BUSINESS	COMPANIES, PARTNERSHIPS, TRUSTS AND FUNDS	INSTRUCTIONS	NAT2639—6.2004
SEGMENT	AUDIENCE	FORMAT	PRODUCT ID

Australian Government
Australian Taxation Office

Schedule 25A 2004 instructions

Information to help you complete a Schedule 25A, including where to show foreign branch non-assessable, non-exempt income and new country codes for foreign locations.

For more information visit **www.ato.gov.au**

Schedule 25A
2004 instructions

OUR COMMITMENT TO YOU

The information in this publication is current at May 2004 and we have made every effort to ensure it is accurate. However, if something in the publication is wrong or misleading and you make a mistake as a result, you will not be charged a penalty. You may have to pay interest, depending on the circumstances of your case.

If you feel this publication does not fully cover your circumstances, please seek help from the Tax Office or a professional adviser. Since we regularly revise our publications to take account of any changes to the law, you should make sure this edition is the latest. The easiest way to do this is by checking for a more recent version on our website at **www.ato.gov.au**

YOUR RIGHTS

It is important that you are aware of your rights and obligations when dealing with the Tax Office. These are explained in the taxpayer's charter, along with the service and other standards you can expect from the Tax Office. To view the taxpayers' charter, visit our website at **www.ato.gov.au** To get a printed copy of the *Taxpayers' Charter – what you need to know* (NAT 2548), phone our distribution service on **1300 720 092**.

HOW SELF-ASSESSMENT AFFECTS YOU

Self-assessment means the Tax Office uses the information you give on your tax return to work out your refund or tax debt. You are required by law to make sure you have shown all your assessable income and claimed only the deductions and tax offsets to which you are entitled. The Tax Office does not take any responsibility for checking the accuracy of the details you provide in your tax return. However, at a later date the Tax Office may examine the details contained in your tax return more thoroughly by reviewing specific parts, or by conducting an audit on your tax affairs.

What are your responsibilities?

It is your responsibility to lodge a tax return that is signed, complete and correct. Even if someone else – including a tax agent – helps you to prepare your tax return, you are still legally responsible for the accuracy of your information.

What if you lodge an incorrect tax return?

Our audit programs are designed to continually check for missing, inaccurate or incomplete information. If you become aware that your tax return is incorrect, you must contact us straight away.

Initiatives to complement self-assessment

There are a number of initiatives administered by the Tax Office which complement self-assessment. Examples include:

- a change in penalty provisions so that, if you take reasonable care with your tax affairs, you will not receive a penalty for honest mistakes – but please note that a general interest charge on omitted income or over-claimed deductions and tax offsets could still be payable
- the process for applying for private rulings
- your entitlement to interest on early payment or over-payment of a tax debt, or the process for applying for an amendment if you find you have left something out of your tax return.

Do you need to ask for a private ruling?

If you have a concern about the way a tax law applies to your personal tax affairs, you may want to ask for a private ruling.

A private ruling will relate just to your situation. Write to the Tax Office describing your situation in detail and ask for advice. To do this, complete an *Application for a private ruling for individuals* (NAT 4106 – 3.2001). You should lodge your tax return by the due date, even if you are waiting for the reply to your private ruling. You may need to request an amendment to your tax return once you have received the private ruling.

The Tax Office publishes on its website all private rulings issued. What we publish will not contain anything which could identify you.

You can ask for a review of a private ruling decision if you disagree with it, even if you have not received your assessment. Details of the review procedures are sent to you when the private ruling decision is made. For more information on private rulings, visit the Tax Office website at **www.ato.gov.au**

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SCHEDULE 25A INSTRUCTIONS 2004

INTRODUCTION

This publication is to assist in the completion of *Schedule 25A 2004*. This publication is NOT a guide to income tax law. More detailed information is available in other publications.

If you answered yes on a partnership, trust, company or fund tax return to a question indicating the aggregate amount of your transactions or dealings with international related parties was greater than $1 million complete Section A of Schedule 25A and lodge it with the appropriate tax return. The aggregate amount of the dealings is the total amount of all dealings, whether on revenue or capital account, and includes the balance of any loans or borrowings outstanding with international related parties.

