

Recent insights into ATO streamlined assurance reviews

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In brief

As the Australian Taxation Office (ATO) ramps up its program designed to provide assurance that the largest 1,000 public and multinational companies (MNEs) are reporting the right amount of Australian tax, a remaining 650 taxpayers can expect their review to commence in the next two years.

PwC recently obtained feedback from the ATO Program leaders regarding the overall performance of the companies that have been subject to a completed reviewed so far. According to the ATO, transfer pricing remains the most common area where taxpayers are not receiving a high assurance rating.

The ATO is significantly ramping up its completion of these reviews, with 230 reviews completed to date with 120 in progress.

Based on our work assisting taxpayers prepare for and deal with such reviews, we have identified the following key trends and practices:

- The ATO review teams appear to expect that taxpayers will prepare in advance for any review given that the ATO has previously disclosed the types of information it will seek and likely focus areas of the reviews.
- Clients are often surprised by the speed and depth of the reviews (typically completed in four months).
- PwC has recently seen the ATO try to influence taxpayer behaviour by recommending that taxpayers initiate further follow up action, with the expectation that this will reduce the chance of the ATO undertaking further compliance activity in relation to the relevant issues.
- Taxpayers in certain industries may be asked to provide detailed validation of facts underpinning key private rulings, or information regarding the nature and likelihood of future restructuring.
- The ATO may seek to challenge whether a taxpayer has a 'reasonably arguable position' on certain issues where detailed supporting papers have not been prepared in relation to those matters.
- The ATO is trialling a new model which involves taxpayers who receive a high level of assurance from the review process provided with ongoing access to a 'key client manager' at the ATO in order address matters on a more 'real-time' basis.

In detail

In 2016 the ATO commenced a Government-funded program to review the 'Top 1000' public group and international companies. Since commencement of the program, 230 taxpayers have had their reviews completed.

The ATO has advised there will be a significant increase in the number of companies reviewed over the next two years. At the time of writing another 120 reviews are underway with a further 650 reviews to be completed in the next two years. Companies that should expect a review in the next two years are those with Australian total business income of approximately AUD 250m or more.

Taxpayers will only have a short window (typically about three to four months) to prove to the ATO that their tax affairs warrant a 'high' tax assured rating. Low or medium tax assurance ratings face the increased possibility of an ATO audit and ongoing scrutiny. The ATO has also commenced writing to taxpayers to advise them of impending reviews so extensions of time are only granted in exceptional circumstances.

Current trends to date suggest that Australian subsidiaries of MNEs are particularly challenged through this process, with more than two-thirds of MNEs already reviewed receiving 'low' or 'medium' levels of assurance.

The ATO has recently established a dedicated team, led by an Assistant Commissioner, to determine 'next steps' for those taxpayers that have been given a 'high risk' rating for a specific risk or risks at the conclusion of the review. PwC understands those 'next steps' can vary in their scope, but may include an audit.

ATO perspectives

ATO Assistant Commissioner, Judy Morris, is leading the Streamlined Assurance Review program of the Top 1000 public groups and international taxpayers. Ms Morris provided PwC with the following explanation of the Top 1000 Program:

The Top 1000 Program is part of the shift from risk based reviews to tailored assurance engagements where we work to obtain greater confidence that the taxpayer has paid the right amount of tax. We use a holistic approach to understand the taxpayer's business both within and outside of Australia. We apply the justified trust methodology to determine our level of confidence in their compliance with the income tax law and identify areas of potential non-compliance.

In PwC's view, this shift away from the traditional 'risk hypothesis' approach to completion of a risk review to an 'assurance' based review provides an opportunity for taxpayers to provide the ATO with comfort that their tax affairs are being managed appropriately. Taxpayers that recognise the assurance based approach to these reviews are able to better tailor their interactions to accord with the ATO's focus. This includes ensuring that record keeping and tax governance systems and controls are not just in place, but are operating effectively in practice.

Ms Morris observed that despite the ATO obtaining medium or high level assurance over 84 per cent of the reviews completed at the time of publication, transfer pricing appears most often as an area of ATO concern:

Transfer pricing is the most common area where we do not obtain high levels of assurance. This includes both supply chain transfer pricing matters and offshore related party financing. Often other concerns tend to arise on the boundaries; for example in the application of tax concessions or in the structuring of significant events or transactions.

In most cases where the ATO has been unable to obtain high assurance of a taxpayer, the ATO recommends that the taxpayer initiates further follow up action, for example through a self-review providing further evidence or submissions, seeking a private binding ruling or requesting an amendment.

This is consistent with PwC's recent experiences. PwC has seen the ATO suggest or propose a solution to a taxpayer and where the taxpayer is willing to agree to the concession or proposal to more closely align with ATO's view, an "improved" assurance level and/or removal of "next actions" will be obtained in the streamlined assurance review report. However, where a taxpayer is comfortable with a position which might not accord with the ATO's suggested position, taxpayers may wish to develop and/or gather any further evidence to support its position.

What is the ATO focusing on?

