

Australian Transfer Pricing: Implications of the recent SNF judgment

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9 November 2011

Topics

- Transfer pricing background
- SNF
- Unresolved issues

- Current Div 13 introduced in 1982
- Section 136AD(1)-(3) requires:
 1. an international agreement
 2. parties not dealing at arm's length
 3. non-arm's length consideration
 - based on consideration that an independent party would have paid in the similar circumstances
 - Second reading speech referred to:
 - the traditional transaction methods
 - 1979 OECD Transfer Pricing and Multinational Enterprises Report
 4. the Commissioner's discretion

- Section 136AD(4) allows the Commissioner to determine arm's length consideration if it is not possible or impracticable to determine the arm's length consideration
- Onus of proof is on the taxpayer

- 1995 Transfer Pricing Guidelines
 - Profit methods introduced but with last resort status
 - The TNMM has been the most commonly used method for some time
 - Comparability analysis
- 2010 Transfer Pricing Guidelines - the profit methods given equal status

- Article 9 uses different tests
 - applies to associated enterprises
 - allows for profits to be adjusted
 - provides for corresponding adjustments
- OECD Commentary on Article 9 states that the conclusions on transfer pricing are contained in the Transfer Pricing Guidelines

SNF

- Taxpayer, SNF (Australia) is a member of the SNF group with a French parent company
- The SNF group carries on the business of manufacturing and selling industrial chemicals called polyacrylamides
- Taxpayer purchased products from associated enterprises in France, US and China and distributed them products in Australia
- Its customers were mining, paper manufacturing and sewerage treatment industries

SNF: First instance

- Commissioner sought adjustments for the 1998-2000 and 2002-2004 years in which the taxpayer made losses
- Commissioner issued assessments under:
 - s 136AD(3): excessive consideration
 - s 136AD(4): arm's length consideration cannot be ascertained
 - Art 9 of the Australia- France, US and China tax treaties
- Middleton J saw some merit in the Commissioner's Article 9 argument but the case was argued on the basis of Div 13

- Taxpayer claimed the losses were due to:
 - intense competition
 - poor management
 - employee fraud
 - excessive stock levels
 - low sales per person
 - bad debts
- And not from excessive transfer prices

- Transfer pricing disputes turn on which expert evidence is accepted by a court
- Taxpayer relied on internal CUPs in proving that the transfer prices paid were less than arm's length prices
- Commissioner applied the TNMM and concluded that the taxpayer should have had an average net profit to sales of 1.7%

- Middleton J rejected the use of the TNMM for determining arm's length consideration
 - conflicts with the terms of Div 13
- Middleton J concluded that the taxpayer had paid consideration which was less than the arm's length amount

SNF (Full Court)

- Commissioner's appeal was dismissed
- The Full Court found that the process by which the trial judge approached his findings of fact disclosed errors
- But a review of the evidence does not lead to a different conclusion

- Commissioner argued that:
 - Trial judge made errors of fact
 - Trial judge erred in accepting evidence that the French supplier made losses (‘outburst’ evidence)
 - Trial judge erred in interpreting the meaning of ‘arm’s length consideration’ in s 136AD(3)
 - Taxpayer could only use as comparable transactions those in which the purchasers were making losses

Comparable transactions

- Taxpayer used 3 sets of comparable transactions:
 - foreign comparables based on product groups
 - comparables in Aust and NZ
 - Mr Seve's (KPMG) comparables for individual products
- First set of comparables prepared by SNF France on the basis of sales to independent buyers for the same product groups
 - adjustments made to deal with differences

- Comparability was based on the existence of a global market for the products
 - the products were high-volume industrial chemicals used in worldwide industries and were transportable
- Table (para 66) shows that the taxpayer's prices were lower than those of comparable independent buyers
- The trial judge's made errors in dealing with the comparables, such as whether the purchasers were distributors
- The Full Court found that the first and third set of comparables were appropriate and proved that the taxpayer paid less than the arm's length price

- Commissioner's arguments on s 136AA(3)(d), the meaning of 'arm's length consideration . . . between independent parties dealing at arm's length'
- In the context of s 136AD(3) the words do not mean that the comparables must be loss-making distributors (perfect comparables)
 - not supported by the Guidelines
 - the threshold requirement would be impossible for the taxpayer to satisfy

- The Full Court found Guidelines are not a legitimate aid in the construction of Article 9
- Nevertheless, the comparability under Div 13 was based on the Guidelines

- Full Court concluded that the Commissioner had incorrectly applied s 136AD(4) as there were comparable prices
- Court rejected that the argument that the consideration must be one price; all that is required is that the taxpayer established it paid arm's length prices

Conclusions

- The Full Court decision provides principles for determining comparability based on the Guidelines
- The Full Court's approach was balanced and practical
- SNF's losses were caused by inefficiency and not excessive transfer prices
- But the case was exceptional as there were internal CUPs
- SNF adjustments in France, US and China?

Unresolved issues

- Can the TNMM be used?
- Does the Commissioner have a separate assessing power under Article 9?
- Should Div 13 be amended?
 - OECD issued draft transfer pricing legislation in June
- What is the status of the Commentary on Article 9?
- Should Australia enter into agreements with treaty partners on the 2010 Guidelines?

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- On 1 November 2011 the Australian Government announced that ‘it would introduce changes to the existing transfer pricing rules to bring them in line with Australian and international developments in the area’
- On the same day the Treasury issued a Consultation Paper on proposed amendments to Australia’s transfer pricing rules