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1.0 USE OF THE SELF ASSESSMENT RISK PRODUCT

The Australian Taxation Office (ATO) has developed this self assessment risk product to assist taxpayers to evaluate their risk of transfer pricing audit. The product provides taxpayers with an understanding of the manner in which the ATO evaluates the quality of transfer pricing documentation and the commercial realism of outcomes in line with the four steps recommended in Taxation Ruling TR 98/11.

Understanding the ATO approach enables a taxpayer to test the adequacy of its transfer pricing processes and outcomes in a cost efficient manner and establish whether it is necessary to take any further action in order to reduce the risk of a transfer pricing audit.

The product is designed to assist taxpayers who do not need the level of certainty provided by entering into an Advance Pricing Arrangement (APA) but nevertheless wish to obtain some level of assurance about the arm's length nature of their international related party dealings based on their transfer pricing documentation.

This product is designed primarily for use by taxpayers with:

- less complex transfer pricing arrangements and lower levels of international related party dealings
- a single line of business (for example distributors or service providers) where transfer pricing arrangements may be viewed on a 'whole of entity' basis
- taxpayers with annual turnovers less than \$250 million or other companies with low levels of international related party dealings¹.

Where a company has high levels of international related party dealings or complex or multifaceted transfer pricing arrangements in place it will be more appropriate to consider one of the alternative products available from the ATO.

This product replicates the process set out in TR 98/11 and used by ATO auditors in assessing the risk of an audit of transfer pricing outcomes and allows a taxpayer to evaluate its risk of audit by the ATO. It allows a taxpayer to evaluate its risk of transfer pricing audit in three stages:

Stage 1: Evaluate the quality of its transfer pricing documentation.

Stage 2: Evaluate the commerciality of its profit outcomes.

¹ For purposes of this product, low levels of international related party transactions are considered to be where the taxpayer satisfies the following conditions:

- i) international related party dealings involving the purchase or sale of tangible goods do not exceed \$150 million annually
- ii) international related party dealings involving the provision or receipt of routine services do not exceed \$50 million annually
- iii) international related party dealings involving intangible property do not exceed \$10 million annually.

Stage 3: Based on results from Stages 1 and 2, evaluate the risk of an ATO audit of transfer pricing outcomes.

After completing the self assessment process, a taxpayer should be in a position to evaluate its transfer pricing risk profile and decide whether it may be possible to lower its risk profile by either supplementing its documentation with additional information or addressing the commerciality of profit outcomes. However, the ATO cannot guarantee that it will ultimately agree the documentation quality rating reached by a taxpayer using this product or the transfer pricing risk rating.

2.0 ASSESSMENT OF DOCUMENTATION QUALITY

The starting point for using the self assessment risk product is the taxpayer's transfer pricing documentation.

2.1 Using the documentation checklist

The first step is to evaluate the documentation against the checklist contained in section 4 of this document to establish a documentation quality rating.

The checklist is structured to examine the quality of the taxpayer's documentation for each of the steps contained in the ATO's four step process discussed in TR 98/11:

- Step 1 Accurately characterise the international dealings in the context of the business.
- Step 2 Select the most appropriate transfer pricing methodology.
- Step 3 Apply the most appropriate method to determine an arm's length outcome.
- Step 4 Implement support processes to ensure adjustment for material changes.

The taxpayer evaluates its documentation by reference to criteria for each step, as follows:

- adequately addresses
- inadequately addresses²
- does not address, or
- not applicable for the taxpayer's circumstances.

At the end of each step in the checklist, the taxpayer is required to make an assessment of the documentation quality rating for that step as:

- low quality
- low to medium quality
- medium quality
- medium to high quality, or
- high quality.

² 'Inadequately addresses' indicates that there are material omissions from the expected subject matter for that aspect of the documentation.

A description of the quality ratings is contained at the end of each step in the checklist in order to assist a taxpayer in arriving at the score for that step.

After rating the documentation against each of the four steps contained in the checklist, it is then necessary to undertake the overall evaluation of the quality of transfer pricing processes and documentation contained at the end of the checklist. The checklist provides guidance on how overall documentation quality should be evaluated in the light of ratings achieved for each of the four steps, including a suggested weighting of the steps.

2.2 Overall documentation quality rating check

A reliability check for the overall documentation rating derived from the checklist may be obtained by using the following descriptions as guidance for overall documentation quality.

