# *TR 98/16 - Income tax: international transfer pricing - penalty tax guidelines*

This cover sheet is provided for information only. It does not form part of *TR 98/16 - Income tax: international transfer pricing - penalty tax guidelines*

This ruling contains references to repealed provisions, some of which may have been re-enacted or remade. The ruling has effect in relation to the re-enacted or remade provisions. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten.
Australia's tax treaties and other agreements except for the Taipei Agreement are set out in the Australian Treaty Series. The citation for each is in a note to the applicable defined term in sections 3AAA or 3AAB of the International Tax Agreements Act 1953.

This document has changed over time. This is a consolidated version of the ruling which was published on *4 November 1998*

# Taxation Ruling
Income tax: international transfer pricing - penalty tax guidelines

**other Rulings on this topic**

**IT 2311; IT 2517; TR 92/10; TR 92/11; TR 94/2; TR 94/3; TR 94/4; TR 94/5; TR 94/6; TR 94/7; TR 94/14; TR 98/11**

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*This Ruling is a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953**. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

## What this Ruling is about

### Class of person/arrangement

1. This Ruling is intended for taxpayers involved in international dealings where those dealings are not conducted (or are not adjusted by taxpayers for taxation purposes) in accordance with the arm's length principle.

### What this Ruling is about

2. This Ruling provides guidelines on the imposition and remission of penalty tax under Part VII of the *Income Tax Assessment Act 1936*[1] where the transfer pricing provisions of Division 13 of Part III or a relevant provision of a double taxation agreement (DTA), contained in a schedule to the *International Tax Agreements Act 1953*, have been applied in a taxpayer's assessment.

3. In relation to the 1992-93 and subsequent years of income, **Part A** of the Ruling:

(1) outlines the general application of section 225, the rates of which were altered by the *Taxation Laws Amendment (Self Assessment) Act 1992* (the Self Assessment Act); and

(2) provides the Australian Tax Office (ATO) guidelines on penalty remission.

4. In relation to the 1991-92 year of income, **Part B** of the Ruling explains how the ATO considers the present penalty rates under

[1] All subsequent legislative references are to the *Income Tax Assessment Act 1936* (ITAA36) unless otherwise indicated.

section 225, as altered by the Self Assessment Act, when exercising its general power of remission.

5. In relation to income years prior to the 1991-92 year, **Part B** of the Ruling explains how the guidelines provided in Taxation Rulings IT 2311 and IT 2517 continue to apply.

6. **Part C** of the Ruling deals with the remission policy applying to the special case of taxpayers with a substituted accounting period that commenced before 1 July 1992 in relation to their 1992-93 year.

7. **Part D** of the Ruling provides practical guidance to taxpayers on how they can minimise the penalties imposed by section 225.

8. Penalties, where appropriately used, play a role in improving compliance in the transfer pricing area. This Ruling adopts the general principle that there should be no penalty in cases where there is no fault. This exceeds the minimum standards recommended by the Organisation for Economic Co-operation and Development (OECD).

### Terms used in this Ruling

9. The terms '**transfer pricing**' and '**profit shifting**' in this Ruling relate to the allocation of income and/or expenses between tax jurisdictions that is not in accordance with the '**arm's length principle**'. They are not intended to imply any purpose or intention on the part of a taxpayer. For further discussion on the arm's length principle, see Taxation Rulings TR 97/20 and TR 94/14 and the *'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations'* released by the OECD in 1995.

10. References to a '**scheme section**' in this Ruling adopt the term used in the legislation. It is not intended to imply that a scheme actually exists or is the design and intention of the taxpayer. Where a scheme is entered into with the intention to avoid tax, the legislation specifically provides for higher penalties.

11. References to a '**relevant provision of a DTA**' in this Ruling mean either the Associated Enterprises Article or the Business Profits Article of the relevant DTA.

12. References to a '**per annum**' penalty component are not references to 'interest' under section 170AA.

## Date of effect

13. This Ruling applies where penalty tax under section 225 is imposed in respect of a transfer pricing adjustment made by the

Commissioner or where the Commissioner's discretion under subsection 227(3) to remit penalty tax is exercisable after the date of issue of this Ruling.

14. This 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 this Ruling.

# Ruling and Explanations

## PART A

### Legislative framework applying to the 1992-93 and subsequent years of income

#### *General framework*

15. In Part VII there are two groups of penalty provisions dealing with additional tax on tax underpayments. The first group comprises the 'scheme sections', being sections 224, 225 and 226, together with sections 226A to 226F inclusive, which modify the operation of the 'scheme sections'. Penalties imposed by the 'scheme sections' arise upon the exercise of the Commissioner's discretion in calculating the tax that is assessed to the taxpayer in a year of income. The second group comprises the 'shortfall sections', being sections 226G, 226H, 226J, 226K, 226L and 226M, together with a virtually duplicate set of modifying provisions, sections 226U to 226ZA inclusive. The second group of provisions, which were introduced by the Self Assessment Act, penalise taxpayers for underpayments in the assessment of their own tax liability.

