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Overview

Corrs Chambers Westgarth, Taxand Australia

Taxand Australia is the leading independent full service commercial law firm in Australia. Our team provides full service, end-to-end tax transactional support on domestic and cross-border mandates, starting with tax due diligence and structuring advice, through to legal documentation and post-merger implementation advice.

Taxand Australia provides general tax advisory services in relation to the application of Australian transfer pricing law and related international related party tax issues. Our pre-eminent tax controversy team advises on end-to-end tax controversies across the tax disputes life cycle ranging from tax authority engagement strategy, tax reviews, audits, objections, disputes, appeals and litigation. The team regularly advises on transfer pricing matters.

Transfer Pricing Framework

Australia has generally adopted the OECD approach to transfer pricing, including the application of the arm's length principle. Australian transfer pricing rules are set out in Division 815 of the Income Tax Assessment Act 1997 (Cth). Under those rules, where an entity obtains a transfer pricing benefit from conditions that operate between it and another entity in connection with their "commercial or financial relations", those actual conditions are taken not to operate and instead arm's length conditions are applied. In addition, Australian transfer pricing rules require the form of actual commercial relations between parties to be disregarded if they are inconsistent with the substance of those arrangements. Australian thin capitalization rules apply in addition to transfer pricing rules to reduce or further reduce debt deductions. Australia has also recently enacted debt deduction creation rules to deny debt deductions on certain related party transactions and refinancings (refer to further comments below).

An entity is required to disclose certain details of its international related party dealings in its corporate income tax return. Where the value of those dealings exceeds certain thresholds, an entity is required to prepare and file an International Dealings Schedule with its income tax return that includes further details of those dealings (such as the extent to which transfer pricing documentation has been obtained and the degree to which it covers the dealings disclosed).

Accepted Transfer Pricing Methodologies

Australian transfer pricing rules require arm's length conditions to be identified by reference to OECD transfer pricing guidelines. Acceptable transfer pricing methods include the comparable uncontrolled price method, the resale price method, the cost plus method, the transactional net margin method and the profit split method. The Australian Taxation Office has published guidance regarding the factors that should be taken into account when choosing an appropriate methodogy.

Transfer Pricing Documentation Requirements

Australia has country-by-country (CBC) reporting obligations for entities that are CBC reporting entities. In general terms, a CBC reporting entity includes an entity that has annual global income of AUD 1 billion or more, or is a member for a group that has annual global income of AUD 1 billion or more.

Australian CBC reporting requirements include a CBC report, a master file and a local file that is submitted as an XML file with the Australian Taxation Office. A reporting concession may be available where a CBC report or master file is submitted in another country. Reports must generally be filed within 12 months of the end of the income year to which the reports relate.

The Australian local file may require the inclusion of further details to those that are required in other countries. All Australian entities (whether subject to CBC reporting or not) are effectively required to prepare valid transfer pricing documentation in respect of their international related party dealings by the time that the income tax return is due to be filed for that entity (refer below). Any transfer pricing adjustment that arises from a dealing that is not covered by transfer pricing documentation available at the due date for lodgement is subject to increased penalties. Australian transfer pricing documentation must address all requirements under Australian law to be valid. The documentation requirements are generally based on the OECD guidelines and allow the benchmarking methods permissible under those guidelines. There are additional obligations that must be addressed under Australian law (eg reconstruction of transactions is allowable in all circumstances and not just the exceptional circumstances under the OECD guidelines).

There are significant uplifts in penalties that apply to significant global entities (SGEs) if additional tax is imposed in relation to any transfer pricing benefit and for failure to lodge returns, notices or statements on time (refer below).

Entities are required to include disclosures in income tax returns relating to its international related party dealings. Detailed disclosures (including dealing value, transfer pricing methodology and level of documentation prepared) may be required where the value of the dealings exceeds AUD 2 million.

Local Jurisdiction Benchmarks

Australian transfer pricing benchmarking and documentation requirements are generally based on the OECD guidelines and allow the benchmarking methods permissible under those guidelines. As noted above, the circumstances in which a transaction can be reconstructed for the purpose of benchmarking is significantly expanded under Australian law. The Australian Taxation Office has sought to assert rights to reconstruct transactions and this approach has received a degree of endorsement by Australian courts.

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Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

Australia has a unilateral and bilateral advance pricing agreement program. An APA request from a taxpayer will be considered having regard to the particular facts and circumstances, but the Australian Taxation Office is more likely to enter into an APA where certain factors are present. These include consistency with the OECD transfer pricing guidelines, a high level of assurance of the taxpayer's compliance with tax laws, the presence of significant complexity, the arrangement the subject of the request has been, or is highly likely to be, entered into, and where there is a high probability of economic double taxation. Based on published statistics, the average length of time to negotiate an APA is approximately 2 years.

Transfer Pricing Audits

The Australian Taxation Office has an active and well resourced transfer pricing audit function and has litigated a number of transfer pricing disputes. Details of routine audit activities are not made public but the focus of its audit activity seems directed towards large multinational groups. The Australian Taxation Office has published statements that it is focussed upon cross border financing arrangements.

The Burden of Proof in Transfer Pricing: Theory versus Practice

In Australia, the onus of substantiating arm's length pricing of international related party dealings falls on the taxpayer where the pricing of those dealings has been challenged by the Australian Taxation Office.

