

Transfer pricing has traditionally been regarded as a practice in larger businesses and organizations, however as Australian SMEs increasingly look at expanding overseas, the ATO is warning small business owners to be aware of potential tax compliance issues and risks.

What is transfer pricing?

In its most basic form, transfer pricing refers to the process of setting prices to be charged between affiliated parties for the supply and acquisition of goods or services between those parties.

For example a business with an offshore entity and an Australian entity would be considered separate and distinct entities for calculating profit, despite the fact that they may be one and the same organization.

Transfer pricing may be used to reduce Australian assessable income or increase allowable deductions under Australian tax.

Why do businesses use transfer pricing?

A simple illustration is an Australian resident for tax purposes that might sell property at a low price to an affiliate in a low tax country, which in turn sells the property at its market price.

A second example might be that an Australian resident might purchase property from a foreign affiliate at a high price, then sell it locally at market price.

A third example may be inter-group management or service fees, which may be inflated or deductions attributed to the overseas entity might be borne by the Australian resident entity without re-charging to the relevant entity.

Transfer pricing may be an effective method of profit-shifting where separate entities are involved however it may also occur where there is only one entity with a number of branch operations.

What's the ATO's position on transfer pricing?

The ATO has been devoting significant resources to the enforcement of transfer pricing rules, with the result being a large number of lengthy public rulings of various aspects of the fundamental – but very elusive – concept of arm's length pricing.

Like many revenue authorities around the world still developing their transfer pricing audit skills, the ATO is keen to capture what they regard as their proper share of tax on profits arising from the increasing volume of international trade – especially in services and intangibles.

Why is transfer pricing relevant to SMEs?

The ATO sees transfer pricing as a continuing compliance risk for SMEs with a turnover of less than \$250 million.



In July 2010, the OECD released an updated report, **Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration**, which discussed the arm's length principle and a number of acceptable methodologies for determining transfer pricing.

Member countries unanimously accepted these concepts, which has implications for cross-border tax strategy and international taxation for companies who are expanding offshore (or into Australia).

The compliance risk for Australian SMEs has prompted the ATO to undertake 25 transfer pricing review, 8 transfer pricing audits and to contact at least 200 SMEs about these issues. Their plans include addressing the range of international tax issues, including those associated with international shipping operations.

A spotlight on SME transfer pricing risk

The ATO will be contacting SME taxpayers about reporting obligations relating to transfer pricing and the new International Dealings Schedule (IDS). The IDS requires extensive disclosures of internal related party transactions including the level of transfer pricing documentation, which requires taxpayers to disclose information regarding their international dealings with related parties.

The focus will be on the level of transfer pricing documentation that is held to support the arms' length nature of those dealings. The 2012/13 compliance program also emphasizes the value of the simplified APA (advance pricing agreements) product available to SME taxpayers as an avenue to manage transfer pricing risk and gain certainty in respect to future transfer pricing arrangements.

Get advice

Transfer pricing is complex and – as mentioned above – in the ATO's crosshairs for ensuring compliance with Australian tax law. Contact us on 02 9957 4033 to discuss transfer pricing as part of your International taxation and cross-border strategy.

