

# ***PS LA 2014/2 - Administration of transfer pricing penalties for income years commencing on or after 29 June 2013***

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 This document has changed over time. This version was published on *24 January 2025*



# Administration of transfer pricing penalties for income years commencing on or after 29 June 2013

This Practice Statement explains:

- when an entity will be liable for a transfer pricing penalty
- how the entity's transfer pricing penalty is assessed, and
- how the Commissioner's discretion in relation to remission should be exercised.

*This Practice Statement is an internal ATO document and an instruction to ATO staff.*

*Taxpayers can rely on this Practice Statement to provide them with protection from interest and penalties in the following way. If a statement turns out to be incorrect and taxpayers underpay their tax as a result, they will not have to pay a penalty, nor will they have to pay interest on the underpayment provided they reasonably relied on this Practice Statement in good faith. However, even if they do not have to pay a penalty or interest, taxpayers will have to pay the correct amount of tax provided the time limits under the law allow it.*

## 1. Scope

1A. This Practice Statement is published as part of a package dealing with transfer pricing documentation and should be read in conjunction with Taxation Ruling TR 2014/8 *Income tax: transfer pricing documentation and Subdivision 284-E*, which sets out the Commissioner of Taxation's views on the transfer pricing documentation requirements of Subdivision 284-E of Schedule 1 to the *Taxation Administration Act 1953* (TAA).

1B. All legislative references in this Practice Statement are to Schedule 1 to the TAA, unless otherwise indicated.

1C. This Practice Statement explains how we administer scheme penalties arising from the application of the transfer pricing rules in Subdivisions 815-B and 815-C of the *Income Tax Assessment Act 1997* (ITAA 1997). Liability to these penalties arises under subsection 284-145(2B). In this Practice Statement, these penalties are referred to as 'transfer pricing penalties'.

1D. This Practice Statement discusses:

- when an entity will be liable for a transfer pricing penalty, and
- how we will assess an entity's transfer pricing penalty, including determining remission.

1E. This Practice Statement does not provide guidance on an entity's liability to scheme penalties under:

- subsection 284-145(1) that arise from the application of the anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936)

- subsection 284-145(2) that arise from the application of former Division 13 of the ITAA 1936 and Australia's tax treaties, and
- subsection 284-145(2A) that arise from the application of Subdivision 815-A of the ITAA 1997.

## 2. Background

2A. An entity will be liable to a scheme penalty under subsection 284-145(2B) where either Subdivisions 815-B or 815-C<sup>1</sup> of the ITAA 1997 applies to impose a liability to pay additional income tax or withholding tax.

2B. Subsection 284-145(2B) was introduced by the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013*. This Act also introduced Subdivisions 815-B, 815-C and 815-D of the ITAA 1997 (collectively referred to as 'the transfer pricing rules' in this Practice Statement) and Subdivision 284-E.

2C. Subsection 284-145(2B) of Subdivision 284-C imposes administrative penalties on an entity that gets a benefit under a scheme within Subdivisions 815-B and 815-C of the ITAA 1997. Subdivision 284-C is part of the uniform administrative penalty regime that applies to entities for failing to satisfy their obligations under the taxation laws.

2D. Subdivision 815-B of the ITAA 1997 ensures that the amount of Australian tax from cross-border conditions between entities is consistent with the arm's length principle. Subdivision 815-C of the ITAA 1997 ensures that the amount of Australian tax from the attribution of profits by entities operating permanent establishments is consistent with the arm's length

<sup>1</sup> Note: Subdivision 815-D of the ITAA 1997 contains special rules for trusts and partnerships in relation to the application of Subdivisions 815-B and 815-C of that Act.

principle. Subdivision 815-D of the ITAA 1997 clarifies how Subdivisions 815-B and 815-C of that Act apply to trusts and partnerships. Subdivision 284-E sets out the special rules about unarguable positions for cross-border transfer pricing (including the documentation requirements).

2E. Under Subdivision 815-B of the ITAA 1997, an entity will get a transfer pricing benefit where:

- the actual conditions that operate between the entities differ from the arm's length conditions, and
- the other requirements of section 815-120 of the ITAA 1997 are satisfied.

2F. Under Subdivision 815-C of the ITAA 1997, an entity will get a transfer pricing benefit where:

- the amount of profits attributed to the permanent establishment differs from the arm's length profits of the permanent establishment, and
- the other requirements of section 815-220 of the ITAA 1997 are satisfied.

2G. The entity is liable to a transfer pricing penalty based on the total additional amount of income tax or withholding tax<sup>2</sup> arising from the application of Subdivisions 815-B or 815-C of the ITAA 1997 as a result of an entity getting a transfer pricing benefit.

2H. The transfer pricing rules replace:

- Division 13 of the ITAA 1936 and its associated scheme penalty provision of subsection 284-145(2) for income years commencing on or after 29 June 2013, and
- Subdivision 815-A of the ITAA 1997 and its associated scheme penalty provision of subsection 284-145(2A) for income tax years commencing on or after 29 June 2013.

### 3. Steps in the administration of scheme penalties

3A. The administration of Subdivision 284-C scheme penalties involves 3 main steps<sup>3</sup>:

- Step 1 – Determine whether the entity is liable for a penalty

- Step 2 – Assess the amount of the penalty
  - (a) determine the scheme shortfall amount
  - (b) determine the base penalty amount (BPA)
  - (c) increase or reduce the BPA, or both
  - (d) decide whether to remit all or part of the penalty.
- Step 3 – Notify the entity of the liability to pay the penalty.

3B. This Practice Statement provides guidance on these 3 steps in the order they occur in the administrative process. The steps must be completed in the order specified in paragraph 3A of this Practice Statement. A decision about remission of penalty will normally be made in the course of assessing the amount of any penalty, as both are part of Step 2. However, a decision about remission of penalty can also be made after an entity has been notified of its liability to pay the penalty.<sup>4</sup>

### 4. Step 1 – determine whether the entity is liable for a penalty

4A. An entity is liable to a transfer pricing penalty in relation to a scheme where<sup>5</sup>:

- (a)
  - (i) the entity is liable to pay an additional amount of income tax for an income year under an assessment we amend, or
  - (ii) the entity is liable to pay an additional amount of withholding tax under one or more withholding tax notices we serve<sup>6</sup>, or
  - (iii) both of the above
- (b) the amended assessment or withholding tax notice gives effect to Subdivisions 815-B or 815-C of the ITAA 1997, and
- (c) the additional amount of income tax or withholding tax the entity is liable to pay is more than its reasonably arguable threshold.<sup>7</sup>

4B. An entity will be liable to a transfer pricing penalty (under subsection 284-145(2B)) only where the amended assessment or withholding tax notice gives effect to Subdivisions 815-B or 815-C of the ITAA 1997 in relation to a scheme. Those Subdivisions apply to income years commencing on or after 29 June 2013.