Low quality processes

Low quality cases are those where there is no process in place or documentation to check the selection and application of transfer pricing methodologies for tax purposes. In these cases the consideration for the dealings usually has been set without regard to the interests of the Australian party (paragraph 4.13 of TR 98/11).

Low to medium quality processes

In some cases there may be some contemporaneous documentation but no analysis of functions, assets, risks, market conditions or business strategies. These taxpayers need to analyse their contribution to the profit of the Multinational National Enterprise (MNE) group and ensure that this is properly reflected on an arm's length basis in their tax returns (paragraph 4.14 of TR 98/11).

Medium quality processes

The medium quality category includes taxpayers undertaking only rudimentary arm's length analyses when setting pricing policies or determining the terms and conditions of international dealings with associated enterprises. There may be evidence of some limited efforts to develop and implement transfer price setting policies for tax purposes, although these would not be sufficiently developed or properly implemented having regard to the complexity and importance of the particular transfer pricing issues in the case. In these cases, there is an inadequate analysis of functions, assets, risks, market conditions and business strategies and no external benchmarking (paragraph 4.15 of TR 98/11).

Taxpayers may have relied on data that is broadly comparable although they have not sought to refine it to their circumstances or not used it in conjunction with an adequate comparability analysis. There may be some contemporaneous documentation but it provides only limited scope for the ATO to test the taxpayer's transfer price setting processes (paragraph 4.16 of TR 98/11).

A ranking no higher than medium quality applies where the taxpayer has recourse to information from dealings between associated enterprises in the development of their functional and comparability analyses and transfer pricing methodologies (paragraph 4.17 of TR 98/11).

Medium-high quality processes

Medium-high quality cases are those where taxpayers carefully undertake arm's length pricing analyses (and appropriate future monitoring) using available data about independent enterprises or third party international dealings (having regard to comparability), but may be confronted with limitations on data availability which are beyond the control of the MNE group (paragraph 4.18 of TR 98/11).

These taxpayers have undertaken a sound analysis of functions, assets, risks, market conditions and business strategies that are fully supported by contemporaneous documentation and have relied on this information in preparing their tax returns (paragraph 4.19 of TR 98/11).

High quality processes lead to lower risk

High quality cases are those where taxpayers:

- (1) consider their international dealings with associated enterprises carefully
- (2) undertake arm's length pricing analyses (and appropriate future monitoring) using sufficient reliable data about independent enterprises or third party international dealings (having regard to comparability) - including undertaking a sound analysis of functions, assets, risks, market conditions and business strategies
- (3) establish and implement a process which the ATO can readily test
- (4) support the analysis and processes with contemporaneous documentation
- (5) engage in real bargaining or otherwise achieve an arm's length outcome, and
- (6) prepare their tax returns on the basis of their analysis (paragraph 4.20 of TR 98/11).

2.3 Best endeavours and penalty implications

TR 98/11 provides that where the ATO rates documentation as having either 'medium-high quality' or 'high quality' processes, the taxpayer will be regarded as having used its best endeavours and would not generally be subject to penalty tax in the event of a transfer pricing adjustment.

3.0 COMMERCIAL REALISM OF PROFIT OUTCOMES

The commercial reality rating is used in conjunction with the documentation quality rating to arrive at the final risk of an ATO audit of transfer pricing outcomes.

While the documentation quality rating focuses on the **processes** undertaken by a taxpayer in setting or reviewing its transfer prices the commercial reality rating looks at the **outcomes** achieved by those processes in order to support or validate the arm's length nature of the dealings.

3.1 Commercial realism ratings

The chart 'Risk of an ATO Audit of Transfer Pricing Outcomes' contained in section 5 of this document uses three commercial realism ratings:

- A. commercially realistic
- B. less than commercially realistic
- C. consistently returns losses.

In order to establish the final risk of an ATO audit of transfer pricing outcomes, a taxpayer needs to determine which of these three ratings most accurately represents the profit outcomes achieved from the related party dealings detailed in the transfer pricing documentation.

3.2 Establishing a commercial realism benchmark

Establishing the commercial realism of profit outcomes from related party dealings requires an exercise of judgment and it is not possible to provide precise guidelines to do this. The object of the exercise is to benchmark a level of profitability for the related party dealings that is broadly in line with outcomes expected from comparable independent dealings.

It may be possible to establish commercial realism benchmarks from different sources and a taxpayer is best placed to do this because of knowledge of its own business and the industry in which it operates. Potential benchmarks include:

- established industry benchmarks
- Australian Bureau of Statistics industry data
- internal comparable dealings for example outcomes of dealings between the taxpayer and independent parties
- external comparable dealings for example outcomes of comparable dealings between independent parties.

