Transfer Pricing Forum

Transfer Pricing for the International Practitioner

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Australia

Benedicte Olrik and Callen Dendle

Andersen Australia

1. In your jurisdiction, how do the tax and customs departments interact? Are they operating separately or collaborating, especially considering their potentially conflicting interests (e.g., higher import prices leading to higher import duties but lower local profits)?

In relation to the recent tariffs announcements, the Australian Reserve Bank has expressed its view that, on balance, the effect of higher tariffs on Australian exports is expected to be relatively small and fall largely on prices rather than volumes. This is because Australia's exports are dominated by resources, for which Australia is a relatively low-cost producer, and because Chinese fiscal policy is expected to support commodity prices. While certain industry sectors will be impacted, the increased U.S. tariffs are expected to have only a small *direct* effect on overall export demand. There will, however, be other considerations which will *indirectly* impact Australian producers, including an expected increase in global input prices for others impacted by tariffs.

The interaction between transfer pricing and customs valuation can be challenging anywhere in the world, but this is particularly the situation in Australia. Australia has over recent years invested heavily in both of its cross-border law enforcement entities, the Australian Taxation Office (ATO), which manages taxation, and the Australian Border Force (ABF), which manages customs. As government departments they do interact, but with different approaches.

On the customs side with the ABF, the approach is more akin to policing the rules with respect to duties and customs. It is a different approach from that adopted by the ATO, which is more inclined to undertake risk reviews of cross-border entities' profitability. There will typically be a case officer or team assigned, allowing for a consultation and mediation process with the relevant business to understand the position taken before cases are escalated to more serious law enforcement institutions, such as the High Court.

As a general premise, the ATO typically seeks to ensure that the appropriate Australian-sourced profitability is achieved. On the other hand, the ABF is monitoring to ensure that the correct duty is

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levied and the appropriate GST paid, and to check that any changes to the importation price are voluntarily disclosed so that any under- or over-paid duty and GST are captured by the ABF.

Voluntary disclosures are recommended for any entity, subject to duties, that changes its pricing. An entity failing to disclose can be penalized with an infringement notice, and the dollar value risk of not disclosing such price changes is considerable. The Customs Act 1901 (Cth) allows the ABF to penalize non-disclosure of transfer pricing adjustments regardless of the customs duty outcomes. Penalties of up to 100% of the customs duty underpaid and/or 60 penalty units (currently $18,780) per import declaration can be incurred. For example, an importer with 50 duty-free importations in a year could be subject to a penalty of over $900,000 for non-disclosure.

Accordingly, the voluntary disclosure of adjustments to the customs value before the ABF exercises monitoring or verification activities protects the importer from customs penalty action relevant to the matter disclosed.

In addition to voluntarily disclosing transfer pricing adjustments, the ABF strongly recommends that the importer apply for an Advance Ruling (Valuation) in relation to its related party pricing arrangements. While not a legal requirement, from a practical perspective, once a ruling is obtained, fewer administrative requirements are associated with the annual disclosure of transfer pricing adjustments.

Unlike with the ABF, businesses do not need to physically report price changes from year-end adjustments to the ATO, provided these changes that have occurred to ensure profitability of the business are within a set arm's length range. The year-end adjustment must be supported by proper contemporaneous transfer pricing documentation.

Importantly, if a significant change is required, or if an entity is making changes more often, or if it is significantly impacted by tariffs, then risks could be mitigated with an Advance Pricing Arrangement (APA) agreed with the ATO.

The authors would recommend discussing with an advisor about any concerns that companies may have about the impact of increased tariffs on their supply chains. The authors have been involved in such cases numerous times, in particular European outbounds with Australian distributors where an advisor could help navigate the complexity of the ATO and OECD guidelines and ensure appropriate adherence to the ABF's duty requirements.

2. Please explain the interaction between transfer pricing methods (e.g., as outlined in the OECD Transfer Pricing Guidelines) and customs valuation methods (e.g., as described in the WTO Valuation Agreement) in your jurisdiction.

The valuation system and methods of the ABF are based on the World Trade Organization (WTO) Valuation Agreement, the system used by major trading nations throughout the world.[1]

The primary valuation method used by the ABF is the **transaction value** method, which is the price the importer actually paid (or will pay) for the goods. Several conditions must be met before the transaction value method can be used, including the buyer and seller not being related. If the transaction value

[1] Sections 154 through to 161L of the Customs Act 1901 reflect the WTO Valuation Agreement.

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method cannot be used, one of the following alternative methods is used to determine the customs value:

- **Deductive value** – The price in a sale in Australia of the imported goods, identical goods, or similar goods. This price must be adjusted for costs, etc. incurred between the "place of export" and the sale in Australia.
- **Computed value** – This is based on the price of producing the goods, general expenses, other costs, and profits relating to the imported goods.
- **Fall-back value** – Where no other methods are suitable, the ABF will determine the transaction value by taking into account the above valuation methods and any other relevant information.

