with taxpayer and amended in the project plan.
11	Further training, education and practical experience of ATO personnel on technical transfer pricing	<p>Our overarching recommendation is to take a committed approach to increasing investment in, and the structure of, the training and development of ATO personnel. This can be achieved through the following:</p>

No.	Aim of recommendation	Recommendations
	issues	<p>Up skilling:</p> <ul style="list-style-type: none"> Fully implement, grow and monitor the TP Network. For those personnel lacking transfer pricing expertise, ensure they have a regular transfer pricing case load. Members of the Segments and the TPP to work together on individual APAs. Underpinning everything, is building skills and commitment to a consistent service culture across the entire APA program given the voluntary nature of the APA product. Invest significantly in transfer pricing technical training to keep ATO specialist staff abreast of current and developing transfer pricing issues. Consider the use of a "TP Accreditation" system whereby ATO personnel are given a TP rating/ level (e.g. TP1 → TP5) based on specific knowledge and experience criteria. ATO personnel can progress through the levels with more training and experience. This could assist in determining the appropriate make-up of ATO APA teams (as per Section 5, Recommendation 7). Determination of the appropriate levels of TP technical skills and experience for each "TP Accreditation" rating should be discussed and agreed as part of the co-design process with external stakeholders outlined in Recommendation 12. Examples of the appropriate level of TP accreditation required for specific APAs should also be discussed and agreed. Appoint a TP people development champion/ leader. Consider development of a 'transfer pricing' subject(s) delivered by ATAX, UNSW or another tax specialist university program (i.e. a joint profession/ government initiative for a technical TP course/ individual subjects). <p>Knowledge sharing:</p> <ul style="list-style-type: none"> Utilise highly skilled transfer pricing specialists to train and coach other personnel. To accelerate this process, the ATO might consider moving existing transfer pricing specialists to a full time development role. Develop a central repository of APA experience and technical knowledge to facilitate knowledge sharing that can be accessed by all relevant ATO personnel. If appropriate, consideration could be given to allowing external stakeholders access to the repository (or certain parts of). At the completion of every APA, a sanitised case

No.	Aim of recommendation	Recommendations
		<p>study should be prepared and lodged on the central repository.</p> <p>Succession planning:</p> <ul style="list-style-type: none"> Identify future transfer pricing leaders and focus career development of these individuals to facilitate adequate succession planning. In particular, a focus on building resources, capabilities and experience at a Competent Authority level.
12	Use a 'co-design' approach with appropriate ATO and external stakeholders to refine/ remodel the ATO APA Program to implement the recommendations outlined in this report	<ul style="list-style-type: none"> Publish our report and consult with appropriate external stakeholders (e.g. National Tax Liaison Group members) for feedback. Appoint a senior ATO executive responsible for championing the implementation of the recommendations outlined in this report. Use a 'co-design' approach with appropriate external (taxpayers, tax advisors and industry groups) and ATO stakeholders (including the TPP, Economist Practice and the Segments within the ATO) to refine/ remodel specific aspects of the APA program to implement the recommendations outlined in this report. <p>Specific details that should be agreed as part of this approach include:</p> <ul style="list-style-type: none"> Communication to taxpayers of when the submission is formally accepted into the APA process; The use of other compliance products (such as Priority Binding Rulings) to address certain aspects of an APA, and if so, which situations would be appropriate. Who the most "appropriate" person to lead an APA within the ATO should be. The selection of ATO transfer pricing decision makers. Appropriate timeframes (including maximum timeframes) for each phase of the five step process; Information required from taxpayers during the APA to progress; Specific parameters of what LB&I Complex Case Leadership can and should review as part of the APA process; Exit options from APA negotiation process including circuit breaker/ review mechanisms (i.e. escalation and mediation mechanisms) and the suitability of the Chief Tax Counsel for this role; Appropriate levels of TP technical skills and experience required for different "TP Accreditations" ratings together with the level of TP accreditation required for specific types of

No.	Aim of recommendation	Recommendations
		<p>APAs;</p> <ul style="list-style-type: none"> • Agree a process for simplified or standardised APAs outlined in Section 5, Recommendation 13; and • Specific aspects of the Balanced Score Card outlined in Section 5, Recommendation 14 (e.g. appropriate external feedback to which should be received following an APA).
13	Simplified or standardised APA options	<ul style="list-style-type: none"> • Publish safe harbours or benchmarks on an industry basis for use by SMEs. • Use of in-principle signoffs (e.g. on methodology, profile of tested party, agreement on transactions covered) for taxpayers not wishing to embark on a full APA in order to provide a more cost effective way to gain greater tax certainty. • Streamlined APA negotiation process for SMEs and rollovers (e.g. tighter time frames).
14	Implement a 'balanced score card' approach to evaluate performance of APA Program and individual APAs, including a combination of qualitative and quantitative factors	<p>Implementation of a balanced score card approach to measure both individual APAs and the APA program in general.</p> <ul style="list-style-type: none"> • The balanced score card should measure a range of qualitative and quantitative factors which when considered in totality provide an overall assessment. • ATO personnel involved in APAs need to be held accountable to all aspects of the balanced score card. <p>The balanced score card on the next page outlines a suggested framework to measure the performance of the APA program in general.</p> <ul style="list-style-type: none"> • The framework highlights the fact that the overall goals of ATO compliance and legal and policy obligations are dependent upon transparent relationships with all APA stakeholders (ATO and external) together with clear best practice processes and governance. Without experienced and technically capable ATO personnel to underpin these transparent relationships and best practice processes, ATO compliance and legal and policy objectives cannot be achieved. • The balanced score card framework outlined on the next page would be appropriate to review the APA Program in general. It could also be cascaded and adapted to apply to individual APAs. • Broad areas have been outlined which should be benchmarked as part of the balanced score card however, there are no detailed specific targets and performance measures as this is outside the scope of our review.

Source: PWC Legal.

APPENDIX 4 — ATO'S COMPLIANCE PRODUCTS

Table – LB&I compliance products

Product Name	Benchmark Cycle Time	Description	Status/Comments
Mutual agreement procedures	730	Mutual agreement procedures seek to provide relief to taxpayers from 'double taxation' arising from the imposition of tax by another Competent Authority.	Plan to transition this product to a new rationalised framework: new product on Siebel, revise/update procedures and guidance material
IT standard bilateral APA	720	The IT simplified APA has been developed to encourage taxpayers with lower levels of international related party dealings to enter into an APA to access greater tax certainty around their international dealings.	Plan to transition this product to a new rationalised framework: new product on Siebel, revise/update procedures and guidance material
IT complex APA	720	Developed to deal with complex/high risk international related party dealings.	Plan to transition this product to a new rationalised framework: new product on Siebel, revise/update procedures and guidance material
IT standard unilateral APA	360	The Standard APA Process has been developed to deal with routine international related party dealings that do not qualify for the simplified APA process and do not include complex/high risk dealings.	Plan to transition this product to a new rationalised framework: new product on Siebel, revise/update procedures and guidance material
IT review comp PCR large	730	The PCR is a comprehensive review conducted in real time that will assist active compliance teams to identify and assess potential tax risks, including reportable tax position (RTP) disclosures as they arise. The PCR is generally used on all higher consequence taxpayers who do not have an Annual Compliance Arrangement (ACA) with us.	The new PCR product. Replaces the IT large pre-lodgment comp review
IT large pre-lodgment comp review	549	The Pre-lodgment compliance review (PCR) product is intended to assist AC teams to identify and assess tax risks for higher consequence taxpayers in real time over the pre-lodgment period.	Has been replaced by IT review comp PCR large. Scheduled for decommissioning once last case is completed
IT large client risk review	240	The client risk review is to be used as the standard risk assessment methodology for higher consequence taxpayers. It is a broad, case level risk assessment product that will normally cover a range of risk focus areas.	Has been replaced by IT review comp CRR large. Scheduled for decommissioning once last case is completed
IT review comp CRR large	240	The client risk review is to be used as the standard risk assessment methodology for higher consequence taxpayers. It is a broad, case level risk assessment product that will normally cover a range of risk focus areas.	The new risk review product. Replaces the IT large client risk review
Transfer pricing record	180	A Transfer pricing record review involves an assessment and analysis of	Investigating whether T/P risks could be undertaken

Product Name	Benchmark Cycle Time	Description	Status/Comments
review		documentation in relation to international related party dealings to support the selection and application of arm's length pricing methodologies and the arm's length principles.	in a CRR or SR. This product could potentially be decommissioned.
IT large specific review	180	An IT large specific review is an examination of a specific issue that has generally originated from a special event, a media source or an emerging issue.	Has been replaced by IT review specific SR large. Scheduled for decommissioning once last case is completed
IT review spec SR large	180	An IT large specific review is an examination of a specific issue that has generally originated from a special event, a media source or an emerging issue.	The new SR risk review product. Replaces the IT large specific review
IT large project risk review — HV	120	The IT Large Project Risk Review product provides for a concise risk review within a specific area of focus, which may require the taxpayer to provide targeted information. This product would generally be used for lower consequence taxpayers.	Current product, due for an update. In low use.
IT audit comp LBA large	730	An IT large business comprehensive audit is a comprehensive audit of a large market client. The audit should confirm or refute our risk hypothesis.	The new comp audit product. Replaces the IT large business comp audit
Transfer pricing audit	730	The audit of companies who have been subject to a TPRR and recommended for follow-up action or selected pursuant to TR 98/11 para 4.9.	Investigating whether T/P risks could be undertaken in an LBA or SIA. This product could potentially be decommissioned.
IT large business comp audit	730	An IT large business comprehensive audit is a comprehensive audit of a large market client. The audit should confirm or refute our risk hypothesis. The LBA seeks to achieve improvement of compliance behaviour through the successful treatment of risks.	Has been replaced by IT audit comp LBA large. Scheduled for decommissioning once last case is completed
IT audit spec SIA large	365	An IT large business specific audit is a specific audit of a large market client. The audit should be based upon a risk hypothesis. The outcomes that the SIA seeks to achieve include the improvement of compliance behaviour through the successful treatment of risks (typically one or two risks).	The new specific audit product. Replaces the IT large business spec audit
IT large business spec audit	365	An IT large business specific audit is a specific audit of a large market client.	Has been replaced by IT audit spec SIA large. Scheduled for decommissioning once last case is completed
IT APA ACR HV	60	All Advance Pricing Arrangements (APA) are subject to an Annual Compliance Report (ACR) review for the period of the APA, usually three to five years, to confirm compliance with the arrangements in the APA.	Current product, due for updating when the APA products are transitioned.
IT large simplified SE — HV	45	The IT Large simplified specific enquiry is a focused enquiry to seek clarification about a major transaction, business event	Current product due for updating, in low use.

Product Name	Benchmark Cycle Time	Description	Status/Comments
		or potential tax risk.	
Risk — PTI			The ATO was unable to explain.
Large advance pricing arrangement			No longer in use
IT transfer pricing			The ATO was unable to explain.
IT specific enquiry			No longer in use Replaced by IT large simplified SE — HV
IT simplified APA			No longer in use Replaced by Mutual agreement procedures, IT standard bilateral APA, IT complex APA and IT standard unilateral APA.
IT Large APA pre lodgement			Non transfer pricing product
IT innovations specific review			Non transfer pricing product
IT compliance assurance review			No longer in use

Source: ATO.