#### *Transfer pricing penalties*

16. Section 225 provides for the imposition of penalty tax where Division 13 or a relevant DTA provision has been applied with a resultant increase in the amount of tax assessed to the taxpayer or, where no tax was previously payable, in an amount now being payable. The Self Assessment Act altered the rates of penalty tax under section 225 and introduced sections 226A to 226F inclusive under which those rates may be varied. The amendments apply to the 1992-93 year of income and all subsequent years.

17. For taxpayers with a substituted accounting period that commences before 1 July, the amendments to section 225 first apply to their 1993-94 year of income.

18. The penalty rates imposed under section 225 are:

(1) 50% of the tax avoided for transfer pricing arrangements entered into with the sole or dominant purpose of enabling a taxpayer to pay no or less tax; reducing to 25% if the taxpayer has a reasonably arguable position (paragraph 225(1)(d));

(2) 25% of the tax avoided for other transfer pricing arrangements; reducing to 10% if the taxpayer has a reasonably arguable position (paragraph 225(1)(e)).

19. For the higher penalty rates under paragraph 225(1)(d) to apply, the ATO must be satisfied on reasonable grounds that the transfer pricing adjustment relates to a scheme within the meaning of Part IVA and the scheme was entered into for the sole or dominant purpose of avoiding tax. For schemes without such a sole or dominant purpose, the ATO is not required to establish the taxpayer's purpose or intention as a precondition for the lower penalty rates to apply.

20. Where the Commissioner has not applied Division 13 and has only applied a relevant DTA provision in making a transfer pricing adjustment because of subsection 4(2) of the *International Tax Agreements Act 1953*, penalty tax is to be calculated by reference to the:

(1) tax that would have been assessed if Division 13 had applied;

(2) tax that would have been assessed upon the application of the DTA provision.

The taxpayer is only liable for the lesser of the two amounts, or if the two amounts are the same, for only one amount (subsections 225(2) and (3)).

21. The penalty tax otherwise attracted under section 225 may be increased by 20%:

(1) where a taxpayer takes steps to prevent or hinder the ATO from discovering that a transfer pricing provision should be applied (paragraph 226C(b)(i)); and/or

(2) where the taxpayer has been penalised under a scheme section in a prior year of income (paragraph 226C(b)(ii)).

22. The penalty tax otherwise attracted under section 225 may be reduced by:

(1) 20% if the taxpayer makes a voluntary disclosure to the ATO after it has been informed of an impending audit (section 226D);

