

2002

Schedule 25A
instructions

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Foreword

This publication is to assist in the completion of the *Schedule 25A 2002*. This publication is **NOT** a guide to the income tax law. More detailed information is available in other publications.

Please get help from a tax office or a professional tax practitioner if you feel this publication does not fully cover your circumstances.

As part of our commitment to producing accurate publications, a taxpayer will not be subject to penalties if it is demonstrated that a tax claim is based on wrong information contained in this publication. However, interest could be payable depending on the circumstances of each case.

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Introduction

If you answered yes to a question concerning overseas transactions on the partnership, trust, company or fund tax return, complete part A of Schedule 25A and lodge it with the appropriate tax return.

If you answered yes to a question concerning interest in a foreign company, foreign trust, foreign investment fund or foreign life assurance policy on the partnership, trust, company or fund tax return, complete all questions in part B of Schedule 25A and lodge it with the appropriate tax return.

If you answered yes to both questions, complete parts A and B and lodge Schedule 25A with the appropriate tax return.

Answer all items on Schedule 25A, including Yes/No items, that apply to your particular circumstances. If an item or part of an item does not apply, leave it blank.

In these instructions, a reference to 'you' or 'taxpayer' should be taken as a reference to the company, trust, partnership or superannuation fund, as appropriate.

Related party international dealings

Part A of Schedule 25A refers to related party international dealings.

Complete part A if you answered Yes to any of the following:

- item 19 of the *Company tax return 2002*
- item 26 of the *Partnership tax return 2002*
- item 26 of the *Trust tax return 2002*
- item 15 of the *Fund income tax and regulatory return 2002*.

The Australian Taxation Office (ATO) is in the process of issuing a series of public rulings setting out its policies regarding taxation aspects of related party international dealings.

The rulings issued include:

- *TR94/14 Transfer pricing and international profit shifting*
- *TR95/23 Advance pricing arrangements*
- *TR97/20 Arm's length pricing methodologies*
- *TR98/11 Documentation in setting and reviewing transfer pricing*
- *TR98/16 Penalties*
- *TR1999/1 International transfer pricing for intra-group services*
- *TR1999/8 Effects of Determinations made under Division 13, and consequential adjustments.*

In addition, you may gain some assistance from the following draft taxation rulings. You should be aware however that draft rulings do not necessarily give the ATO's final opinion on the operation of the tax law.

- TR95/D11 Basic concepts underlying Division 13 and permanent establishments
- TR95/D31 Adjustments to relieve double taxation arising from adjustment by a foreign tax administration.

It is recommended that taxpayers with related party international dealings be familiar with these rulings. The ATO has also introduced a number of publications about international transfer pricing. To find out how to obtain a copy of these rulings and publications see the inside back cover.

Additional help may be obtained from the Organisation for Economic Co-operation and Development (OECD) publication *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations—1995*.

Definitions of some terms used in Schedule 25A are listed at appendix 2 of these instructions.

Permanent establishments

If you have a fixed place of business in Australia or overseas, other than a mere storage or display facility, or if you have a non-independent agent who contracts on your behalf, you may have a 'permanent establishment' in Australia or overseas.

If you are uncertain whether this may be the case, refer to the appropriate international tax agreement for the comprehensive definition of a 'permanent establishment'.

The ATO adheres to a 'single entity' approach in its allocation of profits or income and expenditure in tax matters. That is, a permanent establishment is not to be regarded as a separate legal entity from your head office or other geographically separate business site.

Any allocation of profits or income and expenditure between the permanent establishment and the taxpayer's other business sites or activities must be established following the arm's length principle.

Examples

Examples, including answers, for items 2–6 of Schedule 25A are provided at appendix 4 of these instructions.

Part A of Schedule 25A

Item 1

This item asks you for details of the 3 main business activities carried out with international related parties, and the 3 principal foreign locations for each. If you had fewer than 3 business activities with related international parties, or any of those dealings in fewer than 3 locations, list only those that apply.

The industry codes to be used in this question are those listed in the publication *Business industry codes 2002*. To find out how to obtain a copy of this publication, see the inside back cover of these instructions.

The appropriate code is the code best describing the international business activities giving rise to or underlying the international dealings. It will not necessarily be the same as the code describing your general business activity or the types of transactions between the parties.

Where your business is divided into divisions, or business segments, which are reasonably in accordance with industry codes, these divisions may also be an appropriate basis for responding to this item.

You are not expected to conduct a detailed financial analysis to answer item 1. A reasonable degree of estimation is sufficient.

In the first column, at labels **A**, **E** and **I**, list the appropriate industry code that describes the 3 main business activities carried out with international related parties. List these codes in descending order of total dollar value.

Write the foreign location code—from the list provided in appendix 1—for the 3 principal foreign locations involved in each international related party dealing. If there are fewer than 3 locations in each dealing, list only those applying. List location codes in descending order of dollar value.

Example 1

An Australian manufacturing and holding company has 3 subsidiaries, located in Thailand, Singapore and Indonesia. The following international business activities occurred during the year:

- The Thai subsidiary manufactured household appliances that were purchased by the Australian parent taxpayer for wholesale distribution.
- The Singapore subsidiary manufactured electrical components for distribution in Australia and South-East Asia. During the year, the Australian parent company purchased finished components for re-sale and also carried out product design projects on behalf of this subsidiary.

- Dealings the Australian parent company had with the Indonesian subsidiary consisted only of a loan to that subsidiary and the receipt of interest on the loan.

Select the code for your underlying international businesses as follows:

- Thailand (location code 63): household appliance wholesaling—that is, purchase of finished goods from its subsidiary for wholesale distribution—industry code 47310
- Singapore (location code 56): product design services—industry code 78230
- Indonesia (location code 32): in this instance no clearly identifiable business activities were carried out and the most appropriate industry code is 'financing nec—industry code 73300'.

The following answer is applicable:

| | |
|----------|--------|
| A | 47 310 |
| E | 78 230 |
| I | 73 300 |

| | | | | | |
|----------|----|----------|----|----------|--|
| B | 63 | C | 56 | D | |
| F | 56 | G | | H | |
| J | 32 | K | | L | |

Example 2

An Australian parent company has subsidiaries in New Zealand, Thailand and the United States of America (USA).

The company has 3 identifiable divisions:

- chemical products manufacturing—industry code 25490
- agricultural chemicals wholesaling—industry code 45190
- mining and oilfield services—industry code 15200.

International transactions between the Australian parent and its foreign subsidiaries can be reasonably attributed to the divisions' business activities.

Use codes from the publication *Business industry codes 2002* at labels **A**, **E** and **I** and the appropriate location codes from appendix 1 of these instructions.

| | |
|----------|--------|
| A | 25 490 |
| E | 45 190 |
| I | 15 200 |

| | | | | | |
|----------|----|----------|----|----------|----|
| B | 51 | C | 63 | D | 68 |
| F | 68 | G | 51 | H | 63 |
| J | 63 | K | 51 | L | 68 |

Example 3

An Australian company carries out a food manufacturing business—industry code 21790—through a permanent establishment in New Zealand—location code 51.

The company's head office in Australia carries out research in the Asia Pacific markets for food and confectionery—industry code 78530. This information is used in its New Zealand business.

In the accounts a monthly charge of \$20 000 is made by the head office to the New Zealand business for the marketing service.

