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# Transfer Pricing and Thin Capitalisation in Australia

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# Introduction

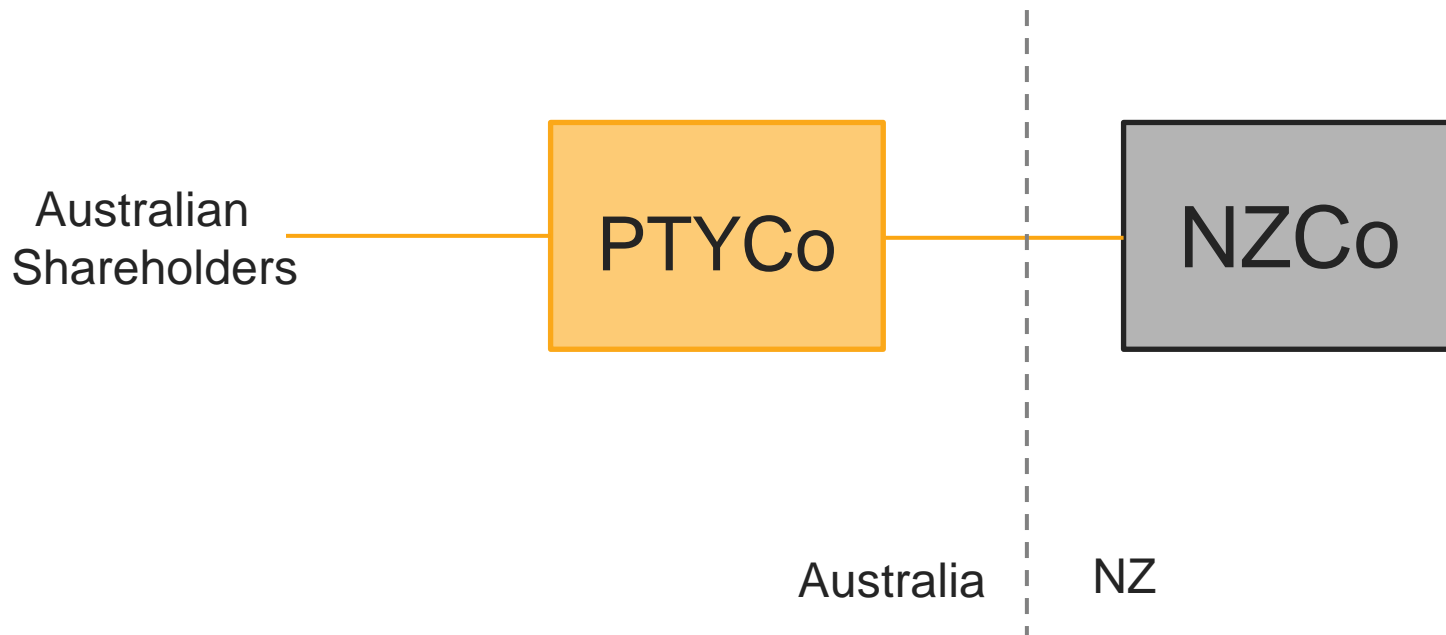
- Australia has specific tax rules dealing with:
  - Thin Capitalisation; and
  - Transfer Pricing

# Thin Capitalisation

- The Thin Capitalisation rules apply to both inward and outward investing entities
- The rules operate to limit debt deductions (e.g. interest) where thresholds and ratios are exceeded
- A *de minimis* rule applies – where annual debt deductions are less than \$250,000\*, the ‘thin cap’ rules do not apply