<sup>2</sup> Referred to in subsection 284-150(4) as the 'scheme shortfall amount'.

<sup>3</sup> These 3 steps are followed in Law Administration Practice Statement PS LA 2011/30 *Remission of administrative penalties relating to schemes imposed by subsection 284-145(1) of Schedule 1 to the Taxation Administration Act 1953*. These steps are also followed in a Subdivision 284-B context in Law Administration Practice Statements

PS LA 2012/4 *Administration of the false or misleading statement penalty – where there is no shortfall amount* and PS LA 2012/5 *Administration of the false or misleading statement penalty – where there is a shortfall amount*.

<sup>4</sup> Subsection 298-20(1).

<sup>5</sup> Subsection 284-145(2B).

<sup>6</sup> Issued under subsection 128C(7) of the ITAA 1936.

<sup>7</sup> Section 284-165.

## 5. Meaning of reasonably arguable threshold

5A. An entity will only be liable for a transfer pricing penalty where the entity's scheme shortfall amount is more than its reasonably arguable threshold.<sup>8</sup>

5B. An entity's scheme shortfall amount is the total amount of additional income tax and additional withholding tax it is liable to pay from the application of the transfer pricing rules.<sup>9</sup> Guidance on calculating an entity's scheme shortfall amount is found under Step 2(a) in section 7 of this Practice Statement.

5C. Subsection 284-90(3) provides that an entity's reasonably arguable threshold for an income year is:

- if the entity is a trust or partnership, \$20,000 or 2% of the entity's net income, whichever is the greater<sup>10</sup>, or
- for all other entities, \$10,000 or 1% of income tax payable, whichever is the greater.<sup>11</sup>

5D. If the entity's scheme shortfall amount is equal to or less than the reasonably arguable threshold, the entity will not be liable to a transfer pricing penalty.

5E. If an entity's scheme shortfall amount is higher than the reasonably arguable threshold, (provided all other conditions in subsection 284-145(2B) are satisfied) the entity will be liable to a transfer pricing penalty and we must assess the amount of the penalty under Step 2.

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### Example – scheme shortfall amount greater than threshold

5F. *Matthew Co is liable to pay \$20 million income tax based on its tax return for an income year. In that year, Matthew Co has received a transfer pricing benefit under Subdivision 815-B of the ITAA 1997 and has a scheme shortfall amount of \$500,000. As Matthew Co is a company, the scheme shortfall amount must exceed the greater of \$10,000 or 1% of the income tax payable by Matthew Co in that income year for a liability for an administrative penalty to apply. \$200,000 is 1% of the income tax payable by Matthew Co. This is the reasonably arguable threshold.*

5G. *Matthew Co has a scheme shortfall amount of \$500,000, which is greater than its reasonably arguable threshold of \$200,000. Matthew Co is liable to an administrative penalty on the full \$500,000.*

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<sup>8</sup> Section 284-165.

<sup>9</sup> The 'scheme shortfall amount' is for a scheme to which subsection 284-145(2B) applies (see subsection 284-150(4)).

<sup>10</sup> For the purpose of this calculation, treat a trust or partnership that has no net income for an income year or no tax loss or partnership loss for an income year as having an income or a loss of a nil amount (subsection 284-165(4)).

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## 6. Step 2 – assess the amount of the transfer pricing penalty

6A. Where, as a result of the application of Step 1, an entity is liable to a transfer pricing penalty, Step 2 requires that we assess the amount of the transfer pricing penalty.

### 7. Step 2a – determine the transfer pricing shortfall amount

7A. As noted in this Practice Statement, an entity's scheme shortfall amount is the total amount of additional income tax and additional withholding tax payable from the application of the transfer pricing rules (transfer pricing shortfall amount).<sup>12</sup>

7B. As it is necessary to calculate an entity's transfer pricing shortfall amount in Step 1 to ascertain whether the entity's transfer pricing shortfall amount is above or below its reasonably arguable threshold, the entity's transfer pricing shortfall amount should have already been calculated:

- Where there is both an additional amount of income tax and an additional amount of withholding tax in relation to a particular income year, an entity's transfer pricing shortfall amount will be the total of these amounts it is liable to pay.<sup>13</sup>
- A scheme benefit that an entity would have received from a scheme to which the anti-avoidance provisions in Part IVA of the ITAA 1936 apply is not included in the entity's scheme shortfall amount to the extent that it is already included in the transfer pricing shortfall amount under the transfer pricing rules.<sup>14</sup>

### 8. Step 2b – determine the transfer pricing base penalty amount

8A. The transfer pricing shortfall amount is then adjusted by a particular percentage. The result of this adjustment is the base penalty amount (BPA).

<sup>11</sup> Subsections 284-90(3)(a) and (b).

<sup>12</sup> Subsection 284-150(4).

<sup>13</sup> Subsection 284-150(4). Note that this situation would only arise in respect of 2 separate transactions.

<sup>14</sup> Subsection 284-150(5). This ensures that scheme penalties are not imposed twice on what is, in essence, the same shortfall amount.

8B. The BPA is worked out by multiplying the transfer pricing shortfall amount by the relevant percentage.

8C. The relevant percentage in the formula reflects whether or not:

- having regard to any relevant matters, it is reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme, or part of it, did so with the sole or dominant purpose of that entity or another entity getting a transfer pricing benefit from the scheme (sole or dominant purpose)<sup>15</sup>
- the entity has a reasonably arguable position that the transfer pricing rules do not apply to a matter in a particular way (reasonably arguable position)<sup>16</sup>, and
- the entity treated the law as applying in an accepted way.

#### ***Determining the BPA under subsection 284-160(3)***

8D. Subsection 284-160(3) provides specific rules for determining the BPA for transfer pricing penalties.

