Simpler Australian transfer pricing requirements

New Zealand companies with trans-Tasman operations should benefit from recent Australian Tax Office ("ATO") guidance simplifying Australian transfer pricing record keeping requirements.

The aim is to reduce compliance costs for smaller businesses and to ensure that the ATO allocates its audit resources appropriately to higher risk transactions and businesses.

This follows changes last year when the ATO toughened its approach to transfer pricing, including introducing more comprehensive (onerous) transfer pricing documentation requirements. You can read more about those developments here.

For eligible Australian businesses, there will be a reduced need to prepare detailed documentation and, importantly, a lower risk of audit.

The simpler requirements should provide relief for New Zealand businesses looking to expand into Australia or those with small Australian distribution functions. (The low value intra-group service and loan 'safe harbours' will however be applicable for larger taxpayers as well.)

Who qualifies?

In recognition of the additional compliance burden, the ATO has taken conciliatory steps by simplifying transfer pricing record keeping requirements for:

- Small taxpayers – businesses (or groups) with a turnover of less than A$25 million.
- Distributors – distributors (or groups) with turnover of less than A$50 million and a profit before tax ratio of at least 3%.
- Low value intra-group services – where the value is less than A$1 million or less than 15% of total expenses or revenue.
- Low value loans – where total related-party loan balances are less than A$50 million.

However, Australian operations that would otherwise meet one (or more) of the above criteria will NOT be eligible for relief if:

- Incurring losses for more than three consecutive years.
- Involved in transactions with entities in certain (low or no tax) jurisdictions.
- Undergoing a business restructuring.
- Engaging in cross-border related-party transactions involving intellectual property (e.g. royalties or licence fees) or research and development.

What are the simplified requirements?

The ATO guidance reduces the need to prepare detailed transfer pricing documentation if the eligibility requirements above are met and, importantly, emphasises that ATO audit resources will not be allocated to these 'low risk' taxpayers and transactions.

In relation to intra-group services, under the guidance, the ATO will accept a mark-up of up to 7.5% for services provided to an Australian business and 7.5% or more for services provided by that business.

For low-value related party loans received by an Australian business, the ATO will accept an interest rate that is no more than the Reserve Bank of Australia ("RBA") indicator lending rate for '*small business; variable; residential-secured; term*'. The loan must also be AUD denominated.

It should be noted that the simplified requirements do not eliminate the need for an Australian taxpayer to conduct business with its offshore related parties (such as its NZ parent) on an arm's length basis or to file an International Dealings Schedule ("IDS"), if required, with the ATO. Instead, eligible Australian businesses will need to disclose in their IDS the simplified record keeping option(s) that have been adopted.

This new administrative practice will be introduced for an initial period for 3 years (i.e. income years commencing from 1 July 2013 and ending 30 June 2016).

Full details of the ATO's new administrative practice can be found here.

KPMG comment

This latest guidance should provide some relief for New Zealand businesses with qualifying Australian operations. Typically, these will be New Zealand companies looking to expand into Australia or those with small Australian distribution functions. The low value intra-group service and loan 'safe harbours' will however be applicable for larger taxpayers as well, if the service value/loan balance conditions are met.

By way of comparison with New Zealand, the ATO's administrative concession for intra group services is slightly wider than Inland Revenue's administrative practice, which allows for mark-ups of up to 7.5% on non-core services charges up to NZ$600,000. New Zealand will still require documentation for amounts in excess of this safe harbour value.

For related party loans, Inland Revenue will accept a spread of up to 200 basis points above an appropriate base rate (typically this will be a NZ Bank Bill rate) for loans up to NZ$10 million. Based on current interest rates, an Australia subsidiary would be able to borrow up to A$50 million for one year from its New Zealand parent at a rate of up to 7.1% (the current RBA small business lending rate), under the ATO's administrative guidance. In comparison, under the Inland Revenue's administrative approach, the applicable interest rate on outbound loans up to NZ$10 million must not be less than 4.5%.

The potential for a mismatch should be noted if the loan is in NZD as the Australian safe harbour only applies to AUD denominated loans, unlike the NZ safe harbour. In this particular example, assuming the loan is in AUD, the transfer pricing requirements in both countries would be met for loan balances less than around A$9 million (which converts to less than NZ$10 million at current exchange rates). However, foreign exchange rate movements may result in the NZ safe harbour ceasing to applying if the converted loan value exceeds NZ$10 million at any time. There is also scope for the two administrative practices to come into conflict if Australian interest rates drop (or NZ rates rise).

Inland Revenue is planning to review its administrative practices on service charges and low value loans in 2015. Furthermore, Inland Revenue is preparing revised guidance on its transfer pricing focus for the next two years, which will set out its compliance priorities. The statement is likely to be issued in early 2015.

The Australian simplification measures do not waive or limit the operation of the law and there is still the overriding requirement for Australian taxpayers to 'assess [their] compliance with the transfer pricing rules'. It is not clear how this should be evidenced. Potentially, completing the IDS disclosure and electing the simplified option(s) will mean the relevant assessment has been made. In our view, best practice would be for New Zealand businesses to maintain appropriate documentation explaining how their Australian operations meet the eligibility criteria. This does not have to be an onerous exercise. It should cover the nature of the Australian business, its turnover and expenses and, in the case of intra-group services and loans, the key terms, interest rate/mark-ups applied, and cost base and benefits received (in the case of service charges).

New Zealand businesses should also bear in mind that they will still need to comply with domestic transfer pricing requirements.

Transfer pricing record keeping for non-eligible taxpayers

For those not eligible for the simplified record keeping requirements discussed above, the ATO has finalised its view on the transfer pricing documentation that will need to be mainlined to establish a 'reasonably arguable position'. Complying with this standard is necessary to reduce penalties, in case of a transfer pricing adjustment.

Further guidance has also been provided on the new transfer pricing 'reconstruction' powers available to the ATO. The ATO has indicated that the analysis of the potential reconstruction does not need to be extensive, for simple transfer pricing transactions for which comparable third party transactions exist. This reinforces the view that commercial and financial relations are relevant when determining arms-length conditions.

This ATO's finalised view on transfer pricing documentation and reconstruction is available here.

KPMG comment

The additional guidance on how the ATO will look to apply its new transfer pricing documentation and reconstruction powers is welcome. KPMG Australia's commentary on these development is available here.

From a New Zealand perspective, the latest guidance does little to mitigate the additional compliance costs for Australian operations of New Zealand businesses which do not fit within the small taxpayer or distributor framework above. For those businesses, the legal form and substance of Australian arrangements will need to be regularly monitored for mismatches. It will not be possible to treat the preparation of Australian transfer pricing documentation as an irregular event.

We consider it best practice to consider the Australian transfer pricing position in tandem with the New Zealand position, to ensure both are consistent, well supported and regularly documented.

Further information

If you would like to discuss these Australian transfer pricing developments in greater detail, please contact your regular KPMG advisor or:

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