TR 2011/1 - Income tax: application of the transfer pricing provisions to business restructuring by multinational enterprises

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Taxation Ruling

Income tax: application of the transfer pricing provisions to business restructuring by multinational enterprises

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What this Ruling is about

1. This Ruling set outs the Commissioner's views on the application of Australia's transfer pricing provisions in Division 13 of Part III (Division 13) of the *Income Tax Assessment Act 1936* (ITAA 1936)[1] and the Associated Enterprises Article of Australia's tax treaties (treaty Article 9) of the *International Agreements Act 1953* (Agreements Act) to business restructuring arrangements.

2. For the purposes of this Ruling, 'business restructuring' refers to arrangements of multinational enterprises (MNEs) by which functions, assets and/or risks of a business are transferred between jurisdictions.

3. This Ruling considers situations where such transfers occur between MNE members to implement changes in the MNE's existing business arrangements or operations. Common examples are product supply chain restructurings involving conversion of a distributor into a sales agency arrangement or of a manufacturer into a provider of manufacturing services. Business restructurings also commonly involve the transfer of the ownership and management of intangibles such as patents, trademarks and brand names.

[1] All subsequent legislative references in this Ruling are to the ITAA 1936 unless indicated otherwise.

4. This Ruling does not address permanent establishment issues arising from business restructuring. The Australian Taxation Office (ATO) has previously issued guidance on the attribution of profit to a dependent agent permanent establishment.[2] This guidance is illustrated by reference to examples of arrangements that are relevant to business restructuring.

5. This Ruling only addresses the application of the transfer pricing provisions. It does not address the application of other provisions in the Australian tax law that may be relevant in the facts and circumstances of a particular business restructuring arrangement. For instance, the capital gains tax provisions may be relevant where a taxpayer disposes of an asset under a business restructuring arrangement, or the Controlled Foreign Company (CFC) provisions[3] may be relevant in determining attributable income of a taxpayer where a CFC is a party to a business restructuring.

6. In addition, this Ruling does not address the application of the general anti-avoidance provisions.[4]

7. Where the Commissioner applies Division 13 to determine the arm's length consideration, this deemed consideration applies for all purposes of the Australian income tax law in relation to the taxpayer.[5] It is a matter for the operative provisions of that law as to whether, and if so how and when, the arm's length consideration deemed under Division 13 is brought into calculating a taxpayer's taxable income. This Ruling does not address this matter. For instance, the deemed consideration may be relevant to the amount assessable on the disposal of a capital asset, the amount assessable or deductible in respect of the disposal or acquisition of trading stock, or the amount assessable on the termination of a contract.

Ruling

8. Division 13 permits adjustment where the consideration for a supply or acquisition of property by a taxpayer under an international agreement in respect of a business restructuring is not an arm's length amount. The arm's length consideration for a supply or acquisition of property is that which might reasonably be expected under an agreement between independent parties dealing at arm's length with each other in relation to the supply or acquisition.

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[2] *Attributing profits to a dependent agent permanent establishment* (September 2005) available on the ATO's website www.ato.gov.au
[3] Part X.
[4] Part IVA.
[5] Refer to paragraphs 179 to 181 of Taxation Ruling TR 94/14.

9. Treaty Article 9 permits adjustment to a taxpayer's profits where the conditions of the taxpayer's commercial or financial relations with an associated enterprise in respect of a business restructuring differ from those which would be made between independent enterprises dealing wholly independently with each other and results in profits not accruing to the taxpayer that would otherwise have accrued.

10. Division 13 and treaty Article 9 are both based on the arm's length principle, so there should be no fundamental inconsistency in the outcomes under the two sets of provisions.[6] Like Division 13, the practical application of treaty Article 9 involves a comparison of the pricing of a transaction or arrangement between associated enterprises in implementing a business restructuring and the pricing of a similar transaction or arrangement between independent enterprises dealing at arm's length in similar circumstances.[7]

11. Accordingly, the ATO approach is to adopt the same process in applying Division 13 and treaty Article 9 to a business restructuring.

12. Where a particular transaction is part of a broader agreement in respect of a business restructuring, determining the arm's length consideration for that transaction requires that all of the circumstances relevant to the agreement are taken into account in evaluating comparability with the consideration that might reasonably be expected under an agreement between independent parties dealing at arm's length.

13. Where possible and practicable, the arm's length consideration is determined by applying the most appropriate arm's length pricing method[8] using available reliable data relating to an agreement between independent parties dealing at arm's length for a comparable transaction in comparable circumstances.

14. Where there are insufficient such reliable uncontrolled comparables data, the consideration that might reasonably be expected under an agreement between independent parties dealing at arm's length in comparable circumstances can be determined by considering the following indicia of arm's length behaviour and outcomes that might reasonably be expected to shape such an agreement:

(a) an arm's length outcome is one that makes business sense in the circumstances of the particular taxpayer;[9]

(b) an independent party dealing at arm's length would seek to protect its own economic interest;[10]

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[6] Paragraph 186 of TR 94/14.
[7] See paragraphs 2.4 and 2.5 of the OECD Guidelines.
[8] Taxation Ruling TR 97/20 provides guidance on arm's length pricing methods.
[9] Paragraphs 1.1 and 2.15 of TR 97/20.
[10] Paragraphs 2.6 and 2.11 of TR 97/20.

(c) an independent party dealing at arm's length would compare the options realistically available and seek to maximise the overall value derived from its economic resources;[11]

(d) one option might be not to enter into a transaction because it does not make commercial sense for the particular taxpayer.[12]

15. This enables a comparison, in the absence of sufficient reliable uncontrolled comparables data, between the consideration under the agreement in respect of a business restructuring and the consideration that might reasonably be expected under an agreement between independent parties dealing at arm's length. Based upon these indicia, such consideration is predicated as that which makes commercial sense for the parties, having regard to what is in their best economic interests and the options realistically available to them at arm's length.

16. Where it is concluded from an examination of all relevant matters that the consideration for a transaction under the agreement in respect of a business restructuring is comparable with that which might reasonably be expected to be agreed between independent parties dealing at arm's length, then that consideration is regarded as satisfying the arm's length principle under the transfer pricing provisions.

17. In most cases comparability with what might reasonably be expected to be agreed between independent parties dealing at arm's length should be achievable by adjusting the consideration payable or receivable by the taxpayer based upon the business restructuring arrangement as agreed by the associated enterprises.

18. However, in the exceptional case where it is not possible or practicable to achieve an arm's length outcome in this way, the ATO considers that it may apply the transfer pricing provisions to adjust the consideration receivable or payable by the taxpayer by reference to an agreement that might reasonably be expected between independent parties dealing at arm's length in comparable circumstances.

Process for setting or reviewing transfer pricing

19. Consistent with paragraphs 12 to 18 of this Ruling, the following process provides a useful basis for setting or reviewing transfer pricing for international dealings between associated enterprises in respect of a business restructuring arrangement:

[11] Paragraph 2.4 of TR 97/20
[12] Paragraph 2.17 of TR 97/20.

Step 1: Characterise the international dealings between the associated enterprises in the context of the taxpayer's business[13]

- Identify the scope, type and value of the international dealings with associated enterprises involved in the business restructuring.
- Perform functional analyses of the pre and post-restructuring business activities affected by the business restructuring.
- Refer to any relevant contracts, including those entered into to implement the business restructuring (for example, contracts for the sale of property) and those evidencing the terms of the pre and post-restructuring arrangements for the business activities affected by the restructuring.
- Examine whether the contractual terms accord with the outcomes of the functional analyses and determine the true nature, terms and effects of the business restructuring.

Step 2: Select the most appropriate transfer pricing methodology or methodologies[14]

- Identify the available data that may establish an arm's length consideration for each of the dealings involved in the business restructuring and for the dealings in their entirety:
  - obtain any available data as to arrangements between independent parties dealing at arm's length in comparable circumstances;[15]
  - depending upon the extent of such comparables data, obtain any other available data relevant to determining whether the pricing of the business restructuring makes commercial sense for the parties, having regard to what is in their best economic interests and the options realistically available to them at arm's length.[16]
- Determine the most appropriate arm's length pricing methodology or methodologies based on the facts and circumstances of the particular case.

[13] Paragraphs 49 to 68 of this Ruling.
[14] Paragraphs 69 to 108 of this Ruling.
[15] Paragraphs 72 to 76 of this Ruling.
[16] Paragraphs 77 to 108 of this Ruling.

Step 3: Apply the most appropriate method and determine an arm's length outcome[17]

- Determine the consideration that might reasonably be expected under an agreement between independent parties dealing at arm's length in comparable circumstances.[18]
- Perform a comparability analysis using any available data as to arrangements between independent parties dealing at arm's length in comparable circumstances.
- If this analysis is sufficiently reliable, use the outcomes to apply the most appropriate arm's length pricing method(s) to determine the amount(s) of arm's length consideration receivable or payable by the taxpayer in connection with the business restructuring.
- If not, then use the functional and comparability analyses and any other relevant available data to examine whether the pricing of the business restructuring makes commercial sense for the parties, having regard to what is in their best economic interests and the options realistically available to them at arm's length.
- If the pricing of the business restructuring arrangement is considered to make commercial sense using this analysis, then this determines the amounts of arm's length consideration receivable or payable by the taxpayer under that arrangement.
- If the examination of these matters shows that the pricing of the business restructuring arrangement does not make commercial sense, then seek to achieve an arm's length outcome by a pricing adjustment by reference to the arrangement as entered into by the parties.
- If it is not possible or practicable to achieve an arm's length outcome in this way, then determine arm's length pricing using an arrangement that might reasonably be expected to exist between independent parties dealing at arm's length in comparable circumstances.[19]

[17] Paragraphs 109 to 145 of this Ruling.
[18] Paragraphs 112 to 136 of this Ruling.
[19] Paragraphs 137 to 145 of this Ruling.