Table – SME compliance products

Product name	Product Status	Used by PGH?	Description	Further comments
IT audit spec SME office	Active	Yes	Outlines the process steps a case owner must complete when conducting a letter-based Specific Audit on IT issues in the PGH market	CORE PRODUCT
IT HWI Comprehensive risk review	Obsolete	No	A risk assessment product used to test tax risks of HWI clients that may require further explanation or treatment.	Superseded now decommissioned
IT Ind tax haven review HV	Active	Yes	Review of tax haven risk whose participants include SME, LB&I and MEI.	Used mainly by the international teams
IT internal review	Obsolete	No	A specific review product that examines IT risks without taxpayer contact.	Superseded now decommissioned
IT Large APA pre lodgment	Obsolete	No	Used for advance pricing arrangements in relation to related party international dealings	Product owned by PGI not used by PGH
IT review spec internal HV	Obsolete	No	A specific review product that examines IT risks without taxpayer contact.	Superseded now decommissioned
IT review spec SME PRR	Active	Yes	Conducting a preliminary risk review on IT issues in the PGH market.	CORE PRODUCT
IT simplified APA	Active	No	Used for advance pricing arrangements in relation to lower end related party international dealings	Product owned by PGI not used by PGH

Product name	Product Status	Used by PGH?	Description	Further comments
IT SME 1 comprehensive audit	Obsolete	No	Comprehensive audit of one or more issues over multiple periods to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 1 office specific audit	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 1 specific audit	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 1 specific audit esc	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 2 comprehensive audit	Obsolete	No	Comprehensive audit of one or more issues over multiple periods to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 2 office specific audit	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 2 specific audit	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 2 specific audit esc	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 3 comprehensive audit	Obsolete	No	Comprehensive audit of one or more issues over multiple periods to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 3 office specific audit	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 3 office specific audit esc	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned years ago
IT SME 3 specific audit	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned years ago
IT SME audit comprehensive	Obsolete	No	Comprehensive audit of one or more issues over multiple periods to establish the taxpayer's correct liability	Superseded — cases using this product are still on hand
IT SME comprehensive audit	Obsolete	No	Comprehensive audit of one or more issues over multiple periods to establish the taxpayer's correct liability	Superseded — cases using this product are still on hand
IT SME comprehensive review	Obsolete	No	A risk assessment product used to test tax risks that require further explanation or treatment.	Decommissioned some time ago
IT SME Comprehensive risk review	Obsolete	No	A risk assessment product used to test tax risks that require further explanation or treatment.	Superseded — some cases using this product are still on hand
IT SME field specific review	Obsolete	No	Specific reviews that involve contacting SME taxpayers face to face	Decommissioned some time ago

Product name	Product Status	Used by PGH?	Description	Further comments
IT SME office spec audit	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Superseded now decommissioned
IT SME office spec audit esc	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned some time ago
IT SME PRA	Obsolete	No	Conducting a specific preliminary risk review on IT issues in the SME market.	Superseded now decommissioned
IT SME preliminary risk review	Obsolete	No	Conducting a specific preliminary risk review on IT issues in the SME market.	Superseded now decommissioned
IT SME PRR	Obsolete	No	Conducting a specific preliminary risk review on IT issues in the SME market.	Superseded now decommissioned
IT SME specific audit	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned some time ago
IT SME specific audit esc	Obsolete	No	Specific audit of an issue to establish the taxpayer's correct liability	Decommissioned some time ago
IT SME SR corr	Obsolete	No	Specific reviews that involve contacting SME taxpayers by letter	Superseded now decommissioned
IT SME SR corr HV	Obsolete	No	High volume reviews that involve contacting SME taxpayers by letter	Superseded to be decommissioned
IT standard bilateral APA	Active	Yes	Used for advance pricing arrangements in relation to related party international dealings	Owned by PGI this product is used in a limited capacity in PGH
IT standard unilateral APA	Active	Yes	Used for advance pricing arrangements in relation to related party international dealings	Owned by PGI this product is used in a limited capacity in PGH
IT voluntary disclosure	Obsolete	No	Used where a voluntary disclosure is made other than within another audit or review product	Superseded — to be decommissioned
Large advance pricing arrang	Active	No	Used for advance pricing arrangements in relation to related party international dealings	Product owned by PGI not used by PGH
Lge adv pricing arra rollover	Obsolete	No	Used for advance pricing arrangements in relation to related party international dealings	Decommissioned some time ago
Mutual agreement procedures	Active	No	Outlines the process steps a case owner must complete when conducting an agreement case on IT issues in the large market.	Product owned by PGI not used by PGH
SME advance pricing arrang	Obsolete	No	Used for advance pricing arrangements in relation to related party international dealings	Decommissioned some time ago
Transf pricing record review	Active	No	A Transfer pricing record review involves an analysis of international related party dealings to support arm's length pricing principles.	Product owned by PGI not used by PGH

Source: ATO.

APPENDIX 5 — ATO ADVICE AND GUIDANCE ON TRANSFER PRICING

A.5.1 The public Taxation Rulings concerning transfer pricing and related matters include:

- *Taxation Ruling TR 92/11* — Loan arrangements and credit balances;
- *Taxation Ruling TR 94/14* — Basic concepts underlying the operation of Division 13;
- *Taxation Ruling TR 95/23* (withdrawn 10 March 2011) — Procedures for bilateral and unilateral advance pricing arrangements;
- *Taxation Ruling TR 97/20* — Arm's length transfer pricing methodologies;
- *Taxation Ruling TR 98/11* — Documentation and practical issues associated with setting and reviewing transfer pricing;
- *Taxation Ruling TR 98/21* — Withholding tax implications of cross-border leasing arrangements;
- *Taxation Ruling TR 98/16* — Penalty tax guidelines;
- *Taxation Ruling TR 1999/1* — Intra-group services;
- *Taxation Ruling TR 2000/16* and *Taxation Ruling TR 2000/16A* — Transfer pricing and profit reallocation adjustments, relief from double taxation and Mutual Agreement Procedure;
- *Taxation Ruling TR 2001/11* — Operation of Australia's permanent establishment attribution rules;
- *Taxation Ruling TR 2001/13* — Interpreting Australia's Double Tax Agreements;
- *Taxation Ruling TR 2002/2* — Meaning of 'arm's length' for the purpose of dividend deeming provisions;
- *Taxation Ruling TR 2003/1* — Thin capitalisation, applying the arm's length debt test;
- *Taxation Ruling TR 2004/1* — Cost contribution arrangements;
- *Taxation Ruling TR 2005/11* — Branch funding for multinational banks;
- *Taxation Ruling TR 2007/1* — Effects of determinations made under Division 13, including consequential adjustments (replaces *Taxation Ruling TR 1999/8*);

- *Taxation Ruling TR 2010/7* – Interaction of the thin capitalisation provisions and the transfer pricing provisions;
- *Taxation Ruling TR 2011/1* – Application of the transfer pricing provisions to business restructuring.

A.5.2 Transfer pricing related Taxation Determinations include:

- *Taxation Determination TD 2002/20* – Income tax: if an Australian film production company alters its method of charging for film production services supplied to a foreign associate to account for the impact of the tax offset scheme under Division 376 of the *Income Tax Assessment Act 1997*, will the Commissioner apply Division 13 of Part III of the *Income Tax Assessment Act 1936* or the Associated Enterprises article of a relevant double tax agreement to increase the charge?
- *Taxation Determination TD 2002/28* – Income tax: when can a foreign bank elect not to apply Part IIIB of the *Income Tax Assessment Act 1936* (ITAA 1936) in calculating the taxable income attributable to the activities of its Australian branch?
- *Taxation Determination TD 2007/1* – Income tax: consolidation: in working out the market value of the goodwill of each business of an entity that becomes a subsidiary member of a consolidated group, should the value of related party transactions of each business of the entity be recognised on an arm's length basis?
- *Tax Determination TD 2008/20* – Income tax: where a taxpayer has supplied or acquired property under an international agreement and that gives rise to a debt interest or an equity interest as defined for the purposes of Division 974 of the *Income Tax Assessment Act 1997*, does Division 974 bear upon the characterisation to be adopted for the purposes of the application of Division 13 of Part III of the *Income Tax Assessment Act 1936* to the transaction?

A.5.3 The Practice Statements that are directly applicable to transfer pricing include:

- *Practice Statement PSLA 2003/5* – Making a determination under Division 13 and applying the relevant Articles of Australia's DTAs;
- *Practice Statement PSLA 2004/13* – The transfer pricing review panel;
- *Practice Statement PSLA 2005/14* – Transfer pricing review work;
- *Practice Statement PSLA 2006/9* – Referral of work to International Strategy and Operations;
- *Practice Statement PSLA 2007/8* – Treatment of non-resident captive insurance arrangements;

- *Practice Statement PSLA 2008/18 – Interaction between Subdivisions 284-B and 284-C of Schedule 1 to the Taxation Administration Act 1953;*
- *Practice Statement PSLA 2011/1 – ATO’s Advance Pricing Arrangement program;*
- *Practice Statement PSLA 2013/2 – Provision of accredited economic advice.*

A.5.4 Other ATO publications on transfer pricing include:

- *International Transfer Pricing: Introduction to Concepts and Risk Assessment;*
- *International Transfer Pricing: Applying the Arm’s Length Principle;*
- *International Transfer Pricing: A Simplified Approach to Documentation and Risk Assessment for Small to Medium Businesses;*
- *International Transfer Pricing: Marketing Intangibles;*
- *International Transfer Pricing: Attributing Profits to a Dependent Agent Permanent Establishment.*
- *What are Tax Treaties;*
- *Mutual Agreement Procedures (MAP) Operational Guidance for Member Countries of the Pacific Association of Tax Administrators (PATA);*
- *Bilateral Advance Pricing Arrangement (BAPA) Operational Guidance for Member Countries of the Pacific Association of Tax Administrators (PATA);*
- *Pacific Association of Tax Administrators (PATA) Transfer Pricing Documentation Package.*

APPENDIX 6 — LB&I BETTER TEAMS BETTER PRACTICES INFORMATION AND CHECKLIST (BETTER TEAMS REPORT)

A.6.1 The following tables are extracts from the ATO's Better Teams Report.

Table – Capability: build and sustain a capable, flexible and highly skilled workforce – Buddying, mentoring and networking

Develop EL1s so that all can project manage and lead cases.	Provide an opportunity to manage a case and prepare project plans, as well as taking greater responsibility for complex technical issues as well as the management of a case. Encourage EL1's to take on extra responsibility — such as to lead and run a case. Consider staff strengths and weaknesses when allocating cases. Team leader plays a guiding/mentoring role but encourages independent thinking and ultimate decision making to be done by staff member.
Develop staff by providing opportunities to take responsibility for complex technical issues.	Staff provided with opportunity to take greater responsibility for complex technical issues, which can be demonstrated by: - Technical papers being prepared. - Delivering issues papers at workshops. - Leading discussions with the taxpayer meetings where appropriate.
Experienced staff act as buddy / mentor to less experienced staff. Help to integrate less experienced staff into the culture of the team and LB&I as well as providing support for technical issues.	- Conducting joint presentations at workshops. - Introduce and assist with the development of detailed and realistic project plans for casework that clearly identify the tasks to be undertaken and alternative paths to resolution. - Experienced staff work with less experienced officers to guide and assist them in their interaction with taxpayers, including; providing helpful input to develop meaningful and well structured information requests; and helping them to develop the necessary skills to write well structured and clearly written position papers.
Inexperienced team members are allocated challenging and developmental work while still being mentored.	Staff given the opportunity to work with experienced officers and undertake more difficult cases as part of a teams learning culture. Mentors to introduce staff to tools and guides such as the Compliance Manual, the E2E process maps and technical data bases and provide them with practical support to enable the skills and knowledge that they acquire through use of those tools and training.
Teams harness key skills and appropriate resources to operate effectively — 'the right mix'.	Team and technical leaders identify each individual staff member's strengths and weaknesses through tasks and opportunities such as calling for volunteers at team meetings or holding one on one discussion with staff to encourage their input to and participation in particular tasks and activities. Allocates work in a resourceful manner whilst considering staff interests and takes steps to build people and address insufficiencies in the team. Transparency with staff around the allocation of work and the reasons underpinning those plans and work allocation.