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

If you answered yes to both questions, complete sections 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

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

Complete Section A if you answered yes to any of the following:

- item 19 of the *Company tax return 2004* (NAT 0656—6.2004)
- item 26 of the *Partnership tax return 2004* (NAT 0659—6.2004)
- item 26 of the *Trust tax return 2004* (NAT 0660—6.2004)
- item 15 of the *Fund income tax and regulatory return 2004* (NAT 0658—6.2004).

The Tax Office 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*
- *TR2000/16 International transfer pricing and profit allocation adjustments—relief from double taxation and the Mutual Agreement Procedure*
- *TR2001/11 International transfer pricing—operation of Australia's permanent establishment attribution rules*

It is recommended that taxpayers with related party international dealings be familiar with these rulings. The Tax Office 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. However, for the purposes of this Schedule 25A certain items (2a–d; 3a–b) should be answered on the **notional** basis that a permanent establishment is a separate but related entity.

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.

Interests in foreign companies or foreign trusts

Section B of Schedule 25A refers to foreign branches of Australian companies, 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:

- item 20 of the *Company tax return 2004* (NAT 0656—6.2004)
- item 19 of the *Partnership tax return 2004* (NAT 0659—6.2004)
- item 19 of the *Trust tax return 2004* (NAT 0660—6.2004)
- item 16 of the *Fund income tax and regulatory return 2004*. (NAT 0658—6.2004)

If Section B is required, item 11, and items 12 to 16 (which are all **Y** for yes and **N** for no questions), must be answered in all cases. Leave other items blank if they do not apply.

SECTION A OF SCHEDULE 25A

Item 1

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

The industry codes to be used in this question are those listed in the publication *Business industry codes 2004* (NAT 1827—6.2004) available from our website at **www.ato.gov.au**

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**, **F** and **K**, list the appropriate industry code that describes the three main business activities giving rise to, or underlying, the dealings carried out with international related parties. List these codes in descending order of total dollar value.

In the second column, at labels **B**, **G** and **L**, provide the values of the activities with international related parties for each of the industry codes. The value of the activities is the total for all locations for each underlying industry code. If part of the value of the activities is attributable to loans, this amount should not be included in the total value for each industry code.

Write the foreign location code—from the list provided in appendix 1—for the three principal foreign locations involved in each industry code. If there are fewer than three locations in each code, list only those applying.

List the location codes in descending order of dollar value. Please note that in 2004 new 3 character alpha country codes are being used.

Example 1

An Australian manufacturing and holding company has three 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 value of these purchases was $50,000.
- 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. The value of the products purchased was $900,000, and the value of the design work carried out by the Australian company was $40,000.
- 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. The value of the loan was $250,000 and $25,000 interest was received. The loan was to enable the Indonesian subsidiary to undertake market research in Indonesia.

Select the code for your underlying international businesses as follows:

- Thailand (location code THA): household appliance wholesaling—that is, purchase of finished goods from its subsidiary for wholesale distribution—industry code 47310
- Singapore (location code SGP): product design services—industry code 78230, and
- purchase of finished goods from its subsidiary for resale—industry code 47310
- Indonesia (location code IDN): in this instance the business activity giving rise to, or underlying, the loan was market research and the most appropriate industry code is 'market research service—industry code 78530'.

The following answer is applicable:

A	47310	B	950,000	C	SGP	D	THA	E	
F	78230	G	40,000	H	SGP	I		J	
K	78530	L	25,000	M	IDN	N		O	

The interest amount is put at label **L**. The loan is not included in the total value for this industry code.

As there is no other market research activity with international related parties, the interest is the only amount put at this label.

Example 2

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

The company has three identifiable divisions:

- chemical products manufacturing—industry code 25490. The related party dealings by this division total $120,000 across all three locations.
- agricultural chemicals wholesaling—industry code 45190. The related party dealings by this division total $200,000 across all three locations.
- mining and oilfield services—industry code 15200. The related party dealings by this division total $700,000 across all three locations.

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

Use codes from the electronic publication available on our website *Business industry codes 2004* (NAT 1827—6.2004) at labels **A**, **F** and **K** and the appropriate location codes from appendix 1 of these instructions.

A	15200	B	700,000	C	NZL	D	THA	E	USA
F	45190	G	200,000	H	USA	I	NZL	J	THA
K	25490	L	120,000	M	THA	N	NZL	O	USA

Example 3

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

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 $200,000 is made by the head office to the New Zealand business for the marketing service. For this year, the head office has made 12 such monthly charges.