- If, for instance, the analysis in Step 3 leads the Commissioner to conclude that independent parties dealing at arm's length in comparable circumstances would not be expected to have entered into the business restructuring arrangement as actually agreed, then the Commissioner may apply the transfer pricing provisions to adjust the consideration receivable or payable by the taxpayer by reference to the agreement that might reasonably be expected between independent parties dealing at arm's length in comparable circumstances.

20. This process is an application of the 4-step process for testing the arm's length nature of international transfer prices as set out in Chapter 5 of Taxation Ruling TR 98/11.[20] The guidance in this Ruling is intended as a suggested basis for undertaking the process described in TR 98/11 in a business restructuring context. It does not require any work beyond that needed to adopt the process in TR 98/11 in developing and documenting a reliable arm's length outcome for a dealing under a business restructuring arrangement. The processes set out in TR 98/11 and in this Ruling are neither mandatory nor prescriptive and, importantly, need to be tailored to the facts of the taxpayer's case. As discussed in TR 98/11, the nature and extent of the process and of the functional and comparability analyses needed in a particular case will depend upon the facts and circumstances, including the complexity of the dealings and arrangements and the availability of reliable independent comparables data.

21. In July 2010 the OECD released a report on the transfer pricing aspects of business restructurings which have been incorporated into the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines). These Guidelines are relevant to the application of treaty Article 9 of the OECD Model Convention on Income and Capital, and therefore to the Associated Enterprises Articles of Australia's tax treaties. The ATO has regard to the OECD Guidelines in applying the arm's length principle under both Division 13 and the associated enterprises article.

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[20] Step 4 of the process in TR 98/11, which involves ongoing review and adjustment for material changes, is not addressed in this Ruling given the one-off nature of dealings implementing a business restructuring.

Date of effect

22. The Ruling applies both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

23. It has been suggested that the Ruling increases the burden on taxpayers to keep records and should therefore apply prospectively only. However, as stated at paragraph 20, the Ruling does not require any greater degree of record keeping than was previously required in accordance with Taxation Ruling TR 98/11. This Ruling merely explains how the general principles of that earlier Ruling apply to the particular case of business restructuring arrangements.

Commissioner of Taxation
9 February 2011

Appendix 1 – Case study

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

24. The following case study illustrates the application of the approach to business restructuring discussed in this Ruling. The comments on the case study summarise the indicative issues and questions that the scenario might raise in addressing the application of the arm's length principle to the particular business restructuring arrangement.[21]

Facts

25. SubCo is a taxpayer that operates a product manufacturing plant in Australia. SubCo has the following rights and responsibilities under its existing business arrangements:

(a) SubCo is responsible for arranging purchase of all raw materials.

(b) SubCo has sole ownership interest and risk in all raw materials, work-in-process and finished goods inventories.

(c) SubCo owns or licenses all intangible property rights (for example, patents, trademarks, and so on) in respect of the products.

(d) SubCo controls what is produced, when, and in what quantity.

(e) SubCo sells the products to associated distributors.

26. SubCo has a history of good profitability over its 20 years of operation; its profit levels have been relatively stable over most of this period, although they have been gradually declining over recent years.

27. The MNE of which SubCo is a member decides to restructure the group's product manufacturing activity by centralising its management and control in a regional headquarters located outside Australia operated by another group member (ForCo). The MNE asserts that its commercial rationale for this decision is to achieve expected cost savings and efficiency gains for the group.

[21] The comments only address the application of Division 13 and treaty Article 9, and do not address any permanent establishment issues or other tax issues that may arise from the facts as presented.

Arrangement

28. Implementing this decision involves the following:

(1) SubCo enters into a toll manufacturing agreement with ForCo. This arrangement has the following features:

- ForCo has sole ownership interest and risk in all raw materials, work-in-process and finished goods inventories;
- ForCo controls what is produced, when, and in what quantity;
- ForCo has the right to dictate design specifications for the product;
- ForCo has ultimate control over product quality; and
- SubCo is paid a processing fee for its manufacturing services. The fee is calculated on a 'cost plus 10%' basis. SubCo has no interest or risk in respect of the profits or losses from sale of the products, and no role in the sale of the products,

(2) SubCo transfers to ForCo all intangible property rights (for example, patents, trademarks, and so on) that SubCo owns in respect of the products. All agreements under which SubCo has rights as licensee in respect of product intangibles are terminated as part of an arrangement whereby ForCo will enter into similar licensing agreements with the owners of these intangibles. SubCo continues to use these rights on a royalty-free basis as a toll manufacturer for ForCo;

(3) SubCo's distribution agreements with associated entities are terminated as part of an arrangement with ForCo whereby it will enter into similar agreements with these entities;

(4) SubCo agrees to transfer to ForCo a number of personnel with the skills and know-how needed to manage the particular product manufacturing activity.

Step 1: Characterise the international dealings between the associated enterprises in the context of the taxpayer's business

29. The following types of questions are relevant:

- *What are the true nature, terms and effect of the business restructuring arrangement and SubCo's international dealings with associated enterprises (*for example, *ForCo) under that arrangement?*

- *What are the business strategies behind the business restructuring, including the expected benefits?*
  - For the MNE, what is the nature of the benefits and what are they worth?
  - How is the business restructuring arrangement, in its agreed terms and form, needed to obtain these expected benefits?
  - How do ForCo and SubCo contribute to producing these benefits?
  - What are the expected benefits for ForCo and SubCo?
- *Do the functional analyses of the business before and after the business restructuring accord with the changes and differences in the terms of the contractual arrangements?*
  - If so, then the contractual terms are used for purposes of Step 2.
  - If not, then the true nature, terms and effect of the business restructuring must be determined from the functional analyses and are used for purposes of Step 2.

30. Where the conduct of the parties does not reflect their written agreements (for example, employees of SubCo continue to manage production schedules, develop quality and design specifications and manage the relationships with the distribution entities in practice, rather than under direction from ForCo), then the actual arrangement between the parties must be determined. This then forms the basis for Step 2.

Step 2: Select the most appropriate transfer pricing methodology or methodologies[22]

31. The following question should be addressed:

- *Are comparables data available evidencing similar business restructuring arrangements entered into between independent parties dealing at arm's length in comparable circumstances?*

32. Relevant data would include:

(i) similar uncontrolled arrangements involving business restructuring by a manufacturer to a toll manufacturer;

[22] Note: the questions and comments in paragraphs 31 to 43 of this Ruling are premised upon Step 1 establishing that the contracts reflect the true nature, terms and effect of the business restructuring.

(ii) similar uncontrolled transfers of patent and trademark rights;

(iii) the terms governing termination of uncontrolled licensing and distribution agreements similar to the pre-restructuring controlled agreements;

(iv) uncontrolled toll manufacturing arrangements similar to the post-restructuring controlled arrangements.

33. Depending upon the extent of such comparables data, any other available data should be obtained that are relevant to determining whether the pricing of the business restructuring makes commercial sense for SubCo and ForCo, having regard to what is in their best economic interests and the options realistically available to them at arm's length.

34. Using all of the above data, the most appropriate arm's length pricing methodology or methodologies based upon the particular facts and circumstances should be determined.

Step 3: Apply the most appropriate method and determine an arm's length outcome

35. The following question should be addressed:

- *What consideration might be expected under an agreement between independent parties dealing at arm's length in comparable circumstances?*

  For example:

  - Is there a transfer of property from SubCo to ForCo?

    If there is a transfer of property (for example, patent and trademark intangibles), and if an independent party might reasonably be expected to pay for it or to obtain consideration for supplying it, then an arm's length consideration would be expected between SubCo and ForCo.

  - Is there a supply of a benefit from SubCo to ForCo?

  - Did SubCo surrender its rights under its licensing and/or distribution agreements or employment contracts of its personnel for the benefit of ForCo?

    As an independent party, would SubCo have realistically had the option of continuing those arrangements?

If so, would this have been more beneficial to it than termination of the arrangements given the terms of the business restructuring?

- Is any such benefit something that ForCo as an independent party would be expected to pay for and SubCo as an independent party would be expected to obtain consideration for supplying?
- Would ForCo as an independent party have other options realistically available to it that might obviate the need to pay SubCo for any such benefit? (for example, entry into similar licensing, distribution and toll manufacturing arrangements without the need for SubCo's agreement, assistance or co-operation)
- Does SubCo expect to derive benefits from the business restructuring that would explain why it would make commercial sense for it to surrender its rights under its existing arrangements without additional consideration?
- If an identifiable benefit has been supplied by SubCo to ForCo, and if an independent party might reasonably be expected to pay for it or to obtain consideration for supplying it, then an arm's length consideration would be expected between SubCo and ForCo.
- Does SubCo have any right to compensation for termination of its existing arrangements?
- Did SubCo have its licensing and/or distribution agreements terminated by the other parties to those agreements, and if so would this give a right to compensation as between independent parties?
- Is the consideration payable and receivable under the post-restructuring (toll manufacturing) arrangements arm's length?
- Is cost plus 10% an arm's length basis for remunerating the manufacturing activity performed by SubCo?

36. Comparability analyses should be performed using any available data as to similar arrangements between independent parties dealing at arm's length in comparable circumstances.

37. If these analyses are sufficiently reliable to determine whether the pricing of the business restructuring accords with what would be expected under an agreement between independent parties dealing at arm's length, then the outcomes would be used to apply the most appropriate arm's length pricing method(s) to determine the amounts of arm's length consideration receivable or payable by SubCo in connection with the business restructuring.