Teams build a learning culture that keeps staff up to date and prepares them for the job at hand.	Makes time to discuss every staff member's cases / work e.g. at team meetings to keep the whole team in the loop with what everyone else is doing. Encourages the sharing of information between team members. Promotes the importance of keeping up to date and continuous improvement (e.g. staff attending training courses, both formal and informal. Encouraging team members to research new areas of law / technical issues and present it to the rest of the team) and to be aware of networks and other resources (e.g. risk owners/risk managers) who can provide input and assistance. Identifies the benefits of continuous learning by providing practical examples of case work.
Prepare for staff movements out of the team by allocating a variety of work to team members.	Work with all team members as part of regular team and individual discussions to ensure that business continuity is actively managed. Identify risks to plans due to unexpected absence or inability of any team member to continue with duties. Develop a realistic succession plan and ensure that work is done to enable that plan to be brought into action as necessary (e.g. pairing up staff members so that there is a back up or alternative person who is aware of what's happening and able to get up to speed quickly if required). Team / technical leaders and team members assist with developing expertise and a greater understanding of the capability requirements of the position.

Source: ATO LB&I Better teams better practices information and checklist.

Table – Work satisfaction: Challenge staff, greater responsibility, independence and diversity

Team members are provided with a variety of work (varied products and taxpayers) over time.	The variety of challenging work should promote staff motivation and provide team members with a sense of achievement and greater job satisfaction.
Team members are actively involved in decision making. This encourages independence and responsibility and the confidence to put forth ideas in a technical environment.	This is most important for inexperienced and newer team members Team leader provides guidance and direction and focuses team thinking around the issues. Leaves ultimate decision making to the case officer and supports them appropriately to manage risks. Encourages staff for their viewpoints and ideas and listens. Provides feedback throughout the process to facilitate learning. Upholds the importance of engaging other stakeholders into the decision making process and when formulating/following ATO views e.g. the risk hypothesis and assist/support the team member in engaging those other stakeholders and working with them collaboratively to bring issues to resolution.
Good performance is recognised, rewarded and acknowledged.	This helps to promote team bonding and building an effective team. Good performance is rewarded by providing opportunities to do higher level project work that broadens their skills and raises the individual's profile, attend relevant external seminars and development events. The team leader acknowledges good performance at team meetings, recommendations for ATO reward scheme or acknowledgement by senior managers via topic, etc newsletters.

<p>Underperformance is addressed and steps put in place to assist bringing the staff member up to the standards required within the team. Includes staff who work at the required standard, but work below their potential.</p>	<p>Discusses underperformance with staff member, including the reason for underperformance and puts in steps to improve the standard e.g. by recommending training, building experience through relevant case work and more importantly providing continuous honest feedback on work done. Any instance of underperformance is identified early to prevent it from becoming entrenched and affecting team's morale.</p> <p>In addition, keeps a formal record of staff performance, has regular discussions at the first instance of underperformance and putting in measures to avoid problems of underperformance or at least their escalation.</p>
<p>Set achievable results — the team should be outcome focused with good practical process in place to achieve plan.</p>	<p>Team has a team plan/schedule outlining outcomes which staff can refer to as they go. Team leader actively discusses with the team how they are going to achieve the outcomes, taking team members input / views on the best processes / avenues.</p>
<p>Teams have a learning culture.</p>	<p>Assists the team to stay up to date with changes to procedures as well as tax legislation via 'staff PDA's'. Structured individual learning plans are in place and monitored and actively managed as a shared responsibility between the team leader and team members.</p> <p>Staff to present on specific topics at team meetings e.g. chapters of the Compliance Manual. Knowledge debriefs shared at team meetings. Staff should also be encouraged and supported to attend 'dialogue days' tax technical conferences, site conferences and specific training events appropriate to their learning needs, recognising that learning is not just a narrow focus on technical or procedural skills and knowledge and should incorporate an appropriate mix of developmental learning e.g. leadership skills, corporate or APS wide relevant training or other development activities.</p>

Source: ATO LB&I Better teams better practices information and checklist.

APPENDIX 7 — TRANSFER PRICING CAPABILITY ASSESSMENT QUESTIONS FOR 2013

Table – transfer pricing capability assessment questions 2013

TRANSFER PRICING
the concept of the arm's length principle
the operation of Div 24 of the ITAA 1936
the operation of the Associated Entities Article and the Business Profit Articles in our Double Tax Agreements
the application of the transfer pricing rules and ATO procedures through risk reviews, audits, MAP proceedings and APAs
advising, leading and mentoring in all aspects of transfer pricing law and regulations
analysing the financial statements of taxpayers to evaluate their compliance with the arm's length principle
the interaction between transfer pricing and other areas of international and domestic tax law, eg thin capitalisation, Part IVA, CFC, NRWT, CGT.
Overall, how would you rate your current knowledge AND application of skill in this topic?

Source: ATO capability assessment 2013.

Table – analysis of financial information capability assessment questions 2013

ANALYSIS OF FINANCIAL INFORMATION
Rank your current level of proficiency against the following capabilities: My understanding of and/or ability in
financial statements (Profit and Loss, Balance Sheet, Cashflow statement etc) and how to dissect financial information
Tax Effect Accounting and AIFRS
the interaction between Financial Statements and tax returns
analysing and connecting aspects of a tax return with other financial information
analysing and connecting aspects of a financial statement with other financial information
Overall, how would you rate your current knowledge AND application of skill in this topic?

Source: ATO capability assessment 2013.

Table – industries capability assessment questions 2013

INDUSTRIES
Rank your current capability against the following INDUSTRIES:
Banking/Finance
Overall, how would you rate your current knowledge AND application of skill in this industry?
Insurance
Overall, how would you rate your current knowledge AND application of skill in this industry?
Superannuation

INDUSTRIES
Overall, how would you rate your current knowledge AND application of skill in this industry?
High Wealth
Overall, how would you rate your current knowledge AND application of skill in this industry?
Manufacturing
Overall, how would you rate your current knowledge AND application of skill in this industry?
IT, Media
Overall, how would you rate your current knowledge AND application of skill in this industry?
Not for profit
Overall, how would you rate your current knowledge AND application of skill in this industry?
Sales and service
Overall, how would you rate your current knowledge AND application of skill in this industry?
Energy & Resources
Overall, how would you rate your current knowledge AND application of skill in this industry?
Building & Construction
Overall, how would you rate your current knowledge AND application of skill in this industry?

Source: ATO capability assessment 2013.

Table – relationship/situational management capability assessment questions 2013

Relationship / Situational Management Section
Rank your current capability against the following BEHAVIOURAL INDICATORS:
Displaying confidence
Listening when own ideas are challenged and justifying own position and actions.
Constructively challenging issues; discussing alternatives to find a way forward.
Taking a decisive course of action.
Able to remain focused on objectives and not become intimidated.
Negotiating persuasively
Discussing issues credibly and thoughtfully without becoming personal or aggressive.
Anticipating and identifying other people's expectations and concerns.
Commencing negotiations with a clear understanding of the desired outcomes.
Seeks cooperative agreement on actions and avoids confrontation.
Managing conflict
Using appropriate strategies to resolve conflicts and address concerns quickly.
Using appropriate interpersonal styles and methods to reduce tension or conflict.
Finding agreement on issues and following through on implementation.
Able to deal with conflict and communicate ATO position without becoming judgmental.
Communicating effectively
Focusing on clearly communicating key points.
Limiting the use of jargon and abbreviations; using appropriate language.
Presenting messages confidently and selecting the appropriate medium.

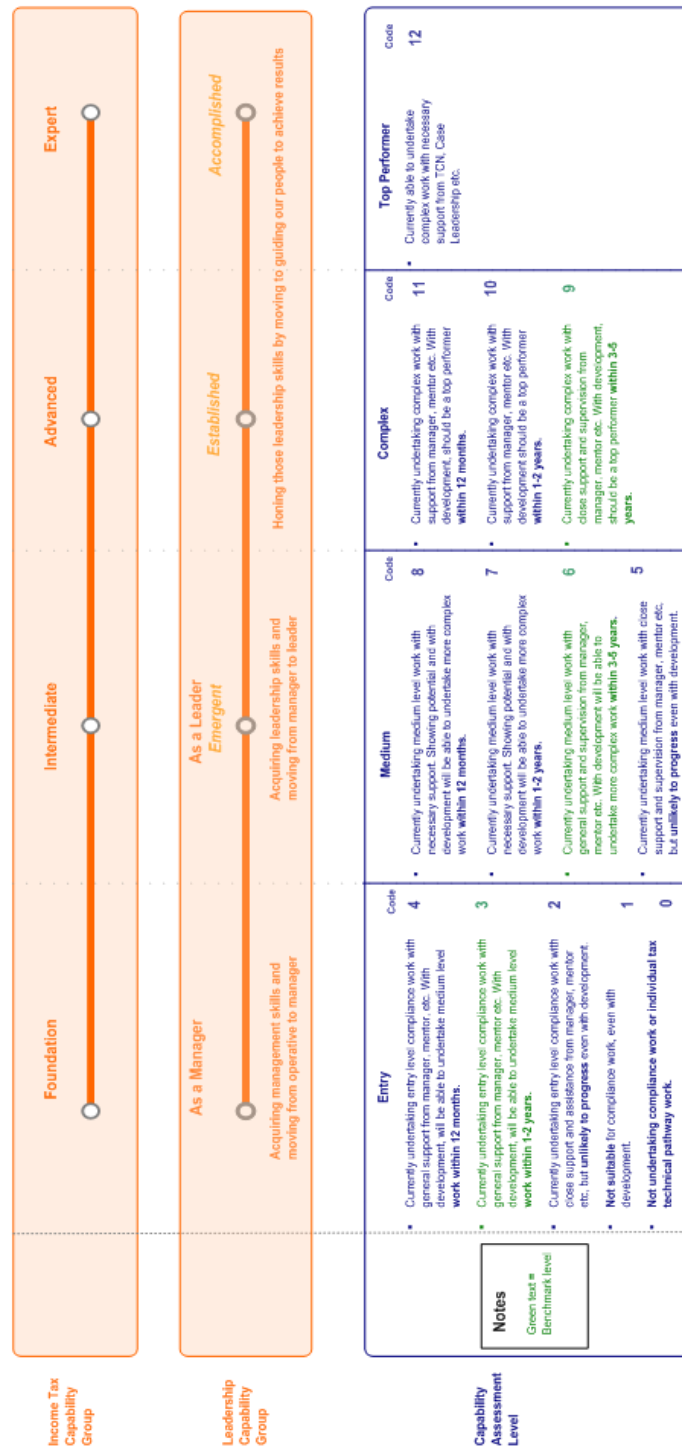
Relationship / Situational Management Section
Willingly communicates process and keeps taxpayers/stakeholders informed of process.
Demonstrating influence
Presenting persuasive alternative views.
Encouraging relevant stakeholders in supporting the position.
Identifying and proposing solutions that benefit all parties involved in a situation.
Recognises delaying tactics used by taxpayers/stakeholders and agents and employs effective response.
Managing relationships
Building and sustaining relationships; liaising with a range of stakeholders.
Anticipating clients' needs and providing courteous, prompt and professional service.
Develops and maintains a network with others internally and externally.
Establishes rapport with taxpayers/stakeholders, agents and other representatives.
Making appropriate decisions
Making critical and timely decisions in difficult or ambiguous situations.
Taking charge of a group if/when necessary (eg to facilitate change).
Making appropriate decisions when required.

Source: ATO capability assessment 2013.

APPENDIX 8 — TRANSFER PRICING CAPABILITY ASSESSMENT RATING CRITERIA

Figure – Benchmark Criteria Capability Assessment Level

Benchmark Criteria Capability Assessment Level



Source: ATO LB&I capability snapshot 2011.