All methods applied by the ABF are predominantly focused on direct price comparison of identical or similar products, whereas the transfer pricing regime in Australia (similar to the OECD Guidelines) apply the typical five transfer pricing methods to find comparable arm's length considerations. There is no hierarchy of transfer pricing methods, but the one most appropriate for the actual commercial and financial relations of the international related party dealings in question should be selected.

While this seems like two divided application approaches to the valuation and justification of price changes, there is an understanding between the ABF and the ATO in the event of year-end adjustments. This interaction occurs when the importation price is adjusted to ensure that the business's profitability is within a set arm's length range.

In practice, this interaction occurs through the voluntary disclosure process. The taxpayer will justify the price change to the ABF by providing appropriate transfer pricing documentation supporting that the importation price has changed due to the requirements of the arm's length profitability range. Typically, the transfer pricing method used is a Transaction Net Margin Method establishing a range of comparable independent operating profit margins.

To reiterate, it is highly recommended for companies using year-end adjustment to ensure that their profit margins are within the arm's length range and have contemporaneous, Australian-appropriate transfer pricing documentation in place. They should also disclose the price adjustments to the ABF through a voluntary disclosure or valuation advice.

3. From a supply chain perspective, MNEs may consider implementing restructuring strategies to mitigate the impact of higher customs duties. Transfer pricing strategies employed by MNES may include lowering operating margin levels for limited risk distributors, or converting contract manufacturers into toll manufacturers, for example.

How would general anti-abuse provisions in your jurisdiction address such strategies, assuming the behavior of parties aligns with economic reality and the new or modified contractual agreements?

Part IVA of the Income Tax Assessment Act 1936 is Australia's principal anti-avoidance provision. It empowers the ATO to cancel tax benefits obtained through schemes that are primarily designed to avoid tax. It is a broad-based provision that was originally designed to capture arrangements which were blatant, artificial, or contrived, but can also capture arrangements that could have been structured

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in a more straightforward or commercial way. There is published guidance from the ATO on their approach to this provision, as well as recent case law on its application to cross-border arrangements).[2]

A simple example of a company exploring price change strategies might be an Australian-based entity selling products into the U.S. and seeking to reduce costs due to the impact of tariffs. The key transfer pricing measure is typically the arm's length benchmarked operating margin. If, in this example, it was originally 3% it should now be reduced to 2% to account for changes to the U.S. business to absorb the cost instead of the customer.

The critical consideration for the ATO is that the changed pricing or activity is not being undertaken to avoid tax or that it would result in a mismatch between substance and form. It is critical for a business to demonstrate that the restructuring or adjustment is for business needs and driven by commercial reasons which are not unnecessarily complex. There will likely be the need to redo transfer pricing analysis of the business economics already in place to support and justify the new situation. Again, the authors recommend that businesses work with an advisor to consider the appropriate action, including considering the Australian restructuring provisions, to ensure the new transfer pricing position is safeguarded.

4. How are customs authorities in your jurisdiction responding to transfer pricing year-end adjustments? What are the specific requirements and procedures for decreasing customs duties following a year-end adjustment?

As noted above, year-end adjustments are allowed in Australia, if appropriately managed. The ABF manages any adjustments to customs duty amounts slightly differently to the ATO. It tends to approach them more procedurally and is concerned with understanding the change and its ultimate impact on the duty value. There will still be a need to appropriately document the arm's length values as noted above, to ensure that the same detail can be used to explain any adjustments to meet the Australian Transfer Pricing Rules. Similarly, when this occurs regularly, the company may wish to consider engaging with the ATO to agree to an APA to help manage these types of adjustments in a more timely and efficient manner.

In the authors' experience, MNEs are increasingly looking into prospective transfer pricing adjustments to manage supply chains appropriately and mitigate customs valuation challenges on account of retrospective transfer pricing adjustments. If an MNE utilizes prospective transfer pricing adjustments, it should actively monitor the profitability of the importing entity. If the profitability is not in line with the benchmark, it should adjust the price of the imported goods within the year. The aim is to avoid retrospective transfer pricing adjustments at the end of the year, or at least to reduce the quantum of the adjustment.

[2] *See* the judgment of the High Court in *PepsiCo Inc v. Commissioner of Taxation*.

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Contributors

Benedicte Olrik is the Managing Director of Transfer Pricing, and Callen Dendle is the National Tax Director at Andersen Australia. They may be contacted at:

Benedicte.Olrik@au.andersen.com
Callen.Dendle@au.Andersen.com

au.andersen.com

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