TRANSFER PRICING

TP MINDS AUSTRALIA 2021: EVENT WRAP UP

EXECUTIVE SUMMARY

TP Minds Australia 2021 conference, held in a digital format on 9 – 10 November, catered to a wide range of tax and transfer pricing (TP) professionals and also covered some topics helpful to those who only occasionally deal with the transfer pricing issues. The conference offered workshops covering foundational TP concepts, combined with in-depth sessions covering the latest ATO programs and guidance, including:

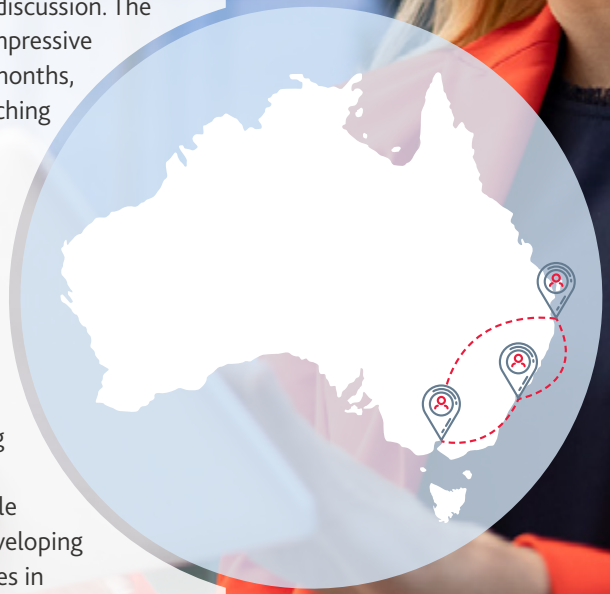
- The perspectives of corporates regarding operational transfer pricing
- Practical considerations for financial transactions
- Managing TP audits and the future of tax disputes in Australia and overseas
- Various perspectives on base erosion and profit shifting (BEPS) 2.0 and its potential impact
- Dealing with transfer pricing and commercial aspects of intangibles
- Learnings from when transfer pricing projects do not go according to plan.

Key themes emerged across the sessions, including:

- The increasing importance of data in implementing and defending transfer pricing policies
- The increasing standards for contemporaneous evidence and robust TP analysis
- An increased ATO focus requiring taxpayers to demonstrate commerciality in all intercompany dealings
- The importance of a strong tax governance framework to manage TP risk and processes
- The ATO's expectations that taxpayers risk-assess the transfer pricing issues they face and prepare the supporting documentation accordingly
- The clear message that MNEs (multi-national enterprises) will almost certainly be subject to tax authority review in Australia or overseas.

BEPS 2.0 was also a key topic of discussion. The OECD update summarised the impressive progress made over the past 12 months, including its breakthrough in reaching agreement across 136 of the 140 inclusive framework members in relation to Pillar One and Pillar Two.

Various speakers shared their thoughts on the potential impact of Pillars One and Two on 'business as usual' transfer pricing, with most contemplating that the arm's length principle (ALP) is broadly here to stay, while noting the tight timetable for developing detailed rules. The clear challenges in implementing the regime across the world, in a way that does not result in double taxation in future years, were also highlighted.



HIGHLIGHTS

OECD DEVELOPMENTS

- **BEPS 2.0** - Melinda Brown from the OECD noted that 2021 has been one of the busiest years on record at the OECD, culminating with the work on BEPS 2.0, where agreement was reached across 136 of 140 inclusive framework members regarding the global minimum tax (GMT) of 15% which is intended to take effect from 2023. This is recognised as a landmark development considering that countries who are party to the agreement make up approximately 94% of global GDP
- The timeline for the implementation of the GMT is ambitious and will require numerous countries to re-write and amend local legislation in 2022 for the changes to be implemented and enacted the following year
- A significant amount of work remains to further define and agree to the rules and scope, including issues such as revenue sourcing, the role of mandatory binding arbitration, disputes involving Amount A of Pillar One, elimination of double tax and the marketing and distribution function safe harbours – to name but a few
- Importantly, the ALP will remain the core principle in TP analysis post BEPS 2.0. There had been some conjecture as to whether a global formulary approach may replace the ALP and, although BEPS 2.0 will incorporate a type of formulary apportionment in its application, this is likely to be limited. Therefore, traditional concepts and transfer pricing practice will continue to play an integral part in the post BEPS 2.0 world
- Additional initiatives being undertaken by the OECD in respect to tax and transfer pricing include work to develop an inclusive framework on carbon pricing, and ongoing reviews of previously published BEPS related guidance materials.