Table – Rating scale

RATINGS SCALE — LARGE MARKET ENVIRONMENT AND TECHNICAL SKILLS SECTIONS	
6 = Expert	The officer has expert/specialist knowledge and skills in relation to this criterion. NB: This rating should only be used where exceptional skills have been demonstrated.
5 = High	The officer has highly developed/advanced understanding, knowledge and skills.
4 = Medium	The officer has full understanding, knowledge and skills.
3 = Low	The officer has a general understanding and requires some training or further opportunity to apply skills.
2 = Limited	The officer has limited knowledge/understanding and skill.
1 = Unable to rate	The officer has not been exposed to work in this criterion.

Source: ATO LB&I capability assessment 2012 — core tax technical skills.

KEY COMPETENCIES/BEHAVIOUR INDICATORS

TRANSFER PRICING

- the concept of the arm's length principle
- the operation of Div 13 of the ITAA 1936
- the operation of the Associated Entities Article and the Business Profit Articles in our Double Tax Agreements
- the application of the transfer pricing rules and ATO procedures through risk reviews, audits, MAP proceedings and APAs
- advising, leading and mentoring in all aspects of transfer pricing law and regulations
- analysing the financial statements of taxpayers to evaluate their compliance with the arm's length principle
- the interaction between Transfer Pricing and other areas of international and domestic tax law, eg thin capitalisation, Part IVA, CFC, NRWT, CGT

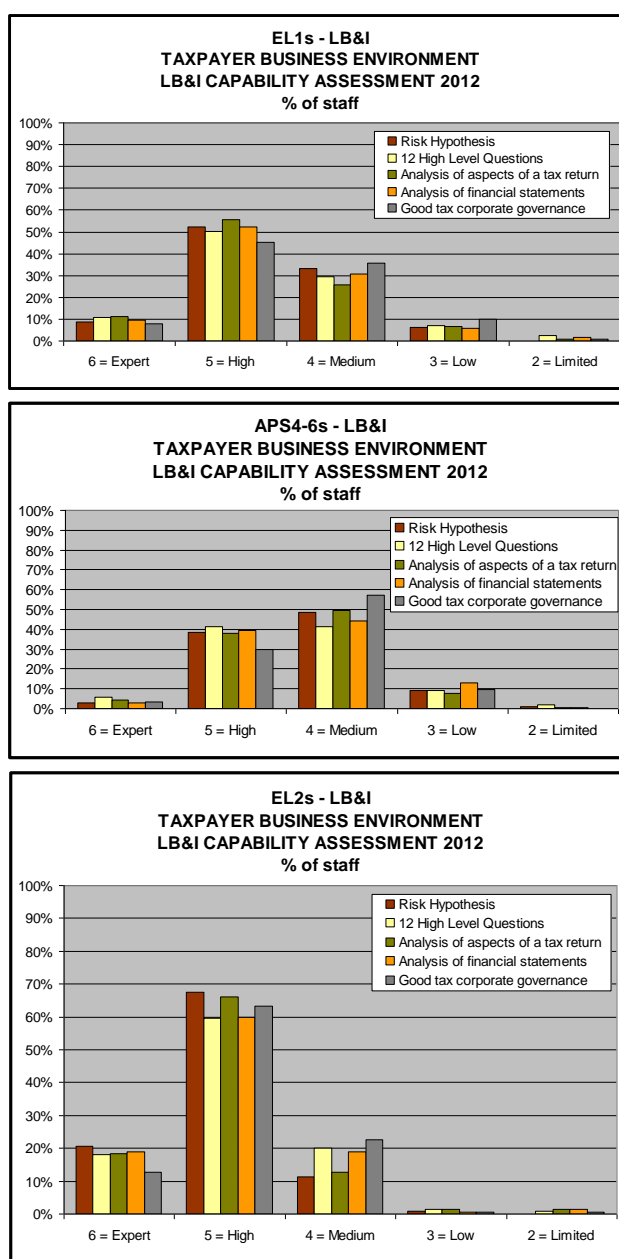
Source: ATO LB&I capability assessment 2012 — core tax technical skills.

APPENDIX 9 — LB&I OFFICER CAPABILITY ASSESSMENTS

INDUSTRY CAPABILITY ASSESSMENT

A.9.1 In the 2012 capability assessment, results were also compiled in respect of officers' understanding of taxpayers' business environment, reproduced below.

Figure — Taxpayer Business Environment — LB&I



Source: ATO LB&I Capability assessment results 2012 — Taxpayer Business Environment.

KEY COMPETENCIES/BEHAVIOUR INDICATORS

TAXPAYER BUSINESS ENVIRONMENT

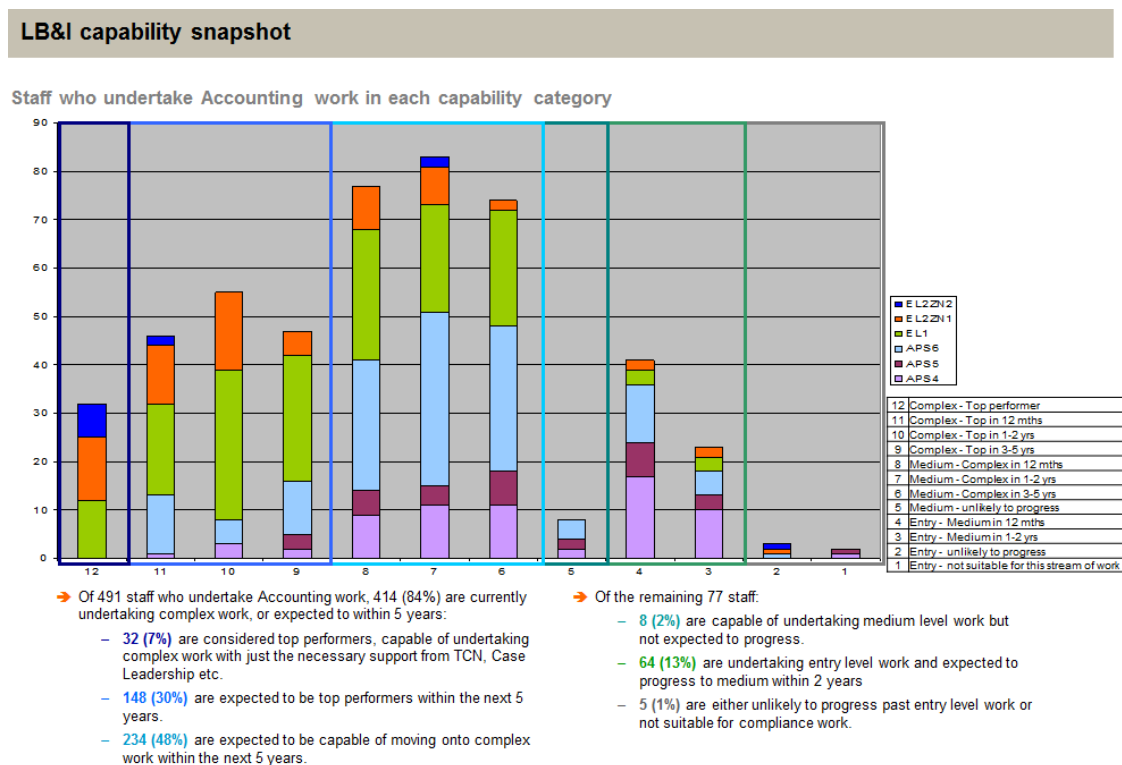
- the Risk Hypothesis
- the 12 High Level Questions
- the analysis of aspects of a tax return
- the analysis of financial statements
- good tax corporate governance

Source: ATO LB&I Capability assessment results 2012 – Taxpayer Business Environment.

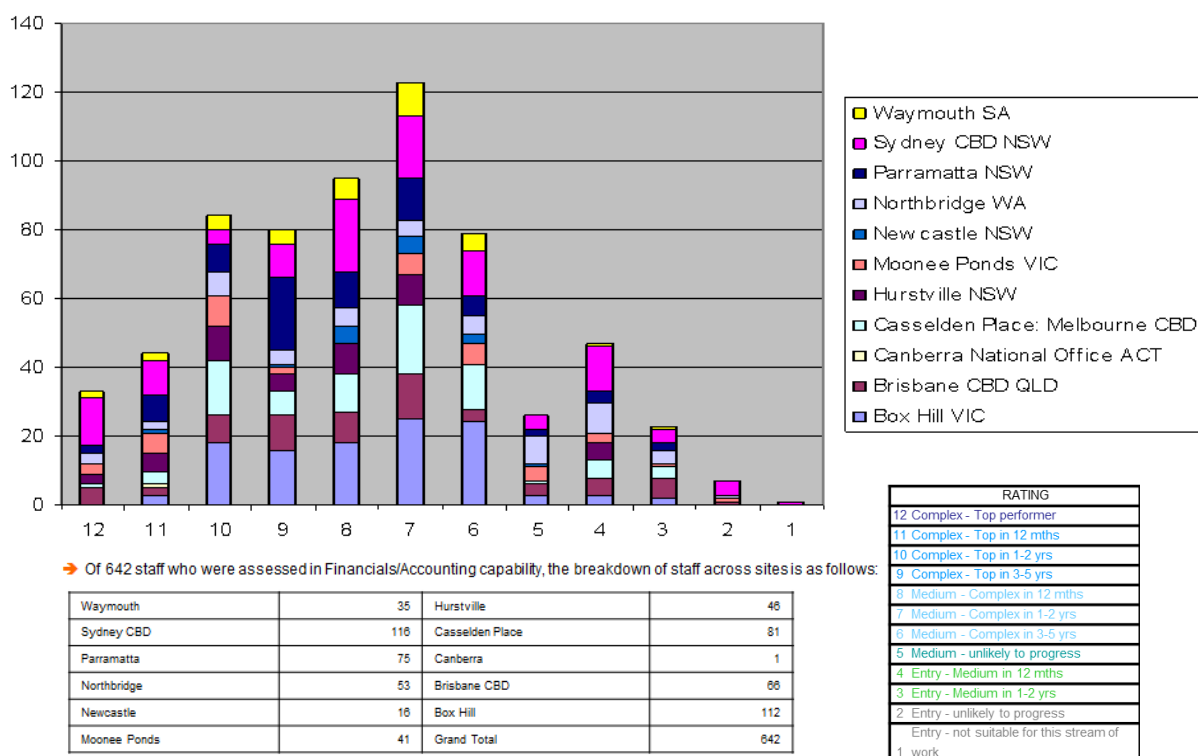
FINANCE AND ACCOUNTING CAPABILITY ASSESSMENT

A.9.2 The capability assessment in respect of finance and accounting are reproduced below.

Figure – 2010 Finance and accounting capability assessment



Source: ATO Capability Assessment 2010.

Figure – 2011 Finance and accounting capability assessment

Source: ATO Capability Assessment 2011.