3.3 Determining the commercial realism rating

Having established an appropriate commercial realism benchmark, the taxpayer needs to consider its own profit performance in light of that benchmark.

Where the taxpayer's level of profitability is broadly in line with the selected benchmark, it would be appropriate to rate the outcome as 'commercially realistic'.

Where the taxpayer's profitability is substantially below the selected benchmark on a consistent basis, it would be appropriate to rate the outcome as 'less than commercially realistic'.

Where a taxpayer has a history of incurring trading losses, it would be appropriate to rate the outcome as 'consistently returns losses'.

In situations where a taxpayer's profitability has been adversely impacted by circumstances unconnected to the related party dealings, it may be necessary to consider whether the profit

performance is commercially realistic despite the fact that it falls substantially below the selected benchmark. In this situation it is expected that details of the adverse circumstances would be set out in the taxpayer's transfer pricing documentation.

For example, where a taxpayer has experienced a fall in its level of profitability due to the bankruptcy of one of its major local customers, it may be appropriate to rate the outcome as commercially realistic despite the fact that the taxpayer's profitability has fallen substantially below industry benchmarks.

However, it should be noted that these circumstances are likely to be short term in nature and it would not be considered commercially realistic for a company to achieve substantially reduced levels of profitability or losses on a long term basis.

4.0 CHECKLIST FOR EVALUATING QUALITY LEVEL OF TRANSFER PRICING DOCUMENTATION

Tick the following boxes for the type of international related party dealings as disclosed by the business in Schedule 25A to the partnership, trust, company or fund tax return:

		purchases/ expenditure	sales/ revenue
tangible property	stock in trade and raw materials		
royalties, rent and intangible property	royalties		
	rent		
services	management—financial— administrative—marketing— training		
	technical construction		
	research and development		
other	interest discounts		
	insurance guarantees		
	other transactions		
interest in or disposal of an asset			
interest free loan			

Is the documentation prepared by the business contemporaneous – at what stage has this documentation been created?	please tick only 1 box
at the time prices are set (ie at or prior to the time transactions are entered into → contemporaneous)	
at the time the outcomes are tested (ie at the end of the year or time of preparation of the tax return under review → contemporaneous)	
at the times the outcomes are tested (ie subsequent to the preparation of the tax return → not contemporaneous)	

Step 1. Analysis of functions, assets, risks, market conditions and business strategies

Has the documentation identified the scope, type, value and timing of the international dealings with associated enterprises?

Is the following information covered in the documentation?

	adequately addressed	inadequately addressed	not addressed	not applicable
1. Does the documentation identify the: <ul style="list-style-type: none"> a. scope b. type c. value d. timing, and e. contractual terms of the business's dealings with international related parties?				
2. Does the documentation identify the process the business used to set the transfer price for each international related party dealing?				
3. Does the documentation include a description and analysis which describes: <ul style="list-style-type: none"> a. the operations of the business b. whether or not it has more than one operational segment c. the product lines d. the service lines e. the nature of the industry and its markets f. the structure, intensity and dynamics of competition experienced—covering competitors, vendors and customers g. the broader economic, regulatory and other factors affecting the 				

	adequately addressed	inadequately addressed	not addressed	not applicable
business h. the effects of exchange rates, or i. the business strategy, budgets and other managerial decisions?				
4. Does the documentation coverage of the issues in 1 and 3 above draw to a conclusion as to where the business is positioned in the industry and market having regard to its strategies and business model?				
5. Does the documentation include a functional analysis which identifies the most economically significant activities/functions undertaken (or to be undertaken) by the business in regard to dealings with related parties, such as: a. manufacturing, production and processing b. marketing and/or distribution–management and/or back office services c. professional services (legal, engineering, etc) d. financial services (banking, insurance, etc) e. agent–dependent/independent, or f. other – comment on.				
6. Does the documentation include a functional analysis that describes the most economically important assets used in the business in respect of the business activities conducted with related parties? Covering: a. tangible assets (factory, office buildings, machinery, fleet of vehicles, etc) b. intangible property (patents, trade marks, customer lists, know-how, etc)				

