

[324] ATO sees "intangible" risks everywhere: ATO's draft risk assessment framework for intangible arrangements

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The ATO has continued its focus on cross-border intangible arrangements with the release of an updated draft "risk assessment framework" in Draft Practical Compliance Guide *PCG 2023/D2* ("Draft PCG"): see 2023 WTB 21 [316].

In doing so, the ATO appears to confirm 2 important points:

- it sees many (if not most) cross-border related party intangible arrangements that would be implemented in practice as medium or high risk; and
- the ATO has a significantly broader focus in this space than just the recently announced "integrity measures" that deny deductions for significant global entities ("SGEs") and that are due to commence 1 July 2023 (and which are carved out of the Draft PCG). The Draft PCG therefore indicates the ATO will also seek to achieve similar outcomes for non-SGEs and/or for periods prior to 1 July 2023 using existing laws (including relating to transfer pricing, Pt IVA/diverted profits tax, CGT and capital allowances).

What is the ATO's focus?

The Draft PCG is very broad, and essentially applies to cross-border related party dealings of any kind (including any direct or indirect contributions to the design, enhancement, maintenance, protection or exploitation/use) in relation to "intangible assets" (being any non-physical, non-financial asset used in commercial activities) ("Intangibles Arrangement"). The Draft PCG applies to both existing arrangements (whenever entered ie it is retrospective) as well as new arrangements. Importantly, it applies to all taxpayers, not just SGEs.

The Draft PCG sets out a framework for assessing the ATO's view of the risk associated with an Intangibles Arrangement. The risk assessment is based on a points allocation under one of 2 frameworks. The

applicable framework depends whether there has been a "migration" (which essentially captures any arrangement entered into by an Australian entity, whether now or in the past, under which a non-Australian entity accesses, holds, uses, transfers or benefits from intangible assets) or merely a potential "mischaracterisation" (covering all other arrangements related to intangible assets). In practice, it will nearly always be necessary to apply the "migration" risk assessment, and this is likely to result in Intangibles Arrangements having a higher risk score.

The Draft PCG also sets out a list of evidence the ATO will expect to see in relation to an Intangibles Arrangement to substantiate its risk assessment (as discussed below).

Risk ratings skewed towards producing a medium or high risk

A key observation of the draft risk rating frameworks is that they appear skewed towards producing a medium or high-risk outcome for arrangements that are likely to be entered into in practice.

In particular, an Intangibles Arrangement will almost certainly produce a medium or high-risk rating where:

- *there has been some international dealing with Australian intangible assets* – ie, an Australian entity moves or gives rights to (or has in the past moved or given rights to) intangible assets to an international related party, or has access to or provides access to intangible assets of an international related party;
- *there is a continuing Australian connection* – ie, an Australian entity maintains some development, enhancement, maintenance, protection and exploitation of those intangibles assets in Australia or has continued use of or benefit from the intangible assets; and
- *it could be expected to result in a difference in tax outcome* – ie, there could

be expected to be a reduction in tax resulting from the arrangement compared to a situation where everything had occurred in Australia (which, in practice, is not particularly difficult to imagine given the Australian taxation regime).

To put it another way, the Draft PCG suggests that for an Intangibles Arrangement that represents a migration to be "low risk", the migration of intangible assets would need to be or have been to an existing related party that has always held worldwide group intangibles and has an existing workforce to take over nearly all of the significant aspects of the development, enhancement, maintenance, protection and exploitation (ie use) of those intangible assets now and into the future (and possibly be in a jurisdiction that has no favourable intangibles tax regime).

That would seem to place *any* Australian entity looking to expand overseas by way of entry into an Intangibles Arrangement into the medium or high-risk category, whether it enters its Intangibles Arrangement pre- or post-commercialisation, or for market value or otherwise, and whether it has legitimate commercial reasons for the arrangement.