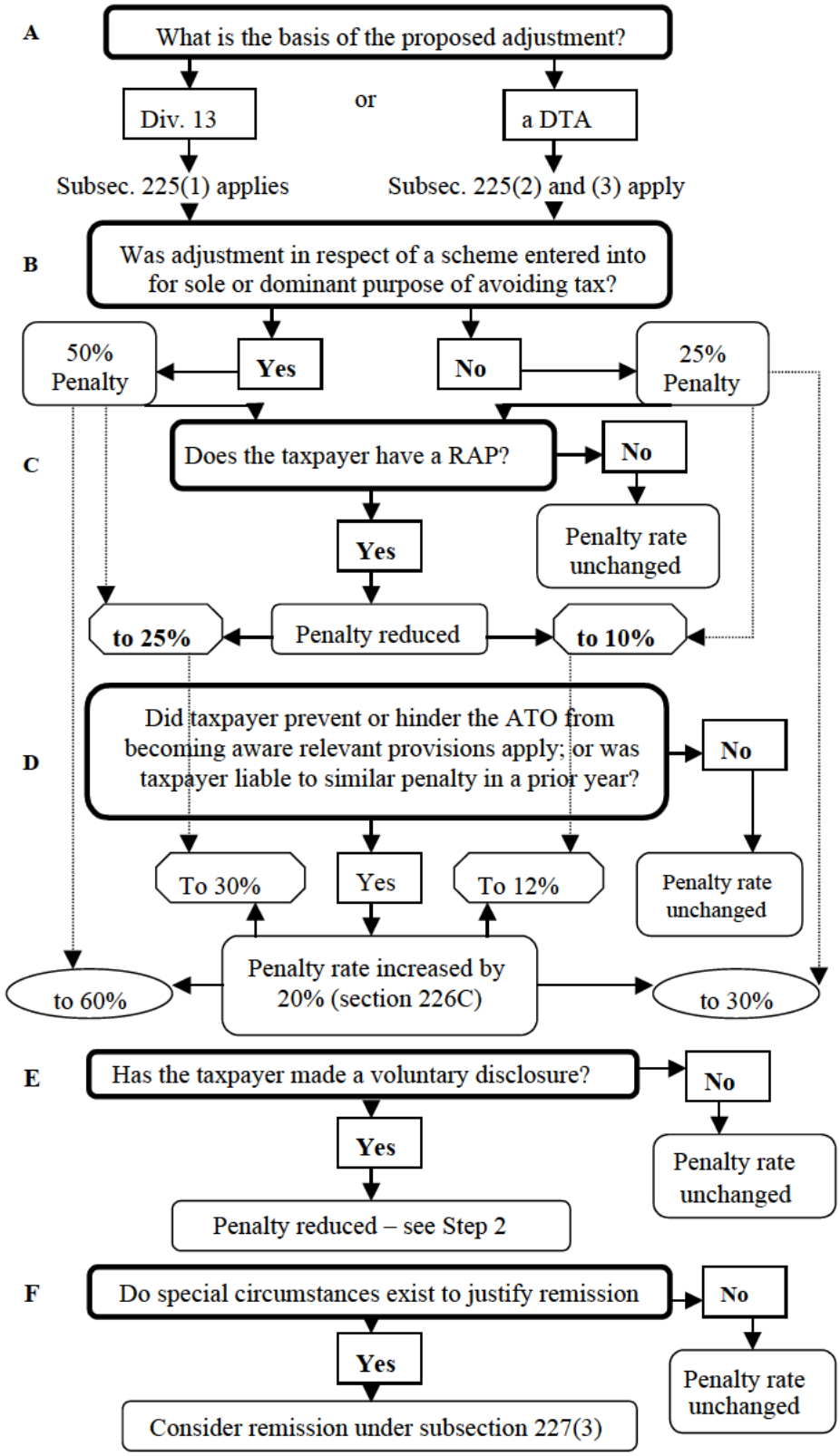
(2) 80% if the taxpayer makes a voluntary disclosure to the ATO before it has been informed of an impending audit

(section 226E). Where a taxpayer makes a voluntary disclosure after having been informed that a tax audit is to be carried out, the Commissioner may treat the disclosure as having been made before being so informed (section 226F).

23. Subsection 227(3) confers on the Commissioner the discretion to remit all or part of such penalties.

24. The following charts reflect the overall application of section 225 penalties where a transfer pricing adjustment is made by the ATO under Division 13 (sections 136AD or 136AE) and/or under a relevant provision of a DTA:

***Step 1: Determine the rate of section 225 penalty***


A
What is the basis of the proposed adjustment?
Div. 13
or
a DTA
Subsec. 225(1) applies
Subsec. 225(2) and (3) apply
B
Was adjustment in respect of a scheme entered into for sole or dominant purpose of avoiding tax?
50% Penalty
Yes
No
25% Penalty
C
Does the taxpayer have a RAP?
No
Penalty rate unchanged
Yes
to 25%
Penalty reduced
to 10%
D
Did taxpayer prevent or hinder the ATO from becoming aware relevant provisions apply; or was taxpayer liable to similar penalty in a prior year?
No
To 30%
Yes
To 12%
Penalty rate unchanged
to 60%
Penalty rate increased by 20% (section 226C)
to 30%
E
Has the taxpayer made a voluntary disclosure?
No
Yes
Penalty rate unchanged
Penalty reduced – see Step 2
F
Do special circumstances exist to justify remission
No
Yes
Penalty rate unchanged
Consider remission under subsection 227(3)

