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The Secretary
Review of Business Taxation
Department of the Treasury
Parks Place
CANBERRA ACT 2600

Dear Sir,

REVIEW OF BUSINESS TAXATION DISCUSSION PAPER
TRANSFER PRICING - DOCUMENTATION AND PENALTIES
FRINGE BENEFITS TAX - MOTOR VEHICLES

Through a number of associations of which Nissan is a member, submissions are being made on a number of key issues raised in the Discussion Paper. However, Nissan considers that a much more thorough analysis is required on the above areas of reform .

Summary points:

1. To avoid any measures which seek to apply a "zero tolerance" regime whereby taxpayers who may not have the required documentation to support their transfer prices are fined notwithstanding the transfer prices satisfy the arm's length principle.

On the international front, imposing "black letter" law requirements on taxpayers to retain documentation have shown to be arbitrary and only barely workable with a series of screening committees enacted by legislation to adjudicate on penalty cases. The reality is that such penalty measures create unnecessary disputes between taxpayers and revenue authorities in a number of Australia's treaty countries. The only workable regime would be to have simple set of rules on documentation to meet a minimalist standrad which is critical to supporting the transfer prices in international transactions. Anything approaching the US example will be unfair and unworkable *(33.61)*.

2. To avoid prescriptive legislative rules on the selection and application of pricing methodologies. To do so, the Government would be, in effect, telling companies how to

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set transfer prices and what they can and can't negotiate in business. Again a minimalist standard should operate. Otherwise it could get to the stage which existed in the late 1970s and 1980s where export coal companies required Government approval in negotiating export prices with arm's length parties and would call Government officers in the middle of price negotiations to check if a certain price is acceptable (*33.45).*

3. On balance, it is better to continue with the existing approach where the Commissioner issues public rulings as to his views and expectations and for taxpayers to have regard to them but to be able to set and test their transfer prices against the OECD's arm's length principle. The current Schedule 25A asks sufficient questions on documentation and methodologies which must be signed off by the public officer of the company. This puts taxpayers on notice and still allows the Commissioner of Taxation (C of T) to audit the high risk taxpayers and raise assessments, if necessary.

Based on tax rulings issued, some of the expectations of the C of T on documentation and commercial behaviour are, frankly, unrealistic and unnecessary for compliance with the arm's length standard. Putting them into law will require every taxpayer with international transactions whether with related and/or unrelated parties to compile documentation which is, in effect, a convenient audit trail for tax auditors but at a large (and unnecessary) cost to businesses *(33.44 -45).*

4. Support for going to a self assessment basis for transfer pricing with the provisions to protect taxpayers against double taxation rather than to provide any more powers to the C of T to "beat up on" Australian taxpayers. Taxpayers who test their transfer prices and want to make adjustments to their tax return should be able to increase or **decrease** taxable income (or adjust tax losses) (*33.44).*

5. To support domestic laws to address the gap on corresponding relief for double taxation. For too long senior tax officers in Canberra have taken a literal approach on the law to where taxpayers with genuine double tax situations could not obtain tax relief in Australia because the tax laws were viewed as deficient. A casual reader need only read the Commissioner of Taxation's 1995 ruling on correlative adjustments to relieve double taxation to know that the Commissioner puts too many hurdles in front of taxpayers before he will grant tax relief. The Australian competent authority's track record in the last ten years on granting tax relief to deserving taxpayers is disappointing and shows reluctance to help taxpayers with genuine cases *(33.46).*

6. The trade off for removing FBT on entertainment to increase FBT on vehicles reflects a lack of understanding and feel of the contribution to the Australian economy that employment supplied vehicles provide. The BTR group values appear such that they consider "free" lunches and a company paid holiday for employees earning over $70,000 remuneration should be tax free and to increase the tax on a vehicle supplied to a trade person or sales person which travels 40,000 km a year with over 75% of that distance being business km.

The paper lacks any regard to recent history where, prior to the 1985 changes on entertainment, the abuses by taxpayers such as charging private living expenses to "business" entertainment were prevalent. If this change is enacted, these practices will reappear in a more sophisticated form *(Chp 38).*

7. Vehicles already provide more than its fair share of tax to Australian Governments and the proposed increase is equivalent to taxing vehicles like an exotic consumer product and not as a necessary tool for getting business done. An enclosed analysis shows that the tax take on a $38,000 vehicle with a four year lease will go from the current 103% of retail price to up to 164% under the proposals.