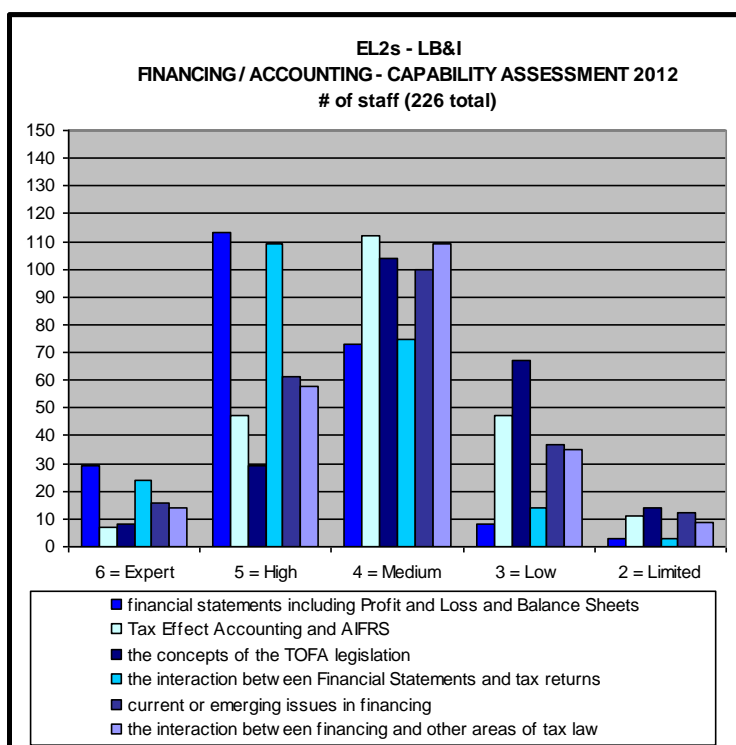
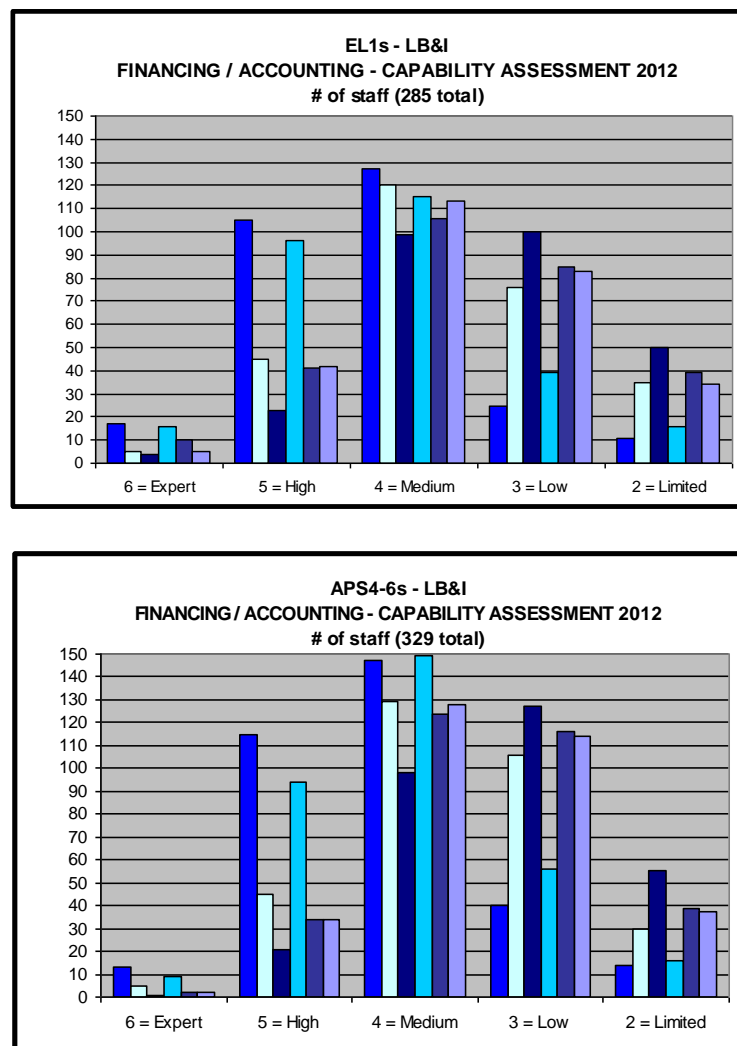
Figure – 2012 Finance and accounting capability assessment

Figure – 2012 Finance and accounting capability assessment (continued)



Source: ATO Capability Assessment 2012.

KEY COMPETENCIES/BEHAVIOUR INDICATORS

CAPITAL GAINS TAX

- what causes a CGT event to occur
- what constitutes an asset for CGT purposes
- what is needed to calculate a Capital Gain or Loss
- what exemptions or rollovers are available in CGT legislation
- current or emerging issues in Capital Gains tax
- the interaction between CGT and other areas of tax law

CONSOLIDATIONS

- the general concepts, terminology and core rules behind Consolidations
- the membership rules that underpin the Consolidations regime
- rules around entries and exits
- rules for the calculation of an ACA
- the concepts surrounding MECs
- current or emerging issues in Consolidations, including issues such as asset characterisations and investments in associates
- the interaction between Consolidations and other areas of tax law

FINANCING/ACCOUNTING

- financial statements including Profit and Loss and Balance Sheets
- Tax Effect Accounting and AIFRS
- the concepts of the TOFA legislation
- the interaction between Financial Statements and tax returns
- current or emerging issues in financing, including products such as hybrids and debt vs. equity
- the interaction between financing and other areas of tax law

INTERNATIONALS

- the concepts of residency and source
- the concepts included in Double Tax Agreements
- the concept and operations of Thin Capitalisation
- the concepts behind a Permanent Establishment
- the operation of the Transfer Pricing regime
- the interaction between tax planning and global tax avoidance issues
- the CFC rules
- current or emerging issues in internationals
- the interaction between international matters and domestic tax law

Source: ATO Capability Assessment 2012 – Core Tax Technical Skills.

RELATIONSHIP MANAGEMENT AND COMMUNICATION CAPABILITY ASSESSMENT

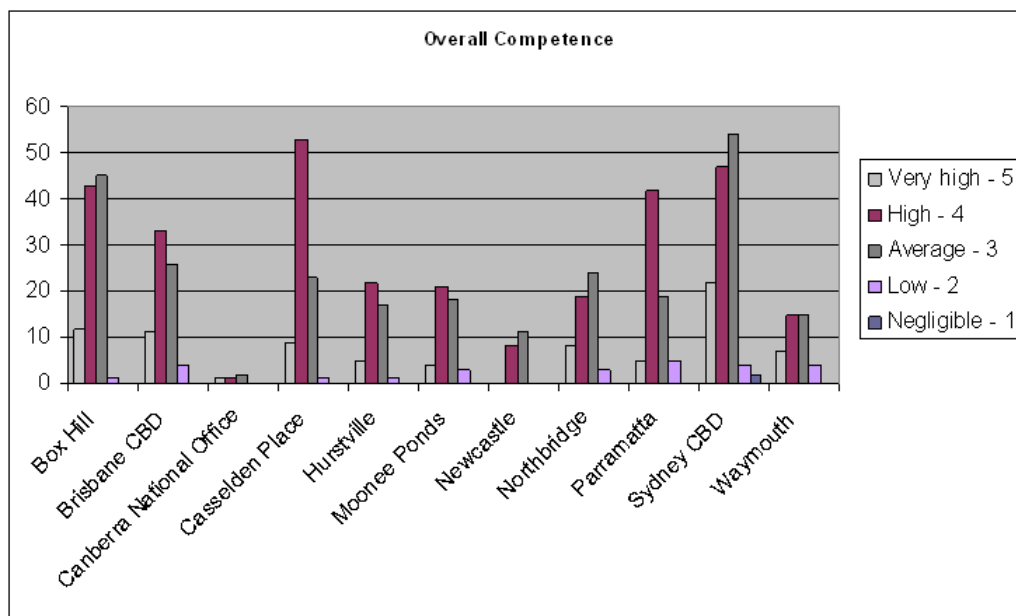
A.9.3 Beginning in 2011, LB&I started measuring officers' capability in respect of client relationship management which includes competence, confidence, negotiation, conflict resolution, communication, influencing and relationship management. The capability assessment outcomes for 2011 are outlined below.

In 2011, 7 Client Relationship Management skills were assessed – Overall competence, Confidence, Negotiation, Conflict resolution, Communication, Influencing and Relationship Management. The results for **Overall competence** across sites are displayed below:

Overall competence

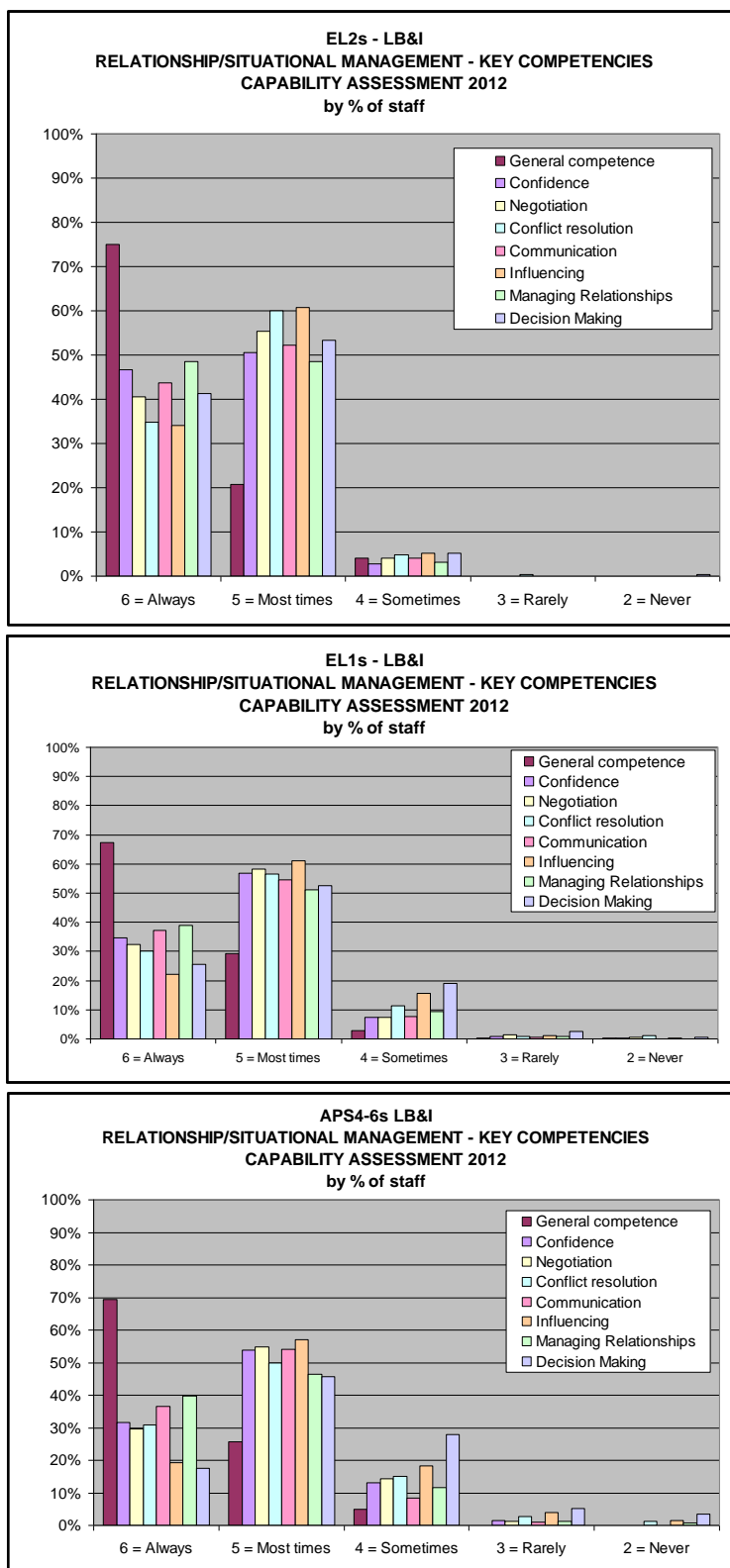
- 13% of the ratings were recorded at Very High.
- 45% of the ratings were recorded at High.
- 38% of the ratings were recorded at Average.
- 4% of the ratings were recorded at Low.
- 0% of the ratings were recorded at Negligible.

Figure – 2011 client relationship management — overall competence



Source: ATO LB&I capability assessment 2011.