8E. Under subsection 284-160(3), where an entity has a sole or dominant purpose and does not have a reasonably arguable position, the BPA will be equal to 50% of the transfer pricing shortfall amount.<sup>17</sup>

8F. Where an entity has a sole or dominant purpose and does have a reasonably arguable position, the BPA will be equal to 25% of the transfer pricing shortfall amount.<sup>18</sup>

8G. Where an entity does not have a sole or dominant purpose and does not have a reasonably arguable position, the BPA will be equal to 25% of the transfer pricing shortfall amount.<sup>19</sup>

8H. Where an entity does not have a sole or dominant purpose and has a reasonably arguable position, the BPA will be equal to 10% of the transfer pricing shortfall amount.<sup>20</sup>

8I. An entity cannot have a reasonably arguable position for the purposes of calculating the BPA where it has not met the documentation requirements specific to transfer pricing penalties arising from the transfer

pricing rules.<sup>21</sup> See also paragraphs 8AM to 8AQ of this Practice Statement.

8J. The Attachment to this Practice Statement contains a flow chart on how to determine the BPA for transfer pricing penalties under subsection 284-160(3).

#### ***Determining whether there is a 'sole or dominant purpose'***

8K. Table item 1 of subsection 284-160(3) provides that to work out the BPA for transfer pricing penalties, we must consider whether:

having regard to any relevant matters, it is reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme, or part of it, did so with the sole or dominant purpose of that entity or another entity getting a transfer pricing benefit from the scheme

8L. Where an entity has a sole or dominant purpose, the entity will be liable to a higher BPA.

8M. The following paragraphs of this Practice Statement set out guidelines to assist you in determining whether there is a sole or dominant purpose.

#### ***Transfer pricing benefit***

8N. Table item 1 of subsection 284-160(3) provides that an entity must have a sole or dominant purpose of getting a 'transfer pricing benefit from the scheme'.

8O. Subsection 995-1(1) of the ITAA 1997 states that 'transfer pricing benefit' has the meaning given by (among other things) sections 815-120 and 815-220 of the ITAA 1997.<sup>22</sup>

8P. Subsection 815-120 of the ITAA 1997 provides that an entity gets a transfer pricing benefit from conditions that operate between the entity and another entity in connection with their commercial or financial relations (referred to collectively as 'tax advantages') if:

- the actual conditions differ from the arm's length conditions

shortfall amount may relate to a matter that has a reasonably arguable position and part of the transfer pricing shortfall amount may relate to another matter that does not have a reasonably arguable position (where there is no sole or dominant purpose). In this case, that part of the BPA for the transfer pricing shortfall amount would be 10% and the balance would be 25% to reflect the extent to which there is a reasonably arguable position.

<sup>21</sup> Section 284-250.

<sup>22</sup> The definition of 'transfer pricing benefit' in subsection 995-1(1) also refers to section 815-15 in Subdivision 815-A of the ITAA 1997.

<sup>15</sup> The meaning of the phrase 'sole or dominant purpose' is outlined at paragraphs 8AA to 8AL of this Practice Statement.

<sup>16</sup> The meaning of the phrase 'reasonably arguable' is outlined at paragraphs 8AM to 8BG of this Practice Statement.

<sup>17</sup> Table item 1 of subsection 284-160(3).

<sup>18</sup> Table item 1 of subsection 284-160(3).

<sup>19</sup> Table item 2 of subsection 284-160(3).

<sup>20</sup> Table item 2 of subsection 284-160(3). The transfer pricing shortfall amount may consist of amounts to which different BPAs may apply. For example, part of the transfer pricing

- the actual conditions satisfy the cross-border test, and
- had the arm's length conditions operated instead of the actual conditions, the result would be one or more of the following
  - the entity's taxable income being greater
  - the entity's loss being less
  - the entity's tax offsets being less, or
  - the entity's withholding tax payable being greater.

8Q. Where the transfer pricing penalty arises from the application of Subdivision 815-B of the ITAA 1997, the transfer pricing benefit will be equal to the total of the tax advantages listed in paragraph 8P of this Practice Statement.

8R. Section 815-220 of the ITAA 1997 provides when an entity gets a transfer pricing benefit for the purpose of Subdivision 815-C of the ITAA 1997.

8S. Subsection 815-220(1) of the ITAA 1997 provides that an entity gets a transfer pricing benefit from the attribution of profits to a permanent establishment if:

- the actual profits attributed to the permanent establishment differ from the arm's length profits, and
- had the arm's length profits been attributed, instead of the actual profits, the result would be one or more of the following (referred to collectively as 'tax advantages')
  - the entity's taxable income being greater
  - the entity's loss being less, or
  - the entity's tax offsets being greater.

8T. Where the transfer pricing penalty arises from the application of Subdivision 815-C of the ITAA 1997, the transfer pricing benefit will be equal to the total of the tax advantages listed in paragraph 8S of this Practice Statement.

### **From a scheme**

8U. In order for the test in table item 1 of subsection 284-160(3) to be satisfied, the transfer pricing benefit must come from a scheme.<sup>23</sup>

<sup>23</sup> Note: For a liability for a scheme penalty to arise under subsection 284-145(2B), the adjustment under Subdivisions 815-B or 815-C must be in 'relation to a scheme' (see paragraph 4A of this Practice Statement).

<sup>24</sup> The definition of 'arrangement' in subsection 995-1(1) of the ITAA 1997 contains the terms stated in the definition of

Subsection 995-1(1) of the ITAA 1997 defines 'scheme' as:

- (a) any arrangement; or
- (b) any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise.

8V. Subsection 995-1(1) of the ITAA 1997 states that 'arrangement':

... means any arrangement, agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings.

8W. The meaning of 'scheme' in subsection 995-1(1) of the ITAA 1997 is substantively the same as the meaning of 'scheme' in subsection 177A(1) of the ITAA 1936.<sup>24</sup>

8X. The High Court considered the meaning of 'scheme' in subsection 177A(1) in *Commissioner of Taxation v Hart* [2004] HCA 26 (*Hart*) at [43], per Gummow and Hayne JJ:

...Th[e] definition is very broad. It encompasses not only a series of steps which together can be said to constitute a "scheme" or a "plan" but also (by its reference to "action" in the singular) the taking of but one step.