	adequately addressed	inadequately addressed	not addressed	not applicable
<p>c. intangible property not recorded in the taxpayer's balance sheet or owned by it (so called economic ownership, as opposed to legal ownership in b. above)—for example, it may be stated to be licensed from related or non related parties who own it, who charge the business a royalty, service charge, or franchise fee; or grant use of the knowledge for no charge, or</p> <p>d. human capital/competencies—for example, knowledge held by managers, engineers or other specialists and used in the functions performed by the business in Australia.</p>				
<p>7. Does the documentation include a functional analysis that describes the most economically important risks assumed by the business and the related party to the transaction that could affect the consideration given or received or the profit that would be earned by the business or the related party?</p> <p>(eg market risk, inventory risk, research and development risk, financial risk including Foreign Exchange (FX) exposure, product liability risk, etc)</p>				

	yes	no
8. Does the documented functional analysis draw a conclusion as to the characterisation of the business?		

Taking into account the above indicative ratings, does the documentation address the most economically important functions, assets and risks?

Allocate your score as follows:

1	no analysis of functions, assets, risks, market conditions and business strategies	low quality
2	no analysis of functions, assets, risks, market conditions and business strategies	low to medium quality
3	inadequate analysis of functions, assets, risks, market conditions and business strategies	medium quality
4	sound analysis of functions, assets, risks, market conditions and business strategies	medium to high quality
5	sound analysis of functions, assets, risks, market conditions and business strategies	high quality

score and quality rating

Comment on the adequacy and quality of documentation:

Step 2. Selection of the most appropriate methodology or methodologies

Does the documentation contain a description of the method selected and an explanation of why it is the most appropriate method? Is the following information covered in the documentation?

		adequately addressed	inadequately addressed	not addressed	not applicable
1. Does the documentation include a description of the pricing method selected for each material intercompany dealing? (refer Taxation Ruling TR 97/20 paragraph 3.1)					
type of dealing:	method:				
	traditional transaction – comparable uncontrolled price (CUP), resale price (RP), cost plus (CP)				
	transactional profit – profit split (PS), transactional net margin method (TNMM)				
	other –				
In some cases a hybrid method may be needed (refer TR 97/20 paragraph 3.4) or other methods may be considered because there is a need to find an answer for all transfer pricing problems (refer TR 97/20 paragraph 3.88 to 3.99).					

	adequately addressed	inadequately addressed	not addressed	not applicable
<p>2. Does the documentation include analysis that the method/s selected (after other methods were considered and rejected) was/were the most appropriate based on a practical weighing of the evidence having regard to (refer TR97/20 paragraph 3.6):</p> <ul style="list-style-type: none"> a. the nature of the activities being examined b. the availability, coverage, and reliability of the data c. the degree of comparability between the business's related dealings and the potential comparables dealings, or d. the nature and extent of any assumptions made. 				
<p>3. Does the documentation establish the reasons why rejected transfer pricing methods were not appropriate?</p>				
<p>4. Has consideration been given to the confirmation of the results using another method?</p> <p>For example:</p> <ul style="list-style-type: none"> a. using a profit method to confirm the result of a transactional method applied and using broad data b. using a different profit level indicator (PLI), for example, return on costs, to confirm the result of a TNMM analysis using, for example, return on sales, or c. other. 				

Taking into account the above indicative ratings, does the documentation address the selection of the most appropriate pricing method?

Allocate your score as follows (refer TR 98/11 paragraph 4.26):

1	no taxpayer documentation or processes to enable a check on selected methodologies	low quality
2	insufficient taxpayer documentation or processes to enable check on selected methodologies	low to medium quality
3	selection of method supported with some contemporaneous documentation	medium quality
4	selection of method fully supported with contemporaneous documentation	medium to high quality
5	selection of method fully supported with contemporaneous documentation	high quality

score and quality rating

Comment on the adequacy and quality of documentation:

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Step 3. Application of the selected method and testing of the arm's length outcome using comparability analysis

This step considers the comparability analysis contained in the documentation and coverage of the features of the application of the most appropriate transfer pricing methods. Is the following information covered in the documentation?

	adequately addressed	inadequately addressed	not addressed	not applicable
<p>1. Does the documentation address the application of particular business strategies in the business's Australian operations as they relate to international related party dealings?</p> <p>In particular, are any of the following identified and discussed and linked to related party dealings? (ref TR 98/11 Chapter 8):</p> <ul style="list-style-type: none"> a. sustained losses b. market penetration c. marginal costing d. global price lists, or e. set-off arrangements. 				
2. Does the documentation link the methods selected in step 2 to the application of those methods and test the arm's length outcome of the dealings between the business and international related parties?				
<p>3. In applying the methods selected to set related party pricing or a review of the outcome of the application of that method, does the documentation include:</p> <ul style="list-style-type: none"> a. a description of the comparables used b. how comparability was evaluated, and c. what adjustments if any were made? 				