Figure – 2012 Client relationship/situation management LB&I



Source: ATO LB&I capability assessment 2012 – relationship/situational management section.

A.9.4 The rating scale for both 2011 and 2012 in respect of these client relationship management skills are reproduced below.

Figure – Ratings scale — relationship/situational management and leadership sections

RATINGS SCALE — RELATIONSHIP/SITUATIONAL MANAGEMENT AND LEADERSHIP SECTIONS	
6 = Always	The officer always displays this behaviour indicator.
5 = Most times	The officer most times displays this behaviour indicator.
4 = Sometimes	The officer sometimes displays this behaviour indicator.
3 = Rarely	The officer rarely displays this behaviour indicator.
2 = Never	The officer never displays this behaviour indicator.
1 = Unable to rate	The officer has not been exposed to work in this criterion.

Source: ATO LB&I capability assessment 2012 — relationship/situational management section.

KEY COMPETENCIES/BEHAVIOUR INDICATORS

GENERAL COMPETENCE

- Showing an interest in what others have to say; acknowledging their perspectives.
- Operating in a professional manner when representing the Tax Office.
- Treating people fairly and equitably and being transparent in dealings with them.

Displaying confidence

- Listening when own ideas are challenged and justifying own position and actions.
- Constructively challenging issues; discussing alternatives to find a way forward.
- Taking a decisive course of action.

Negotiating persuasively

- Discussing issues credibly and thoughtfully without becoming personal or aggressive.
- Anticipating and identifying other people's expectations and concerns.
- Commencing negotiations with a clear understanding of the desired outcomes.

Managing conflict

- Using appropriate strategies to resolve conflicts and address concerns quickly.
- Using appropriate interpersonal styles and methods to reduce tension or conflict.
- Finding agreement on issues and following through on implementation.

Communicating effectively

- Focusing on clearly communicating key points.
- Limiting the use of jargon and abbreviations; using appropriate language.
- Presenting messages confidently and selecting the appropriate medium.

Demonstrating influence

- Presenting persuasive alternative views.
- Encouraging relevant stakeholders in supporting the position.
- Identifying and proposing solutions that benefit all parties involved in a situation.

Managing relationships

- Building and sustaining relationships; liaising with a range of stakeholders.
- Anticipating clients' needs and providing courteous, prompt and professional service.
- Develops and maintains a network with others internally and externally.

Making appropriate decisions

- Making critical and timely decisions in difficult or ambiguous situations.
- Taking charge of a group if/when necessary (eg to facilitate change).
- Making appropriate decisions when required.

Source: ATO LB&I capability assessment 2012 – relationship/situational management section.

APPENDIX 10 — TRANSFER PRICING CAPABILITY STRATEGY 2012–13

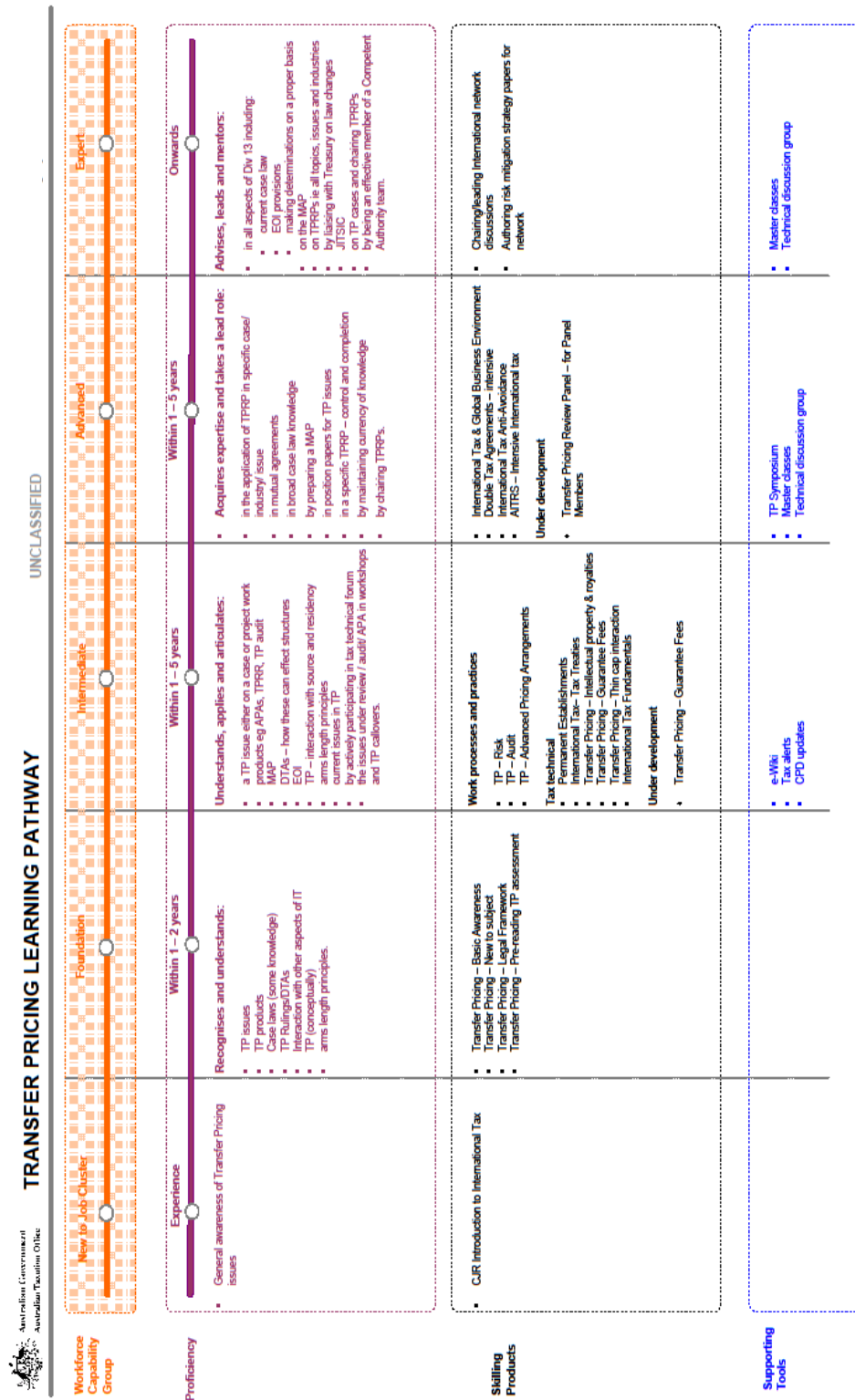
Outcome: <ul style="list-style-type: none"> To build Transfer Pricing (TP) capability across the Tax Office in a timely and cost effective manner, ie to facilitate the initial development of officers to the 'foundation' level and then development of officers from 'foundation' level to 'intermediate' level and from 'intermediate' level to the 'specialist' level. Provide a mix of suitably qualified staff to allow for succession planning and for the efficient operations of the TP program Implement the TP capability aspects of the TP Management System (TPMS) 	
Where does this framework fit in? <div> <div>Strategic Statement 2010-15</div> <div>We are passionate about improving our capabilities to be more innovative, agile and responsive to challenges and opportunities</div> <div>Corporate Overview & Annual Plan 2012-13</div> <div>Our continuing focus on building the capabilities and engagement of our people</div> <div>Compliance Overview 2012-13</div> <div>LB&I Delivery Plan 2012-13</div> <div>Enabling Output 2.7 - Sub-plan and line people</div> <div>LB&I Integrated Capability Development Framework 2010-13</div> <div>Transfer Pricing Capability Strategy 2012-13</div> <div>International Learning Pathway</div> <div>Foundation/Intermediate/Specialist Capability Levels</div> </div>	Strategy 1 Sponsor: ADC BM Build a flexible, highly skilled workforce Recruit / retain <ul style="list-style-type: none"> Workforce Plan is aligned to strategy and work program. Seek staff with skills in commercial knowledge and transfer pricing. Build a cross business-line core of professional expertise that attracts motivated talent TP specialist case leaders to mentor intermediate and foundation level case officers on the job Succession planning <ul style="list-style-type: none"> Transfer of skills and knowledge prioritised by departure of key staff Capability building of direct reports by delegation of work under supervision of TP specialists Build capability through TP Network (TPN) activities <ul style="list-style-type: none"> Workforce plan that is flexible and mitigates risk (eg allocation of work based on skill set and/or opportunity to build capability) Network activities designed to build capability and share best practice, eg Monthly hook-ups, audit forums and video workshops Staff committed to transfer pricing work through membership of the transfer pricing network Project strategy <ul style="list-style-type: none"> Transfer pricing project officers supported by formal skilling and development program (see strategy 3) Project officers supported through TPN activities designed to build capability and share best practice eg monthly hook-ups audit forums and video workshops TP mentors allocated to project officers Flexible cross segment/BSL work allocation criterion for project officers based on skill set and/or opportunity to build capability Allocate project officers to TP cases being managed on a project basis in order to leverage opportunities to build capability Career paths <ul style="list-style-type: none"> Develop Career paths for TP specialists to make specialisation worthwhile (refer International Learning Pathway or ILP) Performance management <ul style="list-style-type: none"> TP learning objectives to be included in PDAs. Use results of the capability survey to design and plan capability plan
Our Current Environment <ul style="list-style-type: none"> Many of our more experienced specialist level people are leaving We have recruiting difficulties in a competitive market TP work is complex and requires a lengthy lead time to meet the expected market capability We have a limited intermediate to advanced skilling program We have difficulties keeping our knowledge up to date 	Strategy 2 Sponsor: AC CAG Develop and build clear, 'easy to use' policies, practices and procedures that support our people <ul style="list-style-type: none"> RDF incorporated in selection of TP risk and audit cases Monitor and review effectiveness of APA program Review TPRP process and implement improved processes Develop policy for identifying, addressing and allocating risks in Q3 and Q4 Further develop the TP Governance Group processes for overseeing effective operation of the TPMS including managing workflows and interactions with the TPN and the Jurisdictional Income Working Group and International Steering Committee Further develop the Gatekeeper process for work allocation Expand and promote effective operation of the TPMS to build capability on the job by: <ul style="list-style-type: none"> Allocating work based on skill set and/or opportunity to build capability Ensuring that TP work carried out by junior staff is under the supervision of an appropriate mentor Conducting TPN activities designed to build capability (technical, practices, and procedures) and share learning eg. monthly hook-ups, audit forums and video workshops Further develop the TPGG process for periodic review of RAPT, intelligence, emerging risks and the development of risk flags to improve case selection TP technical developments embedded in work practices, procedures and systems (eg embed litigation learnings, APA review, Service Hubs, Market Support Payments etc into TP work practices)
Our Measures of Success <ul style="list-style-type: none"> We are able to retain and recruit quality people up to our budget Capability is rising due to support from case leaders, good processes, skilling programs and use of experts We have an integrated skilling framework linked to on-the-job We are introducing new products and approaches into our work Positive feedback from our own people eg MSF, promotions etc 	

Source: ATO.