8Y. You will need to identify the particulars of the scheme or schemes to which subsection 245-145(2B) applies in order to ascertain whether there is a sole or dominant purpose.

8Z. Given the broad scope of the definition of 'scheme', the whole or part of the commercial or financial relations in connection with which the actual conditions operate may well be relevant in identifying a 'scheme' as defined in subsection 995-1(1) of the ITAA 1997. As a result, the requirement in table item 1 of subsection 284-160(3) for the existence of a scheme will generally be satisfied.

### **Sole or dominant purpose requirement**

8AA. Where you have concluded that an entity has received a transfer pricing benefit from a scheme, you must then consider, having regard to any relevant matters, whether it is reasonable to conclude that an entity that carried out the scheme did so with the sole or dominant purpose of that entity or another entity getting a transfer pricing benefit from the scheme.

scheme in subsection 177A(1) of the ITAA 1936. The definition of 'scheme' in paragraph 995-1(1)(b) of the ITAA 1997 contains the same terms as the definition of 'scheme' in subsection 177A(1) of the ITAA 1936 and incorporates subsection 177A(3) of the ITAA 1936.

8AB. The meaning of the phrase 'sole or dominant purpose' was considered in *Commissioner of Taxation v Spotless Services Ltd* [1996] HCA 34; 186 CLR 404 at [416] (*Spotless*). The High Court observed:

Much turns upon the identification, among various purposes, of that which is "dominant". In its ordinary meaning, dominant indicates that purpose which was the ruling, prevailing, or most influential purpose.

8AC. Although *Spotless* was concerned with the application of the general anti-avoidance provisions in Part IVA of the ITAA 1936, there is no reason why the word 'dominant' in table item 1 of subsection 284-160(3) should not take on this ordinary meaning.

8AD. In working out what matters are relevant for the purposes of table item 1 of subsection 284-160(3), the matters to which you can have regard are confined only to the extent that they are relevant to the question of whether an entity that entered into or carried out the scheme did so with the sole or dominant purpose of that entity, or another, getting a transfer pricing benefit from the scheme. Whether a matter is relevant to this question will depend on the facts and circumstances of the case.

8AE. In *Commissioner of Taxation v Star City Pty Limited (No 2)* [2009] FCAFC 122 (*Star City*) at [73], Dowsett J observed that paragraph 284-145(1)(b) (which is similar to table item 1 of subsection 284-160(3)) requires that, having regard to any relevant matters, '... it [is] "reasonable to conclude" that a relevant entity entered into, or carried out the scheme, or part of it, with the relevant purpose'.<sup>25</sup>

8AF. At [74] in *Star City*, Dowsett J held that:

... the question posed by s 284-145(1)(b)(i) is whether a reasonable person could conclude that the relevant entity had the identified purpose. The language used in the section is not apposite to require an actual decision as to purpose. It rather addresses the availability of an inference. Had Parliament intended that the Commissioner form an actual opinion as to purpose, it would have said so.

8AG. At [73] in *Star City*, Dowsett J also stated that paragraph 284-145(1)(b) '... prescribes an assessment of the adequacy of available information to support an inference that the relevant purpose existed'.

8AH. Matters that may be relevant when assessing the adequacy of available information include:

- the nature of the transfer pricing benefit that was obtained by the entity (or another entity)
- the commercial or financial relations in connection with which the actual conditions operated
- the form and substance of the scheme
- the arm's length contribution made by an Australian operation through functions performed, assets used and risks assumed
- any inconsistency between the way the entity has applied the transfer pricing rules and the guidance material<sup>26</sup>
- the methods used, and
- the comparable circumstances.

8AI. You will need to consider carefully whether the evidence gathered in relation to the actual commercial or financial relations adopted by the entities or any other relevant matter would enable the requisite inference to be drawn.

8AJ. In doing so, just because an entity gets a transfer pricing benefit from a scheme does not mean that you should 'automatically assume that associated enterprises have sought to manipulate their profits'.<sup>27</sup> The fact that conditions adopted by entities under the actual transaction or arrangement are not the arm's length conditions is generally not, of itself, sufficient to conclude that the relevant entity had the identified purpose. The instances where there is a sole or dominant purpose in transfer pricing cases would be rare and would need to be supported by the particular facts and circumstances of that matter.

8AK. Where you conclude that an entity entered into the scheme with the sole or dominant purpose of that entity or another getting a transfer pricing benefit, the BPA of the entity that received the benefit will be either 50% or 25% of the transfer pricing shortfall amount, depending on whether the entity has a reasonably arguable position.

8AL. Where you conclude that an entity did not enter into the scheme with the sole or dominant purpose of getting a transfer pricing benefit, the entity's BPA will be either 25% or 10% of the transfer pricing shortfall

<sup>25</sup> Dowsett J's judgment is the dissenting judgment. The majority of the court in *Star City* did not consider how subsection 284-145(1) should be construed as they considered that subsection 284-145(1) did not apply. However, in *Lawrence v Commissioner of Taxation* [2008] FCA 1497 (*Lawrence*), Jessup J held at [105] that section 284-145 required a consideration of the entity's subjective rather than objective purpose in entering the scheme. This is at odds with Dowsett J's view that the section 284-145 refers to a reasonably drawn inference

about whether the entity had the relevant purpose. The Decision Impact Statement on *Lawrence* states that we will follow the view of Dowsett J in *Star City*, rather than the view of Jessup J in *Lawrence*.

<sup>26</sup> Being the guidance material referred to in sections 815-135 and 815-235 of the ITAA 1997.

<sup>27</sup> Refer to paragraphs 1.2 and 1.11 of the [OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations](#).

amount, depending on whether the entity has a reasonably arguable position.

### ***When a transfer pricing treatment is not reasonably arguable***

8AM. Section 284-250 states that if an entity does not have records explaining the particular way in which the transfer pricing rules apply (or do not apply) to a matter (or identical matters) (referred to as 'transfer pricing treatment'), the entity cannot take a reasonably arguable position for that treatment.

8AN. The specific requirements for documenting a transfer pricing treatment in a way so that an entity is eligible to take a reasonably arguable position are set out in section 284-255 (referred to as 'documentation requirements').

8AO. Where the entity has not met the documentation requirements in relation to a transfer pricing treatment (referred to as an 'undocumented transfer pricing treatment'), the entity cannot take a reasonably arguable position, for administrative penalty purposes, concerning that treatment.