38. If the analyses are not sufficiently reliable in this regard, then the following question is relevant:

- *Does the pricing of the business restructuring make commercial sense for SubCo and ForCo, having regard to what is in their best economic interests and given any other options realistically available to them at arm's length?*

39. The functional and comparability analyses and all other relevant available data would be used to determine whether the pricing of the business restructuring is arm's length by addressing the following types of questions:

- What are the expected benefits of the business restructuring for SubCo and ForCo (see Step 1)?
- Would any options other than the business restructuring be realistically available to ForCo and SubCo at arm's length?
  - Given all of the legal, commercial, economic and financial circumstances, would SubCo as an independent party have any option realistically available to it other than to enter into the business restructuring on the agreed terms?
  - For example:
    - Would SubCo as an independent party legally have any option to termination of its existing licensing and distribution arrangements?
    - Are there commercial or economic imperatives for SubCo to restructure?
    - If SubCo as an independent party would have options other than the business restructuring realistically available to it, how would the expected benefits of those options compare to the expected benefits of the restructuring?
    - Would ForCo as an independent party have any option realistically available to it other than to enter into the business restructuring on the agreed terms?

- Would ForCo have the option of entry into similar licensing, distribution and toll manufacturing arrangements without involving SubCo?
- If ForCo as an independent party would have other options realistically available to it, how would the expected benefits of those options compare to its expected benefits from the business restructuring?

- Do the terms of the business restructuring make commercial sense for ForCo and SubCo, given their relative bargaining positions at arm's length?
- Does the risk-reward trade-off involved in entering into the restructuring make commercial sense for SubCo in the circumstances?
  - What are the reasons for SubCo's declining profitability?
  - What financial forecasts have been made for SubCo's existing business?
- Does the allocation of risk under the restructured arrangements make commercial sense for ForCo and SubCo?
  - Is the allocation of risks consistent with decision-making related to assuming and managing those risks?
    - Does ForCo have both the decision-making capability and financial capability to assume and manage the risks it is allocated?
    - Does ForCo have the decision-making capability to assume and manage the ownership risks of the patent and trademark intangibles?
- Would an amount of consideration be expected to be payable and receivable between independent parties in comparable circumstances?

40. If the examination of these matters shows that the pricing of the business restructuring makes commercial sense for the parties, having regard to their economic circumstances and the options realistically available to them at arm's length, then this determines the amounts of arm's length consideration receivable or payable by SubCo under that arrangement.

41. If the examination of these matters shows that the pricing of the business restructuring arrangement does not make commercial sense in this regard, then the Commissioner would seek to achieve an arm's length outcome by a pricing adjustment (for example, by imputing a receipt of consideration by SubCo or by adjusting any agreed amount of consideration receivable or payable by SubCo) by reference to the arrangement as entered into by the parties.

42. If it is not possible or practicable to achieve an arm's length outcome in this way, then the Commissioner may determine arm's length pricing using an arrangement that might reasonably be expected to exist between independent parties dealing at arm's length in comparable circumstances.

43. For instance, the analysis in Step 3 may lead the Commissioner to conclude that independent parties dealing at arm's length in comparable circumstances would not be expected to have entered into the business restructuring arrangement as actually agreed. The Commissioner may then apply the transfer pricing provisions to adjust the consideration receivable or payable by SubCo by reference to an agreement that might reasonably be expected between independent parties dealing at arm's length in comparable circumstances.

Appendix 2 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

44. This Ruling discusses the application of the arm's length principle under Australia's transfer pricing rules in a business restructuring context. The arm's length principle is the key concept that underpins both Division 13 and treaty Article 9.[23] The operation of the arm's length principle in respect of Division 13 is addressed in several ATO Rulings.[24] The operation of the arm's length principle in respect of Article 9 of the OECD Model Tax Convention is addressed in the OECD Guidelines. The Agreements Act incorporates treaty Article 9 into Australia's tax laws. The ATO view is that treaty Article 9 authorises the making of transfer pricing adjustments independently of Division 13.[25]

45. The arm's length principle requires that profits are allocated between associated enterprises by reference to the conditions that would have existed between independent parties in comparable circumstances.[26] It is inappropriate to be prescriptive in discussing what these conditions would be, particularly as this depends upon facts and circumstances and the availability of data on comparable uncontrolled transactions or arrangements.[27] This Ruling recognises that the application of the arm's length principle requires judgement, particularly in the case of business restructuring, where directly comparable uncontrolled transactions or arrangements may well be difficult to identify.

46. A business restructuring gives rise to the need to determine the amounts of arm's length consideration payable and receivable in connection with the restructuring itself (that is, the transfers of functions, assets and risks accompanying changes in business arrangements or operations), as well as in relation to the post-restructuring arrangements. This Ruling provides guidance in dealing with the first of these issues.

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[23] Paragraphs 10, 164 and 184 of TR 94/14; paragraphs 1.5 and 1.6 of TR 97/20.
[24] TR 94/14, TR 97/20 and TR 98/11 are considered of particular relevance for purposes of this Ruling.
[25] Paragraph 33 of Taxation Ruling TR 2001/13; paragraph 18 of TR 94/14; paragraphs 25 to 27 of Taxation Ruling TR 2009/D6.
[26] Paragraph 1.6 of the OECD Guidelines; paragraph 10 of TR 94/14.
[27] Paragraph 1.10 of the OECD Guidelines.

47. This Ruling does not address the issue of how to determine an arm's length outcome for associated enterprise dealings of a taxpayer entered into after it has participated in a business restructuring. In isolation, the same principles and approach should be applied in selecting and applying the most appropriate arm's length pricing method to those dealings as if they were not connected with a business restructuring.[28] Where the overall business restructuring arrangements include agreement as to consideration payable and receivable in respect of the post-restructuring dealings, it is relevant to take account of that consideration, and whether it is arm's length, in determining whether the consideration payable and receivable for the business restructuring itself is arm's length.

48. Paragraphs 49 to 145 of this Ruling explain in more detail the process suggested at paragraph 19 of this Ruling for applying the arm's length principle under the transfer pricing provisions to a business restructuring arrangement.

Step 1: Characterise the international dealings between the associated enterprises in the context of the taxpayer's business

49. For Division 13 purposes, this step is relevant to:

(a) determining whether a taxpayer has supplied or acquired property under an international agreement (paragraphs 136AD(1)(a), 136AD(2)(a) and 136AD(3)(a));

(b) determining whether parties to the international agreement were dealing at arm's length in respect of a supply or acquisition of property (paragraphs 136AD(1)(b), 136AD(2)(b) and 136AD(3)(b));

(c) determining the arm's length consideration for a supply or acquisition of property as defined in paragraphs 136AA(3)(c) and 136AA(3)(d) by reference to a comparable agreement between independent parties dealing at arm's length (paragraphs 136AD(1)(c), 136AD(2)(c) and 136AD(3)(c)).

50. For treaty Article 9 purposes, Step 1 is relevant to determining comparability between the conditions of the taxpayer's commercial or financial relations with an associated enterprise in respect of the business restructuring arrangement and the conditions which would be made between independent enterprises.

51. A business restructuring may involve a series of inter-related dealings. These may include transfers of functions, assets and/or risks, transfers of property and/or benefits, the termination of existing related party arrangements and the entry into new arrangements. Where this is the case, the proper application of the arm's length principle requires having regard to the arrangements in their entirety.

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[28] See TR 97/20 for these principles.

52. In applying Division 13 it is necessary to identify the relevant international agreement or agreements. Division 13 is 'agreement' based and is not limited to considering specific transactions.[29] The term 'agreement' is broadly defined in subsection 136AA(1) of Division 13. The term 'agreement' is broad enough to include situations where parties other than those directly involved with the supply or acquisition of property are somehow involved or can influence the outcome of the dealings between the parties directly involved.[30] An arrangement (and therefore an 'agreement') would exist if the facts showed a course of dealing between the parties, even though no formal agreement had been entered into and no legally enforceable relationship was intended.[31]

53. In appropriate cases an 'agreement' may comprise more than one contract, transaction or arrangement which together form a broader 'agreement'.[32] Where only a part of the 'agreement' involves the supply or acquisition of property, this part will not be viewed in isolation but in the context of the broader arrangement, understanding or scheme. It is only when all connected steps are viewed in their proper context that the true nature, extent and effects of an 'agreement' can be determined.[33] The ATO does not accept the view that in applying Division 13 regard can only be had to a specific transaction when deciding whether the parties were dealing at arm's length in relation to a supply or acquisition of property and whether the consideration given was an arm's length consideration.[34]

54. The ATO needs to examine whether all aspects of the relevant agreement can be explained by reference to ordinary commercial dealings and real bargaining.[35]

55. The most important aspects of Step 1 are:[36]

(a) identifying the scope, type and value of the international dealings with associated enterprises involved in the business restructuring; and

(b) preparing the preliminary functional analysis of the business restructuring.

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[29] Paragraphs 47, 264 and 265 of TR 94/14.
[30] Paragraph 35 of TR 94/14.
[31] Paragraph 37 of TR 94/14.
[32] Paragraphs 42 and 257 of TR 94/14.
[33] Paragraph 258 of TR 94/14.
[34] Paragraph 264 & 265 of TR 94/14.
[35] Paragraph 57 of TR 94/14.
[36] Paragraph 5.18 of TR 98/11.

56. The functional analysis is needed to identify the economically significant functions performed, assets used and risks assumed in respect of the business affected by a business restructuring, and to understand the relative economic significance of the functions, assets and risks transferred in implementing the business restructuring. In examining a business restructuring, the ATO performs functional analyses of both the pre-restructuring and post-restructuring business circumstances and arrangements, so as to understand and determine how the allocation of functions, assets and risks has changed as a result of a business restructuring. Performing these functional analyses includes examining any relevant contracts, including those entered into to implement the business restructuring (for example, contracts for the sale of property) and those evidencing the terms of the pre and post-restructuring arrangements for the business activities affected by the business restructuring.