	adequately addressed	inadequately addressed	not addressed	not applicable
4. Does the documentation refer to potential internal comparable dealings (CUPs) which are relied upon as arm's length indicators?				
5. Does the documentation include a description of the criteria used to select comparables?				
6. Does the documentation describe the source of comparable data (eg database, public data) which was examined by and applied by the business?				
7. Does the documentation include an explanation of why comparables were included or excluded—based on for example, controlled data, loss companies, size of comparables activity or market position relative to the tested business, diversity of comparables activities in aggregated data, functional differences between the comparable and the tested business, etc?				
8. Does the documentation cover explanation of the effect, if any, of potential factual differences upon the transfer price—for example, to cover working capital adjustments or inventory adjustments?				
9. Does the documentation assess the reliability of comparables (low, moderate or high) for example, as per the decision tree at paragraph 2.65 of TR 97/20?				
10. Does the documentation address the aggregation of data to improve comparability? For example, if the business's comparables are applied at a whole of business level, are reasons for this adequately addressed?				
11. Does the documentation include use of multiple year data analysis to determine the arm's length result? For example, is the analysis based on the performance of the taxpayer for the current year and the preceding four years? (refer TR97/20 paragraph 2.98)				

	adequately addressed	inadequately addressed	not addressed	not applicable
<p>12. Does the documentation refer to the development of a range of comparable outcomes or data points to determine whether the business's outcomes are arm's length? (refer TR 97/20 paragraph 2.83 to 2.95)</p> <p>(Note: that while a range of comparable outcomes may not always be relevant in the application of a traditional transaction method, such as CUP, you would expect to see such a range in all cases where a TNMM is being applied)</p>				
13. If the documentation relies upon the CUP method ?				
<p>Does the documentation address the application of the CUP method? (refer TR 98/11 paragraph 7.4):</p> <ul style="list-style-type: none"> a. features of the products or services compared, including the value of any intangibles associated with the products or services b. differences in the quality of the products or services that were compared c. whether any services were supplied in relation to products d. conditions other than product or service differences that impacted on comparability e. the quantification of differences identified and where those differences had a material affect on the consideration and the adjustments made f. processes undertaken to determine the reliability of any internal CUPs used as a benchmark g. the development and application of any pre-determined pricing policy rather than developing CUPs for individual dealings. Such an approach could be appropriate where, for example, a taxpayer dealt in large numbers of differentiated products or services and it was not practical or cost effective to conduct a CUP analysis on a transaction by transaction basis. 				

	adequately addressed	inadequately addressed	not addressed	not applicable
14. If the documentation relies upon application of the Resale Price method ?				
<p>Does the documentation address the following points? (refer TR 98/11 paragraph 7.5):</p> <ul style="list-style-type: none"> a. the functional analysis of the business including the process undertaken to ensure that there was functional comparability and, where there were material differences, the quantification and adjustment of those differences b. comparison of the gross margin achieved by the business from related party international dealings with gross margins from uncontrolled dealings and any adjustments made to improve comparability c. alternatively, has the business used a margin calculated as a certain percentage of the resale price without benchmarking the margin against comparable independent dealings? If so, does the documentation address how this fixed percentage was calculated to produce a result that fairly reflects the functions performed, assets employed, and risks undertaken by the business? (refer TR 98/11 paragraph 7.6) d. reconciliation of differences in accounting treatment which had an effect on the gross profit (or other profit level) used as the basis of comparison between the business and any potential benchmarks e. where it was not possible, in applying the Resale Price method, to find independent enterprises performing comparable functions in a comparable market, the process undertaken to broaden the comparability analysis f. where the business was limited by the extent of information available and relied on a broad analysis to determine comparability, identification of the limitations or knowledge gaps associated with the analysis and how the judgments made allow for this g. an analysis of any other factors which were taken into account when 				