The information for item 1 would be:

| | | | | | | | |
|----------|--------|----------|----|----------|--|----------|--|
| A | 78 530 | B | 51 | C | | D | |
| E | | F | | G | | H | |
| I | | J | | K | | L | |

Item 2

The terms used in item 2 have their ordinary meanings within the context of Australian tax law and accounting practices. The particular terms related party international dealings and international related parties used in these instructions are defined in appendix 2 of these instructions.

Include only dealings between international related parties, and not dealings between you and Australian resident entities. For example, if you received management fees from a foreign subsidiary but incurred costs in Australia to earn those fees, show only the gross management fees received from the foreign subsidiary.

Show only the gross amounts in columns A and B at this item, in whole dollars. Where, for example, a related party international dealing involved payments by an Australian taxpayer to an international related party and also receipts from an international related party, show the payments at column A and the receipts at column B. Do not record only the net amount of the transactions.

The amounts shown should also be amounts that are relevant for taxation purposes. For revenue transactions, include those amounts that constitute assessable income or allowable deductions.

For capital transactions, include amounts that constitute acquisition and sale prices for tax purposes, including any **deemed** acquisitions or disposals.

If you have a permanent establishment, record any transactions such as purchases or expenditure and sales or revenue at items 2a to 2d, as appropriate, on the **notional** basis that the permanent establishment is a separate entity.

These transactions include both revenue and capital—including deemed acquisitions or disposals.

Do not include at items 2e or 2f a transfer of funds from your head office, or other business site, to the permanent establishment. Such amounts are not to be treated as borrowed or loaned amounts as between the affected international related parties.

However, where the transfer of funds reflects the internal allocation of funds you acquired from unrelated parties—for example, from financial institutions—include at items 2c or 2d, as appropriate, the interest and incidental costs of borrowing which are allocated to the permanent establishment by the head office.

Item 2a Tangible property

Show your gross purchases or expenditure for trading stock and raw materials from international related party dealings at label **A—Stock in trade and raw materials**.

At label **B** show the gross sales or revenue from stock in trade and raw materials transactions with international related parties.

These amounts will typically be included in trading account items, and will include partially finished goods.

Show the gross purchases or expenditure at label **C—All other tangible property** and gross sales or revenue at label **D** in respect of all tangible property other than:

- stock in trade and raw materials—include in item 2a
- services—include in item 2c
- other Items—list separately in item 2d.

Note: New measures dealing with lease assignments may affect the amount of gross purchases or expenditure and sales or revenue of intangible property.

Item 2b Royalties, rent and intangible property

Royalties are defined in subsection 6(1) of *Income Tax Assessment Act 1936* (ITAA 1936) for the purposes of Schedule 25A. Show gross purchases or expenditure at label **E**, and gross sales or revenue of this nature at label **F**.

Rent other than royalties includes gross expenditure and revenue for the use of, or the right to use, property, both tangible and intangible, not included as royalties. Show gross rent between international related parties at labels **G** and **H**.

Include gross purchases or expenditure and gross sales or revenue for **all other intangible property**—not in the nature of royalties or rent—at labels **I** and **J** respectively.

Item 2c Services

This part of item 2 is directed at the provision of services between international related parties. An inclusive definition of 'services' is provided at section 136AA(1) of ITAA 1936.

Item 2c is broken up into the various forms that the provision of services may take between international related parties.

Identify the nature of any services and group them if appropriate, recording purchases or expenditure on the types of services at labels **K**, **M** and **O**, and recording sales or revenue at labels **L**, **N** and **P**.

If you are unable to categorise the service as any of the specified types at item 2c, include the expenditure or revenue at the Other category of item 2c, labels **Q** and **R** respectively.

Item 2d Other

This part of item 2 is directed at financial and similar dealings between international related parties, and all other dealings or transactions not specifically included at other labels.

The terms, as mentioned earlier, have their ordinary tax or accounting meanings. At label **C** include any gross expenditure relating to insurance, such as premiums, and at label **D** any gross revenue from insurance dealings, including settlements, from international related party dealings.

Item 2e Loans—interest bearing

This part of item 2 is concerned with identifying the gross amounts of loans and advances between international related parties for which an interest component is being charged.

The loans and advances to be shown here include all amounts borrowed between a taxpayer and the related parties.

Where you have **borrowed** amounts or **received** advances from an international related party or parties, add all the opening balances of these loans or advances and write the sum at label **G**, column A. Add all the closing balances for these loans and enter this amount at label **H**, column B.

Where you have **loaned** or **advanced** amounts to international related parties, similarly add the opening balances of these loans and enter that total at label **I**, column A. Add the closing balance of the loans or advances and enter the total at label **J**, column B.

For example, an Australian company has several affiliates, who are related parties, in foreign countries. At the start of the financial year the company's balance sheet showed \$182 678 owing to the affiliates by the company, and \$53 250 owing by the affiliates to the company.

At the end of the financial year, \$86 782 was owed to the affiliates by the company, and \$245 354 was owed by the affiliates to the company. Item 2e would be completed as follows:

| Opening balance | | Closing balance | |
|-----------------|---------|-----------------|---------|
| G | 182 678 | H | 86 782 |
| I | 53 250 | J | 245 354 |

Item 2f Loans 1—interest free

This part of item 2 is concerned with identifying the gross amounts of loans and advances between international related parties for which no interest component is being charged.

The loans and advances to be shown here include all amounts borrowed between a taxpayer and the related parties. The terms 'loans' and 'advances' are intended to be applied broadly, and to include quasi-equity loans in which no amount of interest was paid or accrued during the year.

The terms are not intended to include trade debtors and creditors who fall within ordinary commercial dealings. However, where trade debtors or creditors who are international related parties are allowed or give terms significantly more generous than those allowed to, or given by, comparable arm's length parties, those terms may constitute interest-free loans or advances. In completing this item, have regard to the terms of trade that are arm's length in your own particular circumstances.

Where you have **borrowed** amounts or **received** advances from an international related party or parties, add all the opening balances of these loans or advances and write the sum at label **K**, column A. Add all the closing balances for these loans and enter the total at label **L**, column B.

Where you have **loaned** or **advanced** amounts to international related parties, similarly add the opening balances of these loans and enter that total at label **M**, column A. Add the closing balance of the loans or advances and enter this at label **N**, column B.

Item 3a

This item asks whether any non-monetary consideration has been given or received in any dealings with related international parties.

These dealings may include providing services, transferring property—both tangible and intangible—or any similar dealings.

The nature of the dealing in which the non-monetary consideration is provided may be a barter, swap, bonus or discount, or any type of similar agreement.

Non-monetary consideration will generally include any consideration other than:

- monetary payment or
- payment by cheque, telegraphic transfer of funds or inter-company loan account charges.

In particular, debt-for-equity swaps and non-monetary settlements of inter-company loan accounts will be taken to be non-monetary consideration.

For example, a taxpayer purchased trading stock for \$20 million from an international related party.

If, rather than the paying for the trading stock with a \$20 million telegraphic funds transfer to the related party's loan account, the decision was made to settle the debt by any of the following:

- forgiving royalties that would otherwise be payable to the related party
 - transferring title in a fixed asset or
 - agreeing to a discount on specified future transactions,
- the appropriate response to this question would be to enter **Y** for Yes at label **B**.

However, where individual debts between two parties are aggregated or netted and the net balance settled monetarily, this will not be considered to be non-monetary consideration.