<p>Outcome:</p> <ul style="list-style-type: none"> To build Transfer Pricing (TP) capability across the Tax Office in a timely and cost effective manner, ie to facilitate the initial development of officers to the 'foundation' level and then development of officers from 'foundation' level to 'intermediate' level and from 'intermediate' level to the 'specialist' level. Provide a mix of suitably qualified staff to allow for succession planning and for the efficient operations of the TP program Implement the TP capability aspects of the TP Management System (TPMS) 		
<p>Strategy 3</p> <p>Sponsor: ADC BM</p> <p>Build a cohesive skilling and development program for our workforce</p> <ul style="list-style-type: none"> Continue development of a structured skilling program that encompasses theory (formal training), application (case studies), learning (including self directed learning and informal training), casework (on the job) and mentoring at foundation, intermediate and specialist levels <ul style="list-style-type: none"> Formal training program to include TP curriculum, relevant aspects of the EZE skilling program, the international curriculum, Financial Analysis training program, external training courses and seminars, use of external experts where appropriate. Informal training program including monthly TPN technical discussion, telephone hook-ups, provision to the TPN of resources, materials, guides, publications and tools (e.g. the e-wiki, Tax Management TP Report, Knowledge Exchange, International E-Alert, ATO Publications, and the International Article Review) and on the job opportunities such as attendance at TPRPs and working with international experts. Monitor the level of formal and informal training, learning and level of achievement in casework to attain ILP progression (to be quality assured by segment TPGG members) Cross line responsibility for skilling PDAs to clearly express a commitment to increasing transfer pricing capability through a combination of formal skilling and allocation of transfer pricing work Maintain TPN capability stock-take and identify TP training needs. Skilling program to provide training just-in-time, where possible Liaise with LB&I Business Capability Group to ensure transfer pricing receives appropriate priority for its skilling program. Results from Capability Survey to be used in planning the TP capability program Liaise with L&D for implementation of formal TP training program Integrate TP learning program with the International ILP and training activities. 	<p>Strategy 4</p> <p>Sponsor: ADC CTL</p> <p>Develop experts (refer to ILP) and networks to assist us in our day to day work.</p> <ul style="list-style-type: none"> Transfer Pricing Network to be appropriately resourced and supported by patron and network leader TPN supports delivery across the ATO of voluntary and active compliance and interpretive advice products by capable staff TPN used as a platform to share knowledge, deliver career opportunities and implement an effective succession plan strategy TPN actively participates in the Technical Network Leaders' Forum Transfer pricing forms integral part of TPN members PDAs Specialist level members to attend courses 25-50hrs pa and external) and to provide feedback of new learnings to the TPN Specialist level members to be involved in building capability of other members Foundation and intermediate members to be mentored by specialist members and devote at least 30hrs CPD to Transfer Pricing 	<p>Strategy 5</p> <p>Sponsor: AC CAG</p> <p>Staying current and up to date – in tax, commerce and the large market</p> <ul style="list-style-type: none"> Ensure transfer pricing is included in learning plans for all members Continue to build awareness of new developments and emerging issues in TP through the TPN, e.g. TP litigation learning, restructures, guarantee fees/loans, Permanent Establishments, OECD developments, Hubs, Market Support Payments. Expand TPN activities, for example: <ul style="list-style-type: none"> Cross Segment/BSL/region workshops to discuss cases with common TP issues and share learnings Regional Case Forums to discuss a range of current TP issues encountered in casework Cross Segment/BSL training strategies Facilitate ILP progression through provision of formal training, learning and level of achievement in casework (to be quality assured by segment TPGG members) Build skilling through provision of resources, materials, guides, publications and tools such as phone hook-ups, site forums, workshops, e-wiki, Tax Management TP Report, Knowledge Exchange, International E-Alert and media monitor via the TPN. TPN members devote at least 30hrs a year to keeping up to date
		<p>Strategy 6</p> <p>Sponsor: ADC BM</p> <p>Build an improvement, innovation & change culture</p> <ul style="list-style-type: none"> JWG & ISC to build a TP business improvement and change culture through developing a TP Strategy that promotes implementation and effective operation of the TPMS Promote the APA program and implement changes that improve the APA program. The TPGG to identify opportunities for improvement in overseeing the successful implementation of the TP Strategy. Conduct and promote a review into the conduct of transfer pricing risk reviews and implement any recommendations Conduct and promote a review into the conduct of transfer pricing review panels and implement any recommendations

Source: ATO.

APPENDIX 11 — TRANSFER PRICING LEARNING PATHWAY



Transfer Pricing Learning Pathway v 1.1 25/10/2012

Source: ATO, LB&I Learning Pathways 2012.

APPENDIX 12 — DRAFT TRANSFER PRICING LEARNING PLAN

Topics	Level	Date	Source of learning	Applied to casework
Legislation				
ITAA 1936 Div 13				
EM for Div 13				
Double tax agreements				
OECD Guidelines				
Transfer Pricing Guidelines for MNEs (1995)				
International Transfer Pricing (ITP) Booklets				
Introduction to Concepts and Risk Assessment				
Applying the Arm's Length Principle				
Advance Pricing Arrangements				
A Simplified Approach to Documentation & Risk Assessment for Small to Medium Businesses				
Risk Assessment for Small to Medium Businesses				
Marketing Intangibles				
Taxation Rulings				
92/11 Loans and credit balances				
94/14 Application of Div 13				
97/20 Methodologies				
98/11 Documentation and risk assessment				
98/16 Penalties				
1999/01 Services				
2000/16 MAP				
2001/11 PEs				
2001/13 DTAs				
2004/1 Cost Contribution Arrangements				
2005/11 Branch funding for multinational banks				
2007/11 Consequential adjustments				
2010/7 Interaction of Division 820 and the transfer pricing				
2011/1 Business restructuring				
Tax Determinations				
2007/D20 Thin Cap and Div 13				
2008/20 Debt/Equity rules and Div 13				

Practice Statements Law Administration				
2003/5 Div 13 Determination				
2004/13 Transfer Pricing Review Panels				
2005/14 Transfer Pricing Review Work				
2006/9 Referral to ISO				
2011/1 ATO's Advance Pricing Arrangement Program				
ATO Interpretive Decision				
2001/315 Application of Div 13				
Discussion Papers				
<i>OECD</i>				
Business Restructures				
Profit Methods				
Permanent Establishments				
Topics				
The Arm's Length Principle				
The Four Step Process				
<i>Step 1: Understand the business</i>				
Functional Analysis				
Intangibles				
Industry Analysis				
Identify the IRPDs				
Business Strategies				
<i>Step 2: Select a methodology</i>				
Considerations				
Alternatives				
Grouping/Aggregation				
<i>Step 3: Applying the methodology</i>				
CUP				
Resale price method				
Cost plus method				
Transaction net margin method				
Profit split method				
Other methods				
Comparability				
Range				

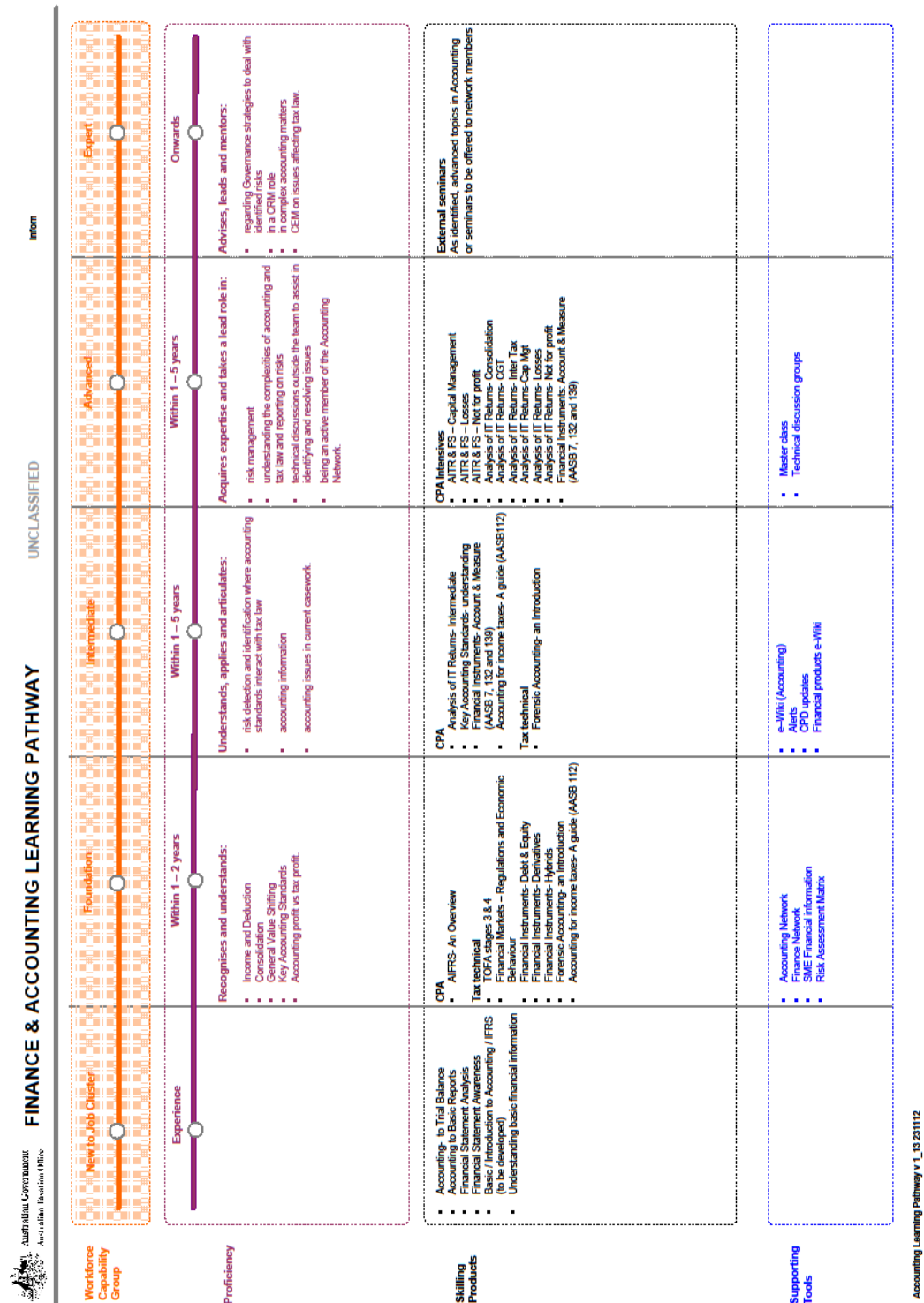
<i>Step 4: Review the methodology</i>				
Monitor dealings				
Data collection				
Support system				
Review mechanism				
Transfer pricing issues				
Services				
Restructures				
Guarantee fees/ Intra-group loans				
Permanent Establishments				
Litigation Learnings				
Div 13 Determinations				
TPRP procedures				
TPRP membership				
Business strategies				
Set off arrangements				
Market penetration				
Sustained losses				
Global pricing				
Marginal costing				
Contract manufacturing				
Compliance Activities				
Risk review				
Booklet — ITP Introduction to Concepts and Risk Assessment				
TR 98/11				
TPRR manual				
Schedule 25A				
Commercial realism				
Attachments 3 & 4				
Audit				
Compliance Manual				
4 step process				
Audit plan				
TPRPs				
Questionnaires				
Interviews				
Position papers				
Div 13 determination				
Penalties				

Review into the Australian Taxation Office's management of transfer pricing matters

MAP				
Application				
DTAs				
Position papers				
Adjustments				
Interest/GIC				
APA				
5 step process				
Pre-lodgement				
APA plan				
Analysis				
Negotiation				
Critical assumptions				
APA agreement				
Simplified APA process				

Source: ATO.

APPENDIX 13 — FINANCE AND ACCOUNTING LEARNING PATHWAY



Source: ATO, LB&I Learning Pathways 2012.

APPENDIX 14 — CHARACTERISTICS OF EXPERT COMPLIANCE OFFICERS: EXTRACT FROM INSIDE STORY'S REPORT

A.14.1 In July 2010, Inside Story presented its report, SME Compliance Officer Research, to the SME business line. The report identified the characteristics of expert compliance officers in five core areas and created an 'Expertise Assessment Tool' from these areas:

1. Strategic thinking

1.1 Convergent thinking – Can distil a large volume of information down to core issues

1.2 Investigative ability (Divergent thinking) – Identifies critical information sources and asks a range of questions to uncover valuable information

1.3 Critical thinking – Seeks to verify identified information, close gaps and resolve discrepancies

1.4 Diagnostic ability – Explores context and relationships between individuals and between individuals and companies to identify beneficiaries of transactions and deals. Seeks to identify path of money and other benefits.