The information for item 1 would be:

A	78530	B	2,4000,000	C	NZL	D		E	
F		G		H		I		J	
K		L		M		N		O	

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 the net amount of the transactions. An exception to this general approach applies in the case of certain **derivative instruments**. Refer to item 2d **Other** for further details.

For revenue transactions, unless otherwise specified, include those amounts that constitute assessable income or allowable deductions.

For capital transactions, include amounts that constitute acquisition and sale prices 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.

Unless you are an authorised deposit-taking institution (ADI) within the meaning of section 995-1 of ITAA 1997, or fall within the situation described in the next paragraph, do not include at items 2e or 2f any internal transfer of funds which are akin to the borrowing or lending of money (eg from your head office, or other business site, to a permanent establishment or vice versa) as such internal transfers of funds are not recognised under Australia's income tax laws.

Where, however, the internal transfer of funds reflects the internal allocation of funds you have borrowed from related or unrelated parties and the funds so borrowed are attributable to the PE, include at item 2d the interest and incidental costs of borrowing which are allocated to the permanent establishment by the head office and at item 2e include the amount borrowed from related or unrelated parties (see paragraphs 3.41–3.44 of TR2001/110).

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 trading stock 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:

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

Include acquisitions or disposals of ordinary shares or preference shares between international related parties at **All other tangible property**. Show the gross acquisition costs or receipts on disposal at labels **C** and **D** respectively.

> **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 the *Income Tax Assessment Act 1936* (ITAA 1936). Show gross purchases or expenditure on royalties paid or payable to international related parties at label **E**, and gross sales or revenue from royalties derived from international related parties, 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.

At labels **E** and **F** of this item include any transactions between international related parties involving derivative instruments and any financial transactions other than loans. Definitions of these terms and how they should be recorded are provided below.

A derivative instrument is a contractual right that derives its value from the value of something else, such as a debt security, equity, commodity, or a specific index. The most common derivative instruments are forwards, futures, options and notional principal contracts such as swaps, caps, floors, collars and credit derivatives. Unlike traditional debt and equity securities, these instruments do not involve a return on an initial investment.

For many derivative instruments such as notional principal contracts (eg interest rate swaps), the parties to the contract will often only exchange net cash flows at certain specified times during the term of the contract. In completing Schedule 25A in respect of such derivative instruments, only net cash flows should be recorded at label **E** if it is an outgoing and at label **F** if it is a receipt. Do not record any gross cash flows or any notional principal amounts associated with such transactions.

In some cases, only one party to the derivative instrument transaction may make a payment (eg settlement amounts in respect of forward rate agreements, option premiums). In such cases, the gross amount of the derivative instrument transaction should be recorded at label **E** if it is an outgoing and at label **F** if it is a receipt.

Mark-to-market accounting may be used for recording amounts in respect of derivative instruments at this label where this is used by a taxpayer for financial accounting purposes.

A financial transaction other than a loan is any other form of financial transaction which is not a derivative instrument or an amount to be recorded elsewhere in item 2d (ie interest, discounts, insurance) or at items 2e or 2f (ie interest bearing loans and interest free loans) and which is of a revenue (ie non-capital) nature. For example, payments or receipts in respect of guarantee arrangements, lease agreements, repurchase agreements, securities lending arrangements, etc, should be recorded at this item.

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.

The terms ‘loans’ and ‘advances’ are intended to be applied broadly in accordance with commercial and accounting practices (a rigorous application of the debt/equity test is not necessary).

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, 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—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 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 print **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 of 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. Print **Y** for yes at label **C**. Where you have disclosed an outbound interest free loan at item 2f on Schedule 25A, a **Y** for yes is not required 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 methods for those dealings, as described in step 2 of Taxation Ruling TR98/11, and
- the application of the most appropriate arm's length pricing methods 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 either at the time you are developing or implementing any arrangement that might raise transfer pricing issues, or when you are reviewing these arrangements prior to or at the time of the preparation of tax returns, and the documentation 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 Tax Office 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 Tax Office 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 Tax Office 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 methods

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 method to establish the arm's length pricing, or order in which methods should be applied, is prescribed in the double tax agreements or related legislation, and taxpayers have the greatest scope to use methods appropriate to their circumstances.