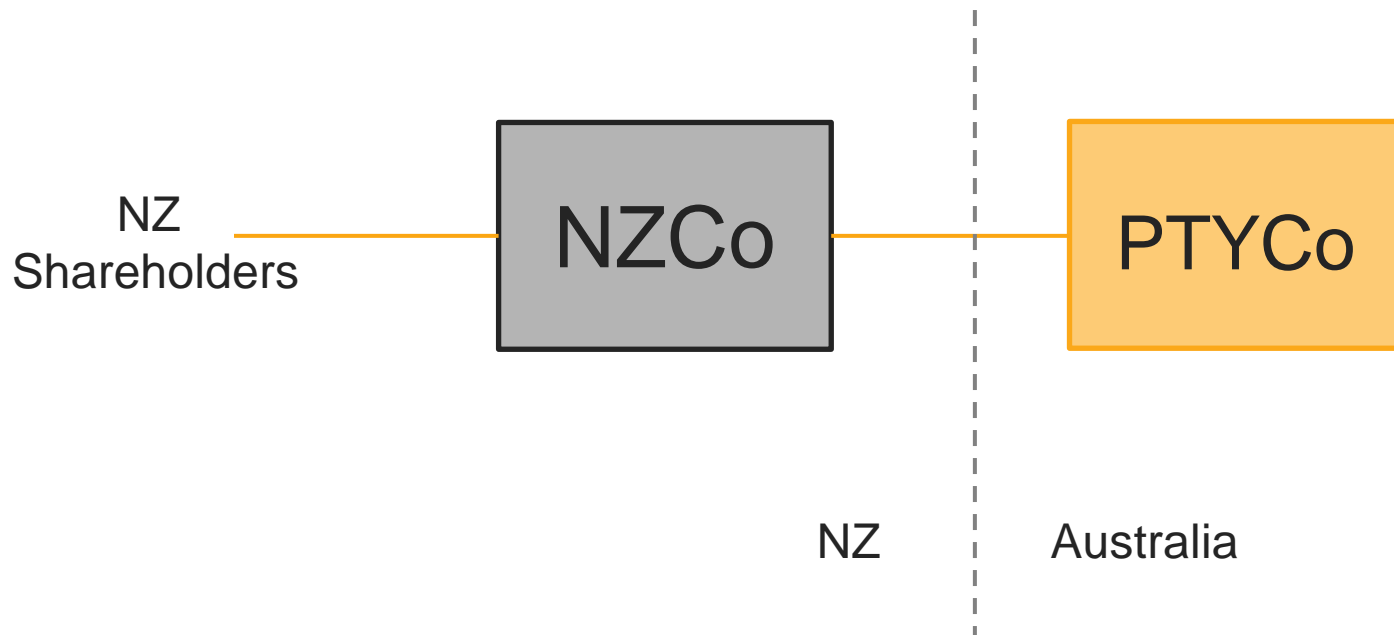
# Thin Capitalisation

- Outward investor:
  - e.g. PTYCo owns a NZ subsidiary, NZCo



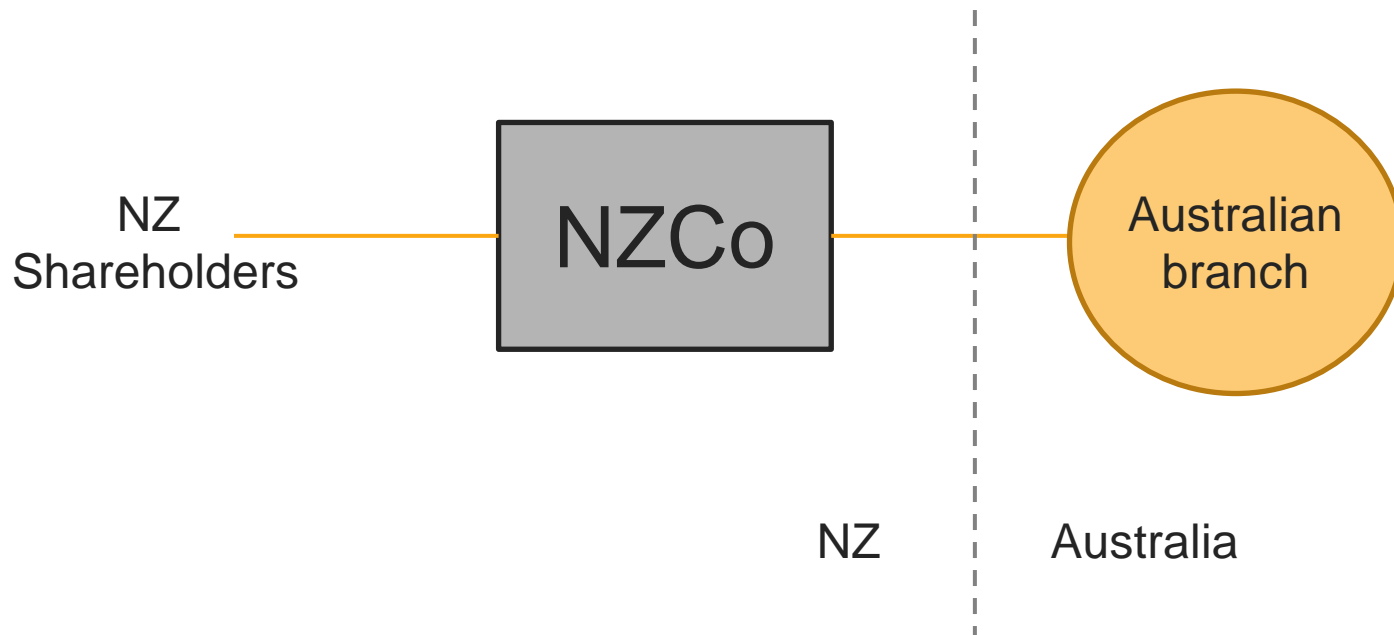
# Thin Capitalisation

- Inward investment vehicle:
  - e.g. NZCo owns an Australian subsidiary, PTYCo



# Thin Capitalisation

- Inward investor (general) :
  - e.g. NZCo has an Australian branch

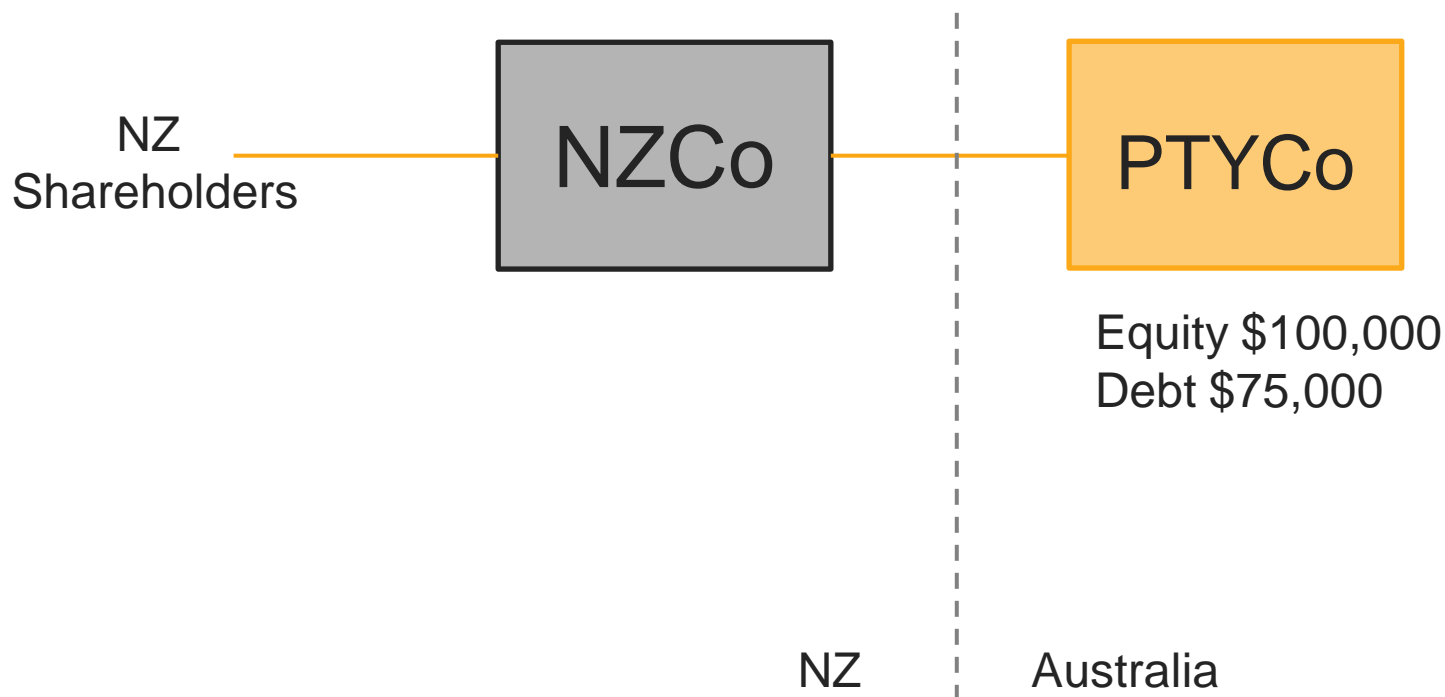


# Thin Capitalisation

- For NZ residents doing business in Australia, we will limit comments to inward investors.
- Debt deductions are denied if:
  - adjusted average debt > maximum allowable debt
  - where, maximum allowable debt is the greater of:
    - The safe harbour debt (75%\* of average value of Australian assets, adjusted for equity in and debt owed by, associates); and
    - The arm's length debt amount (the amount that could have been borne by an independent party under the same conditions)

# Example

- Inward investment vehicle:





# Example

- Inward investment vehicle with:
  - Equity = \$100,000
  - Debt = \$75,000 (interest bearing)
  - Thin Cap N/A - as *de minimis* will apply
- Assume *de minimis* threshold exceeded:
  - Equity = \$10,000,000