Australian taxation law does not create an express obligation upon taxpayers to create specific records demonstrating their international related party dealings comply with the arm's length principle. However, there are separate statutory obligations on taxpayers to create and keep records to explain and substantiate all transactions that are relevant to their tax compliance obligations generally. This is separate to any CBC reporting obligations for entities that are part of significant multinational groups. In the event of a dispute as to adequate compliance, the burden of proof rests with the taxpayer. It is therefore generally recommended that taxpayers prepare sufficient contemporaneous transfer pricing documentation that may be used to demonstrate compliance with the arm's length principle in the event of any inquiry by the Australian Taxation Office. As a practical matter, creating specific contemporaneous records may reduce the risk of tax audits and may also mitigate the impact of penalties in the event of a dispute that gives rise to an amended assessment for additional tax payable (refer below). The Australian Taxation Office has confirmed that it will follow as closely as possible the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration* and Australian transfer pricing rules are generally expected to be interpreted in accordance with these Guidelines.

In practice, taxpayers that meet or exceed certain value thresholds must disclose details of their international related party dealings in their annual corporate income tax return. The details that must be disclosed can include the type of transactions to which the taxpayer is a party, the value of the dealings, and extent to which the taxpayer has prepared transfer pricing documentation for those dealings (ie as a percentage) prior to its tax return being due. As such, the Australian Taxation Office is on notice of the degree to which certain taxpayers have complying transfer pricing documentation. Taxpayers that are able to disclose a higher percentage of compliant transfer pricing documentation may be, but not always, at lower risk of enquiries regarding transfer pricing.

The consequence of failing to prepare complying transfer pricing documentation by the time a taxpayer must file its income tax return is that the taxpayer cannot take the position that the pricing of its international related party dealings was reasonably arguable. A position that is not reasonably arguable (eg an undocumented transfer pricing arrangement) is subject to a minimum penalty of 25% of the shortfall in tax payable. This penalty is doubled for SGEs. These rules, coupled with the onus of proof resting with the taxpayer, will generally see taxpayers ensure that they prepare Australian compliant transfer pricing documentation before the relevant corporate income tax return is lodged.

The Australian Taxation Office has increased its audit activity in respect of multinational groups in recent years and this audit activity has included transfer pricing reviews. This focus is likely to keep transfer pricing and transfer pricing documentation high on the agenda of any enquiries that the Australian Taxation Office makes (which may occur before the commencement of a formal audit).

Transfer Pricing Penalties

Penalties are imposed for a failure to comply with Australian transfer pricing rules. These penalties may take the form of an administrative penalty or prosecution of an offence. Where a failure to comply with transfer pricing rules results in a shortfall of tax, an administrative penalty equal to 25%-75% of the shortfall in tax may apply (plus a general interest charge of approximately 11% per annum on the amount underpaid). The Australian Taxation Office has the discretion, but not an obligation, to reduce penalties based on the particular circumstances. However, the administrative penalty would be a minimum of 25% of the shortfall where a taxpayer does not have complying transfer pricing documentation.

Penalty amounts are doubled for SGEs. An entity will be an SGE if it is a global parent entity with annual global income of AUD 1 billion or more, or is a member of group that is consolidated for accounting purposes where the global parent entity has annual global income of AUD 1 billion or more. In addition, there are also significantly increased penalties for SGEs where certain documents are not lodged on time (including income tax returns and CBC statements). These increased penalties may be between AUD 165,000 – 825,000, depending on the number of days after the due date that the documents are lodged.

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Local Hot Topics and Recent Updates

- Australia has passed amendments to its thin capitalization rules but has not proceeded to enact new legislation to deny deductions for payments attributable to a right to exploit an intangible asset of an owner resident in a low tax jurisdiction as a result of the implementation of Pillar Two global minimum tax rules in 2024. While not strictly a transfer pricing matter, the amended thin capitalization rules will impact the way in which transfer pricing rules may operate in Australia. For example, it is possible for interest deductions to be denied under both thin capitalization rules and transfer pricing rules and this could lead to a different result under transfer pricing rules than has been the case in prior tax years. Under the amended thin capitalization rules, the transfer pricing rules are required to be considered in determining the arm's length price and also the quantum of debt. The thin capitalization rules then apply to the remaining arm's length debt deductions (ie. the new fixed ratio test is not a 'safe harbor' where cross-border loans subject to transfer pricing are involved). This may result in deductions being denied under the transfer pricing rules before thin capitalization rules then apply.
- Australia has enacted debt deduction creation rules that apply from 1 July 2024 which disallow debt deductions in respect of related party debt in connection with:
  - the acquisition of assets or obligations from associates; and
  - financial arrangements to fund certain payments or distributions to an associate.

  The rules affect entities that, with associates, have more than AUD 2 million of annual debt deductions. Debt arrangements established both before and after 1 July 2024 are affected. Restructuring of debt arrangements to avoid denial of debt deductions can be subject to specific anti-avoidance rules.
- Australia has also published guidelines as to the evidentiary expectations it has of taxpayers in relation to related party offshore intangible arrangements. These guidelines set a high threshold for parties to have contemporaneous documentation that demonstrates the arrangements were genuine commercial transactions. A higher range of penalties will apply where such documentation is not prepared at the time the arrangement is implemented.
- Australia has also announced rules that will introduce a new penalty for taxpayers with more than AUD 1 billion in global turnover annually that mischaracterize or undervalue royalty payments to which withholding tax would ordinarily apply. This measure has not yet been enacted and is proposed to commence from 1 July 2026.

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Documentation threshold

Master file	Group revenue of AUD 1 billion or more
Local file	Group revenue of AUD 1 billion or more
CbCR	Group revenue of AUD 1 billion or more

Submission deadline

Master file	Generally 12 months after income year end
Local file	As above
CbCR	As above

Penalty Provisions

Documentation – late filing provision	Up to AUD 825,000 (ie for SGEs)
Tax return disclosure – late/incomplete/no filing	Penalty depends on circumstances but may be up to AUD 825,000 plus potential further penalties calculated as a percentage of tax shortfall
CbCR – late/incomplete/no filing	Up to AUD 825,000

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