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

- the methods acceptable to the Tax Office
- when these methods are considered acceptable, and
- our views on the concepts involved, and the definitive issues that arise, in applying the methods.

It is strongly recommended that all taxpayers with international 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 methods is given at item 5 of these instructions. However, you should refer to the above mentioned references for detailed discussions of the different methods.

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 methods 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 methods are recommended.

For the purpose of answering items 4a and 4b, include capital dealings where written documentation is held to support the choice of method 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 method to determine arm's length pricing

The characterisation of the dealings and the selection and application of the appropriate method are three steps in a four-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 method.

The four steps, briefly, are:

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

The first two steps may be complex processes and you may need to refer to specific details provided in Taxation Ruling TR98/11.

The Tax Office considers that the prudent taxpayer will document:

- the processes of characterisation and selection
- reasons for the final choice of method, and
- reasons why other methods were considered and rejected.

As mentioned earlier, the Tax Office 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 methods

The application of the chosen method will usually require two separate processes:

- an assessment of comparability, and
- 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 method 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 (characterisation and selection) of chapter 5 of Taxation Ruling TR98/11. 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 four principal methods 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 methods 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 methods, leave item 5 blank. If you used fewer than four, list only those used.

Record the four methods at labels **H** to **N** in descending order of total dollar value, using the appropriate code from the table following:

Pricing method	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 methods are explained in detail in Taxation Ruling TR97/20 and Taxation Ruling TR1999/1, and it is strongly recommended that taxpayers with related party dealings read these rulings before completing item 5. The rulings generally accept the principles in the 1995 OECD report. However, any differences are clearly indicated.

A brief summary of each of the methods 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 method will be acceptable under all circumstances.

As in item 4, in order to establish appropriate arm's length pricing under a particular method, 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' (other than the case of certain **derivative instruments**—refer to item 2d **Other** for further details). 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 method identified in column A, the total dollar value of related party dealings to which you applied that method. Express them as a percentage of the sum of all the related party dealings for which you used methods 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 print **N** for no at item 6a below, disregard items 6b and 6c and go to item 7.

Item 6a

This question requires a **Y** for yes or **N** for no. You should answer **Y** for 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 3-1 of the *Income Tax Assessment Act 1997* (ITAA 1997).

The words 'acquired', '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 capital assets from, or have disposed of capital assets to international related parties, use the codes below to indicate the four 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 four 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 'adjustable value' 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 method that is based on the directors' opinion of an asset's value, and not on any of the methods listed in codes 1 to 8.

'Independent valuation' is a pricing method 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 methods 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 international related party acquisitions and disposals of capital assets, as a percentage of the total value of related party international dealings of both a revenue and non-revenue (or capital) nature. Print the code 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 to 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% or greater in the company. Print **Y** for yes or **N** for no at label **S**.

Item 8

In this item you are asked to show the number of international related parties with which you had dealings during the year. 'International related parties' are parties (including subsidiaries and permanent establishments) whose international dealings can be subject to Division 13 of the ITAA 1936. An expanded definition can be found at appendix 2 of these instructions.

SECTION B OF SCHEDULE 25A

Section B of Schedule 25A refers to foreign branches of Australian companies, 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:

- item 20 of the *Company tax return 2004* (NAT 0656—6.2004)
- item 19 of the *Partnership tax return 2004* (NAT 0659—6.2004)
- item 19 of the *Trust tax return 2004* (NAT 0660—6.2004)
- item 16 of the *Fund income tax and regulatory return 2004*. (NAT 0658—6.2004)

If Section B is required, item 11, and items 12 to 16 (which are all **Y** for yes and **N** for no questions), must be answered in all cases. Leave other items blank if they do not apply.

Item 9

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 five 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 10

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 11

This item asks for the amount of foreign income that is non-assessable non-exempt income under sections 23AH, 23AI, 23AJ and 23AK of ITAA 1936. Non-assessable non-exempt income is a category of income now recognised by the income tax law. Non-assessable non-exempt income is not taken into account in working out a taxpayer’s taxable income for an income year. Also, it is not taken into account in working out a taxpayer’s tax loss for an income year or in working out how much of a prior year tax loss is deductible in an income year.

For amounts that are non-assessable and non-exempt income 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 that are non-assessable non-exempt income under each of the sections 23AH, 23AI, and 23AJ at labels **O** to **V** as appropriate.