	adequately addressed	inadequately addressed	not addressed	not applicable
comparability was determined				
h. checks undertaken by the business to determine how the use of the Resale Price method resulted in an outcome which was consistent with the arm's length principle.				
15. If the documentation relies upon application of the Cost Plus method ?				
<p>Does the documentation address the following points? (refer TR 98/11 paragraph 7.7 to 7.11):</p> <ul style="list-style-type: none"> a. costs which were included in the cost base (noting whether full absorption costing has been used) b. the method of allocation of costs between related party international dealings and independent dealings within the same business activity c. the basis of allocation or apportionment of all indirect costs included in the cost base d. where marginal costing was used, analyses or evaluations which support the use of marginal costing in determining an arm's length outcome e. the determination of the arm's length value of any purchases of materials or services from associated enterprises f. the functional analysis of the business including the process undertaken to ensure that there was functional comparability and, where there are material differences, the quantification and adjustment of those differences g. comparison of the mark-up from the related party international dealings with mark-ups from uncontrolled dealings and any adjustments made to improve comparability h. alternatively, has the business used a margin calculated as a fixed percentage mark up to a relevant cost base rather than benchmark the 				

	adequately addressed	inadequately addressed	not addressed	not applicable
<p>margin against comparable independent dealings? If so, does the documentation address how the fixed percentage mark up has been calculated to produce a result that fairly reflects the functions performed, assets employed, and risks undertaken by the business in Australia? (refer TR98/11 paragraph 7.11)</p> <p>i. reconciliation of differences in accounting treatment which had an effect on the mark-up used as the basis of comparison between the business and any potential benchmarks</p> <p>j. where it was not possible, in applying the CP method, to find independent enterprises performing comparable functions in a comparable market, the process undertaken to broaden the comparability analysis</p> <p>k. where the business was limited by the extent of information available and relied on a broad analysis to determine comparability, identification of the limitations or knowledge gaps associated with the analysis and how the judgments made allow for this</p> <p>l. an analysis of any other factors which were taken into account when comparability was determined</p> <p>m. checks undertaken by the business to determine how the use of the CP method resulted in an outcome which was consistent with the arm's length principle.</p>				
16. If the documentation relies upon application of the profit split method ?				
<p>Does the documentation address the following points? (refer TR 98/11 paragraph 7.13):</p> <p>a. the level at which the profit split was undertaken, for example on a transactional or an aggregated dealings basis and the rationale for undertaking the split at a particular level</p>				

	adequately addressed	inadequately addressed	not addressed	not applicable
<ul style="list-style-type: none"> b. how the combined profit was calculated, including the basis used to allocate the indirect costs and the relevant general administrative and selling expenses of each of the associated enterprises c. whether the profit that was split was net or gross profit d. the effects on the calculation of each enterprise profit attributable to differences in accounting treatment of profit between jurisdictions, or to the effects of currency e. the functional analysis undertaken in respect of all parties to the dealings, including the identification of significant economic contributions by each enterprise to the combined profit f. the basis for any allocations of values to functions which contributed to the profit that was split g. where profits were split using contribution analysis (or as part of the first stage of a residual profit split), supplementation of the analysis with external market data that indicated how independent enterprises would have divided the profits in similar circumstances (comparability of the external benchmark having regard to the functions undertaken, assets employed and risks assumed is also an important factor in undertaking this type of analysis) h. where a residual profit split was applied, the basis used to determine the allocation of values under the second stage of the analysis and details of external benchmarking applied to supplement this allocation i. in the case where the combined profit that was split was a projected profit, the basis used for such projection, details of its estimation and the critical assumptions on which it was based. 				

17. If the documentation relies upon the application of the TNMM method ?				
<p>Does the documentation address the following points? (refer TR 98/11 paragraph 7.16):</p> <ul style="list-style-type: none"> a. the process used to confine the comparison to the taxpayer's international dealings with associated enterprises b. the process used to identify, analyse and benchmark against comparable uncontrolled data c. any adjustments that were made to the uncontrolled data to improve comparability d. where profitability ratios were used in applying the TNMM, reasons why the particular ratios used were selected and why other ratios were discarded e. reasons for the selection of a particular net profit margin including factors considered in determining that a particular profit margin was the most appropriate one f. has the business ensured that appropriate accounting and measurement consistency existed in relation to the application of the selected ratio for the business and any comparable independent enterprises? g. has a multi-year analysis been undertaken? h. in cases where the application of ratio analysis resulted in the creation of a range of outcomes, details of why this range represents an arm's length range i. in relation to an arm's length range, the business's process in selecting the most appropriate outcome in the range to reflect the arm's length result j. how the relevant amount for costs was ascertained in cases where TNMM was used on a net cost plus basis. 				

Taking into account the above indicative ratings, does the documentation address the application of the selected method(s) in determining the arm's length outcome?