57. The true nature, terms and effects of a business restructuring arrangement are determined by an examination of relevant formal contracts and what the functional analyses show to be the actual functions performed, assets used and risks assumed by the parties as evidenced by their conduct.

58. The term ‘arm’s length consideration’ is defined in subsection 136AA(3) of Division 13 as the consideration that might reasonably be expected if the property had been supplied or acquired under an agreement between independent parties dealing at arm’s length with each other in relation to the supply or acquisition.

59. This, therefore, requires an analysis of comparability with an agreement between independent parties dealing at arm’s length in similar circumstances. Step 1 of the process is intended to determine the true nature, terms and effects of the business restructuring arrangement for purposes of performing this comparability analysis.

60. As stated at paragraph 5.20 of TR 98/11:

> The taxpayer needs to understand the nature and extent of the dealings with associated enterprises in the context of the Australian taxpayer’s business, the strategies adopted by the MNE group, and the economic and market circumstances in which the taxpayer is operating. In determining whether the dealings are consistent with the arm’s length principle it is important to understand:
>
> (1) what the international dealings with associated enterprises are;
>
> (2) which enterprises are party to what dealings;
>
> (3) how and when the dealings were negotiated;
>
> (4) the purpose or object of the dealings;
>
> (5) the property or services involved;
>
> (6) the contractual terms and timing of the dealings;
>
> (7) what the taxpayer contributes and obtains from its participation in them; and
>
> (8) their significance to the taxpayer’s overall business activities and those of the multinational group.

61. All of this information can be relevant to dealings entered into to implement a business restructuring. This includes information on business strategies:

> An evaluation of the strategies of the taxpayer and the MNE group is also generally necessary and this should be documented as part of the four steps. Information on the business strategies can assist in establishing the selection of methodologies and may be very important when addressing questions associated with comparability. In considering these issues, the underlying question is whether an independent enterprise in the taxpayer's circumstances might have been expected to have initiated or participated in these strategies or policies or accepted these objectives, and if so, what reward would have been expected (see paragraphs 3.2 and 3.3 of TR 97/20).[37]

62. The ATO therefore not only needs to understand the benefits expected by an MNE from a business restructuring, but in order to apply the arm's length principle it needs to understand the expected benefits from the business restructuring for the individual group members that are parties to the arrangement.

63. The ATO's examination of the benefits sought from a business restructuring addresses the following aspects:

(a) the nature of the benefits;

(b) what the benefits are worth, in terms of additional shareholder value or profit;

(c) why the business restructuring is needed in order to derive these benefits;

(d) how the various elements or transactions within the overall business restructuring arrangements help to deliver these benefits;

(e) what the involvement of each of the parties contributes to producing these benefits; and

(f) how the parties share in these benefits.

64. The ATO analyses the value chain for the particular business operations as at the time of the restructure with a view to determining how it was expected to be changed as a result of the business restructuring and what the expected benefits of the changes were (as distinct from using hindsight to judge the changes and benefits that actually resulted in the event). Determining the value added to the business from the expected benefits of the business restructuring, the contributions of the parties to adding that value by producing those benefits, and how the parties were to share in those expected benefits are all factors directly relevant to determining the amounts of arm's length consideration payable and receivable in connection with the business restructuring.

[37] Paragraph 5.30 of TR 98/11.

65. Benefits expected from a business restructuring can be any form of economic or commercial advantage that assists an entity's profitability or net worth by enhancing its business circumstances. A business restructuring may be a response to changes in business opportunities, competitive pressures, market conditions, and changing operating and regulatory environments. In light of such changes an entity may restructure to protect its profit-making ability or financial viability. It may seek to seize opportunities to improve its revenue efficiency or cost efficiency. The alternatives to restructuring may be operating less profitably, at a loss, or going out of business.

66. For example, outsourcing is a common feature of business restructurings. Outsourcing arrangements are increasingly occurring between independent enterprises for activities such as inventory management and logistics, IT support, after-sales support, customer receivables management, and R&D. The commercial explanation for this is generally that there are expected to be net benefits to the enterprise from contracting out compared to performing the activity itself. These expected benefits essentially relate to increased profits through having the activity performed more effectively, efficiently and/or at less cost to the enterprise, or through opening up profit opportunities to the business that would not be available within the constraints of its own resources and in-house capabilities.

67. In making the decision to restructure, a MNE would typically undertake a detailed cost benefit analysis or similar type of objective analysis. If it exists the ATO will seek such documentation[38] as well as other financial and commercial data relevant to the matters at paragraph 63 of this Ruling. For a foreign owned MNE this documentation may have been prepared overseas for the MNE group as a whole. The Commissioner will examine the reasonableness and reliability of assumptions, data and forecasts used in the MNE's analyses of the benefits sought from the business restructuring.

68. In some cases the obtaining of tax benefits is a motivation for entering into a business restructuring arrangement.[39] For instance, a business restructuring may involve transferring functions, assets and/or risks to a tax advantaged location. This does not of itself warrant a conclusion that it is a non-arm's length arrangement if independent parties dealing at arm's length would be expected to have entered into the business restructuring agreement and acquired or supplied the property agreed to by the taxpayer. Provided the pricing of the business restructuring itself and of the post-restructuring arrangements accords with what would be expected under an agreement between independent parties dealing at arm's length in comparable circumstances, then the arm's length principle under the transfer pricing provisions is satisfied.

[38] Paragraph 149 of this Ruling.
[39] The general anti-avoidance provisions in Part IVA may apply in these cases. The possible application of Part IVA is not addressed in this Ruling (see paragraph 6 of this Ruling).

Step 2: Select the most appropriate transfer pricing methodology or methodologies

69. For Division 13 purposes, this step is relevant to determining the arm's length consideration for a supply or acquisition of property as defined in paragraphs 136AA(3)(c) and 136AA(3)(d) by reference to a comparable agreement between independent parties dealing at arm's length (paragraphs 136AD(1)(c), 136AD(2)(c) and 136AD(3)(c)).

70. For treaty Article 9 purposes, this step is relevant to determining comparability between the conditions of the taxpayer's commercial or financial relations with an associated enterprise in respect of the business restructuring arrangement and those which would be made between independent enterprises.

71. The use of the concept of 'arm's-length consideration' in Division 13 is modelled on the arm's length principle. This principle is in turn modelled on notions of comparison and predication about what independent parties dealing at arm's length either did or might reasonably be expected to have done in the taxpayer's circumstances.[40]

72. In this step of the process, the Commissioner ascertains whether any reliable uncontrolled comparables data are available evidencing a similar transfer or reallocation of functions, assets and/or risks on similar terms in similar circumstances between independent parties dealing at arm's length. If so, then the uncontrolled comparables data can be used to apply the most appropriate arm's length pricing method(s) to the taxpayer's dealings under the business restructuring arrangement.[41]

73. In some cases, an agreement in relation to a business restructuring may consist of a single international dealing between associated enterprises. For instance, the taxpayer may simply transfer ownership of an intangible asset to a foreign associate. In such a case, relevant uncontrolled comparables data would evidence any similar intangible transfers in similar circumstances between independent parties dealing at arm's length, and absent such data an indirect pricing method may be reliable.[42]

74. As previously discussed, a business restructuring is commonly implemented through a series of inter-related steps or transactions. For instance, the taxpayer may transfer ownership of an intangible asset to a foreign associate and also agree to a licence for the taxpayer's future use of the intangible. In seeking to apply an accepted arm's length pricing method to a dealing that is part of a broader business restructuring arrangement, comparability needs to be assessed by taking account of the dealing in the context of the overall arrangement. The most reliable uncontrolled comparables data would evidence a similar overall arrangement in similar circumstances between independent parties dealing at arm's length.

[40] Paragraph 54 of TR 94/14.
[41] See TR 97/20 for detailed guidance on the selection and application of arm's length pricing methods.
[42] See paragraph 122 of this Ruling.

75. Absent such data, comparables data related to individual dealings that are part of a broader arrangement might have value in determining whether pricing under the overall arrangement is arm's length.

76. Depending upon the particular circumstances, relevant uncontrolled comparables data might include that relating to similar uncontrolled transfers of functions, assets and/or risks, similar uncontrolled transfers of property and/or benefits, the terms governing termination of uncontrolled arrangements similar to the pre-restructuring controlled arrangements, and uncontrolled arrangements similar to the post-restructuring controlled arrangements. Importantly, the outcomes of the comparability analyses of individual dealings that are inter-related parts of a broader business restructuring arrangement must make commercial sense when viewed in the context of the overall arrangement in order for those outcomes together to be used to reliably evidence that the pricing under that arrangement is arm's length.

77. The types of business restructuring arrangements discussed in this Ruling tend to be unique to MNEs. There are therefore ordinarily no available data as to uncontrolled arrangements that are comparable to the overall business restructuring arrangement.

78. Simply because a related party arrangement is one not seen between independent parties, this should not of itself justify a conclusion that the arrangement is non-arm's length.[43] Conversely, it does not mean that the arm's length principle does not apply.[44]

79. Given that there is a need to find an answer in such cases where there are insufficient data available as to comparable uncontrolled dealings, some reasonable basis has to be used by the Commissioner to ensure that a sufficiently reliable approximation of an arm's length outcome is produced.[45] If necessary, subsection 136AD(4) of Division 13 may be relied upon in these circumstances.[46]

80. Where the application of Division 13 is contemplated in situations involving types of dealings between related parties which may not occur between unrelated parties, the role of the Division is to consider the underlying economic and commercial reality of the situation.[47]

[43] Paragraph 1.10 of the OECD Guidelines.
[44] Paragraphs 84 and 341 of TR 94/14.
[45] Paragraphs 3.88 and 3.89 of TR 97/20.
[46] See paragraphs 138 and 139 of this Ruling and paragraphs 1.15 to 1.24 of TR 97/20.
[47] Paragraphs 85 and 342 of TR 94/14.