  - Debt = \$7,500,000 (interest bearing; interest approx \$375K)
  - Thin Cap N/A – as within safe harbour (75% of assets)
  - If \$10m interest bearing debt, interest deductions denied on \$2.5m (debt above \$7.5m) unless amount meets arm's length debt amount

# Thin Capitalisation

- \* Note: May 2013 Budget
- Proposed changes to thin cap rules, namely:
  - to increase the *de minimis* threshold to \$2m of debt deductions
  - to tighten the safe harbour limit to 60%

# Thin Capitalisation

- The thin cap rules:
  - operate in conjunction with the Transfer Pricing rules
  - Applies across taxpayer types including companies, trusts, partnerships and individuals

# Transfer Pricing

- Australia has domestic tax rules for transfer pricing
- The rules apply to 'related party international dealings'
- Adopts the 'arm's length principle'
- Objective is to ensure that Australian businesses do not underpay Australian tax compared to truly independent businesses

# Transfer Pricing

- Where transactions are not arm's length the ATO can reallocate income or adjust deductions by substituting arm's length consideration for the international transactions
- Applies to transactions between entities and also to branches or divisions of the same entity

# Transfer Pricing

- Australia looks to the OECD Guidelines on Transfer Pricing particularly with regard to accepted methodologies
- The ATO has issued a number of public rulings setting out the ATO view with regard to pricing, methodologies and documentation
- The ATO accepts a simplified approach to documentation and risk assessment for small to medium businesses (those with a turnover less than A\$100m)

# Transfer Pricing

- Entities that have international related party dealings above \$2m pa are required to complete an International Dealings Schedule:
  - When completing this schedule entities must indicate the pricing methods chosen and the level of documentation support maintained for such transactions
  - Contemporaneous documentation

# Transfer Pricing

- Advanced Pricing Agreements (APA's)
  - Multinationals looking for certainty on intra-group pricing can enter into an APA
  - This would allow the ATO (or the ATO and the relevant overseas revenue authority) to agree on the basis of pricing dealings between Australia and international jurisdictions



# Transfer Pricing/Thin Cap in Australia

Thank You

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