The purpose of Australia's transfer pricing rules is to counter the underpayment of Australian tax by requiring businesses to price related party international dealings according to what truly independent parties acting independently would reasonably be expected to have done in the same situation.

Methods of setting prices and reviewing the outcome of international transactions with related parties are recognised internationally using the arm's length principle.

A transfer pricing adjustment is usually raised under both of the following:

- Division 13 of the *Income Tax Assessment Act 1936* (ITAA 1936) and
- The Associated Enterprises article (usually Article 9) of the relevant treaty.

The arms length principle

The arms length principle uses the behaviour of independent parties as a guide or benchmark to determine how income and expenses are allocated in international dealings between related parties. It involves comparing what a business has done and what a truly independent party would have done in the same or similar circumstances.

There are several internationally accepted methodologies that can be used to ensure compliance with the arms length principle. Australia's transfer pricing rules do not prescribe any particular methodology or preference for the order in which methodologies are applied to arrive at an arms length outcome. The method that is the most appropriate or best suited to the circumstances should be adopted.