81. Implicit in the concept of the 'arm's length principle' and of the expression 'arm's length consideration' used in Division 13 is the notion that independent parties when evaluating the terms of a potential deal would compare the deal to the other options realistically available to them and would enter into the deal only if there was no alternative clearly of greater commercial advantage to the individual entity. It could therefore be said that independent parties who were dealing at arm's length would each seek to maximise the overall value of their respective entities from the economic resources available to or obtainable by them.[48]

82. The appropriate arm's length consideration should reflect commercial and market realities, would have regard to the nature of competition and the nature of business (that is, what it means to compete and what it means to carry on business) whereby it would generally be expected that entities would seek to:

(a) maximise the consideration received in respect of the supply of property;

(b) minimise the consideration to be given in respect of the acquisition of property; and

(c) be adequately rewarded for the activities carried out so as to be commercially viable.[49]

83. The determination of the arm's length consideration involves an element of judgment and is not a precise science. Accordingly, taxpayers and ATO auditors need to approach cases with a degree of flexibility and commonsense, having regard to business and market realities.[50]

84. Given the above, where there are insufficient reliable uncontrolled comparables data to establish whether the pricing of a business restructuring arrangement is arm's length, the Commissioner might need to evaluate comparability with what might be expected under an arrangement between independent parties dealing at arm's length by considering the following indicia of arm's length behaviour and outcomes that might be expected to shape such an agreement:

(a) an arm's length outcome is one that makes business sense in the circumstances of the particular taxpayer;[51]

(b) an independent party dealing at arm's length would seek to protect its own economic interest;[52]

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[48] Paragraphs 66 and 315 of TR 94/14.
[49] Paragraph 68 of TR 94/14.
[50] Paragraph 74 of TR 94/14.
[51] Paragraphs 1.1 and 2.15 of TR 97/20.
[52] Paragraphs 2.6 and 2.11 of TR 97/20.

(c) an independent party dealing at arm's length would compare the options realistically available and seek to maximise the overall value derived from its economic resources;[53]

(d) one option might be not to enter into a transaction because it does not make commercial sense for the particular taxpayer.[54]

85. Accordingly, in determining whether the pricing of a business restructuring arrangement is arm's length in the absence of sufficient reliable uncontrolled comparables data, the Commissioner may need to adopt an approach that takes into account whether the pricing of the arrangement makes commercial sense for each of the parties, having regard to what is in their best economic interests and the options realistically available to them at arm's length.

86. This examination generally involves a consideration of the following factors (bearing in mind the need for this to be tailored to the particular circumstances):

(a) the expected benefits of the business restructuring for the parties (paragraphs 62 to 68 of this Ruling);

(b) the other options realistically available to the parties at arm's length (paragraphs 87 to 102 of this Ruling);

(c) the allocation of risk under the restructured arrangements (paragraphs 103 to 108 of this Ruling);

(d) whether an amount of consideration might be expected under an agreement between independent parties in comparable circumstances (paragraphs 112 to 136 of this Ruling).

The other options realistically available to the parties at arm's length

87. The OECD Guidelines state:[55]

> Independent enterprises, when evaluating the terms of a potential transaction, will compare the transaction to the other options realistically available to them, and they will enter into the transaction if they see no alternative that is clearly more attractive.

[53] Paragraph 2.4 of TR 97/20.
[54] Paragraph 2.17 of TR 97/20.
[55] Paragraph 1.15.

88. Generally, independent parties would enter into a transaction or arrangement only if they both expect to obtain benefit by doing so, or at least if they do not expect to be disadvantaged by doing so. Thus, the application of the arm's length principle to an arrangement between associated enterprises requires that neither enterprise as an independent party would have a more beneficial option than entering into the arrangement, or be worse off by doing so compared to its other options. Real bargaining between independent parties may produce a range of outcomes in agreeing the terms and conditions of the arrangement that satisfy this requirement, depending upon the options realistically available to the parties and hence their relative bargaining positions.

89. Whether an independent party has options realistically available other than to enter into a particular transaction or arrangement directly affects its bargaining position and hence the terms upon which it would be expected to choose to enter into that transaction or arrangement. Accordingly, for the purpose of determining whether a business restructuring arrangement accords with what independent parties might be expected to agree, it is relevant for the Commissioner to take account of whether the parties, had they been independent, would have had options realistically available to them other than to enter into the business restructuring.

90. Where an entity as an independent party is found not to have other options realistically available, it is in a relatively weak bargaining position for negotiating the terms of the business restructuring arrangement. For instance, it might not as an independent party be expected to be able to negotiate for receipt of consideration simply for agreeing to enter into the business restructuring, unlike an entity with other options.

91. Where an entity as an independent party would have had options realistically available other than the business restructuring, then whether it would be expected to choose the restructuring depends upon its expected benefits from this, taking account of any consideration receivable and payable in connection with the restructuring itself and the post-restructuring activity, compared with its other available options. An independent entity would be expected to choose the best available option. It would not be expected to choose the business restructuring if it would be worse off by doing so compared to its other options. An entity with other options is in a stronger bargaining position than one without options. Therefore, the independent entity would be expected to use its bargaining position to either refuse the business restructuring if it is not the best available option, or alternatively to negotiate terms for the business restructuring that compensate it for forgoing the benefits of another option. For instance, it might seek the payment of consideration for agreeing to enter into the business restructuring.[56] In this situation the consideration received by the entity is itself an expected benefit from entry into the business restructuring and explains why as an independent party it might choose to enter into the restructuring compared to its other options.

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[56] See paragraphs 126 to 130 of this Ruling.

92. The object of taking account of the options realistically available to the parties to a business restructuring is only to test whether it is comparable with an agreement between independent parties dealing at arm's length in comparable circumstances, for purposes of determining the amounts of arm's length consideration payable or receivable by the taxpayer in connection with the restructuring. This testing is performed by examining whether, consistent with what would be expected of an agreement between independent parties, the pricing is such that both parties expect to benefit, or at least not be disadvantaged, by participating in the business restructuring compared to their other realistically available options.

93. It is not the role of a tax administration to 'second guess' the decision to restructure by using the existence of other options as a ground of itself for disregarding the business restructuring arrangement based upon a tax administration's views as to what may have been a better available option for the taxpayer. Such an approach goes beyond when it may be appropriate to use the arm's length principle to disregard the terms or form of the arrangement actually entered into.[57]

94. In considering the options realistically available, all of the legal, commercial, economic and financial circumstances affecting those options must be taken into account. For instance, one option that an entity as an independent party may realistically have in some cases is to refuse to enter into a business restructuring and to continue operating its existing business. In considering whether an entity as an independent party would have this option realistically available to it, all of the relevant circumstances should be examined, including:

(a) whether the contractual arrangements under which the entity operates its business, give it the option to legally resist termination of those arrangements; and

(b) whether the commercial and economic conditions (that is, market forces) affecting the entity's pre-existing business give it the realistic option of continuing to operate that business.

[57] See paragraphs 142 to 145 of this Ruling regarding the application of treaty Article 9 under paragraph 1.37 of the OECD Guidelines.

95. Thus, an entity may not legally have the option of continuing to operate its existing business where its contractual right to do so is legally terminated by the other party. In any event, it may not have this as a realistic option given the commercial or economic circumstances affecting the business. Even if a restructured entity has chosen to retain its existing operations instead of restructuring, it cannot necessarily be assumed that it would in future have continued to earn a similar level of profit from those operations to what it achieved pre-restructuring. This is clearly so in circumstances where a business restructuring is made in response to commercial or economic circumstances that mean the current operating structure cannot profitably be maintained. In evaluating whether the option of continuing to operate the existing business was realistically available, and for purposes of valuing this option and comparing it with the option of restructuring, it is the forecast profitability of the business that is relevant.

96. The options realistically available at arm's length should be considered from the perspectives of all parties to the business restructuring arrangement, not just the taxpayer or the restructured entity. For instance, where a business restructuring involves an entity becoming a service provider to a principal (for example, a toll manufacturer or commissionaire), then subject to any legal, commercial or other restrictions, the principal as an independent party might realistically have the option of employing other entities in the marketplace to perform such services.[58] As an independent party, the principal entity would be expected to consider whether it could obtain the same service at a lower price from another party.[59]

97. In identifying and evaluating the options realistically available at arm's length, the Commissioner takes account of the circumstances existing and reasonably foreseeable, and the information reasonably available, at the time the business restructuring arrangement was proposed, negotiated and entered into. This is the relevant time by reference to which the issue of whether the business restructuring makes commercial sense for the parties when applying the arm's length principle. Hence, it would be inappropriate for the Commissioner to use hindsight where it examines this issue at some time after the business restructuring is implemented, for example in an audit situation.

98. A factual circumstance potentially affecting the options realistically available to an associated enterprise is its group membership. The options available to such an entity may differ from, (for example, be more limited than), those of a stand-alone entity. This raises a question as to whether the arm's length principle permits this circumstance to be taken into account. A group member deals with the marketplace as a member of a group carrying on the business of the group. Any effects of this on its business operations and profits that are the result of independent commercial and open-market forces are not attributable to non-arm's length conditions of its relationships with the group or its other members.

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[58] See also paragraph 133 of this Ruling.
[59] Paragraphs 1.15 and 1.16 of the OECD Guidelines.