For amounts that are non-assessable and non-exempt income 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 non-assessable non-exempt income for some sections, leave those labels blank.

Item 12

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, or
- 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 13 TO 18

Unless otherwise specified, the terms used in items 13 to 18 have the same meaning as set out in Divisions 6 and 6AAA of ITAA 1936.

Item 13

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 14

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 15

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 16

This item asks whether any of the non-resident trust estates for which a yes answer was given at items 13, 14 or 15 is a discretionary trust estate. Discretionary trust estate is defined in section 102AAB of ITAA 1936. If you answered yes at 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 17

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 18

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
511	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% 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 18 is:

B	0 4	C	100,000·~~00~~
D	0 1	E	65,000·~~00~~

APPENDIX 1

LOCATION NAMES AND CODES

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

Please note that Guernsey, Jersey and Isle of Man have allocated their own country codes

Location name	Code
Afghanistan	AFG
Albania	ALB
Algeria	DZA
American Samoa	ASM
Andorra	AND
Angola	AGO
Anguilla	AIA
Antarctica	ATA
Antigua and Barbuda	ATG
Argentina	ARG
Armenia	ARM
Aruba	ABW
Australia	AUS
Austria	AUT
Azerbaijan	AZE
Bahamas	BHS
Bahrain	BHR
Bangladesh	BGD
Barbados	BRB
Belarus	BLR
Belgium	BEL
Belize	BLZ
Benin	BEN
Bermuda	BMU
Bhutan	BTN
Bolivia	BOL
Bosnia and Herzegowina	BIH
Botswana	BWA
Bouvet island	BVT
Brazil	BRA
British Indian Ocean Territory	IOT
Brunei Darussalam	BRN
Bulgaria	BGR
Burkina faso	BFA
Burundi	BDI
Cambodia	KHM
Cameroon	CMR
Canada	CAN
Cape verde	CPV
Cayman islands	CYM
Central african republic	CAF
Chad	TCD

Location name	Code
Chile	CHL
China	CHN
Christmas Island	CXR
Cocos (Keeling) Islands	CCK
Colombia	COL
Comoros	COM
Congo	COG
Cook Islands	COK
Costa Rica	CRI
Cote D'Ivoire	CIV
Croatia (local name: Hrvatska)	HRV
Cuba	CUB
Cyprus	CYP
Czech Republic	CZE
Denmark	DNK
Djibouti	DJI
Dominica	DMA
Dominican Republic	DOM
East Timor	TLS
Ecuador	ECU
Egypt	EGY
El Salvador	SLV
Equatorial Guinea	GNQ
Eritrea	ERI
Estonia	EST
Ethiopia	ETH
Falkland Islands (Malvinas)	FLK
Faroe Islands	FRO
Fiji	FJI
Finland	FIN
France	FRA
France, Metropolitan	FXX
French Guiana	GUF
French Polynesia	PYF
French Southern Territories	ATF
Gabon	GAB
Gambia	GMB
Georgia	GEO
Germany	DEU
Ghana	GHA
Gibraltar	GIB
Greece	GRC
Greenland	GRL
Grenada	GRD
Guadeloupe	GLP
Guam	GUM
Guatemala	GTM
Guernsey	GGY
Guinea	GIN
Guinea-Bissau	GNB
Guyana	GUY