As mentioned earlier, for the purposes of Schedule 25A, a permanent establishment is to be treated as a separate party to its head office or other related parties. Consequently, where non-monetary consideration passes between a permanent establishment and its head office in return for the provision of services or other transactions listed on Schedule 25A, the appropriate answer to item 3a is **Y** for Yes at label **B**.

Item 3b

This item asks whether you have made any provision of services, transfer of assets—both tangible and intangible—or any similar dealings with any related international party, for which you received no consideration.

For example, an Australian parent company manufactures trading stock that it sells to a foreign subsidiary for resale. The Australian parent develops a new product, which requires considerable training of the foreign subsidiary's staff, in order to on-sell the new product.

The Australian parent provides this training, but does not charge the subsidiary. The Australian company should answer **Y** for Yes at label **C**.

Similarly, the answer Yes at label **C** would also be required where an Australian company owned a trade mark which it allowed an international related party to use without payment.

A permanent establishment should be regarded as a separate, but related, party to that of the head office for the purposes this item.

Where there is no charge or adjustment allocating income or expenditure between the parties for a provision of services, transfer of property, or other transactions listed on Schedule 25A,

- by the head office to the permanent establishment or
- by the permanent establishment to the head office or another related international party,

this will be regarded as being for nil consideration. Enter **Y** for Yes at label **C**.

Item 4

This item requires estimations of the percentages of the total dollar value of the related party international dealings for which you have written documentation to support:

- the characterisation of the international dealings in the context of your business, as described in step 1 of *Taxation Ruling TR98/11*
- the selection of the most appropriate arm's length pricing methodologies for those dealings, as described in step 2 of *Taxation Ruling TR98/11* and
- the application of the most appropriate arm's length pricing methodologies to those dealings, as described in step 3 of *Taxation Ruling TR98/11*.

The total related party dealings to be included in this calculation are those dealings identified in items 2a to 2d. Do not include related party dealings identified in items 2e or 2f.

The concept of 'the most appropriate method' is discussed in *Taxation Ruling TR97/20*, at paragraphs 3.5 to 3.9.

Contemporaneous documentation

Documentation is contemporaneous if it is existing or brought into existence at the time you are developing or implementing any arrangement that might raise transfer pricing issues, or reviewing these arrangements prior to or at the time of the preparation of tax returns, and which records information relevant to transfer pricing decisions. The documentation may be in the form of books, records, studies, budgets, plans and projections, analyses, conclusions and other material which records the information. It may be in electronic or written form.

The initial analysis of your international dealings against the arm's length principle will have been carried out and documented at the time of engaging in the dealings; the review of those international dealings prior to preparing tax returns is regarded as being prudent business practice.

Where you have not used arm's length consideration in the ordinary course of your related party international dealings, review prices prior to preparing the tax return and make any adjustments for taxation purposes. Keep all your documentation in relation to this.

Adequacy of documentation

The ATO does not expect taxpayers to prepare or obtain documents beyond the minimum needed to make a reasonable assessment of whether they have complied with the arm's length principle in setting prices or consideration.

However, the documentation which is created in the **ordinary** course of the taxpayer's business and used by it to establish the prices for its international related party dealings—for example, invoices and orders—will not generally be regarded as contemporaneous documentation in relation to the arm's length nature of the dealings. This is because the documents do not produce any evidence or provide any basis for comparison for determining whether prices are established at arm's length.

It is not possible to provide a general checklist of documentation that would be adequate or desirable. The ATO realises that it is necessary to strike an acceptable balance between the need to keep compliance costs to a minimum, and the legitimate concern of the ATO in ensuring the proper amount of Australian tax is paid.

The amount and type of documentation that should be created or obtained over and above that created in the ordinary course of business will depend on the facts and circumstances of each case.

The issue is a practical one having regard to what a prudent business person would do in the same circumstances, and taxpayers need to exercise commercial judgment in assessing their own compliance with the arm's length principle.

Arm's length pricing methodologies

The arm's length principle is the statutory test for pricing related party international dealings. The principle is incorporated into the associated enterprise articles in each of Australia's double tax agreements.

No particular methodology to establish the arm's length pricing, or order in which methodologies should be applied, is prescribed in the double tax agreements or related legislation, and taxpayers have the greatest scope to use methodologies appropriate to their circumstances.

Taxation Ruling TR97/20 Income tax: arm's length transfer pricing methodologies for international dealings sets out:

- the methodologies acceptable to the ATO
- when these methodologies are considered acceptable
- the ATO's views on the concepts involved, and the definitive issues that arise, in applying the methodologies.

It is strongly recommended that all taxpayers with related party dealings read this ruling.

Further information can be obtained from *Taxation Ruling TR 94/14*, paragraphs 86 and 343, and also from the OECD's report *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations—1995*.

A brief overview of some methodologies is given at item 5 of these instructions. However, you should refer to the above mentioned references for detailed discussions of the different methodologies.

Permanent establishments

Where the international dealings are conducted between a permanent establishment and its head office, or between related permanent establishments, the prices adopted for those dealings, for tax purposes, should be determined under the arm's length principle where the prices form the basis for the allocation of profits of the taxpayer in and out of Australia.

Capital dealings

Where the dealings between related parties are capital in nature, the methodologies discussed at item 5 may not necessarily be appropriate.

Some alternative suggestions are given at item 6b of these instructions, and these may be appropriate under certain circumstances. However, no specific methodologies are recommended.

For the purpose of answering items 4a and 4b, include capital dealings where written documentation is held to support the choice of methodology for the processes involved in steps 1, 2 and 3 of *Taxation Ruling TR98/11*, and a *bona fide* belief is held that the resulting transfer pricing is arm's length.

Choice of methodology to determine arm's length pricing

The characterisation of the dealings and the selection and application of the appropriate methodology are 3 steps in a 4-step process for establishing arm's length transfer prices between associated enterprises. The fourth step is to provide processes for review and adjustment, if necessary, to the chosen methodology.

The 4 steps, briefly, are:

- understanding the cross-border dealings in the context of the taxpayer's business—that is, characterisation
- selecting the most appropriate methodology or methodologies
- applying that methodology
- establishing review and adjustment processes.

Steps 1 and 2—Characterising the dealings and selecting the most appropriate methodologies

These two processes may be complex and it is not intended in these instructions to provide a detailed explanation of how the characterisation and selection is to be done, or the issues to be considered in these processes. A detailed study of the processes is provided in Taxation Ruling TR98/11.

The ATO considers that the prudent taxpayer will document:

- the processes of characterisation and selection
- reasons for the final choice of methodology and
- reasons why other methodologies were considered and rejected.

As mentioned earlier, the ATO requires that adequate documentation be kept; however, the complexity of the dealings will indicate the extent to which analysis and supporting documentation is required.

Application of pricing methodologies

The application of the chosen methodology will usually require 2 separate processes:

- an assessment of comparability
- the collection of supplementary data.

The first process will include:

- searching for comparable transactions or enterprises
- identifying sources of information used in the search
- adopting transactions or enterprises as being comparable
- rejecting other transactions or enterprises as not being comparable
- providing reasons and amounts where an independent transaction has been adjusted to make it comparable with the dealings under examination and
- applying the pricing method, and any checking method—such as sampling—to ensure the validity of the chosen methodology and resultant arm's length price.