99. The arm's length principle therefore does not require that an entity's group membership be ignored as a factual condition affecting its dealings with independent third parties in the marketplace. The effects of such market forces may be taken into account in considering the options realistically available to the entity at arm's length. If, for instance, a subsidiary is a manufacturer or distributor of the MNE group's products, and a third party (for example, a competitor of the MNE) would not be expected in the particular circumstances to agree for the subsidiary to manufacture or distribute the third party's products, then this is a market condition limiting the options realistically available to the subsidiary at arm's length if its right to manufacture or distribute the group's products is terminated.

Relevance of the concept of 'risk-reward trade-off' to the choice of options

100. A business restructuring typically involves the transfer of functions, assets and risks from one group member to another, so that the transferor's opportunity to derive profit and its risk of incurring loss from those functions, assets and risks is transferred to the transferee. From the transferor's perspective, the commerciality of this might in some cases be explained by the economic theory of the 'risk-reward trade-off'; it is choosing to accept reduced profit-making opportunity as a trade-off for reduced risk of incurring loss.

101. Independent parties are known to agree to assume limited risk for a more stable, albeit potentially lower, return compared to the option of higher risk with a more volatile, albeit potentially higher return. Examples exist of limited risk independent enterprises (for example, contract manufacturers and R&D facilities). There is therefore nothing inherently inconsistent with the arm's length principle for an enterprise to choose to be a low risk service provider. The arm's length principle does not mandate that an entity must always act to maximise its profit-making potential (by maximising its risk of loss). A riskier option is not an inherently better option; an entity is not necessarily worse off by choosing a less risky option, given that this reduces both its potential profits and its potential losses.

102. However, where an existing arrangement is restructured, there is an issue as to whether the business restructuring is arm's length which is separate to the issue of whether the new arrangement itself is arm's length. Thus, for instance, simply showing that independent parties operate as limited risk contract manufacturers does not of itself demonstrate that the choice by a full risk manufacturer to restructure into a limited risk contract manufacturer is one that an independent party would be expected to make based upon the concept of 'risk-reward trade-off'. Whether that concept provides a reasonable explanation of how a business restructuring makes commercial sense for the restructured entity depends upon the particular circumstances and the answers to the following types of questions:

- What does the historical financial data for the business show (for example, what is its history of profitability, is profitability historically volatile or relatively stable)?
- Recognising that in theory there is always a risk of loss, what is the real risk of losses being incurred?
- Recognising that past performance is no guarantee of future performance, what financial forecasts has the entity made to inform its decision?
- Given the relevant historical and forecast data, would an independent party acting in its own best economic interests consider the trade-off of reduced potential profit for reduced risk of loss to be a good deal for it?

The allocation of risk under the restructured arrangements

103. In an economic sense, the types of business risk relevant to business restructurings attach to either assets (through ownership or use) or functions (through decision-making). The most common of these risks are:

- operational risk;
- market risk;
- credit risk;
- inventory risk;
- foreign exchange risk; and
- risk related to ownership and management of intangibles.

104. These types of risks should be viewed as incidental to the performance of real value-adding functions in the business and the use of any assets that may be relevant in that process. Therefore, the shifting of such business risks through a business restructuring should be treated as part of examining whether the changed arrangements under the business restructuring in the performance of the functions and ownership or use of the assets to which those risks relate reflect those that would exist under an agreement between independent parties dealing at arm's length in comparable circumstances.

105. Whether the allocation of risk between related parties is arm's length is in the first instance to be determined having regard to any available uncontrolled comparables data. Even if this data shows a different allocation of risk between independent parties, this of itself does not justify a conclusion that the allocation of risk between the related parties is non-arm's length; that allocation is respected (and the difference taken into account, if possible, through a comparability adjustment), unless the risk allocation is considered not to make commercial sense or to be inconsistent with the economic substance of the arrangement.[60]

106. Under an agreement between independent parties dealing at arm's length, the party to whom a risk is allocated would generally be expected to be both:

(a) financially capable of assuming the risk of loss; and

(b) functionally capable of the decision-making needed to assume and manage the risk.

107. As paragraph 1.27 of the OECD Guidelines states:

> In arm's length dealings it generally makes sense for parties to be allocated a greater share of those risks over which they have relatively more control.

108. Exercising control over a risk implies having a level of decision-making capability relevant to that risk; risk cannot generally be separated from decision-making associated with taking on and managing that risk. Therefore, independent parties would not be expected to allocate risk to a party who lacks this decision-making capability. Nor would they be expected to allocate risk to a party if it is the decision-making of the other contracting party that determines the level of risk and the size and likelihood of potential loss.[61] This would not make commercial sense for the parties where one party is making such decisions in its own best interests with no obligation or incentive to mitigate the risk that is borne by the other party.

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[60] See paragraphs 1.27 and 1.41 of the OECD Guidelines.
[61] See example at paragraph 1.27 of the OECD Guidelines.

Step 3: Apply the most appropriate method and determine an arm's length outcome

109. Like Step 2, this step is relevant for Division 13 purposes to determining the arm's length consideration for a supply or acquisition of property as defined in paragraphs 136AA(3)(c) and 136AA(3)(d) by reference to a comparable agreement between independent parties dealing at arm's length (paragraphs 136AD(1)(c), 136AD(2)(c) and 136AD(3)(c)).

110. For treaty Article 9 purposes, as for Step 2, Step 3 is relevant to determining comparability between the conditions of the taxpayer's commercial or financial relations with an associated enterprise in respect of the business restructuring arrangement and those which would be made between independent enterprises.

111. In Step 3, the data obtained in Steps 1 and 2 is used to perform a comparability analysis to apply the methodology selected in Step 2 to determine an arm's length outcome for the relevant dealing or dealings with associated enterprises.

Determining the consideration that might reasonably be expected under an agreement between independent parties dealing at arm's length in comparable circumstances

112. Under the arm's length principle, consideration should be paid in connection with a business restructuring arrangement between associated enterprises if the payment of consideration would be expected between independent parties dealing at arm's length in comparable circumstances.

113. In determining this, regard should be had to any available, sufficiently reliable, uncontrolled comparables data. Subject to this, in determining whether a payment of consideration would be expected between independent parties, all of the relevant facts and circumstances should be analysed in addressing the following issues:

(a) whether there has been a transfer of property (paragraphs 117 to 122 of this Ruling);

(b) whether there has been the supply of a benefit (paragraphs 123 to 133 of this Ruling);

(c) whether the taxpayer as an independent party would have a right to compensation for termination of its existing arrangements (paragraphs 134 to 136 of this Ruling).

114. The relative bargaining positions of the parties to the business restructuring arrangement, taking account of the options realistically available to them at arm's length, is a relevant factor in determining whether a payment of consideration would be expected between independent parties and the quantum of that consideration.[62]

115. In determining the amount of consideration payable and receivable in connection with a business restructuring, it is important to avoid double-counting. For instance, profit potential may be factored into the value of an asset transferred (for example, the market value of an intangible), the amount of compensation due for termination of an existing arrangement, or the value of a benefit supplied by entry into the business restructuring. Independent parties would not be expected to agree to compensate the same loss of profit potential more than once.

116. The arm's length principle does not always require that an entity receive consideration or compensation where its business activities or arrangements are restructured. Even if the entity expects to suffer detriment or loss from changes to its business, there are circumstances where this would not give rise to a payment of compensation between independent parties. The arm's length principle does not generally require a payment of consideration for the following alone, absent a transfer of property, supply of a benefit or existence of a legal right to compensation:

(a) transfer of a function and/or a risk (paragraphs 126 to 127 of this Ruling);

(b) loss of potential profits or a 'profit-making opportunity' (paragraphs 120 to 121 of this Ruling); and

(c) termination of contractual rights (paragraph 136 of this Ruling).

Whether there has been a transfer of property

117. The arm's length principle requires that the consideration to be paid for a transfer of property between associated enterprises accord with the consideration that would be expected between independent parties dealing at arm's length in comparable circumstances. The term 'property' includes all forms of tangible and intangible property. For Division 13 purposes, 'property' is defined in subsection 136AA(1) to include such things as a chose in action, an interest, right or power in or over property, a right to receive income, and services.

[62] See paragraph 89 of this Ruling.

118. Relevant intangible property includes:

(1) legally protected intellectual property, for example patents, copyrights, trademarks, brand names;

(2) legally enforceable rights, for example, contractual rights.

119. Where a product manufacturer or a distributor/marketer is restructured, its previous activities may have created valuable intangibles that are transferred as part of the business restructuring. For instance, where a distributor/marketer's distribution rights are terminated, it may dispose of the customer list or customer base that it has independently developed in using the rights. The transfer of such an intangible asset to an associate that will in future use this customer base in making sales would be expected to require the payment of consideration if the transfer were between independent parties, to the extent that any value could be attributed to that customer base. This is so if there is a sale of the business as a going concern (including its goodwill). However, in other cases there may be no compensable transfer of such intangibles. For instance, if the distributor has its agreement legally terminated by the other party, it may simply lose its customers who are free to be supplied by others. In this situation the distributor's business simply ceases and it does not have any proprietary right in those customers (that is, as an item of goodwill, the customer list has no separate existence to the business itself).

120. A 'profit-making opportunity', 'business opportunity' or a 'profit potential' is not of itself a proprietary right that is an intangible asset. Profit potential may be relevant to valuing an asset, but is not of itself an asset. A restructured entity may be entitled to receive consideration for loss of profit potential where this attaches to a valuable presently existing asset, and is not a mere expectation of future profit. This asset may be tangible property or it may be an intangible such as intellectual property, a contractual right or goodwill. The profit potential of such an intangible asset is ordinarily factored into its market value, so that disposal of the asset for that value effectively compensates for loss of such profit.