8AP. Where the entity has met the documentation requirements in relation to a transfer pricing treatment (referred to as a 'documented transfer pricing treatment'), the entity may be eligible to take a reasonably arguable position concerning that treatment.

8AQ. You therefore need to consider whether the entity has a documented transfer pricing treatment as part of deciding whether the entity has a reasonably arguable position for a particular treatment.

### ***Documenting a transfer pricing treatment***

8AR. Section 284-255 sets out the documentation requirements specific to transfer pricing penalties.<sup>28</sup>

8AS. These requirements do not mandate the preparation or keeping of such documentation. However, an entity cannot have a reasonably arguable position for administrative penalty purposes where it does not meet the requirements. The result is that the entity will be liable to a higher BPA.

8AT. In order to have a documented transfer pricing treatment, the entity must have records that<sup>29</sup>:

- are prepared before the time the entity lodges its income tax return for the income year relevant to the matter (or matters)

- are in English or readily accessible and convertible into English
- explain the particular way in which Subdivision 815-B or 815-C of the ITAA 1997 apply (or do not apply) to the matter, and
- explain why the application of Subdivisions 815-B or 815-C of the ITAA 1997 to the matter in that particular way best achieves the consistency with the relevant guidance material.

8AU. Further, to have a documented transfer pricing treatment, the records must allow each of the following to be ascertained<sup>30</sup>:

- the arm's length conditions relevant to the matter
- the particulars of the method used and comparable circumstances relevant to identifying those arm's length conditions
- where records explain the application (as opposed to the non-application) of Subdivisions 815-B or 815-C of the ITAA 1997, the records must also explain the result that the application in that particular way has, as compared to the non-application
- for Subdivision 815-B of the ITAA 1997 – the actual conditions relevant to the matter (or matters), and
- for Subdivision 815-C of the ITAA 1997 – the actual profits and the arm's length profits as well as the particulars of the activities and circumstances to the extent they are relevant to the matter (or matters).

8AV. You need to determine whether or not the entity has a documented or undocumented transfer pricing treatment.

8AW. Guidance on whether an entity has a documented or undocumented transfer pricing treatment can be found in TR 2014/8.

8AX. Where the entity is treated as having an undocumented transfer pricing treatment, there is no need to consider the general test for having a reasonably arguable position as the entity cannot have a reasonably arguable position in respect of that matter (or matters). This results in the entity being liable to a higher BPA.

8AY. Where the entity has a documented transfer pricing treatment, you will need to consider whether the entity has a reasonably arguable position.

<sup>28</sup> Note that the general requirement for a person carrying on a business to keep records that explain transactions and other acts set out in section 262A of the ITAA 1936 continues to apply where the transfer pricing rules apply.

<sup>29</sup> Subsection 284-255(1).

<sup>30</sup> Subsection 284-255(2).

### General test for having a reasonably arguable position

8AZ. To have a reasonably arguable position, an entity needs to have a documented transfer pricing treatment and satisfy the general reasonably arguable position test in subsection 284-15(1).

8BA. Subsection 284-15(1) provides when a matter will be reasonably arguable. It states that:

A matter is **reasonably arguable** if it would be concluded in the circumstances, having regard to the relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect.

8BB. In *Walstern v Commissioner of Taxation* [2003] FCA 1428 (*Walstern*) at [108]<sup>31</sup>, Hill J noted that (emphasis added):

4. The decision maker must then determine whether the taxpayer's argument, although considered wrong, is about as likely as not correct, when regard is had to 'the authorities'.

5. It is not necessary that the decision maker form the view that the taxpayer's argument in an objective sense is more likely to be right than wrong. ... Nor can it be necessary that the decision maker form the view that it is just as likely that the taxpayer's argument is correct as the argument which the decision maker considers to be the correct argument for the decision maker has already formed the view that the taxpayer's argument is wrong. The standard is not as high as that. **The word 'about' indicates the need for balancing the two arguments, with the consequence that there must be room for it to be argued which of the two positions is correct so that on balance the taxpayer's argument can objectively be said to be one that while wrong could be argued on rational grounds to be right.**

8BC. You should refer to the guidance contained in Miscellaneous Taxation Ruling MT 2008/2 *Shortfall penalties: administrative penalty for taking a position that is not reasonably arguable* when applying this test.

8BD. You should determine, notwithstanding that the entity has a documented transfer pricing treatment, whether objectively (having regard to the relevant authorities) the entity's argument is about as, or more, likely to be correct as incorrect.

8BE. The test for having a reasonably arguable position is objective. You should be conscious that the ATO and the entity can differ on their view of the correct application of the transfer pricing rules to a

particular set of facts. This difference in and of itself will not mean that the entity has not met the reasonably arguable test.

8BF. Where the entity has a documented transfer pricing treatment but does not satisfy the general reasonably arguable position test, the entity will not be entitled to a lower BPA.

8BG. Where the entity has a documented transfer pricing treatment and does satisfy the reasonably arguable position test, the entity will be entitled to a lower BPA.

### Treating the law in an accepted way

8BH. Subsection 284-160(3) provides that, where it is relevant, section 284-224 is also used when working out the BPA. Accordingly, you also need to consider whether the entity treated the law in an accepted way.

8BI. Section 284-224 applies to things done or statements made on or after 4 June 2010. Under section 284-224, an entity may have their BPA reduced to the extent that they or their agent treated a taxation law in a particular way that agreed with:

- advice given to them or their agent by or on behalf of the Commissioner
- general administrative practice under that law, or
- a statement in a publication approved in writing by the Commissioner.

8BJ. Practical Compliance Guideline PCG 2017/2 *Simplified transfer pricing record-keeping options*, referred to in Law Administration Practice Statement PS LA 2014/3 *Simplifying transfer pricing record keeping* (collectively, the TP Guidelines), would be a statement in a publication approved in writing by the Commissioner. Where an entity falls within the TP Guidelines, subsection 284-160(3) will apply to reduce the entity's BPA to the extent that the entity has applied the TP Guidelines.

8BK. Guidance on the adjustment under section 284-224 is contained in paragraphs 111 to 117 of PS LA 2012/5. The process for determining the BPA in PS LA 2012/5 is identical to the process for determining the BPA for transfer pricing penalties. You should refer to PS LA 2012/5 when making decisions about adjusting the BPA.