Location name	Code	Location name	Code
Haiti	HTI	Monaco	MCO
Heard and Mc Donald Islands	HMD	Mongolia	MNG
Holy See (Vatican City State)	VAT	Montserrat	MSR
Honduras	HND	Morocco	MAR
Hong kong	HKG	Mozambique	MOZ
Hungary	HUN	Myanmar	MMR
Iceland	ISL	Namibia	NAM
India	IND	Nauru	NRU
Indonesia	IDN	Nepal	NPL
Iran (Islamic Republic of)	IRN	Netherlands	NLD
Iraq	IRQ	Netherlands Antilles	ANT
Ireland	IRL	New Caledonia	NCL
Isle of Man, The	IMN	New Zealand	NZL
Israel	ISR	Nicaragua	NIC
Italy	ITA	Niger	NER
Jamaica	JAM	Nigeria	NGA
Japan	JPN	Niue	NIU
Jersey	JEY	Norfolk Island	NFK
Jordan	JOR	Northern Mariana Islands	MNP
Kazakhstan	KAZ	Norway	NOR
Kenya	KEN	Oman	OMN
Kiribati	KIR	Pakistan	PAK
Korea, Democratic People's Republic of	PRK	Palau	PLW
Korea, Republic of	KOR	Panama	PAN
Kuwait	KWT	Papua New Guinea	PNG
Kyrgyzstan	KGZ	Paraguay	PRY
Lao People's Democratic Republic	LAO	Peru	PER
Latvia	LVA	Philippines	PHL
Lebanon	LBN	Pitcairn	PCN
Lesotho	LSO	Poland	POL
Liberia	LBR	Portugal	PRT
Libyan Arab Jamahiriya	LBY	Puerto Rico	PRI
Liechtenstein	LIE	Qatar	QAT
Lithuania	LTU	Reunion	REU
Luxembourg	LUX	Romania	ROU
Macau	MAC	Russian Federation	RUS
Macedonia, the former Yugoslav Republic of	MKD	Rwanda	RWA
Madagascar	MDG	Saint Kitts and Nevis	KNA
Malawi	MWI	Saint Lucia	LCA
Malaysia	MYS	Saint Vincent and The Grenadines	VCT
Maldives	MDV	Samoa	WSM
Mali	MLI	San Marino	SMR
Malta	MLT	Sao Tome and Principe	STP
Marshall Islands	MHL	Saudi Arabia	SAU
Martinique	MTQ	Senegal	SEN
Mauritania	MRT	Seychelles	SYC
Mauritius	MUS	Sierra Leone	SLE
Mayotte	MYT	Singapore	SGP
Mexico	MEX	Slovakia (Slovak Republic)	SVK
Micronesia, Federated States of	FSM	Slovenia	SVN
Moldova, Republic of	MDA	Solomon Islands	SLB

Location name	Code
Somalia	SOM
South Africa	ZAF
South Georgia and The South Sandwich Islands	SGS
Spain	ESP
Sri Lanka	LKA
St. Helena	SHN
St. Pierre and Miquelon	SPM
Sudan	SDN
Suriname	SUR
Svalbard and Jan Mayen Islands	SJM
Swaziland	SWZ
Sweden	SWE
Switzerland	CHE
Syrian Arab Republic	SYR
Taiwan, Province of China	TWN
Tajikistan	TJK
Tanzania, United Republic of	TZA
Thailand	THA
Togo	TGO
Tokelau	TKL
Tonga	TON
Trinidad and Tobago	TTO
Tunisia	TUN
Turkey	TUR
Turkmenistan	TKM
Turks and Caicos Islands	TCA
Tuvalu	TUV
Uganda	UGA
Ukraine	UKR
United Arab Emirates	ARE
United Kingdom	GBR
United States	USA
United States Minor Outlying Islands	UMI
Uruguay	URY
Uzbekistan	UZB
Vanuatu	VUT
Venezuela	VEN
Viet nam	VNM
Virgin Islands (British)	VGB
Virgin Islands (US)	VIR
Wallis and Futuna Islands	WLF
Western Sahara	ESH
Yemen	YEM
Yugoslavia	YUG
Zaire	ZAR
Zambia	ZMB
Zimbabwe	ZWE
Other countries NEI	NEI

Note: NEI means ‘not elsewhere included’.

APPENDIX 2

DEFINITIONS USED IN THIS SCHEDULE

Capital means an equity interest of 10% 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, or
- 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 two permanent establishments of the same entity. It includes all transactions between an Australian resident and international related parties.

APPENDIX 3

PRICING METHODS

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 methods 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 methods may not be appropriate for determining an arm's length price under all circumstances; other methods, which are not listed below, might also be appropriate.

It is not possible to identify all the circumstances under which the various methods 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 arm's length 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 arm's length 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 arm's length 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 method.

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 method 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 multinational 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 a fair share of the costs, and is entitled to receive a 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 timeframe that takes into account their financial and business circumstances.

Apportionment of costs—code 8

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

As with the method for code 8, this method 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 method 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 method discussed at code 3.