121. A mere reduction in an entity's expected or potential future profits or loss of a profit-making opportunity is therefore not of itself a basis for a right to a payment of consideration between independent parties. However, in some cases an independent entity might agree to enter into a business restructuring for the benefit of another entity if compensated by reference to the loss of expected or potential profits from the best other option realistically available to it at arm's length.[63]

[63] See paragraph 128 of this Ruling.

122. It is not within the scope of this Ruling to give detailed guidance on how to determine an arm's length price or value for intangible property. General guidance on this is to be found at paragraphs 6.13 to 6.35 of the OECD Guidelines. In short, the most appropriate methodology to be used will depend upon what data, if any, are available as to comparable uncontrolled intangibles transfers. Subject to this, a comparable uncontrolled price (CUP) method is preferred. Absent data enabling a direct benchmarking of an arm's length price, other indirect methods may be reliable depending upon the particular circumstances. These include a profit split method and traditional valuation approaches such as an income approach based on the earnings or cash flow generated by the intangible or a cost-based approach using the costs incurred in developing the intangible.

Whether there has been the supply of a benefit

123. If, as part of an arrangement between associated enterprises, one entity acts for the expected benefit of another, then the arm's length principle requires that the consideration to be paid for this service accord with the consideration that would be expected between independent parties dealing at arm's length in comparable circumstances.

124. The term 'benefit' may be defined as follows:

> The word benefit contained in the definition of 'services' encompasses anything that would bestow an economic or commercial advantage which an independent entity might reasonably be expected to pay for, or to obtain consideration for supplying. That is, something that would assist a company's profitability or net worth by enhancing, assisting or improving the company's income production, profit making, the quality of its products, or which could result in a reduction of expenses or otherwise facilitate the operations of the company.[64]

125. Thus, a valuable economic or commercial advantage may be a benefit, the supply of which between associated enterprises should be compensated if this would be expected between independent parties.[65]

[64] See paragraph 31 of TR 94/14. See also paragraph 18 of Taxation Ruling TR 1999/1 and paragraph 7.6 of the OECD Guidelines.
[65] For Division 13 purposes, subsection 136AA(1) defines 'property' as including 'services', which is in turn defined to include 'benefits'.

126. The transfer of a business activity or operation ordinarily involves more than the mere transfer of functions and risks, but also transfers or disposals of assets including intangibles such as intellectual property and contractual rights. The shifting or transfer of functions and/or risks, separate from any assets or property rights, is not of itself the supply of a benefit for which independent parties might be expected to agree the payment of consideration. Unless a restructured entity has a valuable contractual right to perform a particular business activity (for example, rights to distribute a product or manufacture it under licence) or has created an identifiable intangible asset by performing that activity, so that it is entitled to consideration for disposal of that right or asset, disposal of the activity itself (that is, by shifting the functions and risks) would not be expected to give rise to a payment of consideration between independent parties. The functions and risks of themselves have no value or benefit that is transferred from one entity to another. The fact that an entity presently performs a function or assumes a risk does not of itself give a right to compensation for loss of any profits from future performance of that function or assumption of that risk by another entity.

127. Assumption of a risk does not guarantee the risk-taker a profit; risk may be both the opportunity to make a profit and to incur a loss. Therefore, where a business risk is transferred as part of a business restructuring, the transferor would not be expected to receive any consideration merely for transfer of the risk (that is, for any loss of a profit-making opportunity). As previously discussed, the types of risk relevant to business restructuring attach to either assets or functions. The mere transfer of a function and its associated risk is not a compensable transfer of property or supply of a benefit. The transfer of an asset is ordinarily a compensable transfer of property, the arm’s length value of which takes account of its associated risk. An independent party transferring a business risk to another party might expect to compensate the other party for taking on the risk, particularly where the transferor benefits from a reduction in risk of losses or improved certainty (for example, insurance, factoring, hedging, swaps).

128. An independent entity might agree to enter into a business restructuring arrangement that is not otherwise to its benefit compared to its other options, provided it is adequately compensated. In this situation the entity’s entry into the business restructuring arrangement is the supply of a benefit to the other party. As an independent party the entity would expect to receive consideration for supplying this benefit. This is the case where, notwithstanding other consideration receivable by the entity in connection with the business restructuring, for example, for transfers of assets or termination of existing arrangements, the entity is regarded as acting to the benefit of the other party by entering into the business restructuring given that this disadvantages the entity compared to its other options. A party to a business restructuring might expect to derive benefit from receipt of consideration for entering into the restructuring, so that this together with any other expected benefits explains why the restructuring makes commercial sense for it in the particular circumstances.

129. Thus, for instance, where an entity agrees to terminate a business activity or contractual arrangement to the benefit of another entity, this may make commercial sense for the first entity provided it is adequately compensated for this supply of a benefit. For example, an MNE may decide to restructure its product manufacturing and/or distribution and marketing activity. Implementing this decision might involve one group member shutting down its manufacturing and/or distribution and marketing operations as part of an arrangement whereby another foreign group member will take over those operations. This may also involve the first entity surrendering valuable rights it has under its existing arrangements (for example, under licensing, distribution or supply agreements) as part of an arrangement with the second entity enabling it to obtain similar rights by entering into similar agreements. In these situations, the Commissioner would examine all of the relevant circumstances to determine whether the business restructuring involves the supply of property or a benefit by one entity to the other for which independent parties would be expected to agree the payment of consideration.

130. A business restructuring may involve the transfer of personnel between the parties to the arrangement. For instance, a business restructuring whereby responsibility for an activity is centralised in a regional headquarters may involve transfer to the headquarters location of key decision-makers or skilled employees from local entities that previously performed that activity. In this situation an issue may arise as to whether, in agreeing to surrender its rights under the employment contracts and shift valuable profit-generating resources, the local entity is acting for the benefit of the headquarters entity and independent parties would be expected to agree the payment of consideration for this.

131. It is not within the scope of this Ruling to give detailed guidance on how to determine an arm's length price or value for any such benefit. The general guidance on determining an arm's length consideration for an intra-group service applies.[66] Whatever particular arm's length pricing method is used, it is important to bear in mind the following:

> In trying to determine the arm's length price in relation to intra-group services, the matter should be considered both from the perspective of the service provider and from the perspective of the recipient of the service. In this respect, relevant considerations include the value of the service to the recipient and how much a comparable independent enterprise would be prepared to pay for that service in comparable circumstances, as well as the costs to the service provider.[67]

[66] Paragraphs 7.29 to 7.37 of the OECD Guidelines; paragraphs 54 to 74 of TR 1999/1.
[67] Paragraph 7.29 of the OECD Guidelines.

132. Therefore, the amount of any consideration that might be expected between independent parties for the supply of a benefit in these business restructuring situations would be influenced by considering the bargaining positions of the parties and any other options realistically available to each of them at arm's length. From the perspective of the entity that is providing a benefit by entering into the business restructuring, it might as an independent party be expected to seek a consideration measured by reference to any net loss of profits or net loss of value it expects to suffer from the business restructuring compared to its best other option (that is, its opportunity cost of entering into the restructuring). Depending upon the options realistically available to the other party, it either may or may not be expected to agree to pay such a consideration as a cost of obtaining expected benefits from the business restructuring. Thus, the outcome of real bargaining as to the level of compensation paid is likely to be determined by reference to both the opportunity cost of the supplier of the benefit and the value of that benefit to the recipient, as well as other factors affecting their relative bargaining positions.

133. An independent party would not reasonably be expected to pay for a benefit where:

- it has not agreed for the benefit to be provided. Thus, in a business restructuring context, the provider and recipient of the benefit must both be parties to the arrangement under which the provision of the benefit occurs; or
- it could get the benefit without paying for it. This may be the case, for instance, where it does not need the other party's agreement, assistance or co-operation in order to obtain the benefit. The options realistically available to the entity that is being asked to pay for the benefit are relevant here. For example, as an independent party it might not be expected to pay for the benefit of an associate agreeing to restructure and become a service provider to the entity (for example, a toll manufacturer or commissionaire) if at arm's length it would realistically have the option of simply contracting with another party to provide similar services on terms that do not require any such payment. On the other hand, it might be expected to pay if the associate has a particular expertise or other business advantage that is not obtainable from another service provider.

Whether the taxpayer as an independent party would have a right to compensation for termination of its existing arrangements

134. Where an entity's existing arrangements are terminated as part of a business restructuring, this may give rise to a legally recognised right to compensation. This covers any right that would be recognised between independent parties, and thus includes contractual, statutory and equitable rights. For instance, a distribution or licensing agreement may give a right to compensation upon early termination or there may be compensation available in the form of damages if the agreement is terminated by breach. In the absence of a formal agreement, the termination of an arrangement evidenced by a course of conduct may give an equitable right to compensation or an equitable interest in property in respect of contributions made or value created under that arrangement.

135. The arm's length principle only requires compensation for termination of an arrangement if compensation would be expected between independent parties dealing at arm's length in comparable circumstances. Thus, where an entity's existing arrangements are with a related party, it is necessary to determine whether the terms of those arrangements relevant to compensation for termination accord with what independent parties might be expected to have agreed when negotiating and entering into those arrangements. Where available, data as to the terms of comparable uncontrolled arrangements should be used in evaluating this. Where no such data is available, it is necessary to determine what terms would make commercial sense having regard to all of the facts and circumstances of the arrangements.

136. Not every termination of a legal or business arrangement between independent parties gives a right to compensation to a party that is disadvantaged or suffers detriment or loss as a result. Even if an entity has a valuable contractual right that carries a profit-making opportunity, a business restructuring that gives rise to a termination or surrendering of that right may not be grounds for compensation under the arm's length principle where that right would not carry an entitlement to compensation in such circumstances were the entity an independent party. This might be the case, for instance, where an entity has valuable distribution rights or a valuable trademark licence and it suffers loss of this asset and its profit potential when the agreement conferring those rights is terminated by the licensor in accordance with (that is, without breaching) the agreement.