<sup>31</sup> The Full Federal Court in *Pridecraft Pty Ltd v Commissioner of Taxation* [2004] FCAFC 339 at [108] held that Hill J's test in *Walstern* was the correct approach to the imposition of penalties under subsection 226C(1) of the ITAA 1936. Subsection 222C(1) is the predecessor section

to section 284-15 and states that a matter is reasonably arguable if, having regard to the relevant authorities '... it would be concluded that what is argued for is about as likely as not correct'.

## 9. Step 2c – consider whether an increase or decrease of the BPA is required

9A. The BPA is then adjusted depending on the individual circumstances of the case. The adjustment formula is<sup>32</sup>:

$$\text{BPA} + [\text{BPA} \times (\text{increase \%} - \text{reduction \%})]$$

## 10. Increase in the BPA

10A. Subsection 284-220(1) provides that the BPA is increased by 20% where the entity:

- prevents or obstructs us from finding out about the transfer pricing shortfall amount
- becomes aware of the transfer pricing shortfall amount after the statement is made and does not tell us within a reasonable time, or
- had a BPA worked out for this type of penalty previously.

10B. The BPA is increased by 20% if one or more of the conditions apply. The increase in the BPA is not cumulative.

10C. Further guidance on the conditions that increase the BPA is found in paragraphs 119 to 134 of PS LA 2012/5. The process for increasing the BPA in this Practice Statement is identical to the process for increasing the BPA for transfer pricing penalties.<sup>33</sup>

10D. PS LA 2012/5 provides additional guidance, among other things, as to what taxpayer behaviour constitutes preventing or obstructing us from finding out about the shortfall amount. You should refer to PS LA 2012/5 when making decisions about increasing the BPA.

## 11. Decrease in the BPA

11A. Section 284-225 provides that the BPA is reduced in certain circumstances where an entity makes a voluntary disclosure, in the approved form, about the transfer pricing shortfall amount or part of it.

11B. The BPA is reduced by 20% if:

- the entity tells us voluntarily in the approved form about a transfer pricing shortfall amount after being told by us that we will examine the entity's tax affairs, and

- telling us can reasonably be estimated to have saved us significant time or significant resources.<sup>34</sup>

11C. The BPA is reduced by 80% where the entity voluntarily tells us in the approved form about a transfer pricing shortfall amount before the earlier of:

- the day we tell the entity that we will examine the entity's tax affairs, or
- if we make a public statement asking entities to make a voluntary disclosure by a particular day – that particular day.<sup>35</sup>

11D. The Commissioner has the discretion to treat an entity as having made a voluntary disclosure before being told of an examination of its affairs even though the disclosure was actually made after that day.<sup>36</sup>

11E. Further guidance on reducing the BPA is contained in Miscellaneous Taxation Ruling MT 2012/3 *Administrative penalties: voluntary disclosures* and paragraphs 135 to 140 of PS LA 2012/5.

11F. MT 2012/3 provides guidance on the meaning of key terms in section 284-225 and contains further guidance on reducing the BPA and the exercise of the discretion referred to in this Practice Statement. You should refer to MT 2012/3 when making decisions about reducing the BPA.

## Increase where the entity is a significant global entity

11G. Subsection 284-155(3) provides that the amount of penalty worked out using the adjustment formula in paragraph 8A of this Practice Statement is doubled where the entity is a significant global entity that does not have a reasonably arguable position.<sup>37</sup>

11H. Subsection 284-155(3) applies to scheme benefits that an entity gets in relation to an income year commencing on or after 1 July 2015.<sup>38</sup>

11I. The meaning of the term 'significant global entity' is set out in section 960-555 of the ITAA 1997. Further guidance on the meaning of significant global entity is contained in paragraphs 6 to 10 of Law Companion Ruling LCR 2015/3 *Subdivision 815-E of the Income Tax Assessment Act 1997: Country-by-Country reporting*.

<sup>32</sup> See Subdivision 284-D and paragraph 99 of PS LA 2012/5.

<sup>33</sup> See section 284-220.

<sup>34</sup> Subsection 284-225(1).

<sup>35</sup> Subsections 284-225(2), 284-225(3), 284-225(4) and 284-225(4A).

<sup>36</sup> Subsection 284-225(5).

<sup>37</sup> Paragraphs 8AZ to 8BG of this Practice Statement outline when an entity will not have a reasonably arguable position, including where an entity has an undocumented transfer pricing treatment.

<sup>38</sup> See table item 2 of Schedule 3 to the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015*.

## 12. Step 2d – decide whether to remit all or part of the penalty

12A. The Commissioner has the discretion to remit all or part of a transfer pricing penalty.<sup>39</sup> After Steps 2a to 2c have been applied correctly, a remission decision must be made.

12B. You must consider whether remission is appropriate whenever an entity is liable to a transfer pricing penalty under subsection 284-145(2B). In making an assessment of the penalty, you must determine in every case whether the BPA or adjusted BPA amount should be remitted in full or part.

12C. This Practice Statement provides guidance on how the discretion to remit the penalty may be exercised. It does not lay down conditions that may restrict the exercise of the Commissioner's discretion, nor does it represent a general exercise of the Commissioner's discretion. Rather, it is provided to:

- guide you in the exercise of the Commissioner's discretion, and
- ensure entities receive consistent treatment.

12D. Subsection 298-20(1) states that 'the Commissioner may remit all or part of the penalty'.

12E. The Commissioner's discretion in subsection 298-20(1) is unconfined in that the subsection does not state the considerations that you must take into account when exercising the Commissioner's discretion.

12F. In *Minister for Aboriginal Affairs v Peko-Wallsend Ltd* [1986] HCA 40; 66 ALR 299 at [15], Mason J observed that<sup>40</sup>:

... where a statute confers a discretion which in its terms is unconfined, the factors that may be taken into account in the exercise of the discretion are similarly unconfined, except in so far as there may be found in the subject-matter, scope and purpose of the statute some implied limitation on the factors to which the decision-maker may legitimately have regard.