***Step 2: Reduced section 225 penalty rates for voluntary disclosures***

## Sole or dominant tax avoidance purpose cases

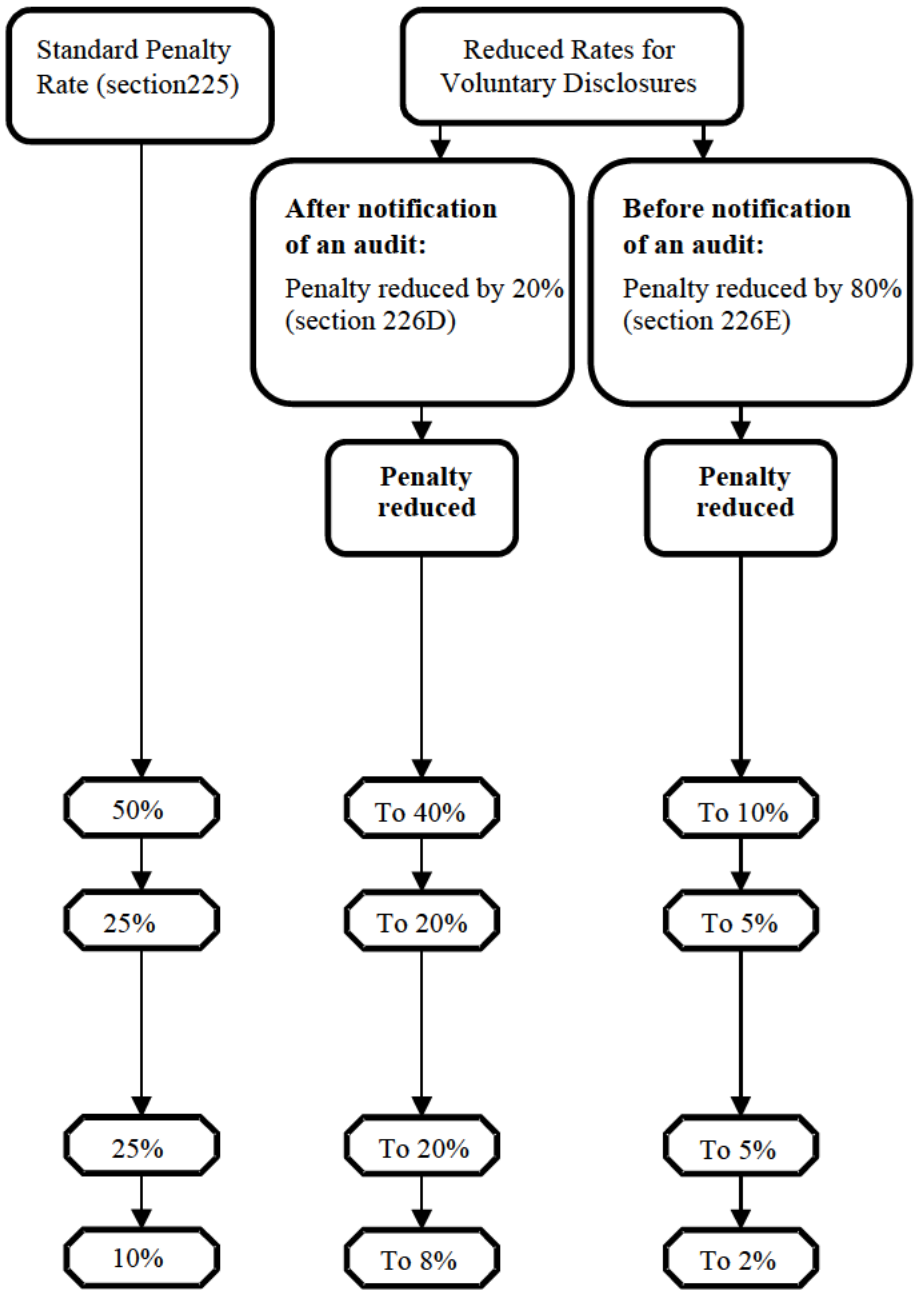
Where taxpayer does not have a RAP

Where taxpayer has a RAP

## All other cases

Where taxpayer does not have a RAP

Where taxpayer has a RAP




RAP: reasonably arguable position

***Reasonably arguable position***

25. Penalties are reduced to 25% (for schemes with a sole or dominant purpose to avoid tax) and 10% (for other schemes) of the tax avoided where the taxpayer has a reasonably arguable position in relation to a transfer pricing adjustment.

26. Section 222C provides that the correctness of the treatment of the application of a law or another matter is reasonably arguable if, having regard to the relevant authorities and the facts of the matter in relation to which the law is applied or the other matter, it would be concluded that what is argued for is about as likely as not correct. Taxation Ruling TR 94/5 discusses the concept of a reasonably arguable position in the context of the shortfall penalties. While subsection 222C(4) provides a non-exhaustive list of authorities that would be of assistance in determining whether a taxpayer has a reasonably arguable position, Taxation Ruling TR 94/5 and the explanatory memorandum to the Self Assessment Act explain that what is important is the relative strength of the argument sufficient to support a reasonable expectation that it be upheld by a Court.