Fixed percentage of resale price—code 11

This pricing method 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 method, 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

WORKED EXAMPLE

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 2004, 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 methods, 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% of which were based on comparative uncontrolled prices (CUP) and 50% based on the cost-plus method.
  - For the CUP dealings, the method for pricing was selected, applied and documented as discussed in the introduction to item 4.
  - For the cost-plus dealings, the pricing method was selected and documented for all the dealings, but written documentation on the application of the method 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% was priced on comparative uncontrolled prices, and the remaining 40% was invoiced at a price the taxpayer considered reasonable.
  - For all CUP dealings, the method 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 method 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%.

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 method.

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.

Loans

On the the 29 June 2004, the parent company approved the interest bearing loan of $450,000 to a subsidiary.

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	
2e Loans—interest bearing	**Opening balance**		**Closing balance**	
Amounts borrowed	G		H	
Amounts loaned	I		J	450,000

Suggested answer to item 2

Show whole dollars only.

Stock in trade	Purchases/expenditure:	
	Raw materials - subsidiary	$178,750
	Raw materials - permanent establisment (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 Machinery purchased	$23,345 $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
Loan from parent		$450,000

Suggested answer to item 3a

A **Y** for 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 **Y** for yes answer is also required here. The subsidiaries used trademarks 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 methods 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% ($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 methods 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 method	$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% being $332,676 divided by $569,345. The appropriate code from the table at item 4a 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 methods used in items 2a to 2d were the comparable uncontrolled price method, code 1, and the cost-plus method, code 3.

The method codes are listed in the instructions at item 5 Column A.

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

The appropriate codes for these percentages are found in the table in the instructions at item 5 Column B.

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

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 **Y** for yes at label **P**.

Suggested answer to item 6b

This item asks for the four principal methods used for pricing the capital dealings. In this example only three methods were used:

- the quoted market price method 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 in the instructions at item 6b.

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

Other publications

Other publications you may need to refer to when completing the Schedule 25A are:

- *Company tax return 2004 instructions* (NAT 0669—6.2004)
- *Foreign income tax return form guide* (NAT 1840—6.2004)
- *Foreign investment funds guide* (NAT 2130—6.2004)
- *Fund income tax and regulatory return 2004 instructions* (NAT 0658—6.2004)
- *Income Tax Assessment Act 1936*
- *Income Tax Assessment Act 1997*
- *Partnership and trust tax returns 2004 instructions* (NAT 2297—6.2004)
- various Taxation Rulings and Determinations

To find out how to obtain copies of these publications, see the inside back cover of this publication.

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Other enquiries are available through the following services:

Website

The website at **www.ato.gov.au** gives access to Tax Office publications and general information on tax matters, 24 hours, 7 days a week.

A Fax from Tax—13 28 60

If you have access to a fax machine, tax information is available 24 hours, 7 days a week.

When you phone, follow the instructions to obtain a list of available documents.

Business Infoline—13 28 66

For information about business income tax, fringe benefits tax, GST, PAYG and activity statements including lodgment and payment, accounts and business registration (including Australian business number and tax file number).

This service operates from 8.00am to 6.00pm Monday to Friday, except public holidays.

The website at **www.ato.gov.au** gives access to business tax information 24 hours, 7 days a week.

Superannuation Infoline—13 10 20

For assistance with all your superannuation enquiries.

Tax Reform Infoline—13 24 78

For information about new business tax reform (BTR) measures including consolidation, simplified imputation and exposure draft enquiries.

This service operates from 8.00am to 6.00pm Monday to Friday, except public holidays.

The website at **www.ato.gov.au** gives access to business tax reform information 24 hours, 7 days a week.

Account Management Infoline—13 11 42

For information about outstanding lodgment or payment obligations in relation to activity statements, PAYG withholding, income tax, or fringe benefits tax.

This service operates from 8.00am to 6.00pm Monday to Friday, except public holidays.

The website at **www.ato.gov.au** gives access to business tax information 24 hours, 7 days a week.

Personal Tax Infoline—13 28 61

This infoline is for non-business tax questions.

Translating and Interpreting Service—13 14 50

If you do not speak English and need help on tax matters, this service sets up a three-way conversation between you, an interpreter and a tax officer.

Hearing or speech impairment

If you have access to appropriate TTY or computer, phone **13 36 77**. For Speech to Speech relay, phone **1300 555 727**. You will need to quote one of the infolines listed on this page. The relay service will then connect you with a tax officer.