It is misleading for the BTR paper to state that vehicles are concessionally taxed when the reality is otherwise. The motor vehicle industry extends beyond manufacturers and importers' business and covers suppliers, service providers, dealers, service stations etc. and it is these employers who will suffer reduced sales and profits and, in turn, result in retrenchment of staff.

The FBT formula put forward should not read:

FBT on Entertainment + Parking = FBT on Vehicles but

Proposed FBT increases on vehicles = Less vehicle sales + less sales turnover of motor dealers, suppliers and local manufacturers + reduced profits of employers + reduced tax revenue + unemployment.

The revenue estimates provided in the Report are deficient in measuring the revenue and economic impact of reduced vehicle sales.

A more thorough investigation covering taxation revenue collections, economic and equity issues is needed before any contemplation should be given to any of the FBT measures *(Chapter 38).*

Items 1 - 3 Transfer Pricing Documentation 33.61

The solution expressed in para 33.61 to impose penalties on taxpayers who don't keep the exact amount of documentation on transfer pricing presupposes that taxpayers who have less documents must be avoiding tax.

An initial reaction is that the BTR team members were becoming tired by the time of writing Chapter 33 and had not thought through the issues or that the ATO had imposed their will on the BTR team promising revenue to be gathered by way of penalties. However, this view cannot be correct as views expressed elsewhere in the report show original thought.

The BTR team should recall that setting of transfer prices and their testing against the arm's length standard is not an exact science. Each company group has its own procedures and approaches in setting transfer prices. Different performance measures exist amongst companies, even within industries, and a diversity of corporate business cultures and practices exist in Australia. To seek to restructure these diverse practices into a regulatory format by a Parliament will only place unnecessary costs on business.

Taxpayers are in the best position to assess whether their transfer prices are arm's length and the European revenue authorities' test of the "reasonably prudent businessman" on documentation in support of transfer prices is what should apply not some prescriptive test where, if a taxpayer does not keep the exact list of documents, it will face a stiff penalty.

Any legislative rules to impose penalties on transfer pricing documentation really miss the point. It is whether the transfer prices meet the arm's length standard as implied or stated in Division 13 of the Income Tax assessment Act (ITAA) and the OECD's Article 9 equivalent in our Double Tax Treaties (DTA) which is the valid issue. Taxpayers should not be required to keep extraneous documents which have negligible bearing on pricing.

Division 13 and the DTAs focus on whether the pricing is right not on documentation kept. It should stay that way.

Australia already has some detailed tax rulings on documentation, TR 97/20 and TR 98/11. These rulings set out the ATO's expectations and surely that is where the line should be drawn. The current Schedule 25A International Transactions asks public officers to sign statements that they hold certain documentation to support their transfer prices. If they make false statements, then the ATO can recommend prosecution for making false statements which is sufficient deterrent in itself.

Also, should the C of T consider a taxpayer to have incorrect transfer prices after examination of what documentation is held, the C of T can raise assessments and both parties can test the matter in the Courts.

There is no need to have Parliament replace the above approach with a rigid list of documents and penalising taxpayers when they fail on one or two when, in fact, the real test is whether the transfer prices are at arm's length. Its inconceivable that taxpayers will be penalised if they don't have every skerrick of the specified documents in these rulings but their transfer prices do meet the arm's length standard.

To illustrate, the ATO's rulings expect taxpayers to set down a full functional analysis of the organisation where every function and economic risk faced must be documented and commented upon and that the rejection and selection of pricing methods in setting transfer prices is to be detailed eg. refer the four step process in TR 98/11 (paras 5.17 - 5.100). The reality is taxpayers dealing with unrelated parties do not go through such a pointless exercise but the Report recommends that those who have related party dealings must do so. I challenge the ATO to provide the BTR team with evidence of even one taxpayer who deals exclusively with overseas unrelated parties to provide even half of the documentation listed in these rulings.

Will the proposed measures change taxpayer behaviour? Probably yes because taxpayers want to avoid disputes and will engage accounting / law firms to do the work to avoid penalties. It won't alter how they do business overseas as commercial factors influence transfer prices.

What is not clear is whether taxpayers who deal with unrelated parties but may not achieve arm's length prices because of collusion will be required to comply.

Before any contemplation is given to recommending the prescription of documentation and methodologies in law, the BTR group should consider the views expressed in articles in the authoritative journals on Transfer Pricing, *Tax Management Transfer Pricing Report and Tax Notes International.* When, in 1993, the US Government brought in their draft transfer pricing regulations on documentation and penalties, there was incisive public comment on their deficiencies and that minute details would be required to cover all permutations and combinations. *Refer Attachment 1.*

The comments on the problems faced on the documentation regulations are made by well regarded tax practitioners and economists in transfer pricing as well as ex-Internal Revenue Service officers. These are highlighted in the enclosed selection of articles in the above journals covering 1993 - 1995 when the US regulations were being introduced. Even now, US businesses continue to find these regulations exasperating in trying to comply.