REGIONAL AND DOMESTIC DEVELOPMENTS

At a regional and global level, tax authorities are increasingly keen to review transfer pricing arrangements, especially as businesses recover or pivot their operations in the aftermath of the pandemic. TP continues to be a key focus for the ATO's Tax Avoidance Task Force and is quoted as being the largest driver of tax disputes in Australia. Key focus areas under these programs include:

- **Business restructuring** with special attention being given to **intangible assets,** including the mischaracterisation of DEMPE (development, enhancement, maintenance, protection and exploitation) functions, the commercial rationale for IP migration and the character and nature of associated payments. This focus area was under development for several years and it is now expected to take centre stage in ATO activity
- **Intragroup services** provided to Australian entities, particularly regarding understanding the economic benefit underlying the service and allocation keys adopted
- **Financing arrangements**, with particular focus on commerciality of arrangements
- Collation of **TP related data** gathered through several sources and processes - to enable tax authorities to identify emerging risks and deploy resources in a targeted manner.

HIGHLIGHTS

CONTINUED

PRACTICAL CONSIDERATIONS FOR CROSS-BORDER TRANSACTIONS

Operational Transfer Pricing

Experienced in-house tax professionals shared their views on what is considered **'best practice'** for MNEs in managing compliance obligations and risk, noting the importance of governance, quality of data, ERP (enterprise resource planning) systems, global consistency, central management of TP and a reduction in manual processes.

Many large corporates continue to manage their operational TP with the help of traditional spreadsheets (typically due to a number of legacy ERP systems within their businesses). Best practice now incorporates a technology-driven approach where an investment in the automation of many manual TP processes can significantly reduce resourcing needs and improve data and reporting quality over the medium to long term.

With an increased level of TP scrutiny and a focus on tax governance as part of the justified trust program, it is evident that operational TP and the wider tax governance of an MNE has become a priority matter for corporate boards and leadership teams.

Intercompany Financing

Intercompany Financing Transactions continue to be a key risk area for tax authorities around the region, especially in a post-pandemic world for businesses that are highly leveraged, or have entered arrangements that the current economic environment may not support.

A panel discussion explored factors to be considered as part of any financing analysis or policy setting process, including:

- Commercial needs for financing, noting that any tax authority review is likely to start with what makes commercial sense in taxpayers' specific circumstances
- The ATO's Practical Compliance Guidelines (PCG) are a tool for risk assessment purposes and not an interpretation of the law or a safe harbour for what the TP outcome should be. Financing analysis should be robust and include an appropriate analysis to support the position adopted, regardless of whether it aligns with the ATO's expectations. The ATO will not automatically reject positions considered high risk in light of published PCGs but will look to understand the commercial drivers and relevant documentation
- The importance of always understanding the risk profile of transactions, using ATO published guidance material, and making sure that all key risk factors are well supported and documented - e.g. Use of local currency loans, and making sure features like tenor are commercial, etc.
- While the ATO may prefer to take a pragmatic approach and look at an arrangement from a commercial perspective, MNEs should keep in mind that other jurisdictions may adopt a more formal approach (i.e. unilateral interest caps). Transfer pricing analysis should always be considered from a multijurisdictional perspective
- The ATO saw an increase in the use of the Arm's Length Debt Test (ALDT) in the past two years, potentially driven by the impact of COVID-19 or changes in rules regarding revaluation.