27. Section 222C further provides guidance on how the reasonably arguable test applies in cases where the application of an income tax law requires the Commissioner to exercise his discretion. The explanatory memorandum to the Self Assessment Act explains it in the following manner in relation to sections 224, 225 and 226:

> 'Because these sections contemplate action by the Commissioner in applying a discretionary anti-avoidance provision against a taxpayer, the 'reasonably arguable' test looks at whether it is about as likely as not that the anti-avoidance provisions do not apply.' (page 90)
>
> 'Pending the progressive removal of Commissioner discretions from the law and their replacement with objective criteria, there will be cases where a taxpayer, in applying the tax law to the facts, will need to make an assumption about the way in which the Commissioner would act. In these cases, a taxpayer will have a reasonably arguable position to the extent that the assumption is in the range of positions which, if decided by the Commissioner in the circumstances of the case, a court would be about as likely as not to conclude was decided according to law. This approach effectively puts the taxpayer in the shoes of the Commissioner, and looks to whether the taxpayer, in making the assumption, has taken into account all relevant considerations, and not taken into account any irrelevant considerations, that bear materially on the decision reached.' (page 85)

28. In relation to section 136AD, the taxpayer has a reasonably arguable position if:

(1) it is about as likely as not the preconditions to a Division 13 application have not been met;

(2) the taxpayer's dealings with the other party (parties) to the international agreement were about as likely as not at arm's length in relation to the supply or acquisition of property;

(3) the prices at which the property was supplied or acquired were about as likely as not the arm's length prices; or

(4) it is about as likely as not the Commissioner has erred in law in making the determination.

29. In relation to section 136AE, the taxpayer has a reasonably arguable position if, for example:

(1) the income the Commissioner determines is attributable to the activities of a non resident, carried on in Australia at or through a permanent establishment, is about as likely as not to be attributable to those activities; or

(2) the expenditure relevant to deriving the income of the permanent establishment is about as likely as not to be greater than the amount determined by the Commissioner.

30. In a practical sense, the test focuses on how well the processes and methodologies adopted by the taxpayer, and the outcomes achieved, reflect the arm's length principle. A taxpayer would be best placed to demonstrate it has a reasonably arguable position where:

(1) documents that were brought into existence as part of the process of determining the prices and terms of dealings (or the adjusted prices and terms of dealings adopted in the return) were maintained;

(2) the conduct of the relevant parties was consistent with the documentation; and

(3) the documents accurately recorded the relevant facts and deliberations.

31. The fact that the ATO may not have released final Rulings on all aspects of the operation of Division 13 or the relevant provisions of a DTA, does not in itself provide a basis for a taxpayer to satisfy the test of a reasonably arguable position, since the taxpayer has to show that the position taken on the tax issue is reasonably arguable. Conversely, the fact that the ATO has taken a view in a public Ruling does not of itself mean that a different view is not reasonably arguable: see Taxation Ruling TR 94/5 at paragraph 9(c).

### *Increased penalties where there is hindrance by a taxpayer*

32. Steps to hinder the ATO would include unreasonable delay by the taxpayer in responding to enquiries by taxation officers, or the

taxpayer regularly failing to attend scheduled interviews without reasonable cause. It would also include instances where the taxpayer destroyed or falsified relevant records, unreasonably failed to produce them, or colluded with other persons (after the relevant dealing had been made) to conceal or distort the matter.

### *Penalties in tax avoidance cases*

33. Tax avoidance schemes (schemes entered into for the sole or dominant purpose of avoiding tax) may be found to be ineffective under the ordinary provisions (e.g., section 8-1 of the *Income Tax Assessment Act* (ITAA97) / subsection 51(1) of the ITAA36) without the need for recourse to specific anti-avoidance or transfer pricing provisions. For example, in a case of a scheme entered into for the sole or dominant purpose of avoiding tax, involving the acquisition of property under an international agreement, section 8-1 of the ITAA97 / subsection 51(1) of the ITAA36 denies a deduction for expenditure to the extent that it was incurred for a purpose other than for the purpose of producing the assessable income of the taxpayer (paragraphs 187 to 199 of Taxation Ruling TR 94/14). Schemes falling into this category that are defeated under the ordinary provisions, face the same level of penalties under Section 226L as under paragraph 225(1)(d), i.e., 50% of the tax avoided, reducing to 25% where the taxpayer has a reasonably arguable position.

## Remission under subsection 227(3) in cases where the taxpayer has made a reasonable attempt in good faith to comply

34. The legislative intention behind the section 225 penalty enactment is to signal to taxpayers to avoid using non arm's length prices in the preparation of their tax returns.

35. The explanatory memorandum to the Self Assessment Act indicated that the Commissioner's remission discretion power was retained to cover any 'good faith' considerations where the prescribed rates, if rigidly imposed, will produce harsh and unjust results. The only means to achieve a nil penalty outcome in respect of an adjustment under Division 13 and/or a relevant DTA provision, is by the Commissioner exercising the remission discretion under subsection 227(3).