The second process will include:

- collecting data on profit projections
- creating or acquiring records to supplement the analysis of comparability and function and
- collecting data to calculate financial performance ratios, as part of applying the chosen pricing methods.

You must prepare and retain relevant documentation about these processes.

Item 4a

Use one of the following numeric codes to state the percentage of the total dollar value of related party international dealings identified in items 2a to 2d only, for which you have written documentation supporting your processes in steps 1 and 2 of chapter 5 of *Taxation Ruling TR98/11*—characterisation and selection. Print the code at label **F**.

Percentage of dollar value of related party dealings—items 2a to 2d only

| PERCENTAGE | CODE |
|-----------------------|------|
| 0% | 1 |
| 0% to less than 25% | 2 |
| 25% to less than 50% | 3 |
| 50% to less than 75% | 4 |
| 75% to less than 100% | 5 |
| 100% | 6 |

Note that the calculations need only be sufficient to allow the percentage range to be estimated or determined. However, this estimating process must be based on rational and objective premises.

A statistical sample may be an appropriate method of calculating the relevant percentage, provided the sample selection and mathematical considerations are consistent with generally accepted statistical methods.

Keep your working papers if you have used a sampling process to make this estimate.

Item 4b

Use one of the codes shown in item 4a to state the percentage of the total dollar value of related party international dealings identified in items 2a to 2d only, for which you have written documentation supporting your processes in step 3, section 5.2 of chapter 5 of *Taxation Ruling TR98/11*. Print the code at label **G**.

As in the instructions for item 4a, you need only estimate the percentage, provided the estimate is objectively and rationally determined. Use—for example, a sampling technique based on accepted statistical methods. Retain your working papers that relate to item 4b.

Item 5 Column A

In column A list the 4 principal methodologies that you used in establishing or reviewing the appropriate arm's length pricing or consideration in your related party international dealings that are **revenue** in nature, and were identified in items 2a to 2d. Related party dealings of a **capital** nature are addressed in item 6.

Not all the methodologies are generally considered to provide an arm's length outcome, but may be arm's length in some cases.

If you did not use any methodologies, leave item 5 blank. If you used fewer than 4, list only those used.

Record the 4 methodologies at labels **H** to **N** in descending order of total dollar value, using the appropriate code from the table below:

| PRICING METHODOLOGY | CODE |
|--------------------------------------|------|
| Comparable uncontrolled price method | 1 |
| Resale price method | 2 |
| Cost plus method | 3 |
| Profit split method | 4 |
| Transactional net margin method | 5 |
| Marginal costing | 6 |
| Cost contribution arrangement | 7 |
| Apportionment of costs | 8 |
| Apportionment of income | 9 |
| Fixed mark-up applied to cost | 10 |
| Fixed percentage of resale price | 11 |
| Other arm's length methods | 12 |

The above methodologies are explained in detail in *Taxation Ruling TR97/20*, and it is strongly recommended that taxpayers with related party dealings read this ruling before completing item 5. The ruling generally accepts the principles in the 1995 OECD report. However, any differences are clearly indicated.

A brief summary of each of the methodologies in the above table is provided in appendix 3 of these instructions. The list is not intended to be exhaustive, nor is it intended that each methodology will be acceptable under all circumstances.

As in item 4, in order to establish appropriate arm's length pricing under a particular methodology, a sampling of the dealings may be sufficient if carried out according to accepted statistical practice. Note that where total dollar value of related party dealings is to be calculated, these dealings should not be 'netted off'. That is, do not set off incomings and outgoings against each other to result in a lesser amount. Instead, add the amounts, both income derived and expenses incurred, to obtain the sum total of all such dealings.

Item 5 Column B

In column B at labels **I** to **O** indicate, against each methodology identified in column A, the total dollar value of related party dealings to which you applied that methodology. Express them as a percentage of the sum of all the related party dealings for which you used methodologies to establish arm's length pricing.

Indicate this percentage by using the appropriate code from the table below:

Percentage of dollar value of related party dealings that are revenue in nature—items 2a to 2d only

| PERCENTAGE | CODE |
|-----------------------|------|
| 0% | 1 |
| 0% to less than 25% | 2 |
| 25% to less than 50% | 3 |
| 50% to less than 75% | 4 |
| 75% to less than 100% | 5 |
| 100% | 6 |

The amount referred to above as the total dollar value of related party dealings is, as in the calculation of the value of dealings in column A, the sum total of such dealings, both income derived and expenses incurred. Do not offset these amounts against each other.

The percentage required is an approximate percentage, and an estimate is acceptable provided it is based on objective premises.

A statistical sampling is an acceptable method, provided the method follows accepted statistical practice. Keep any working papers relating to this process.

Item 6

This question is concerned with any dealings of a capital nature that have occurred between you and an international related party. These capital dealings are those that you would have included at items 2a to 2d, but not those dealings which concern trading stock in the ordinary course of business.

If you answer *No* to item 6a below, disregard items 6b and 6c and go to item 7.

Item 6a

This question requires a *Yes* or *No* response. You should answer *Yes* if you have acquired an interest in an asset as a result of dealings of a non-revenue (capital) nature with international related parties, or if you have had dealings with an international related party that would be classified as a CGT event in terms of Part 3-2 of the *Income Tax Assessment Act 1997* (ITAA 1997).

The words 'acquire', 'CGT event', 'disposal' and 'asset' are used in this item within the context of Part 3-1 of ITAA 1997. The question does not refer to trading stock held in the ordinary course of business.

Item 6b

Where you have acquired or disposed of capital assets to international related parties, use the codes below to indicate the 4 principal methods you used for pricing those acquisitions or disposals. Record the methods you used by placing the appropriate codes in each box at label **Q** in descending order of total dollar value, starting at the left hand side.

If you used fewer than 4 methods leave the remaining spaces blank.

| PRICING METHOD | CODE |
|-----------------------|------|
| Nil consideration | 1 |
| Cost price | 2 |
| Written-down value | 3 |
| Discounted cash flow | 4 |
| Director's valuation | 5 |
| Independent valuation | 6 |
| Quoted market price | 7 |
| Other methods | 8 |

Cost price refers to the price the seller originally paid for the asset, including ancillary costs such as freight or handling.

Written-down value refers to a pricing method based on either the taxation or accounting residual value after depreciation has been allowed.

Discounted cash flow is a pricing method where the price of an asset is based on the discounted cash flow at the time of acquisition or disposal.

Director's valuation refers to a pricing methodology that is based on the directors' opinion of an asset's value, and not on any of the methodologies listed in codes 1 to 8.

Independent valuation is a pricing methodology by which a suitably qualified person, acting at arm's length to both the buyer and seller, assesses the value of an asset.

Quoted market price refers to a price quoted on a public listed market, such as a public stock exchange, or commodities market.

Other methods means any other pricing method that is not mentioned in item 6.

The above pricing methodologies may not necessarily provide an arm's length price under all circumstances. The above examples are not an exhaustive list and the appropriate choice of method must be made on the particular circumstances of the dealings.

Item 6c

In this question you are asked to identify the percentage of your related party international dealings that are capital in nature.

Use the codes in the table below to show the total related party acquisitions and disposals of assets (capital) as a percentage of the total value of related party international dealings of both a revenue and non-revenue (capital) nature. Print the percentage at label **R**.