Draft PCG examples of high-risk arrangements

This is confirmed by some of the examples assigned high risk ratings in the Draft PCG. While some examples might traditionally be expected to be higher risk (ie where there are transfers of significant intangible assets for no value / no recognition of any functions performed by an Australian entity), many are not. For example, from the ATO's perspective high-risk arrangements also include:

- **Example 1 – centralisation of intangible assets:** the licence of existing IP to a new foreign company for an arm's length royalty, with the Australian entity continuing to perform R&D activities under a service agreement, and the new foreign company slowly building out staff and resources to undertake more of the R&D activity; and
- **Example 5 – migration of pre-commercialised intangible assets:** an Australian company has started developing software but is in pre-commercial stage. It moves the intangible assets to a new company in a foreign jurisdiction that becomes the global headquarters and is where the founder travels to further develop that software. The subsequent commercialisation of the software occurs from the foreign company, with services provided to it by the Australian company under a services agreement.

Evidentiary requirements

Where the ATO decides to examine a taxpayer's Intangibles Arrangement, it has extensive expectations as to the evidence required to be produced by the taxpayer in substantiating that its arrangements are not high risk. These are set out in Appendix 2 of the Draft PCG. They focus not only on transfer pricing documentation and legal agreements that implement the Intangibles Arrangements, but also on providing detailed analysis of each Intangibles Arrangement and the reasons for entering into it.

Of particular concern is the ATO's apparent expectation to be granted access to any tax or regulatory advice or correspondence that a taxpayer has been given from its professional advisers, without any consideration of whether that is appropriate or the implications of such access in the context of legal professional privilege and/or the "accountant's concession".

What should taxpayers expect? What should they do?

Whilst the Draft PCG will not have the force of law when finalised/does not require risk assessments to be performed and provided to the ATO, taxpayers with reportable tax positions or other interactions with the ATO on intangibles are likely to face requirements to do the risk assessment. We also expect the ATO to target taxpayers who identify cross-border intangible dealings in their international dealings schedule/tax returns to be targeted for requests to complete the self-assessment.

Accordingly, corporate groups (whether SGEs or otherwise) with Intangible Arrangements should carefully consider their current and past activities in accordance with the draft risk framework set out in the Draft PCG and consider compiling the required documentation. This will ensure groups are adequately prepared to protect

their position in the face of the ATO's expected compliance activity.

Comments on Draft PCG

There remains an opportunity to provide comment and input to the ATO on this draft PCG until 16 June 2023.

TAX PRACTICE UPDATE

[325] TPB imposes sanctions on one agent, terminates registration of another

The Tax Practitioners Board has advised that it has recently imposed sanctions on 2 tax agents.

In the *first case*, a tax agent company was investigated following an ATO audit. The TPB uncovered poor internal controls within the practice and concluded that the practice failed to take reasonable care in the preparation and lodgement of income tax returns on behalf of their clients. The TPB decided to issue a written caution and an order requiring the director and supervising agent to complete the National Tax & Accountants' Association (NTAA) Tax Skills 1 course within 3 months. It took into consideration that the supervising agent re-

sponsible for the misconduct had been "terminated" (to quote from the media release) and the company had since made changes to its processes and procedures.

In the *second matter*, a tax agent lodged a personal income tax return to the ATO claiming deductions in excess of \$100,000, which could not be substantiated. The ATO compliance audit resulted in a tax shortfall of \$60,000 and a penalty for recklessness was imposed. The TPB found the agent had ceased to be a fit and proper person and terminated the registration.

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[326] ATO website updates

From the ATO website:

- *Do you have a pre-2010 employment agreement* - information from the Fair Work Commission about registered agreements made before 2010;
- *Specialist careers* – sets out the technical areas where the ATO is actively recruiting.

Consultation

- *GSTSG membership expression of interest* - information on the criteria for GST Stewardship Group membership and how to nominate;
- *Open consultation* – an invitation to be involved in the ATO's consultation for its future services and advice.

ATO systems/admin

- *Getting STP Phase 2 reporting right* - guidance on how to address some com-

mon questions and mistakes to help employers report correctly through STP Phase 2 reporting;

- *The best service channels for large business tax dealings* – the ATO has several what it terms "channels" that big business can use to meet their tax and super obligations – this provides a summary and links
- *We're moving away from cheques* - reminder to tax practitioners to include their clients' bank account details on every tax return so they will receive any refunds to their bank account;
- *Setting good record keeping habits for the new year* – an invitation to view the webcast or visit the webpage designed to assist SMSFs understand their obligations when setting up systems for good record keeping;