36. Against this background, in order to encourage voluntary compliance and ensure the penalty provisions do not impose an undue burden on compliant taxpayers, remission of section 225 penalty will be made under subsection 227(3), reducing the penalty rate otherwise applying from 10% to nil, where the taxpayer:

(1) has genuinely made a reasonable attempt in good faith to comply with the arm's length principle in preparing the tax return, having regard to what a reasonable business person in the taxpayer's circumstances would do (see Chapter 1 of Taxation Ruling TR 98/11);

(2) has used its best endeavours to document the process of selecting and applying an arm's length method at the time the transaction was negotiated, or at the time the relevant income tax return was prepared, on the basis of the information in the taxpayer's possession and any other information that was reasonably available to the taxpayer at the time (see also Taxation Rulings TR 98/11);

(3) can satisfy the ATO that there was no tax avoidance intention or purpose in adopting the pricing outcomes arrived at from performing the process mentioned in subparagraph (2) above; and

(4) where the transfer pricing adjustment is made as a result of audit action, the taxpayer has fully co-operated with the ATO, including providing all relevant information in the taxpayer's possession or reasonably available to the taxpayer so as to achieve an expeditious conclusion of the audit.

37. Full remission will not be made in a case where a transfer pricing adjustment has been made because of the failure by the taxpayer to furnish the tax return in accordance with the terms and conditions of any relevant advance pricing agreement that the taxpayer has with the ATO (see paragraphs 65 and 66 below).

38. The reference in paragraph 36(2) above to information held by or reasonably available to the taxpayer includes relevant information held in Australia or offshore that could be reasonably obtained or ascertained by the multinational enterprise group.

39. Taxation Ruling TR 98/11 recommends that taxpayers adopt a quality process, such as the four steps explained in Chapter 5 of that Ruling, when developing and documenting international transfer prices. The quality of a taxpayer's process and the adequacy and relevancy of documentation created and maintained in applying the arm's length principle to international dealings with associates, are relevant to the exercise of the remission discretion. Taxpayers assessed as falling in the medium-high quality and high quality categories under Chapter 4 of Taxation Ruling TR 98/11 will be regarded as having satisfied the requirements of paragraphs 36(1) and (2) above.

40. A relevant consideration in applying paragraph 36 above is the reasonable availability of guidance to taxpayers on transfer pricing at the time the dealings were undertaken or the relevant tax return was prepared.

41. On review, the Administrative Appeals Tribunal is also able to exercise the power of remission. Courts are limited to adjudicating on whether the discretion was exercised in accordance with law. Of course, the penalty is also dependent upon the primary adjustment being sustained.

## PART B

### Legislative framework applying to the 1991-92 and prior years of income

42. The present Part VII was inserted in the ITAA36 by the *Taxation Laws Amendment Act 1984*, operative from 14 December 1984.

43. Penalty tax rates imposed under section 225, prior to the amendments made by the Self Assessment Act, were:

(1) 200% of the tax avoided for profit shifting arrangements entered into for the sole or dominant purpose of avoiding liability to Australian tax; or

(2) 25% per annum of the tax avoided for other profit shifting arrangements where tax avoidance was not the sole or dominant purpose.

### Remission policy

44. While different provisions that impact on the question of remission apply for these years, the general thrust of the ATO application of those provisions is to produce, where possible, a result that is broadly consistent with that outlined above. It has to be acknowledged that the understanding of the transfer pricing rules and their application has significantly developed in recent years. In considering remission under the previous provisions, relevant considerations, even in terms of Taxation Rulings IT 2311 and IT 2517 as modified by Taxation Ruling TR 92/11, include the efforts made by the taxpayer to arrive at the proper results and being able to demonstrate the international prices used in the tax return were about as likely as not the arm's length prices, thereby making the matter truly contentious.

**Application of remission policy to adjustments in respect of transactions entered into on or after 14 December 1984 up to and including the 1990-91 year of income**

45. In exercising its discretion to remit penalties, the ATO will apply the principles set out in Taxation Ruling IT 2517 to transfer pricing adjustments made under Division 13 and/or a DTA provision, where it gives a result that is more advantageous to the taxpayer than under Taxation Ruling IT 2311. Taxation Ruling IT 2311 continues to apply to cases where the application of its guidelines results in lower penalties than those determined under Taxation Ruling IT 2517. This was advised in paragraph 30 of Taxation Ruling TR 92/11.

46. While Taxation Rulings IT 2311 and IT 2517 were archived/withdrawn on 29 September 1994 and 26 March 1997 respectively, the Rulings continue to apply to arrangements entered into prior to their archival/withdrawal.