Total of related party acquisitions and disposals as a percentage of the total of related party dealings—
items 2a to 2d only

| PERCENTAGE | CODE |
|-----------------------|------|
| 0% | 1 |
| 0% to less than 25% | 2 |
| 25% to less than 50% | 3 |
| 50% to less than 75% | 4 |
| 75% to less than 100% | 5 |
| 100% | 6 |

As in the instructions for item 4, you need estimate only the percentage, provided the estimate is objectively and rationally determined using—for example, a sampling technique based on accepted statistical methods. Retain your working papers that relate to item 6c.

Item 7

In this item you are asked to advise whether any non-resident has participated in the capital, management or control of the company in this year. 'Participating in the capital' means having an equity interest of 10 percent or greater in the company. Answer **Y** for Yes or **N** for No at label **S**.

Part B of Schedule 25A

Part B of Schedule 25A refers to controlled foreign companies (CFC), foreign investment funds (FIF), foreign life policies (FLP) and controlled foreign trusts (CFT), and is to be completed in all cases where the answer is Yes to:

- items 20 of the *Company tax return 2002*
- item 19 of the *Partnership tax return 2002*
- item 19 of the *Trust tax return 2002*
- items 16 of the *Fund income tax and regulatory return 2002*.

If part B is required, item 11 and items 12 to 16, which are all Yes/No questions, must be answered in all cases. Leave other items blank if they do not apply.

Item 8

This item asks for details of the number of CFCs and CFTs in which the entity had either a direct or indirect interest at the start and end of the accounting period. Separate information is required for broad-exemption listed country, limited-exemption listed country and unlisted country CFCs and CFTs.

Broad-exemption listed countries are listed in Part 1 of Schedule 10 of the Income Tax Regulations.

Limited-exemption listed countries are listed in Part 2 of Schedule 10 of the Income Tax Regulations.

An unlisted country is a country that is not shown in Schedule 10 of the Income Tax Regulations.

Broad-exemption listed country trust estate is defined in section 102AAE of ITAA 1936. The terms 'direct interest' and 'indirect interest' in a CFC and CFT have the same meaning as in Division 3 of Part X of the ITAA 1936. Determine whether the CFCs and CFTs are residents of broad-exemption listed countries, limited-exemption listed countries or unlisted countries.

Labels A, B and C

Show the total number of broad-exemption listed country, limited-exemption-listed country and unlisted country CFCs and CFTs at the start of the entity's accounting period.

Labels D, E and F

Show the total number of broad-exemption listed country, limited-exemption listed country and unlisted country CFCs and CFTs at the end of the entity's accounting period.

If the number of CFCs and CFTs is less than 10, write a zero (0), as the first digit. If the number of CFCs and CFTs is more than 99, insert 99. If the number of CFCs and CFTs is zero, leave the relevant answer block blank.

For example, if an entity had 5 limited-exemption listed country CFCs at the start of the year and nil at the end of the year, and no unlisted country CFCs at either the year's start or end, show 05 at label A. Leave all other labels at item 9 blank.

Item 9

This item asks for details of attributable income that is assessable under sections 456–459 or 459A of ITAA 1936. Show the total amount assessable under each of these sections at the appropriate labels. Use whole dollars. Leave labels blank if they do not apply.

Item 10

This item asks for the amount of foreign income that is exempt under sections 23AH, 23AI, 23AJ and 23AK of ITAA 1936. Show the amount that is exempt before deducting carry-forward foreign source losses.

For amounts that are exempt under section 23AH, include the accounting profits or losses of all branches, adjusted for any eligible designated concession income (EDCI) of those branches. EDCI is defined in section 317 of ITAA 1936.

Show the total amounts in whole dollars for broad-exemption listed countries, limited-exemption listed countries and unlisted countries exempt under each of the sections 23AH, 23AI, and 23AJ at labels O to V as appropriate.

For exempt amounts under section 23AK, show the total amounts in respect of broad-exemption listed countries, limited-exemption listed countries and unlisted countries at label W. If there is no exempt income for some sections, leave those labels blank.

Item 11

This item asks whether transfers of accumulated profits, accumulated losses, paid-up capital and other assets or reserves were made from any unlisted country CFC or CFT to a related entity in a listed country—that is, broad-exemption listed country or limited-exemption listed country—during the year of income.

Transfer includes sale, acquisition, gift, deed of assignment, declaration of trust or otherwise, with or without consideration—monetary or non-monetary.

Examples of the type of transfers to include are:

- the disposal of an asset to a related entity in a listed country—other than trading stock disposed of in the normal course of business
- the waiving of a debt owed by a related entity in a listed country
- the making of a loan to a related entity in a listed country
- the acquisition of a share, a right to acquire a share, or an option to acquire a share in a related entity in a listed country
- the making of a payment in respect of a call on a share in a related entity in a listed country.

Show either **Y** for Yes or **N** for No at each of the labels **S**, **T**, **U** and **V**.

Items 12 to 16

Unless otherwise specified, the terms used in items 12 to 16 have the same meaning as set out in Divisions 6 and 6AAA of ITAA 1936.

Item 12

This item asks whether a transfer of property or services has **ever** been made or caused to be made, to a non-resident trust estate. The item is not restricted to the income year of this tax return.

Transfer, property, and services are defined in section 102AAB of ITAA 1936. Sections 102AAJ and 102AAK of ITAA 1936 provide guidance in relation to whether there was a transfer or a deemed transfer of property or services to a non-resident trust estate. You must show either **Y** for Yes or **N** for No at label **W**.

Item 13

This item asks whether the entity was a beneficiary of a non-resident trust estate at any time during the year of income. You must show either **Y** for Yes or **N** for No at label **X**.

Item 14

This item asks whether the entity had an interest in a non-resident trust estate, or was entitled to acquire an interest in a non-resident trust estate, at any time during the income year.

'Entitled to acquire' has the same meaning as set out in section 322 of Part X of ITAA 1936. You must show either **Y** for Yes or **N** for No at label **Y**.

Item 15

This item asks whether any of the non-resident trust estates for which a 'Yes' answer was given at items 12, 13 or 14 is a discretionary trust estate. Discretionary trust estate is defined in section 102AAB of ITAA 1936. If you answered 'yes' at any labels **W**, **X** or **Y** show either **Y** for Yes or **N** for No, as applicable, at label **Z**. If you answered No at all of labels **W**, **X** or **Y**, leave label **Z** blank.

Item 16

This item asks whether the entity was able to control a non-resident trust estate at any time during the income year. Control in relation to a trust estate is defined in section 102AAG of ITAA 1936. Show either **Y** for Yes or **N** for No at label **A**.

Item 17

This item asks for the current value, at the end of the notional accounting period, of interests in FIF and FLP that are exempt under the specified sections of Part XI of ITAA 1936.

The value should be the most accurate current value that is available, or if no current value is available, use cost. FIF is defined in section 481 of ITAA 1936. FLP is defined in section 482 of ITAA 1936. Interest in a FIF or FLP is defined in section 483 of ITAA 1936.

Notional accounting period in respect of a FIF is defined in section 486 of ITAA 1936.

Notional accounting period in respect of a FLP is defined in section 487 of ITAA 1936.

Show the relevant code from the list below for the interests that qualify for exemptions at labels **B** to **T**. Show the value of the corresponding interest in whole dollars at labels **C** to **U**.