HIGHLIGHTS

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Dealing with Intangibles

The ATO provided an overview of programs focusing on the mischaracterization and migration of intangibles, including draft guidance PCG 2021/D4. Many MNEs are taking the opportunity to discuss proposed restructures or new transactions with the ATO, either on a disclosed or 'no names' basis via their advisers. The opportunity to explore the arrangement with the ATO can often provide insight for local entities and help shape the transaction and the level of analysis and documentation expected to be maintained.

The panel used a case study to explore some of the issues related to intangibles. The case study outlined a 'typical' example where an Australian business, which had developed its own intangibles, was acquired by an overseas investor with a strategy to expand the exploitation of the intangibles and continue to develop new/modified intangibles. The case study considered the roles of both the acquirer and acquired, and highlighted the following requirements:

- The importance of understanding the commercial rationale in moving IP to another jurisdiction, i.e. it's not just about the consideration on sale, but what is the entity giving up in the process
- Financial capacity, decision making and skills of the overseas versus the local entity
- The level of contemporaneous evidence, analysis and documentation recommended and how this might align with the guidance provided in PCG 2021/D4
- Splitting DEMPE functions across multiple jurisdictions and what impact this has on the TP policy
- Use of profit split methods in relation to intangibles.

The ATO also noted that following the public consultation process they anticipate releasing an updated draft ruling in respect of Taxation Ruling 2021/D4, which relates to the character of receipts concerning software.

Disputes

Given the current landscape and TP being a key risk area, there is a good chance that an MNE will be selected for review by one or more tax authorities. These reviews are increasingly data-driven as tax authorities become more sophisticated in their data collection and selection processes. Furthermore, because of the information exchange agreements between governments, peer review, and increase in transparency, tax authorities can tailor reviews with a specific focus and scope.

However, the likely increase in the number of disputes should not inherently intimidate taxpayers. As one panel member stated, "disputes are our contribution to corporate responsibility." By way of disputes, taxpayers are given the opportunity to defend a position and establish a precedent which in many ways is used to shape future behaviour of both MNEs and tax authorities.

Although it may be obvious, there are several reasons why tax authorities around the globe are stepping up reviews and assessments:

- Post-pandemic treasury revenues require repair as a result of government subsidies and/or funding requirements locally
- Tax authorities have access to better quality data to understand and risk assess taxpayers and target their resources.

Increased disputes incentivise taxpayers to seek certainty on complex transactions by way of APAs (advanced pricing agreement) Further, the peer review process under the inclusive framework is encouraging tax authorities to increase the effectiveness of such programs. The IRD (Inland Revenue Department) in New Zealand made it clear they are going to lengths to ensure their APA program is an efficient and cost-effective means to manage tax risk in an open and collaborative manner.

CONCLUSION

Given the increasing momentum behind BEPS 2.0, this year's TP Minds Australia felt like the first in which the impending OECD changes have become a reality in our local region. Now that change is upon us is it will be happening quickly.

The TP landscape will continue to increase in complexity, inviting interpretation as the rules and formulations are not a 'one size fits all'. As a complicated area, TP remains the largest driver of tax disputes and compliance activity. Echoing the themes of this conference, we strongly encourage in-house professionals to consider:

- Having a proactively prepared suite of contemporaneous documentation and 'organic' evidence supporting both the TP analysis undertaken, and the commerciality of related party arrangements
- Developing a strong tax governance framework embedded with and approved by key corporate stakeholders across all of tax, finance, legal and commercial departments
- Implementing appropriate next generation data management tools to ensure integrity of the information utilised to support the transfer pricing policies
- Early and proactive engagement with certain tax authorities.

We look forward to seeing you in person at TP Minds Australia 2022, which will be held in Sydney in May or June next year. If you would like to discuss the topics raised above, or any other transfer pricing related issues, please contact our team using the details provided.

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