***Summary of Taxation Ruling IT 2517 (withdrawn)***

47. While Taxation Ruling IT 2517 provides remission guidelines on penalty tax of 200% of the tax avoided as a result of a false and misleading statement that affects the taxpayer's assessed liability under former section 223, those guidelines may be applied in remitting transfer pricing penalty tax. The penalty tax imposed comprises two components (viz., 'per annum' and 'culpability'). For the ATO views on the various terms used in the table below, the basis for adopting such rates, and the circumstances that warrant an increase or decrease in the resultant penalty rates recommended in the table, see Taxation Ruling IT 2517:

| REASON FOR THE FALSE OR MISLEADING STATEMENT | ADDITIONAL TAX | |
|---|---|---|
| | 'PER ANNUM' COMPONENT | 'CULPABILITY' COMPONENT |
| Deliberate evasion (without aggravating factors) | YES | 45 |
| Recklessness (short of deliberate evasion | YES | 30-40 |
| Carelessness | YES | 15-30 |
| Minor case of carelessness | YES | 5-15 |
| Inadvertent error, honest mistake, (dependent on the degree of care) | YES | 0-5 |
| Contentious item | YES | 0-5 |
| Genuine misunderstanding of the requirements of the legislation | YES | NIL |
| Did not know and could not be expected to know | NO | NIL |
| Genuinely misled by actions of the ATO | NO | NIL |

Source: Paragraph 41 of Taxation Ruling IT 2517

48. The 'per annum' penalty component is calculated by applying a per annum interest rate to the tax avoided for the period during which tax has been avoided. The relevant per annum interest rate is:

(1) 14.026% for the period up to 30 June 1992;

(2) 10% for the period up to 30 June 1993; or

(3) as published in the Gazette for subsequent periods under subsection 214A(8).

49. Where a voluntary admission is made, a 'culpability' component is not imposed and the taxpayer is only subject to a 'per annum' component (and limited to a maximum of 50% of the tax avoided in any year) where there is:

(1) a full and true disclosure of all relevant material facts necessary for a correct assessment; and

(2) such disclosure is not due to ATO activities in connection with the taxation liability of the taxpayer.

50. Further remission of the 'per annum' penalty component may be warranted in exceptional circumstances.

***Summary of Taxation Ruling IT 2311 (archived)***

51. For profit shifting arrangements where tax avoidance does not constitute the sole or dominant purpose, the remission guidelines are:

(1) penalty, calculated at 25% per annum of the tax avoided, should not exceed in any year, 200% of the extra tax payable as a result of the application of Division 13 and/or a relevant provision of the DTA; or

(2) where a prepayment of tax is made prior to the assessment or amended assessment applying Division 13 and/or a relevant DTA provision, the 25% per annum penalty is calculated to the date of prepayment.

52. For profit shifting arrangements where tax avoidance constitutes the sole or dominant purpose, the remission guidelines are:

(1) a basic penalty of 40% of the tax avoided (the 'culpability' component) plus a 20% 'per annum' component where there is co-operation with ATO enquiries; or

(2) the 'culpability' component should be increased by 10-50% of the tax avoided where, for example:

- deliberate steps have been taken, either before or after commencement of ATO enquiries, to conceal the avoidance of tax;
- there has been a lack of co-operation such as to cause undue/excessive delay in the completion of ATO enquiries and/or there has been obstruction or hindrance;
- there has been previous participation in profit shifting, tax avoidance or evasion practices by or on behalf of the taxpayer;

(3) where a prepayment of tax is made prior to the issue of the assessment or amended assessment applying Division 13 and/or a relevant DTA provision, the penalty is calculated to the date of the prepayment;

(4) any remission granted would not reduce the penalty below the level of the 25% per annum rate that is applied where tax avoidance is not the sole or dominant purpose of the arrangement.

53. Other cases of remission are expected to occur in very limited and exceptional cases.

### Application of remission policy to the 1991-92 year of income

54. In Taxation Ruling TR 92/10, the ATO decided to bring forward the principles of the penalty provisions of the Self Assessment Act to the 1991-92 year of income when exercising its remission discretion on penalties arising from tax avoided as a consequence of a false and misleading statement made by a taxpayer. Similarly, the ATO agrees the present penalty rates under section 225 are to be considered in determining the 'culpability' component of the penalty tax when exercising the remission discretion in relation to the 1991-1992 year of income. Such a policy confers on taxpayers the benefits of greater certainty and consistency.