The ATO focus areas include:

- Tax governance, including that the design is effective and framework operational
- Specific tax risk areas, with a particular focus on international tax risks

The ATO has advised that the following specific tax risk areas continue to arise in their Top 1000 reviews. This rather extensive list can be broken into domestic issues, transfer pricing and international as outlined below:

The infographic consists of three vertical panels, each representing a category of tax issues. Each panel has a title on the left side, a large numbered graphic in the center, and a list of issues below. The first panel is titled 'DOMESTIC' and features a large orange number '1'. The second panel is titled 'TRANSFER PRICING' and features a large orange number '2'. The third panel is titled 'INTERNATIONAL' and features a large pink number '3'.

| Category | Issues |
|------------------|---|
| DOMESTIC | <ul style="list-style-type: none">• Taxation of Financial Arrangements• Sustained tax losses• Research and development claims• Earn outs and royalty agreements (for energy and resources taxpayers)• Restructures, acquisitions and disposals• Transactions that have been flagged to market though Practical Compliance Guides |
| TRANSFER PRICING | <ul style="list-style-type: none">• Large international related party dealings• Offshore royalties/licencing fees• Lack of transfer pricing documentation, particularly for financing transactions and permanent establishments• Related party financing |
| INTERNATIONAL | <ul style="list-style-type: none">• Outbound permanent establishments• Intellectual property migration and use of intangibles• Marketing or procurement hubs• Thin capitalisation• Holding entities (inbound or outbound), particularly when located in tax haven jurisdictions• Use of hybrid instruments or entities |

PwC perspectives

PwC has assisted a large number of clients across a range of industries to prepare for an ATO review and to navigate the review process through to its conclusion. Whilst each review will differ in its intensity, duration and focus areas based on a number of factors, we have identified a number of more recent trends in the approach to these reviews.

First, there appears to be an expectation across the ATO review teams that taxpayers will prepare in advance for any review. This is a function of the fact that the ATO has previously disclosed the types of information it will seek from taxpayers in connection with the reviews and the particular taxation issues or matters that it will likely focus on in the course of a review.

Unlike the traditional ATO risk review process, which could sometimes extend for over a year, we are seeing that clients are often surprised by the speed and depth of the reviews (typically completed in four months).

Given the above – particularly ATO expectations regarding the speed and quality of responses to requests for information - we strongly recommend that taxpayers undertake some targeted preparation before the commencement of any review.

PwC has recently seen the ATO try to influence taxpayer behaviour by recommending that taxpayers initiate further follow up actions in order to address certain risk items raised by the ATO during the course of a review. Where the taxpayer agrees to adopt a course of action which is acceptable to the ATO, for example, agreeing to amend prior returns to reflect different pricing of cross-border debt, the taxpayer may be able to remove certain risk items from the final report and/or achieve a higher level of assurance. The ‘carrot’ is that this can reduce the chance of the ATO undertaking further compliance activity in relation to the relevant issues. Accordingly, we recommend that taxpayers remain open minded during the review process and consider taking certain pragmatic actions which may minimise the possibility of future intense audit activity. Equally, if a taxpayer is comfortable with the position adopted and do not agree to initiate further follow up action, we recommend that you develop and/or gather evidence to support the position.

We have also observed taxpayers in certain industries being asked to provide detailed validation of facts underpinning key private rulings, or information regarding the nature and likelihood of future restructuring. Again, given the amount of time that may need to be devoted to such processes, we recommend taxpayers consider the merits of performing any such work ahead of a proposed review.

In a similar vein, the ATO may seek to challenge whether a taxpayer has a ‘reasonably arguable position’ on certain issues where detailed supporting papers have not been prepared in relation to those matters. Where a taxpayer has adopted filing positions on key issues where the taxation treatment is not entirely clear, you may wish to consider whether it would be more efficient to put in place more detailed position papers prior to an ATO review commencing.

One emerging benefit which may be available to those taxpayers that achieve a high level of assurance from the review process is the potential to gain ongoing access to a ‘key client manager’ at the ATO in order address matters on a more ‘real-time’ basis.

How to best prepare?

To increase prospects of a higher assurance rating, and in addition to the above, PwC recommends that taxpayers prepare for a review of the following areas:

a) Tax governance

- Prepare for a review of tax governance arrangements – this area has been the subject of a considerable amount of ATO focus due to the higher level of assurance strong tax governance provides. Effective governance frameworks also assist in compliance with various tax obligations, including transfer pricing related matters (a common area of focus for the Top 1000 reviews). The ATO focus on ensuring there is a tax risk framework in the first instance with improved ratings being given to taxpayers who are able to demonstrate that the controls are operating in practice.

b) Significant transactions and book to tax adjustments

- Prepare with detailed responses and explanations (supported by evidence) in respect of significant transactions. This might include providing documents or information which explain the commercial background and taxation treatment of a transaction, including legal and accounting reasons. A well prepared response can be the difference between a low and high assurance rating.
- The ATO is very focused on related party transactions, particularly debt financing. Therefore, we encourage evidence based responses to support these arrangements and enhance the possibility of a higher level of assurance.

c) Book to tax and tax and accounting differences

- Be able to provide supporting working papers and reconciliation of book to tax adjustments.
- Be able to explain differences between tax and accounting outcomes.

d) Global structure and supply chain

- Be able to explain the global value and supply chain of the MNE.
- Be prepared to explain inbound and outbound global structure of the MNE.
- Be able to explain reasons for hybrid instruments or entities and any proposed steps to deal with anti-hybrid laws.

e) Transfer pricing

- Ensure contemporaneous transfer pricing documentation covering material international related party dealings (including offshore branch and financing transactions).
- Be prepared to provide evidence to support transfer pricing positions.

The takeaway

We strongly encourage taxpayers prepare early for these ATO streamlined assurance reviews as many questions can be anticipated and evidence-based responses prepared. Those who prepare early, together with supporting evidence, increase their likelihood of an enhanced rating, thereby reducing the risk of an audit or specific review in the near future.

If you would like to get a copy of the sample questions that you can expect, or discuss how you can best prepare for the upcoming review, please get in touch with your usual PwC adviser or Tax Controversy &

Dispute resolution specialist who will ensure you have the right team to ensure you are appropriately prepared and supported through the process.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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