Show only the principal 10 in descending order of total dollar value. If there were more than 10 exemptions, show the largest 10 based on dollar values. If there were less than 10 exemptions, leave the remaining answer blocks blank.

| SECTION | CODE |
|--|------|
| 497 Interests in a foreign company engaged in eligible company activities | 01 |
| 503 Interests in a foreign bank | 02 |
| 504 Interests in a foreign holding company of a foreign bank | 03 |
| 506 Interests in a foreign life insurance company | 04 |
| 507A Interests in a foreign holding company of a foreign life insurance company | 05 |
| 509 Interests in a foreign general insurance company | 06 |
| 509A Interests in a foreign holding company of a foreign general insurance company | 07 |
| 510 Interests in a foreign company engaged in certain activities | 08 |
| 511A Interests in a foreign holding company of a foreign real property company | 09 |
| 513 Interests in certain USA entities | 10 |
| 515 Interests of less than \$50 000 | 11 |
| 521 Interests that are trading stock | 12 |
| 523 Interests in a foreign company principally engaged in several activities | 13 |
| 523A Interests in a foreign holding company of a foreign mixed activity company | 14 |
| 525 Interests not exceeding 5 percent of the value of all FIF interests | 15 |
| 527 Certain interests of underwriting members of Lloyds | 16 |

For example, a taxpayer has the following FIF interests:

- investment valued at \$65 000 in a foreign company engaged in eligible activities that is exempt under section 497 of ITAA 1936
- investment valued at \$100 000 in a foreign life assurance company that is exempt under section 506 of ITAA 1936.

The correct response to item 17 is:

| | |
|----------------|----------------------|
| B 0 4 | C 100 000 .00 |
| D 0 1 | E 65 000 .00 |

Appendix 1

The following table lists the location names and codes to be used in completing item 1.

| Location name | Code | Location name | Code |
|------------------------|------|-------------------------------------|------|
| Andorra | 01 | Liechtenstein | 41 |
| Anguilla | 02 | Lithuania | 95 |
| Antigua | 03 | Luxembourg | 42 |
| Austria | 04 | Macau | 43 |
| Argentina | 84 | Malaysia | 44 |
| Bahamas | 05 | Malaysia (Labuan) | 81 |
| Bahrain | 06 | Maldives | 45 |
| Bangladesh | 85 | Malta | 46 |
| Barbados | 07 | Mauritius | 96 |
| Brazil | 86 | Mexico | 97 |
| Belgium | 08 | Monaco | 47 |
| Belize | 09 | Nauru | 48 |
| Bermuda | 10 | Netherlands | 49 |
| British Virgin Islands | 12 | Netherlands Antilles | 50 |
| Brunei | 13 | New Zealand | 51 |
| Canada | 15 | Norway | 52 |
| Cayman Islands | 16 | Panama | 53 |
| Chile | 87 | Papua New Guinea | 54 |
| China (PRC) | 17 | Philippines | 55 |
| Channel Islands | 11 | Romania | 98 |
| Cook Islands | 18 | Russian Federation | 69 |
| Costa Rica | 19 | Singapore | 56 |
| Croatia | 79 | Slovenia | 80 |
| Cyprus | 20 | Slovak Republic | 99 |
| Czech Republic | 88 | South Africa | 57 |
| Denmark | 21 | Spain | 58 |
| Egypt | 22 | Sri Lanka | 59 |
| Estonia | 89 | Sweden | 60 |
| Germany | 23 | Switzerland | 61 |
| Fiji | 24 | Taiwan | 62 |
| Finland | 25 | Thailand | 63 |
| France | 26 | Tonga | 64 |
| Gibraltar | 27 | Turks and Caicos Islands | 65 |
| Greece | 28 | United Arab Emirates | 66 |
| Hong Kong | 30 | United Kingdom | 67 |
| Hungary | 90 | United States of America | 68 |
| India | 31 | United States of America (Delaware) | 71 |
| Indonesia | 32 | Vanuatu | 70 |
| Ireland | 33 | Venezuela | 14 |
| Isle of Man | 34 | Vietnam | 82 |
| Israel | 35 | Western Samoa | 83 |
| Italy | 36 | Zimbabwe | 29 |
| Jamaica | 37 | African countries NEI | 72 |
| Japan | 38 | Asian countries NEI | 73 |
| Kazakhstan | 91 | Central American countries NEI | 74 |
| Kiribati | 92 | European countries NEI | 75 |
| Kuwait | 93 | Middle East countries NEI | 76 |
| Korea (South) | 39 | South American countries NEI | 77 |
| Latvia | 94 | Other countries NEI | 78 |
| Liberia | 40 | | |

Note: NEI means 'not elsewhere included'.

Appendix 2

Definitions used in this schedule

Capital means an equity interest of 10 percent or greater.

International related parties means persons, including permanent establishments, who are parties to international dealings that can be subject to Division 13 of ITAA 1936 and/or the business profits article or associated enterprises article of a relevant double tax agreement. It includes the following:

- any overseas entity or person who participates directly or indirectly in your management, control or capital
- any overseas entity or person in respect of which you participate directly or indirectly in the management, control or capital
- any overseas entity or person in respect of which persons who participate directly or indirectly in its management, control or capital are the same persons who participate directly or indirectly in your management, control or capital
- a permanent establishment and its head office
- two permanent establishments of the same person.

Participate(s) includes a right of participation, the exercise of which is contingent on an agreed event occurring.

Person has the same meaning as in subsection 6(1) of ITAA 1936 and section 995-1 of ITAA 1997.

Related party international dealings means international transactions, agreements or arrangements between related parties, between a permanent establishment and its head office or between 2 permanent establishments of the same entity. It includes all transactions between an Australian resident and international related parties.

Appendix 3

Pricing methodologies

Refer to *Taxation Ruling TR97/20* and *Taxation Ruling TR1999/1* for a more complete explanation of the operation and suitability of each of the methodologies mentioned below for particular circumstances.

The explanations below are intended to be only brief summaries of each method, and the list is not intended to be exhaustive. The methodologies may not be appropriate for determining an arm's length price under all circumstances; other methodologies, which are not listed below, might also be appropriate.

It is not possible to identify all the circumstances under which the various methodologies will produce valid results, and the applicability of any particular method for any given transaction must be determined from all the circumstances of the dealing.

Comparable uncontrolled pricing method—code 1

This method compares the price for property or services transferred in a controlled transaction—that is, with a related international party—to the price that is charged for comparable property or services in an uncontrolled transaction, under similar circumstances.

If you use this method but the comparable uncontrolled price is adjusted to allow for particular circumstances of the controlled dealing, you should still record the adjusted price under this code.

Resale price method—code 2

This pricing method may be appropriate where an enterprise sells a product to a related party, who then re-sells that product to an independent third party.

The resale price is reduced by the resale price margin, and may then be regarded—after adjustments for other costs associated with the original purchase of the product—as an arm's length price of the original transfer of property between the related parties.

Cost-plus method—code 3

The cost-plus method begins with the costs incurred by the supplier of property or services in a controlled transaction for property transferred or services provided to a related purchaser. An appropriate cost-plus mark-up is then added to this cost, to make an appropriate profit in light of the functions performed and the market conditions. What is arrived at after adding the cost-plus mark-up to the above costs may be regarded as an arm's length price of the original controlled transaction.

This method is probably most useful if:

- semi-finished goods are sold between related parties
- related parties have concluded joint facility agreements or long-term buy-and-supply arrangements or
- the controlled transaction is the provision of services.