12G. The guiding principles are that you should exercise the discretion:

- taking into account the particular circumstances of the entity<sup>41</sup>

- taking into account the purpose of the transfer pricing penalty provisions<sup>42</sup>
- so there is consistent treatment of penalty rates – the penalty rate is set by law and remission without just cause, arbitrarily or as a matter of course may compromise consistent treatment of penalty rates
- to avoid an outcome that is unreasonable or unjust<sup>43</sup>, and
- to treat entities in like circumstances consistently in accordance with the commitments made in [Our Charter](#).

12H. For example, where the entity has a BPA of 10% and:

- has genuinely made a reasonable attempt in good faith to comply
- has made its best efforts to have a documented transfer pricing treatment<sup>44</sup>, and
- can satisfy us that it did not have a tax avoidance purpose,

it is most likely that any penalty would be remitted to nil.

12I. The following general considerations should be borne in mind when considering whether or not to exercise the discretion to remit:

- whether a calculation or mechanical process in the law results in an unintended or unjust outcome in the particular circumstances of the entity, and
- whether the entity has made its best efforts to have a documented transfer pricing treatment having regard to efforts that would be considered reasonable in the particular facts and circumstances of the entity.

12J. In a self-assessment regime, an entity will have made its best efforts to have a documented transfer pricing treatment if (objectively considering its risk of not complying with arm's length principle and taking account of its relative resources) the entity has taken all reasonable steps, in its particular facts and circumstances, to ensure that it has a documented transfer pricing treatment.

<sup>39</sup> Section 298-20.

<sup>40</sup> This principle has general application but it has been applied in a number of cases in the context of tax legislation – for example, in *BHP Billiton Direct Reduced Iron Pty Ltd (ACN 058 025 960) v Duffus, Deputy Commissioner of Taxation* [2007] FCA 1528 at [111], *Elias v Commissioner of Taxation* [2002] FCA 845 at [56–57] and *Commissioner of Taxation v Burness (As Trustee for the Property of Bottazzi, A Bankrupt)* [2009] FCA 1021 at [19]. In particular, this principle has been applied in the interpretation of subsection 298-20(1) in *Archibald Dixon*

*as Trustee for the Dixon Holdsworth Superannuation Fund v Commissioner of Taxation* [2008] FCAFC 54 at [21] and *Sanctuary Lakes Pty Ltd v Commissioner of Taxation* [2013] FCAFC 50 (*Sanctuary Lakes*) at [227–229], per Griffiths J.

<sup>41</sup> *Sanctuary Lakes* at [251], per Griffiths J.

<sup>42</sup> *Sanctuary Lakes* at [227], per Griffiths J.

<sup>43</sup> *Sanctuary Lakes* at [249], per Griffiths J.

<sup>44</sup> When an entity will have made its best efforts to have a documented transfer pricing treatment is discussed in paragraph 11F of this Practice Statement.

12K. The following considerations are generally not relevant when considering remission:

- the entity's capacity to pay, or whether payment of the penalty may cause financial hardship for the entity, except in exceptional situations<sup>45</sup>, or
- the quantum of the penalty. This, of itself, is not a ground for remission as the penalty amount is a result of a calculation based on the transfer pricing shortfall amount and the rate set by parliament.

12L. The remission decision should be based on an objective analysis of all the relevant facts in the entity's particular circumstances. The considerations listed in this Practice Statement are not exhaustive and are not necessarily the only valid factors. Rather, they are designed to encourage an analytical approach to each case and the application of sound judgement in making the remission decision.

12M. A remission decision may result in no remission, partial remission or full remission of the penalty.

### **13. Step 3 – notify the entity of the liability to pay the transfer pricing penalty**

13A. We must make an assessment of the transfer pricing penalty.<sup>46</sup> In addition, where a transfer pricing penalty applies and has not been remitted in full, we are required by law to give written notice of the entity's liability to pay the penalty and our decision not to remit the penalty in full.<sup>47</sup>

13B. The written notice (or notices) are required by law to include:

- the reasons why the entity is liable to pay the penalty<sup>48</sup>, and
- the reasons for the remission decision.<sup>49</sup>

13C. Where the entity is not liable to a penalty, or where the entity is liable to a penalty but that penalty has been remitted in full, the law does not require us to give reasons for our penalty decision.<sup>50</sup> However, in these situations, you should provide the entity with a summary of the reasons for decision.

13D. Where the entity is liable to a penalty which we have not remitted in full, we provide written reasons for the decisions made, setting out the findings on material questions of fact and referring to the evidence or other material on which those findings were based.

13E. The law does not specify when the explanation for the decision must be provided to the entity. However, you should ensure that the reasons are provided prior to, or at the same time as, the entity has been notified of the penalty.

13F. The entity should also be provided with an explanation of its review rights. An entity that is dissatisfied with an assessment of penalty may object to it in the manner set out in Part IVC of the TAA. The grounds of the objection may include all elements of the penalty assessment. In the usual situation, where a remission decision is made as part of an assessment of penalty, the affected entity that is dissatisfied with the assessment will need to include in their objection any grounds about their dissatisfaction with the remission. If a remission decision is made after an assessment of the penalty, the entity may object to the separate remission decision in the manner set out in Part IVC if the amount of penalty remaining after the decision is more than 2 penalty units.<sup>51</sup>

**Date issued:** 17 December 2014

**Date of effect:** 29 June 2013

**Business line:** PG

<sup>45</sup> An entity's capacity to pay and hardship may be dealt with through payment arrangement, compromise, release and insolvency and under other taxation or insolvency provisions, and not remission of penalties.

<sup>46</sup> Subsection 298-30(1).

<sup>47</sup> Sections 298-10 and 298-20.

<sup>48</sup> Section 298-10.

