ATO transforms the Reportable Tax Position schedule – impact on the Financial Services sector

15 February 2017

In brief

In January 2017, the Australian Taxation Office (ATO) released the 2017 Reportable Tax Position (RTP) Schedule and related guidance materials. As these mark a material shift from the approach adopted in prior years, taxpayers operating in the Financial Services sector should carefully assess the impact of the changes on their tax compliance processes and the ATO's perception of their tax risk profile.

Key observations are as follows:

- The ATO has already notified certain 'higher consequence' taxpayers (those in Quadrants 1 and 2 of the Risk Differentiation Framework) that they are required to lodge an RTP Schedule in respect of the 2017 income year.
- For 2017, the main change is to completely redefine the concept of a Category C RTP to include transactions that the ATO finds concerning.
- Previously, there was only one type of transaction that needed reporting within a Category C RTP - a CGT event with proceeds of more than AUD200m, where the tax and accounting treatment significantly diverged.
- Now, a reportable Category C RTP arises if any one of a number of scenarios where the taxpayer has entered into specified 'risky' arrangements highlighted in ATO public guidance products e.g. Taxpayer Alerts. Also, the previous materiality threshold has been jettisoned.
- Given the wide manner in which Taxpayer Alerts tend to describe relevant arrangements, and the lack of any concept of materiality, affected taxpayers may find it hard to determine whether a particular arrangement warrants disclosure as a Category C RTP.
- Material errors in, or omissions from, the RTP Schedule can attract penalties for false and misleading statements, with those penalties due to double for significant global entities under new legislation currently before Parliament.
- Taxpayers that have an established process for dealing with RTPs within their governance processes may need to revise it in 2017 to reflect the updated meaning of a Category C RTP.
- The list of Category C matters will be continually updated throughout the year (and disclosed on the ATO website)– right up until the time that lodgment of the RTP Schedule is required.

- For the 2018 income year onwards, the ATO foreshadows that the requirement to lodge an RTP Schedule will be further broadened to those economic groups with a turnover exceeding AUD 250m. This is a significant expansion in the number of affected taxpayers.

In detail

On 23 January 2017, the ATO released a suite of materials in respect of the 2017 RTP Schedule, including an updated Guide to Reportable Tax Positions 2017 (the Guide), the RTP Schedule itself and an early disclosure form.

Changes applicable to the 2017 year

For taxpayers with an income year ending on or after 30 June 2017, the key change from prior years is that the notion of a Category C RTP has been completely transformed.

Instead of only capturing certain Capital Gains Tax (CGT) events which generate large book-to-tax differences, a Category C RTP will now arise where the taxpayer answers 'yes' to any of a prescribed list of questions. Those questions seek to identify whether the taxpayer has participated in arrangements specified in Taxpayer Alerts or other publications which raise risks, or are of concern to, the ATO. The ATO has also removed the materiality test that previously applied, effectively treating any 'yes' answer as requiring disclosure through the RTP schedule.

Of the current listing of ATO 'risky' issues in the Guide, taxpayers in the Financial Services sector should have particular regard to:

- Offshore equity investments: whether debt deductions have been claimed for funding used to support non-portfolio interests in a foreign company which are held through a foreign branch. Particularly relevant for Authorised Deposit-taking Institutions (ADIs), in TD 2016/6 the ATO concluded that such funding costs are incurred in deriving non-assessable non-exempt (NANE) income under section 23AH (rather than section 768-5), with the effect that the corresponding loss is not allowed as a deduction under subsection 230-15(3).
- Equity raisings to distribute franking credits: Whether franked distributions have been made using funds raised from equity issued in the circumstances covered by TA 2015/2. Given that the related government announcement made in the 2016-17 MYEFO is expressed to cover underwritten dividend reinvestment plans, placements and underwritten rights issues, a potentially wide range of situations may need to be considered – including those where tax may not have been front of mind.
- Internal loan and interest rate hedge: Banks and other financial groups that have sourced funding from offshore related parties should also consider whether they may have entered into the type of foreign currency loan and cross currency swap arrangements described in TA 2016/3. This Taxpayer Alert describes an arrangement that, applying the construct more broadly, could conceivably apply to a large range of internal funding arrangements.
- Multinational Anti-Avoidance Law (MAAL): The Guide simply asks whether the taxpayer has entered into any restructure affecting entities that make supplies into Australia after 11 December 2015. While there is a reference to LCG 2015/2, the question does not expressly mention the MAAL and nor is there any suggestion that the taxpayer must have been included in the ATO's MAAL roadmap process. As a result, it would seem that any restructure impacting entities that service Australian customers would be caught – regardless of whether it has been risk assessed by the ATO previously. Furthermore, although the risk being targeted is presumably the Part IVA risk associated with restructuring out of the MAAL, the Guide does not refer to the specific Taxpayer Alerts that have been issued in this regard, e.g. TA 2016/11.
- Cross-border round-robin financing: Financial groups will need to consider whether they have implemented any 'loan up' structures of the kind covered by TA 2016/10 and the decision in Orica Limited v FCT [2015] FCA 1399; 2015 ATC 20-547. Such arrangements, which are already likely

to be on the ATO's radar, broadly involve an Australian taxpayer borrowing funds from an offshore affiliate and using the proceeds to invest in equity interests that produce NANE income (creating a deductible/non-inclusion outcome).

It is also worth bearing in mind that taxpayers are expected to disclose arrangements that have previously been discussed with the ATO. Carve outs only exist for arrangements covered by a Private Ruling, an Advanced Pricing Arrangement or an RTP early disclosure form.

The Guide also suggests that taxpayers must use the most up-to-date listing of Category C items when lodging the RTP Schedule. This implies it is necessary to consider a potentially expanding (or changing) list of inclusions right up until the date that the RTP Schedule is lodged.

Changes applicable the 2018 and later years

During the 2016 consultation process on enhancements to the RTP Schedule, the ATO also made clear its intention to incorporate the schedule as a standard feature of the tax return process for most taxpayers covered by the ATO's Public Groups and International (PG&I). This is why, for years of income ending on or after 30 June 2018, taxpayers in economic groups with turnover above AUD $250m will be required to lodge an RTP schedule.

As a result:

- Many taxpayers that have previously not needed to focus on the RTP process will be drawn in for the first time;
- Whilst the Guide confirms that the ATO must still notify an affected taxpayer of the need to lodge the RTP Schedule in writing, there is nothing to suggest that this is based on the taxpayer's risk rating or position in the Risk Differentiation Framework; and
- By the time the 2018 RTP Schedule will be due for lodgement, it is reasonable to expect the list of Category C RTP questions to be vastly longer, or different than what exists now.

The takeaways

The ATO has significantly re-engineered the RTP schedule for the 2017 income year. More importantly, for 2018 onwards, the ATO will draw a much larger cohort of taxpayers into the RTP regime. This continues the trend of greater mandatory disclosure to the ATO across an increasing population of taxpayers.

Taxpayers in the Financial Services sector would be wise to consider the impact on their 2017 tax return process and, for those who have escaped the RTP process in prior years, how they will manage the lodgment of the RTP schedule in the 2018 income year and beyond.

A measured and timely approach to complying with the RTP requirements will help protect companies and their public officers against penalties for false and misleading statements and minimise the risk of the ATO drawing adverse inferences about the tax risk posed by the group.

Please contact your PwC adviser if you require assistance in addressing the new RTP requirements.

Let's talk

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

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