1.5 Recognises links between interconnected issues – Can recognise & identify patterns in information/data/facts bringing multiple elements together

1.6 Focuses strategically – Understands ATO objectives and prioritises work accordingly taking into consideration whether cases and individual risks are material, worth pursuing and pose a reputation risk to ATO

2. Draws from previous experience

2.1 Interprets taxpayer motivations – Able to identify potential taxpayer motivations from case facts and information

2.2 Applies knowledge of an industry – Applies knowledge or actively seeks out to inform themselves about characteristics of an industry to help interpret facts on a current case

3. Confidence

3.1 Displays confidence – Expresses confidence in moving case forward, knowing what steps to take next, consulting others. Able to maintain momentum on case when faced with uncertainty

4. Productive working relationships

4.1 Able to establish rapport and build relationships—Establishes rapport with taxpayers, agents and other representatives

4.2 Seeks cooperative solutions and avoids confrontation—Seeks cooperative agreement on actions and avoids confrontation,

4.3 Communicates process and keeps taxpayer informed of progress—Communicates process and keeps taxpayer informed of progress. Willingness to communicate.

4.4 Personal integrity—Recognises importance of and deals with taxpayers and their representatives transparently and honestly

5. Negotiation skills

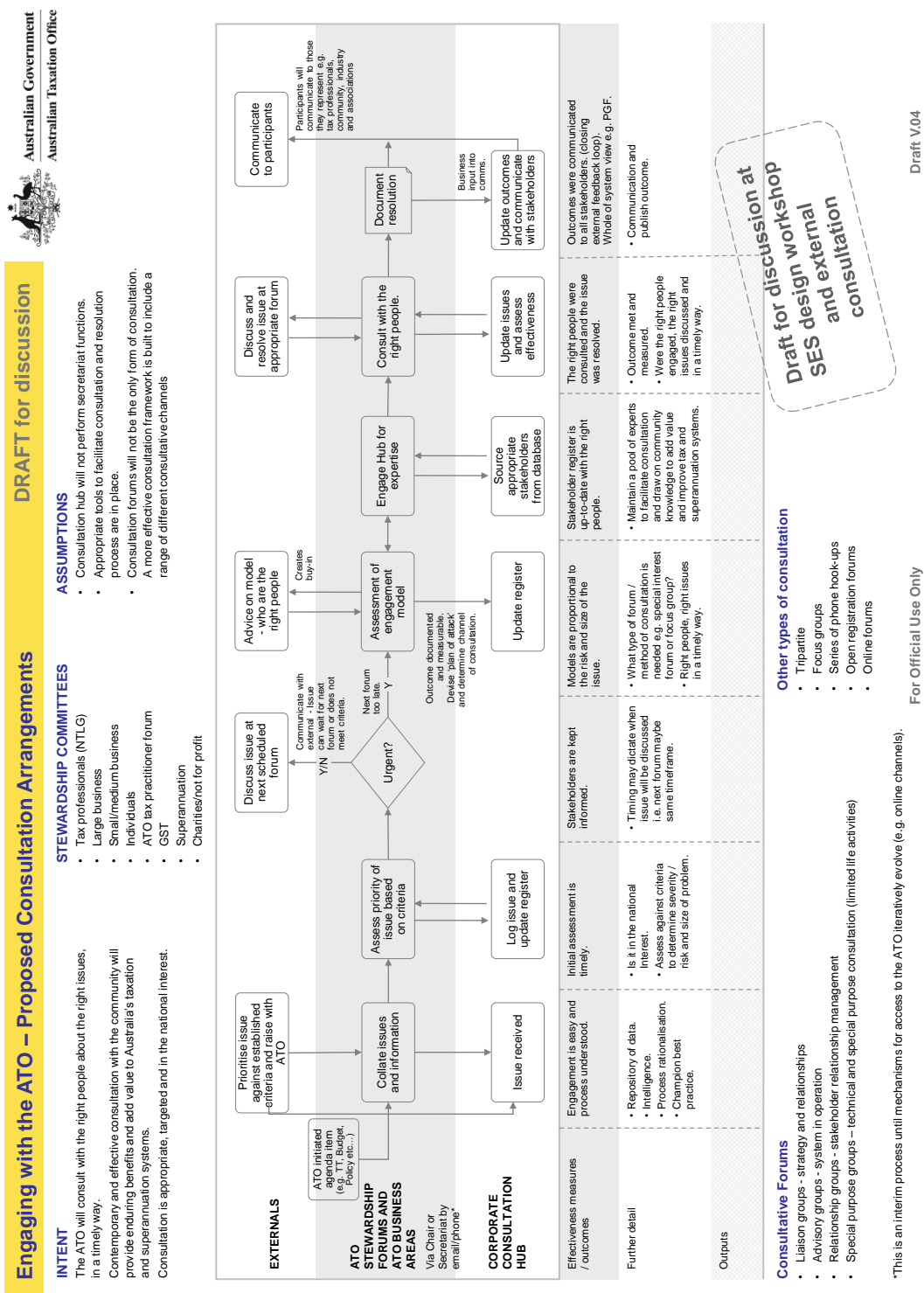
5.1 Effectively overcomes delaying tactics—Recognises delaying tactics used by taxpayers and agents and employs effective response

5.2 Able to effectively communicate ATO position in adversarial situations—Able to deal with conflict and communicate ATO position without becoming judgmental. Resilience in adversarial situations — able to remain focused on objectives and not become intimidated

5.3 Judicious use of formal powers—Uses formal powers as a last resort only when diplomatic negotiations have been unsuccessful.⁶⁶⁴

⁶⁶⁴ ATO, 'Compliance Officer Research', above n 614.

APPENDIX 15 — CORPORATE CONSULTATION HUB



APPENDIX 16 — ATO RESPONSE



Australian Government
Australian Taxation Office

SECOND COMMISSIONER OF TAXATION

Mr Ali Noroozi
Inspector-General of Taxation
GPO Box 551
SYDNEY ACT 2001

Dear Ali

Review into the ATO's management of transfer pricing matters

Thank you for the opportunity to comment on the final draft of your report on the review into the ATO's management of transfer pricing. I would like to acknowledge the efforts of all involved in undertaking this review.

I welcome your draft report's constructive feedback and specific recommendations which will assist us to continue improving our management of transfer pricing matters.

We agree either fully, in principle or in part with 17 of the 18 recommendations.

We disagree with your recommendation 2.6, which is about maintaining an overseeing body of specialists with review functions. It is essential that compliance officers are directly accountable for the decisions they make and are supported by specialist advice, as required. Interposing an 'overseeing body' is contrary to that fundamental principle.

The *Large business and tax compliance* booklet outlines processes for taxpayers to present their position where they disagree with the case team. There are also internal escalation processes where the case team disagrees with the specialist advice provided.

Our detailed response to your recommendations is attached at Annexure 1.

If you require further information on our response, please contact David Allen, Assistant Commissioner.

Yours sincerely

Bruce Quigley
Second Commissioner of Taxation

4 December 2013

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[To minimise space, the appendix to the ATO's response has not been reproduced here, but has been inserted into the text of this report underneath each of the recommendations to which that text relates.]

GLOSSARY

ABS	Australian Bureau of Statistics
ACA	Annual Compliance Arrangement
APA	Advanced Pricing Arrangement
ATO	Australian Taxation Office
Audit Timeframes Review	<i>Review into Tax Office Audit Timeframes</i>
AUSTRAC	Australian Transaction Reports and Analysis Centre
BAU	Business as Usual
BEPS	Base Erosion and Profit Shifting
BISEP Model	Business Industry Sociological Economic Psychological Model
BRICS Countries	Brazil, Russia, India, China and South Africa
CAG	Compliance Assurance and Governance
CAR	Competent Authority Representative
CFC	Controlled Foreign Company
CMPI	Corporate Management Procedures and Instructions
CPD	Continuing Professional Development
CRR	Client Risk Review
CSSC	Case Selection Sub-Committee
CTL	Case and Topic Leaders
CUP	Comparable Uncontrolled Price
E2E Course	LB&I End-to-End Active Compliance Training Course
FDI	Foreign Direct Investment
FIF	Foreign Investment Fund
FTA	Forum on Tax Administration
FTE	Full-Time Equivalent
G20	Group of Twenty Finance Ministers and Central Bank Governors
G8	Group of 8
GAAR	General Anti-Avoidance Rules
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GIC	General Interest Charge
High Court	High Court of Australia
HMRC	Her Majesty's Revenue and Customs
ICDF	Integrated Capability Development Framework
IDS	International Dealings Schedule
IEG	International and Economist Gateway
IFRS	International Financial Reporting Standards

IGT	Inspector-General of Taxation
IGT Act 2003	<i>Inspector-General of Taxation Act 2003</i>
ILT	Internationals Leadership Team
International Review	The ATO's International Review Project into 'Achieving Best Practice for Managing International Work Across the ATO'
International Review Proposal	The ATO's <i>International Review – Proposed Changes to, and Options for, Organisational Structure and Staffing</i> , presented to the ATO Executive on 12-13 October 2010
IRS	Internal Revenue Service
IRSI	International Risk Strategy and Intelligence
ISC	International Steering Committee
ISO	Internationals Strategy and Operations
ISPS	International Structuring and Profit Shifting
ISU	International Strategic Unit
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
ITD	International Tax Division
ITSC	Income Tax Steering Committee
ITX	Indirect Tax
JITSIC	Joint International Tax Shelter Information Centre
LB&I	Large Business and International
LB&I Review	<i>Report into the Australian Taxation Office's Large Business Risk Review and Audit Policies, Procedures and Practices</i>
LB&I RIC	Risk and Intelligence Committee
LBACM Publication	Large Business Active Compliance Manual – Income Tax
LBAG	Large Business Advisory Group
LBTC Booklet	Large Business and Tax Compliance booklet
LIBOR	London Interbank Offered Rate
MAP	Mutual Agreement Procedure
MEI	Micro Enterprises and Individuals
MNE	Multi-National Enterprise
MTC	Model Tax Convention
NTLG	National Tax Liaison Group
NZIRD or IRD	New Zealand Inland Revenue Department
OCTC	Office of the Chief Tax Counsel
OECD	Organisation for Economic Cooperation and Development
OECD Guidelines	Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
PCR	Pre-lodgment Compliance Review
PG&H	Private Groups and High Wealth Individuals
PG&I	Public Groups and International

PSGG	Profit Shifting Governance Group
PSLA	Practice Statement Law Administration
PSP	Profit Shifting Practice
PSWG	Profit shifting working group
PWC	PricewaterhouseCoopers
RIC	Risk and Intelligence Committee
RISS	Risk, Intelligence and Support System
RMC	Risk Management Committee
SES	Senior Executive Service
SME	Small and Medium Enterprises
SCI	Strategic Compliance Initiative
SIC	Shortfall Interest Charge
TCL	Tax and Case Leaders
Tax Compliance Publication	Tax Compliance for Small-to-Medium Enterprises and Wealthy Individuals publication
TLG	Technical Leadership Group
TNMM	Transactional Net Margin Method
TPCS	Transfer Pricing Capability Strategy
TPMS	Transfer Pricing Management System
TPN	Transfer Pricing Network
TPOG	Transfer Pricing Operations Group
TPP	Transfer Pricing Practice
TPR Reviews	Transfer Pricing Record Reviews
TPRP	Transfer Pricing Review Panel
TPSCI	Transfer Pricing Strategic Compliance Initiative
TPWG	Transfer Pricing Working Group
TR	Taxation Ruling
UK	United Kingdom
UN	United Nations
US	United States