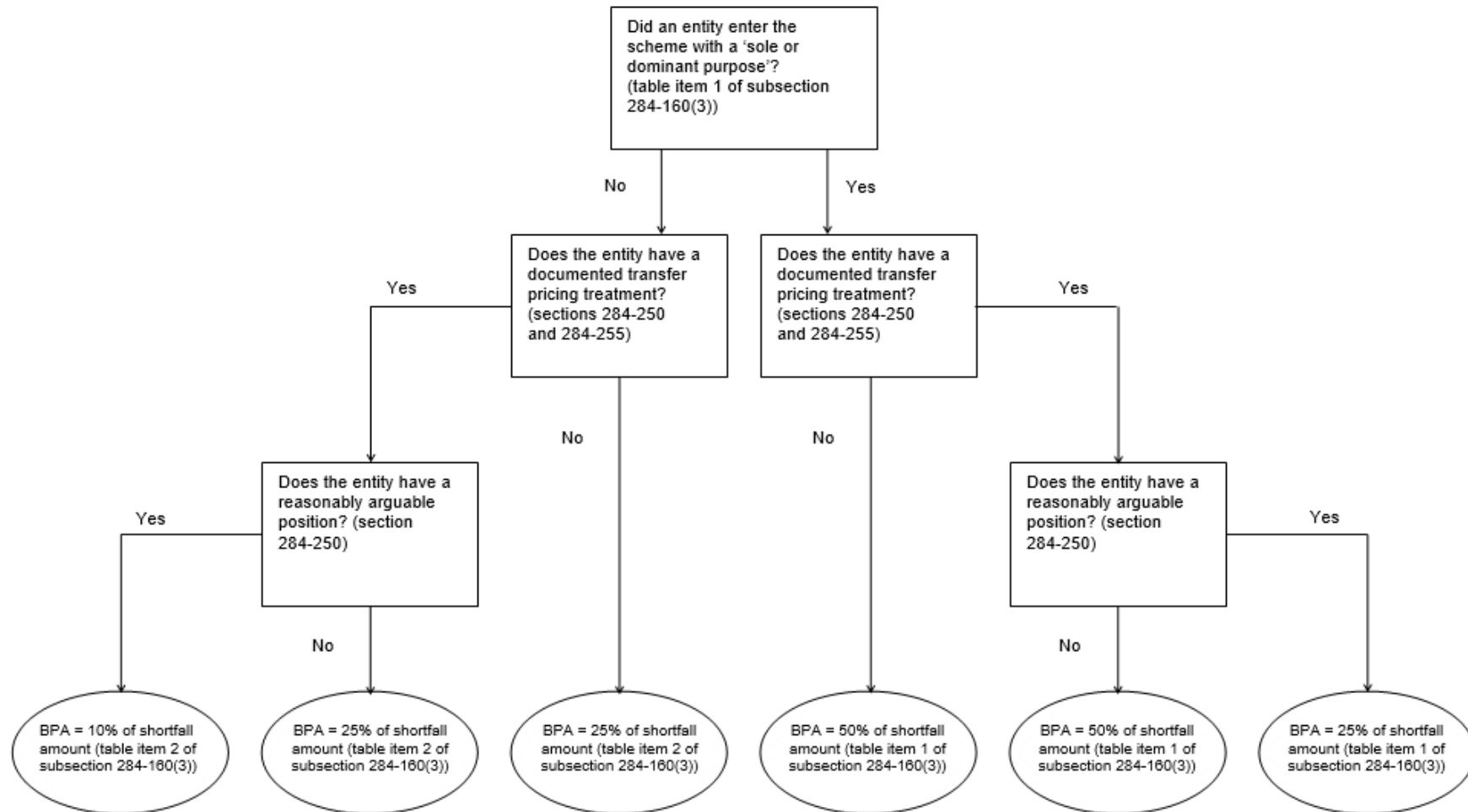
<sup>49</sup> Section 298-20.

<sup>50</sup> Section 298-10.

<sup>51</sup> The value of a penalty unit is contained in section 4AA of the *Crimes Act 1914* and is indexed regularly. The dollar amount of a penalty unit is available at [Penalties](#).

## Attachment

Diagram 1: Determining base penalty amounts under table items 1 and 2 of subsection 284-160(3)



## Amendment history

24 January 2025

Part	Comment
Throughout	Content checked for technical accuracy and currency. Updated in line with current ATO style and accessibility requirements.

10 May 2018

Part	Comment
Paragraph 8BJ	Updated to reference PCG 2017/2.

30 June 2016

Part	Comment
All	Updated to new LAPS format and style.

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	TAA 1953 Sch 1 284-90(3)(a)
	TAA 1953 Sch 1 284-90(3)(b)
	TAA 1953 Sch 1 Subdiv 284-C

	<p>TAA 1953 Sch 1 284-145  TAA 1953 Sch 1 284-145(1)  TAA 1953 Sch 1 284-145(1)(b)  TAA 1953 Sch 1 284-145(1)(b)(i)  TAA 1953 Sch 1 284-145(2)  TAA 1953 Sch 1 284-145(2A)  TAA 1953 Sch 1 284-145(2B)  TAA 1953 Sch 1 284-150(4)  TAA 1953 Sch 1 284-150(5)  TAA 1953 Sch 1 284-155(3)  TAA 1953 Sch 1 284-160(3)  TAA 1953 Sch 1 284-165  TAA 1953 Sch 1 284-165(4)  TAA 1953 Sch 1 Subdiv 284-D  TAA 1953 Sch 1 284-220  TAA 1953 Sch 1 284-220(1)  TAA 1953 Sch 1 284-224  TAA 1953 Sch 1 284-225  TAA 1953 Sch 1 284-225(1)  TAA 1953 Sch 1 284-225(2)  TAA 1953 Sch 1 284-225(3)  TAA 1953 Sch 1 284-225(4)  TAA 1953 Sch 1 284-225(4A)  TAA 1953 Sch 1 284-225(5)  TAA 1953 Sch 1 Subdiv 284-E  TAA 1953 Sch 1 284-250  TAA 1953 Sch 1 284-255  TAA 1953 Sch 1 284-255(1)  TAA 1953 Sch 1 284-255(2)  TAA 1953 Sch 1 298-10  TAA 1953 Sch 1 298-20  TAA 1953 Sch 1 298-20(1)  TAA 1953 Sch 1 298-30(1)  Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013  Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015  Crimes Act 1914 4AA</p>
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<b>Related practice statements</b>	<p>PS LA 2011/30</p> <p>PS LA 2012/4</p> <p>PS LA 2012/5</p> <p>PS LA 2014/3</p>
<b>Related Rulings/Determinations</b>	<p>MT 2008/2</p> <p>MT 2012/3</p> <p>TR 2014/8</p> <p>LCR 2015/3</p>

#### ATO references

<b>ISSN</b>	2651-9526
<b>File no</b>	1-52J2RRC; 1-1569VA3C
<b>ATOlaw topic</b>	Administration ~~ Penalties International issues ~~ Transfer pricing ~~ Documentation

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