Determining arm's length pricing using an arrangement that might reasonably be expected to exist between independent parties dealing at arm's length in comparable circumstances

Division 13

137. In cases where no readily apparent comparable arm's length price can be ascertained because, for example, the arrangements in question do not reflect commercial and market realities and would not exist between independent parties dealing at arm's length, it is open to the Commissioner, in determining the arm's length consideration, to have regard to available information as to the pricing of an arrangement that would be expected to exist between independent parties dealing at arm's length in comparable circumstances.

138. For instance, a taxpayer may have given consideration for property acquired under a business restructuring arrangement where, in all of the circumstances, it is concluded that there is no expected benefit to the taxpayer from acquiring the property and an independent party would therefore not be expected to pay for it. If the acquisition would not be expected to have occurred under any agreement between independent parties dealing at arm's length in comparable circumstances, then the Commissioner may conclude that the arm's length consideration for the property acquired is nil for purposes of subsection 136AD(3).

139. Another example is where a taxpayer has supplied property as part of a business restructuring arrangement under which the allocation of certain business risks is considered not to make commercial sense or lacks economic substance. Assuming that the consideration that might reasonably be expected if the business risks were allocated under an agreement between independent parties dealing at arm's length in comparable circumstances is higher than the consideration received by the taxpayer, the Commissioner may treat the higher consideration as the arm's length consideration for the property supplied for purposes of subsection 136AD(1).

140. This stance is supported by subsection 136AD(4). Where for any reason (including an insufficiency of information available to the Commissioner) it is not possible or practicable to ascertain the arm's length consideration for a supply or acquisition of property under a business restructuring arrangement, subsection 136AD(4) of Division 13 allows the Commissioner to determine an amount which is then deemed, for the purposes of section 136AD, to be the arm's length consideration.

141. The ATO's views on the application of subsection 136AD(4) are set out at paragraphs 79 to 85 of Taxation Ruling TR 94/14. Two important elements of those views for present purposes are:

(a) determining the relevant amount under subsection 136AD(4) needs to be approached in a manner which, in all the circumstances of the case, would lead to a fair result that is as consistent as practicable with the arm's length principle as internationally accepted;[68] and

(b) in situations involving dealings between associated enterprises which may not occur between independent parties, the role of Division 13 is to consider the underlying economic and commercial reality of the situation.[69]

Treaty Article 9

142. In applying treaty Article 9, paragraphs 1.36 to 1.41 of the OECD Guidelines recognise that there can be exceptional cases where the arm's length principle cannot be satisfied by determining arm's length pricing for the associated enterprise dealings actually entered into by the taxpayer. Under paragraph 1.37 of the OECD Guidelines, the Commissioner may appropriately not recognise the parties' characterisation or structuring of a transaction or arrangement where, having regard to all of the facts and circumstances, it is concluded that either:

(a) the economic substance of the transaction or arrangement differs from its form; or

(b) independent enterprises in comparable circumstances would not have characterised or structured the transaction or arrangement as the associated enterprises have, and arm's length pricing cannot reliably be determined for that transaction or arrangement.

143. For this purpose, the economic substance of a transaction or arrangement is determined by examining all of the facts and circumstances, such as the economic and commercial context of the transaction or arrangement, its object and effects from a practical and business point of view, and the conduct of the parties, including the functions performed, assets used and risks assumed by them. This examination is part of Step 1 of the process suggested in this Ruling, which is the same as for applying Division 13.

[68] Paragraph 82 of TR 94/14.
[69] Paragraph 85 of TR 94/14.

144. Regarding whether comparable arrangements would have been adopted by independent enterprises, paragraph 1.37 of the OECD Guidelines refers to whether the arrangements adopted by the associated enterprises 'differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner…'. In the absence of sufficient reliable data as to comparable dealings between independent parties dealing at arm's length, the question of whether the associated enterprise arrangements accord with what would have been adopted by independent enterprises behaving in a commercially rational manner can be evaluated by considering what makes commercial sense for the parties, having regard to what is in their best economic interests and the options realistically available to them at arm's length.

145. Where one of the circumstances in paragraph 1.37 applies to permit non-recognition of the parties' characterisation or structuring of the arrangement, Article 9 would allow an adjustment of conditions to reflect those which the parties would have attained had the transaction been structured in accordance with the economic and commercial reality of parties dealing at arm's length.[70] The Commissioner will apply treaty Article 9 in such a case to achieve an outcome that is consistent with the outcome of applying Division 13 in accordance with this Ruling. Thus, treaty Article 9 will be applied to adjust the pricing of a transaction between associated enterprises under a business restructuring arrangement by reference to the pricing that might reasonably be expected if the arrangement were characterised or structured as under an agreement between independent parties dealing at arm's length in comparable circumstances.

Documentation

146. In analysing a business restructuring, a tax administration needs to examine the facts and circumstances of the business restructuring so as to gain an understanding of what has changed and the impact of those changes. In applying the arm's length principle, it is relevant for a tax administration to consider the underlying commercial and strategic drivers for the business restructuring and the business objectives being pursued. It should not be expected to simply accept a taxpayer's assertions that the business restructuring has a commercial and/or strategic rationale.

[70] See paragraph 1.38 of the OECD Guidelines.

147. The ATO recognises that within MNEs, commercial strategy and objectives may be set at the global, regional or product/functional group level. The local directors and management are generally responsible for the implementation and/or execution of the overall strategy decisions within their own areas of responsibility. In discharging their duties to the local business or entity, the directors should make a commercial assessment as to the terms and conditions of the arrangements and ensure that these accord with the arm's length principle for income tax purposes, but this follows from, rather than drives the overall strategic decision-making process.

148. In terms of documenting the decision-making process, the practical result is that often, much of the documentation supporting the overall strategic decision-making process will also be at the global, regional or product/functional group level, not at the entity level. In order to evidence that the terms of a business restructuring comply with the arm's length principle for income tax purposes, detailed local documentation will also ordinarily need to be prepared at the entity level, even if this is not required for the decision-making process. The fact that this documentation is prepared outside the main decision-making process relating to the business restructuring does not in itself indicate that the terms of the restructuring are not arm's length.

149. The ATO's expectations as to the documentation that a taxpayer should have to evidence compliance with the arm's length principle are stated in general terms in TR 98/11. These expectations apply to business restructuring arrangements. Chapter 5 of TR 98/11 discusses in detail the nature and extent of the documentation relevant to the 4-Step process suggested in that Ruling. TR 98/11 indicates why it is in a taxpayer's interests to have contemporaneous documentation, relevant to managing its risk of transfer pricing audit, adjustments and penalties. It also indicates that a taxpayer should apply a 'reasonable business person' approach to determining the amount of documentation it should have, taking account of the significance and complexity of the issues involved.

150. Consistent with TR 98/11, in examining the application of the arm's length principle to a business restructuring, the Commissioner will ordinarily seek at a minimum the following types of documentation:

(a) the MNE's internal analyses, reports, submissions and calculations relevant to the decision to restructure and to shift particular functions, assets and risks;

(b) documentation articulating the business context for the business restructuring and the benefits and efficiencies that are expected from it, both from the perspectives of the MNE group and the individual group members involved;

(c) any relevant contracts, including those entered into to implement the business restructuring (for example, contracts for the sale of property) and those evidencing the terms of the pre and post-restructuring arrangements for the business activities affected by the restructuring;

(d) documentation of functional analyses of the functions performed, assets used and risks assumed under both the pre and post-restructuring arrangements for the business activities affected by the restructuring; and

(e) documentation of comparability analyses using available uncontrolled comparables data to determine arm's length pricing for the business restructuring.

Appendix 3 Detailed contents list

151. The following is a detailed contents list for this Ruling:

References

Previous draft:

Previously issued as TR 2010/D2

Related Rulings/Determinations:

TR 94/14; TR 97/20; TR 98/11; TR 1999/1; TR 2001/13; TR 2006/10; TR 2009/D6

Subject references:

- arm's length consideration
- arm's length principle
- associated enterprises
- business restructuring
- commercial sense
- commercially rational
- commissionaire arrangement
- comparability
- comparability analysis
- dealing at arm's length
- documentation
- double tax agreements
- economic substance
- functional analysis
- intangible property
- international agreement
- multinational enterprise
- options realistically available
- organisation for economic co-operation & development
- product supply chain
- risk allocation
- risk transfer
- toll manufacturing
- transfer of assets
- transfer of functions
- transfer pricing

Legislative references:

- ITAA 1936
- ITAA 1936 Pt III Div 13
- ITAA 1936 136AA(1)
- ITAA 1936 136AA(3)
- ITAA 1936 136AA(3)(c)
- ITAA 1936 136AA(3)(d)
- ITAA 1936 136AD
- ITAA 1936 136AD(1)
- ITAA 1936 136AD(1)(a)
- ITAA 1936 136AD(1)(b)
- ITAA 1936 136AD(1)(c)
- ITAA 1936 136AD(2)
- ITAA 1936 136AD(2)(a)
- ITAA 1936 136AD(2)(b)
- ITAA 1936 136AD(2)(c)
- ITAA 1936 136AD(3)
- ITAA 1936 136AD(3)(a)
- ITAA 1936 136AD(3)(b)
- ITAA 1936 136AD(3)(c)
- ITAA 1936 136AD(4)
- ITAA 1936 Pt IVA
- ITAA 1936 Pt X
- International Tax Agreements Act 1953

Other references:

- Attributing profits to a dependent agent permanent establishment
  September 2005, available on the ATO's website www.ato.gov.au
- Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, Organisation for Economic Co-operation & Development 2009

ATO references

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