One issue is that comparables data can often not be available before lodging a tax return. In Australia, taxpayers (depending on their tax liability) can be required to lodge about 6 months after year end. The published Australian and overseas financial and analysis data on comparables may not be available by the time of lodgement. Taxpayers would face fines because of practicable difficulties in obtaining the latest data. Any documentation legislation in Australia, unless very simple, would have many practical compliance difficulties. The Report is strangely quiet on such matters.

The BTR Report's comment that a simple regime could operate is frankly naive. It can't be simple unless the Government wants to have minimalist expectations. A minimalist approach is the only workable solution. Anything else will result in practical compliance problems leading to disenchantment of business with Government . You are also referred to the regulations existing in treaty countries France, UK and Denmark which have also shown to be a focus of dispute between taxpayers and the Revenue. *Refer to Attachment 2 for details.*

Finally, the statement on p. 710 that inadequate documentation means no reasonable argument exists is trite. The *reasonable arguable* test is an Australian - invented

statutory test of *interpretation* in determining whether a 25% tax penalty applies to a disputed tax item being that an argument is more likely than not to succeed in a Court.

It is a quantum leap in sound thought for the Report to say that if a taxpayer does not retain every item of documents, then its substantive argument on the adequacy of the transfer prices is not "reasonably arguable". The current political thinking that "zero tolerence" to defeat problems is not appropriate in the area of transfer pricing.

Item 4 Self Assessment extended to Transfer Pricing 33.44

In principle, it is supported as taxpayers can adjust their tax returns to reflect their transfer pricing analysis. The changes could permit taxpayers to increase and decrease taxable income (or tax losses).

The basis philosophy should be not to protect the Revenue but to provide a balance for taxpayers and the Revenue.

Taxpayers who take unreasonable positions without evidence or arguments on file should face tax penalties but they should not have penalties imposed (apart from interest penalty) if they have sought to comply with the laws.

Item 5 Competent Authority Relief - Correlative Adjustments 33.46

The deficiencies in the domestic law to provide valid double tax relief when a treaty country makes a transfer pricing adjustment has obviously been well documented by the BTR group.

Part of the problem has been the reluctance by the senior ATO Head Office personnel who were the nominated competent authorities to find solutions to help taxpayers with genuine cases of double tax relief. The ATO fall back position has been the domestic law does not permit it to provide relief and "sorry we can't help".

The ATO 1995 tax ruling (TR 95/D31) on 'correlative adjustments' by ATO competent authorities reflects an official approach of "we will do our best" but in the next breath outlines a number of impediments which face taxpayers.

This even extends to denying a tax deduction under the general deduction provision (sec 8-1 of the ITAA 1997) where an overseas related party has been adjusted under its own domestic laws and/or the DTA on transactions with Australia and seeks to pass on the adjustment to the Australian entity. The ruling states that no tax deduction is allowable notwithstanding the liability is passed onto the Australian entity. In practice, the ATO "shrugs its shoulders" and "shakes its head" and says ' we can't help as the law is deficient."

Any changes to the law should be to accentuate helping taxpayers getting tax relief. Protecting the Revenue should be secondary.

Item 6 and 7 - FBT on vehicles Chapter 38

The trade off by removing FBT on entertainment by increasing FBT on vehicles is unacceptable.

The logic applied to support the option is deficient and lacks a wider understanding of the impact in terms of employment in the motor industry, the economic multiplier effect for every vehicle sold in Australia and already heavy taxation on vehicles. What the Report proposes is to overtax all vehicles whilst encouraging employers to provide their employee with "free lunches" for the year.

Attachment 3 provides two examples of the taxation of vehicles, one retailing for $38,000; the other for $100,000 under a GST regime with and without changes to FBT.

Vehicle retails at:	**Current**	**FBT 20% business**	**50% business**
$38,000	$31,004	$46,507	$54,258
% of price	*82%*	*123%*	*143%*
Including all state/federal taxes	*103%*	*144%*	*164%*
$100,000	$82,224	$123,336	$143,892
% of price	*82%*	*123%*	*143%*
Including all state/federal taxes	*113%*	*154%*	*175%*

Assume four year lease by employer and vehicle provided to employee. Annualised travel of 15,000 - 24,999 km = 20% of taxable value. Taxable value = Retail price including GST less stamp duty ($470 per Victorian rates). FBT = Gross up 1.9417 x FBT rate 48.5%.