If a fixed percentage mark-up is applied to the relevant cost base without any benchmarking of that percentage against comparable independent dealings, this will not be regarded as cost-plus methodology.

Profit split method—code 4

This is a method of determining the appropriate pricing for transactions by:

- identifying the combined profit or loss from the dealings between the related parties and
- splitting that combined profit or loss between the related parties.

The split of profit or loss between the parties must be made on an economically valid basis that approximates the division of profits that would have been arrived at in an agreement made at arm's length.

Transactional net margin method—code 5

This pricing methodology is based on comparisons made at the net profit level between the taxpayer and independent parties, in relation to a comparable transaction or dealing.

Comparisons at the net profit level can be made on a single transaction or in relation to some aggregation of dealings between associated enterprises.

Marginal costing—code 6

Marginal costing is a method of pricing that applies only the variable production costs to the costs of a product. Marginal costing is often used by companies and multinational enterprise groups for internal cost accounting and management control purposes. However, its use in setting transfer prices on international dealings between associated enterprises for tax purposes is acceptable only if pricing on the basis of marginal costs represents an arm's length outcome for the transfer of goods or services into the particular market.

Cost-contribution arrangement—code 7

A cost-contribution arrangement is one where members of a multi-national group act in concert for the benefit of each of the participants to:

- produce or provide goods, intangible property or services or
- acquire these jointly from a third party and
- agree to share the actual costs and risks undertaken.

Each participant bears its fair share of the costs, and is entitled to receive its fair share of rewards. The concept is akin to a joint venture or partnership.

To be consistent with the arm's length principle, the contributors must be satisfied that they can obtain an acceptable rate of return within a time frame that takes into account their financial and business circumstances.

Apportionment of costs—code 8

This pricing methodology apportions the costs associated with a controlled transaction among the associated enterprises. An answer must be found to all transfer pricing problems. However, cases may arise where neither comparable dealings nor data are available to apply to traditional, or profit-based, methods. In these instances, application of an indirect method such as apportionment of income on the basis of a formula may be applicable.

Apportionment of income—code 9

This pricing methodology apportions the income associated with a controlled transaction among the associated enterprises.

As with the methodology for code 8, this methodology may be applicable where there are neither comparable dealings nor data to apply the traditional, or profit-based, methods to the pricing problem.

Fixed percentage mark-up applied to costs—code 10

This pricing methodology determines the transfer price for a controlled transaction by applying a fixed percentage mark-up to a relevant cost base, where the mark-up is not benchmarked against comparable independent dealings. The absence of benchmarking distinguishes this method from the cost-plus methodology discussed at code 3.

Fixed percentage of resale price—code 11

This pricing methodology determines the transfer price for a controlled transaction as a fixed percentage of the resale price, where the fixed percentage chosen is not benchmarked against the gross margins earned in comparable independent dealings.

The absence of benchmarking distinguishes this method from the resale price methodology, code 2.

Other arm's length methods—code 12

Any arm's length method which is not included at codes 1 to 11.

Appendix 4

The following example shows how the appropriate answers are determined for Schedule 25A for a hypothetical situation involving an Australian resident company.

Example

The Australian company, XYZ Pty Ltd, has its head office in Australia and is a parent company to several wholly owned subsidiaries overseas. The company also has a permanent establishment in Hong Kong.

Subsidiaries and permanent establishments qualify as international related parties—refer to the definition provided at appendix 2 of these instructions.

During the year ending 30 June 2002, XYZ Pty Ltd had related party dealings with its international related parties, the subsidiaries and the permanent establishment. These dealings included both capital and revenue transactions. Some of the dealings were transacted at arm's length prices, ensured by implementing and following various arm's length pricing methodologies, while other dealings were not.

The following related party dealings, shown in Australian dollars, occurred during the year and are grouped under the headings in item 2.

Stock in trade and raw materials

- stock in trade was sold to subsidiaries for \$146 450. All sales were priced at bona fide arm's length prices, 50 percent of which were based on comparative uncontrolled prices (CUP) and 50 percent based on the cost-plus method
 - for the CUP dealings, the methodology for pricing was selected, applied and documented as discussed in the introduction to item 4
 - for the cost-plus dealings, the pricing methodology was selected and documented for all the dealings, but written documentation on the **application** of the methodology was kept for only one-quarter of all these dealings
- raw materials were purchased from subsidiaries for \$178 750. Of this total dollar amount, 60 percent was priced on comparative uncontrolled prices, and the remaining 40 percent was invoiced at a price the taxpayer considered reasonable
 - for all CUP dealings, the methodology was selected, applied and documented as discussed in the introduction to item 4

- stock in trade was transferred to the Hong Kong permanent establishment which then sold to third parties in Hong Kong
 - the company's internal transfer price for the stock transferred from Australia to Hong Kong was \$60 000
 - the arm's length transfer price for the stock was \$70 000
 - for taxation purposes, the parent company selected, applied and documented a *bona fide* CUP. The arm's length price was reflected in the taxable income by an adjustment in the Reconciliation to taxable income or loss on the company's tax return
- raw materials were transferred from the permanent establishment at an internal company invoice price of \$45 000.

No adjustment was considered or made to taxable income.

Other tangible property

- shares in a listed company were sold to a subsidiary for \$23 345, being the quoted share price at the time. This methodology was selected, applied and documented as discussed in the introduction to the notes to item 4
- machinery was purchased by a subsidiary and transferred to the parent company for \$18 850.

This was the actual price paid by the subsidiary, including handling charges. This method was also selected, applied and documented as discussed in the notes to item 4.

Royalties

The subsidiaries used trademarks owned by the parent company but did not pay royalties.

Other intangible property

The company sold a trademark to a subsidiary. This was a 'once only' occurrence and was invoiced at cost plus a nominal mark-up. The amount invoiced was \$17 800.

Management and marketing fees

The parent company performed management services for its subsidiaries, and charged them cost plus 5 percent.

The amount invoiced was \$16 000.

For taxation purposes the company selected, applied and documented a *bona fide* CUP of \$21 700.

This arm's length price was reflected in the taxable income by an adjustment in the Reconciliation to taxable income or loss on the company's tax return.

- training was provided for the sales staff of one subsidiary. No amount was invoiced for this service but, in exchange, the subsidiary completed a specific research project for the taxpayer
- the company provided ongoing administrative services for the Hong Kong permanent establishment and invoiced these for internal accounting purposes at cost, being \$10 200. The company did not use any pricing methodology.

Technical and construction

The company provided ongoing technical services regarding manufacturing processes to a subsidiary, and invoiced those services at rates equivalent to prices for similar services performed for arm's length customers. The process was not analysed in detail, neither was it documented.

The amount invoiced was \$12 650.

Research and development

The taxpayer maintained a research and development (R&D) division and incurred R&D expenditure on behalf of all subsidiaries and its own activities. Subsidiaries paid their own share of the total annual cost, and no mark-up was included in the invoiced price. The total amount was \$24 600.