Allocate your score as follows:

1	no comparables used no taxpayer documentation or processes to enable a check on application of methodologies	low quality
2	no comparables used insufficient taxpayer documentation or processes to enable check on application of methodologies	low to medium quality
3	broad inexact comparables used OR comparability based on data from external related party comparables application of method supported with some contemporaneous documentation	medium quality
4	comparability based on limited data from independent dealings reliability assessed application of method fully supported with contemporaneous documentation	medium to high quality
5	comparability based on adequate data from independent dealings reliability taken into account in choice of comparable application of method fully supported with contemporaneous documentation	high quality

score and quality rating

Comment on the adequacy and quality of documentation:

Step 4. Ongoing review of steps 1 to 3

Is the following information covered in the documentation?

	adequately addressed	inadequately addressed	not addressed	not applicable
Does the documentation address a process to monitor international dealings and their economic context to identify any material changes as they occur?				

Taking into account the above indicative rating, does the documentation address the continual review of steps 1 to 3?

Allocate your score as follows (refer TR 98/11 paragraph 4.26):

1	no effort to implement and review arm's length transfer pricing policies	low quality
2	limited effort to implement and review arm's length transfer pricing policies	low to medium quality
3	limited effort to implement and review arm's length transfer pricing policies	medium quality
4	genuine effort to implement and review arm's length transfer pricing policies	medium to high quality
5	genuine effort to implement and review arm's length transfer pricing policies	high quality

score and quality
rating

Comment on the adequacy and quality of documentation:

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Overall evaluation of quality of transfer pricing processes and documentation for international dealings with associated enterprises

	quality level 1 to 5
<p>step 1</p> <p>analysis of functions, assets, risks, market conditions and business strategies</p>	
<p>step 2</p> <p>selection of the most appropriate methodology or methodologies</p>	
<p>step 3</p> <p>application of the selected method(s) and determining the arm's length outcome</p>	
<p>step 4</p> <p>ongoing review of steps 1 to 3</p>	
<p>overall evaluation of quality</p> <p>Guidelines:</p> <ul style="list-style-type: none"> a. the questions contained in each of the steps, if adequately addressed in all respects, would score a 5 – successive inadequate address or not included will indicate a reduction in score is required b. the characteristics of particular quality levels shown in the boxes under each step are indicative not prescriptive – the quality level for the documentation should generally reflect the traits described in the quality rating c. if all steps are scored 1, 2, 3, 4, 5 then overall score is 1, 2, 3, 4, 5 as applicable d. scores for step 1, step 2 or step 3 carry more weight than step 4 in determining the overall score. 	
<p>commercial realism score – based on company's assessment</p> <p>A = commercially realistic B = less than commercially realistic C = consistently returns losses</p>	

5.0 RISK OF AN ATO AUDIT OF TRANSFER PRICING OUTCOMES

Having established the quality of the taxpayer's transfer pricing documentation from Stage 1 and the commerciality of the taxpayer's profit outcomes from Stage 2, it is now possible to evaluate the risk of an ATO audit of transfer pricing outcomes using the chart on the following page.

5.1 Evaluating the risk

Using the horizontal axis on the chart, the taxpayer should select the commerciality rating from Stage 2 to establish which of the boxes (containing the 1 – 5 documentation rating levels) should be used in the next step of the evaluation.

For example, if a taxpayer has rated its profit outcomes as less than commercially realistic, it should select the middle box on the chart.

The taxpayer should then use the overall documentation quality rating from Stage 1 (rating 1 to 5) to select the equivalent position in that box.

Having established both the box and the position of the number within that box, the taxpayer should then draw a line across to the vertical axis to establish the risk of an ATO.

For example, the left hand box on the chart is selected where profit outcomes are rated as 'commercially realistic'. Where documentation quality is rated 4 (medium to high quality) a line drawn across to the vertical axis shows that the taxpayer has a 'low' to 'low to medium' risk of an ATO audit of transfer pricing outcomes.