Based on the table vehicles are already paying their fair share of tax and the FBT proposals seek to take that taxation to prohibitive levels.

The Report at Chapter 38 seeks to argue that employer expenditure on the following should be FBT free concerning their employees:

- Holidays for employees especially world trips for executives and their families and for weekends at seaside resorts with entertainment facilities for all the family
- Dinners at expensive restaurants in Australia and overseas countries
- Ocean cruises for employees and families

- Corporate golfing holidays for employees and families

- Tours of Australian and overseas favourite sights

- For tightly controlled companies, the private lifestyle of the owners and their families will be paid for by the employer but the cost is non-deductible of the expenses.

The Report's pithy comment that the rules would be tightened on entertainment lacks credibility as there are no specific recommendations made to support the statement.

By contrast, the provision of vehicles especially in the employer fleet area is to provide vehicles for essential business travel and for travel to and from work. Salesmen travelling in rural areas would attract more FBT on his/her vehicle as there would be more Km travelled than a person using the vehicle just for home to work/return and weekend travel. The Government would be taxing the productivity of the salesman who travels to his clients to generate sales.

It is difficult to understand how the Report would fail to comment on these areas. Either there is a deficiency in thinking by the team or it is a deliberate omission.

Other comments made and questions asked:

- Does the $305 M cost to remove entertainment from FBT account for the loss of tax deductions otherwise available to employers in their income tax returns?

- With the increased taxation of vehicles, employers will remove vehicles from the remuneration menu. Less vehicles sold to employers means less FBT, GST, import duty, stamp duty, payroll tax collected by Government. Has any analysis been completed to estimate the revenue shortfall bearing in mind that over 2/3 of vehicles subject to FBT are locally produced ?

- A key premise of the paper is that fringe benefits would be taxed in the hands of employees. Do the Report's comments on FBT still have validity if fringe benefits are still taxed in the hands of employers at 48.5%?

- No comment is provided of the economic fall out in terms of sales, employment etc in the motor industry through the fall in vehicles provided by employers due to the disincentives per the proposals. This covers local manufacturers and importer /distributors to parts suppliers and dealers.

On car parking, the car parking offered by employers to employees which is off premises (due to space restrictions in their building) would not be exempted from FBT but the persons with on premises parking would be exempt. It is difficult to understand the thinking here. It seems like an example of taxation apartheid.

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ATTACHMENT 1

A selection of articles in Tax Management Report - Transfer Pricing and tax Notes International (two respected US tax journal) concerning the 1994 US regulations to specify documents taxpayers dealing with overseas related and unrelated parties are required to retain and produce to the Internal Revenue Service (IRS) within 30 days.

The articles feature interviews with IRS officers, senior tax practitioners and commentary by experienced tax authors. They cover 1994 - early 1997 period.

The comments contained show the detail of the regulations, the unfairness to taxpayers, the response of the IRS to set up administrative and legislative mechanisms for penalty review.

20/7/94	Extract of the penalty and documentation regulations
8/6/94	Interview with IRS's J DeGrosky
22/6/94	Comments by Industry bodies, professional associations
25/7/94	Comments by S Hannes
25/7/94	Comments by G Carlson et al
7/5/95	Comments by American Bar Association Committees
6/9/95	Feature article by M Tropin
20/9/95	Comments by IRS and G Ballentine et al
4/10/95	Interview with IRS's J Dougherty
16/1/95	General Motors open letter to the IRS
30/11/96	KPMG Transfer Pricing update
29/1/97	Interview with IRS's J Lyons

ATTACHMENT 2

Documentation Regulations

Australia	**Tax Rulings TR 94/14, TR 97/20, TR 98/11**
Canada	**Section 247. Information circular 98-2R**
Denmark	**Sec. 2 of the Income Tax Assessment Act, sec 38 of Tax Control Act**
France	**Article 57 (CGI), Articles L138 and L188A (LPF)**
UK of the	**Prior to 1.7.1999, secs 770-773 of the Income and Corporations Taxes Act; post 1 July, Schedule 28AA Corporation Taxes Act**
USA	**Sec. 6662(a) of the Internal Revenue Code and regulations**

ATTACHMENT 3

FEDERAL AND STATE TAXES IMPOSED ON VEHICLES IN A GST ENVIRONMENT

Two examples:

1. **Retail price of $38,000**

2. **Retail price of $100,000**