Summary of the dealings

| | Column A Purchases/ expenditure | Column B Sales/revenue |
|---|---------------------------------------|---------------------------|
| 2a Tangible property | | |
| Stock in trade and raw materials | A 223 750 | B 216 450 |
| All other tangible property | C 18 850 | D 23 345 |
| 2b Royalties, rent and intangible property | | |
| Royalties | E | F |
| Rent other than royalties | G | H |
| All other intangible property | I | J 17 800 |
| 2c Services | | |
| Management, financial, administrative, marketing, training | K | L 31 900 |
| Technical, construction | M | N 12 650 |
| Research and development | O | P 24 600 |
| Other | Q | R |
| 2d Other | | |
| Interests, discounts | A | B |
| Insurance | C | D |
| All other payments, expenses, sales and revenues not included elsewhere | E | F |

Suggested answer to item 2

Show whole dollars only.

| | | |
|-----------------------------------|--|------------------|
| Stock in trade | Purchases/expenditure: | |
| | Raw materials - subsidiary | \$178 750 |
| | Raw materials - permanent establishment (PE) | \$45 000 |
| | Total | \$223 750 |
| Sales/revenue | Stock - subsidiary | \$146 450 |
| | Stock - PE (taxation value) | \$70 000 |
| | Total | \$216 450 |
| Other tangibles | Shares sold | \$23 345 |
| | Machinery purchased | \$18 850 |
| Royalties | No royalties were paid. There were no related party international dealings. | |
| Other intangibles | Trademark—show value of the amount invoiced | \$17 800 |
| Management fees | Subsidiaries: | |
| | • management fees; show the taxable amount | \$21 700 |
| | • staff training/research 'barter'; no amount was invoiced and no amount is included at item 2 | \$0 |
| | PE: | |
| | • show invoiced amount | \$10 200 |
| | Total fees | \$31 900 |
| Technical and construction | Include the amount invoiced | \$12 650 |
| Research and development | Include the amount invoiced | \$24 600 |

Suggested answer to item 3a

A Yes answer is required. This is because the company has provided management services to an international related party and consideration was settled by means of a swap or barter, in this case staff training in return for the research project.

Suggested answer to item 3b

A Yes answer is also required here. The subsidiaries used trade-marks owned by the company but did not pay royalties, therefore this is a dealing for which there was no consideration.

Suggested answer to item 4a

The percentage of the related party dealings for which written documentation is held to support the selection of arm’s length pricing methodologies is calculated as follows.

The total dollar value of related party dealings, from items 2a to 2d, is \$569 345.

The total dollar value of the dealings for which supporting documentation as to selection is held is determined as follows:

| | | | |
|----------------------------------|-----------|------------------|------------------|
| Stock | \$146 450 | CUP method | |
| | | 50% of total | \$73 225 |
| | | Cost plus method | |
| | | 50% of total | \$73 225 |
| Stock—PE | \$70 000 | CUP method 100% | \$70 000 |
| Raw Materials | \$178 750 | CUP method | |
| | | 60% of total | \$107 250 |
| Royalties | Nil | \$0 | |
| Other tangible property | | | |
| | \$23 345 | All included | \$23 345 |
| | \$18 850 | All included | \$18 850 |
| Other intangible property | Nil | | \$0 |
| Management etc. | | | |
| Management | \$21 700 | All included | \$21 700 |
| Training | Nil | \$0 | |
| Administrative | \$10 200 | Nil | \$0 |
| Technical etc. | \$12 650 | Nil | \$0 |
| Research and development | Nil | | \$0 |
| | | Total | \$387 595 |

The percentage is calculated as 68.1 percent being \$387 595 divided by \$569 345. The appropriate code from the table at item 4a is entered at label **F**, item 4a—that is, code 4.

Suggested answer to item 4b

The percentage of the related party dealings for which there is written documentation to support the application of arm’s length pricing methodologies is calculated as follows:

- The total dollar value of related party dealings is determined as \$569 345, based on the amounts shown at items 2a to 2d.
- The total dollar value of the dealings for which supporting documentation as to selection is held is determined as follows:

| | | | |
|--------------|-----------|---|------------------|
| Stock | \$146 450 | CUP method 50% of total | \$73 225 |
| | | Cost-plus method 50% of total cost-plus dealings | \$73 225 |
| | | 1/4 supported by documentation regarding application of methodology | \$18 306 |
| Stock | \$70 000 | CUP method 100% | \$70 000 |
| | | Other items as per item 4a above—all items in 4a below stock in trade | \$171 145 |
| | | Total | \$332 676 |

The percentage is calculated as 58.4 percent being \$332 676 divided by \$569 345. The appropriate code from the table at item 4b is entered at label **G** of item 4b—that is, code 4.

Suggested answer to item 5

This item asks you about **revenue** dealings in items 2a to 2d. Item 6 asks you about capital dealings.

The revenue items in this example are all those items mentioned except the shares in the listed company which were sold to a subsidiary, the machinery purchased by the subsidiary and transferred to the parent company, and the trademark sold to the subsidiary.

| |
|---|
| The value of the revenue dealings was \$509 350 (\$569 345 – (\$23 345 + \$18 850 + \$17 800)). |
| The value of the capital dealings was \$59 995. (\$23 345 + \$18 850 + \$17 800). |

The two arm’s length pricing methodologies used in items 2a to 2d were the comparable uncontrolled price method, code 1, and the cost-plus method, code 3.

The methodology codes are listed in the instructions to item 5.

The percentages of total dollar value of revenue that each methodology covers—from related party dealings identified in items 2a to 2d—are calculated as follows:

| | | |
|--|-----------|-------|
| CUP | \$272 175 | 53.4% |
| (\$73 225 + \$107 250 + \$70 000 + \$21 700) | | |
| Cost plus | \$73 225 | 14.4% |

The appropriate codes for these percentages are found in the table for this item in the instructions.

The appropriate answer for item 5 is:

| | | | | |
|----------|----------|----------|----------|----------|
| H | 0 | 1 | I | 4 |
| J | 0 | 3 | K | 2 |

Item 6

This item concerns related party dealings of a capital nature. These dealings are:

| | |
|---------------------------------------|----------|
| • sale of shares to a subsidiary | \$23 345 |
| • purchase of machinery | \$18 850 |
| • sale of a trademark to a subsidiary | \$17 800 |
| TOTAL | \$59 995 |

Suggested answer to item 6a

The purchase of machinery, the sale of shares and the sale of the trademark to subsidiaries will all be CGT events within the context of Division 104 of ITAA 1997, and so the appropriate response to this item is Yes at label P.

Suggested answer to item 6b

This item asks for the 4 principal methodologies used for pricing the capital dealings. In this example only 3 methodologies were used:

- the quoted market price methodology for the share dealing—code 7.
- the cost price method for the machinery—code 2 and
- other methods for the trade mark—code 8.

These codes are from the table at the instructions for item 6.

The appropriate answer to item 6b is:

| | | | | |
|----------|---|---|---|--|
| Q | 7 | 2 | 8 | |
|----------|---|---|---|--|

Suggested answer to item 6c

This item asks for the percentage of related party dealings of a capital nature—by value—compared with the total dollar value of all related party dealings, both capital and revenue.

In this example, the total of all related party dealings is \$569 345.

The dealings of a capital nature which are CGT events in terms of Division 104 are:

| | |
|-------------------------|----------|
| • sale of shares | \$23 345 |
| • sale of the trademark | \$17 800 |
| • purchase of machinery | \$18 850 |
| TOTAL | \$59 995 |

As a percentage: $\frac{\$59\,995}{\$569\,345} = 10.5\%$

The appropriate code, from the table at the instructions for item 6c, is code 2; the appropriate answer for item 6c is:

| | |
|----------|---|
| R | 2 |
|----------|---|

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