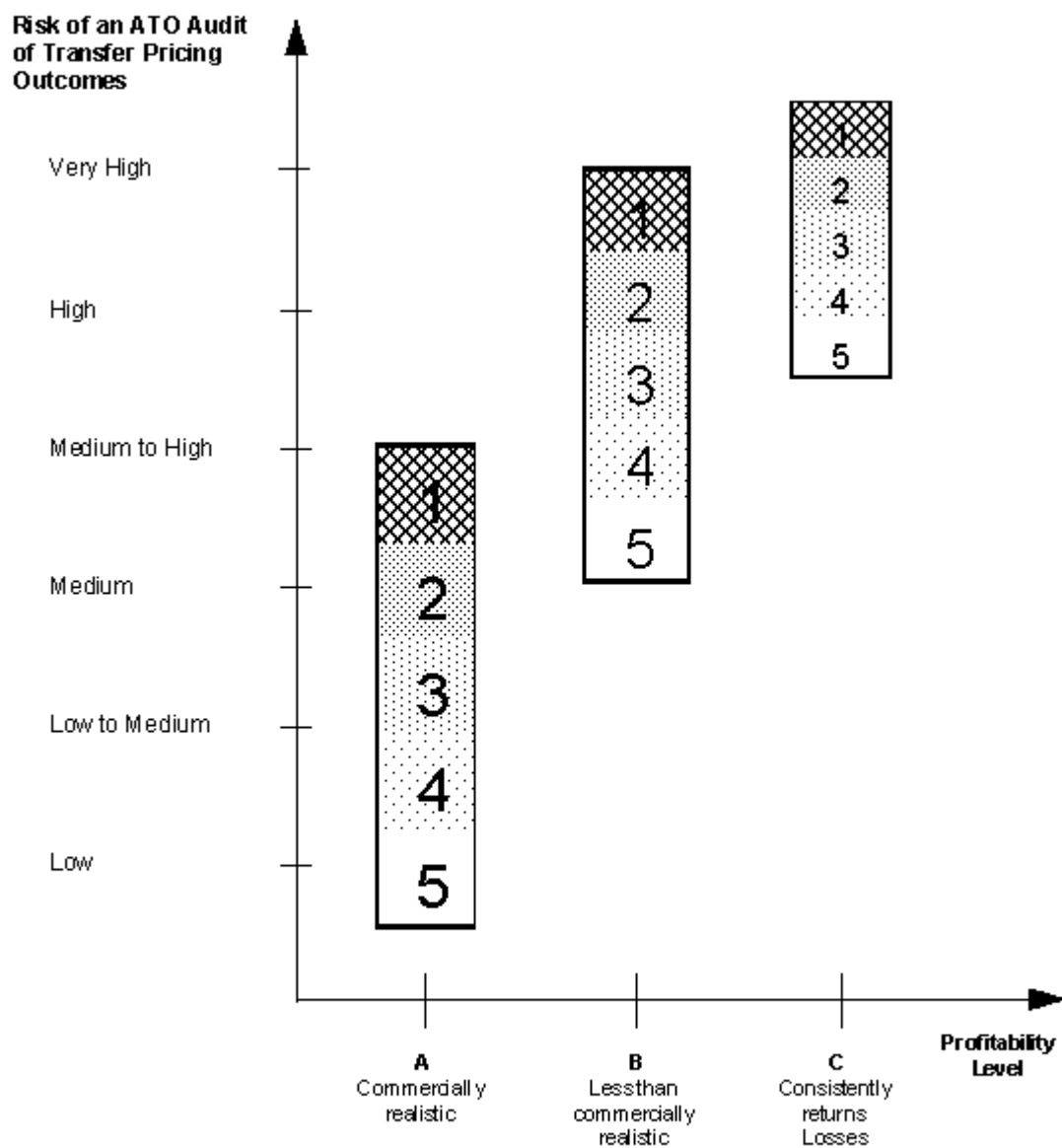
Similarly, the right hand box on the chart is selected where profit outcomes are rated as 'consistently returns losses'. Where documentation quality is rated 2 (low to medium quality) a line drawn across to the vertical axis shows that the taxpayer has a 'high' to 'very high' risk of an ATO audit of transfer pricing outcomes.

5.2 Mitigating the risk

Where a taxpayer wishes to reduce the risk of an ATO audit of transfer pricing outcomes established from using this self assessment risk product, it may consider:

- reviewing its transfer pricing documentation in light of the aspects contained in the documentation checklist to see if it can improve its documentation quality rating
- reviewing the level of its profit outcomes in the light of commerciality considerations and benchmarks used
- applying for an APA where it wishes to achieve tax certainty for its related party dealings.

THE RISK OF AN ATO AUDIT OF TRANSFER PRICING OUTCOMES



Where

1	=	Low quality of processes and documentation
2	=	Low to medium quality of processes and documentation
3	=	Medium quality of processes and documentation
4	=	Medium to high quality of processes and documentation
5	=	High quality of processes and documentation