55. Accordingly, for the 1991-92 year of income, the ATO will exercise its remission discretion so as to apply the lowest level of penalty tax after taking account of:

(1) the remission guidelines provided in Taxation Ruling IT 2311;

(2) the remission guidelines provided in Taxation Ruling IT 2517; and

(3) the present penalty rates under section 225 and the circumstances provided in sections 226C to 226F inclusive, which were brought in by the Self Assessment Act, together with a 'per annum' component. Paragraphs 15 to 32 above discuss the application of the present rates under section 225.

56. The interest rates indicated in paragraph 48 above that are relevant to the calculation of the 'per annum' component are used only:

(1) in applying the remission guidelines in Taxation Ruling IT 2517 (paragraph 55(2) above); and

(2) in conjunction with the present penalty rates under section 225 (paragraph 55(3) above).

## PART C

### Application of remission policy to the 1992-93 year of income for taxpayers with an accounting period that commenced before 1 July 1992

57. For taxpayers with a substituted accounting period that commenced before 1 July, the penalty amendments introduced by the Self Assessment Act first applied to their 1993-94 year of income. Accordingly, the former penalty rates under section 225 apply in relation to their 1992-93 year of income.

58. In addition to penalties imposed under section 225, such taxpayers are also liable to pay interest assessed under section 170AA when their 1992-93 year assessment is amended after 30 June 1992.

59. Section 170AA was amended by the Self Assessment Act so that a taxpayer may be liable to pay interest under the section, in relation to an amended assessment, even though the taxpayer may also be liable to a Part VII penalty in relation to the same matter that led to the assessment being amended. This amendment to section 170AA applies to assessments for the 1992-93 year and subsequent years (including assessments for accounting periods adopted in lieu of the 1992-93 year).

60. Where a taxpayer with a 1992-93 substituted accounting period is subject to a transfer pricing adjustment, it is faced with the prospect of being liable for both a 'per annum' penalty component (calculated in accordance with Taxation Rulings IT 2311 or IT 2517) and per annum interest under section 170AA. To avoid this result, the ATO will exercise its remission discretion so as to apply the lowest level of penalty tax after taking account of:

(1) the 'culpability' component provided in the remission guidelines in Taxation Ruling IT 2517 (and remitting in full the 'per annum' component); and

(2) the present penalty rates under section 225 and the circumstances provided in sections 226C to 226F inclusive that were brought in by the Self Assessment Act.

In addition, the taxpayer will be subject to interest under section 170AA.

61. The remission guidelines in Taxation Ruling IT 2311 will not be considered in order to avoid the imposition on the taxpayer of a substantial penalty, calculated at 25% per annum of the tax avoided (see paragraph 51 above) in addition to per annum interest under section 170AA.

## PART D

## Minimising section 225 penalties

### *Voluntary disclosures*

62. The penalty regime encourages voluntary disclosures by providing significant statutory reductions in penalties to taxpayers who do so. For a detailed explanation of the ATO's policy on voluntary disclosures, see Taxation Ruling TR 94/6. Prudential reviews and the possibility of amendments under subsection 170(1) are covered in paragraphs 108 and 109 of Taxation Ruling TR 94/14.

63. Where amendments under subsection 170(1) are not possible due to statutory time constraints, the ATO will make the amendments under subsection 170(9B) - which enables an initial transfer pricing adjustment to be made at any time. In such voluntary disclosure cases, the ATO will have to consider the limitations on the subsection 170(9B) power imposed by subsection 170(9C). Subject to taxpayers being able to demonstrate that they have made genuine efforts to rectify past transfer pricing practices and co-operate with the ATO in finalising the amendment, they will be afforded the same treatment, by the ATO exercising the remission discretion, as an amendment made under subsection 170(1).

64. However, where taxpayers require a formal determination to be made, the amendment(s) under Division 13 and/or the relevant DTA provision will be made under subsection 170(9B) and must attract the statutory penalties under section 225, with a reduction under either section 226D or 226E. In these cases, the ATO may also require that a full audit or review be carried out on all related transfer pricing issues after giving consideration to the limitations imposed under subsection 170(9C).

***Advance pricing arrangements (APAs)***

65. Taxation Ruling TR 95/23 sets out the ATO policy, process and practice on APAs.

66. A taxpayer with an APA will not incur penalties under section 225 except in relation to:

(1) non-arm's length dealings which are not covered by the APA; or

(2) non-compliance with the terms and conditions of the APA.

# Detailed contents list

67. Below is a detailed contents list for this Ruling:

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**Commissioner of Taxation**

4 November 1998

ISSN 1039 - 0731

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NO 95/4732-1
95/8031-0
98/7825-4
BO

Previously released in draft form as TR 95/D24

Price $2.00

FOI index detail
*reference number*
I 1017814

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