What does the ATO have in store for large business taxpayers?

1 October 2014

Since his appointment just over 18 months ago, the new Commissioner has overseen a period of dramatic reinvention of the Australian Taxation Office (ATO).

Whilst only at the very start of its journey, the ATO has been swift to act in initiating structural, procedural and cultural change focussed on its long term vision detailed within the recently released *ATO Corporate Plan 2014 – 2018*.

A key pillar in the ATO's strategic priorities is the desire for improving the means and efficiency by which it performs its compliance activities. In retaining its overall goal of pursuing a voluntary compliance culture, the ATO has stated that it will manage its compliance activities based on three key criteria: **risk**, **transparency** and **behaviour**.

Whilst recognising that most do the right thing, the ATO has forewarned those who don't will be targeted and face the appropriate level of compliance activities. With better use of technology and data analytics the ATO has indeed stated that it will be a matter of 'when' they catch up with non-compliant taxpayers, not 'if'.

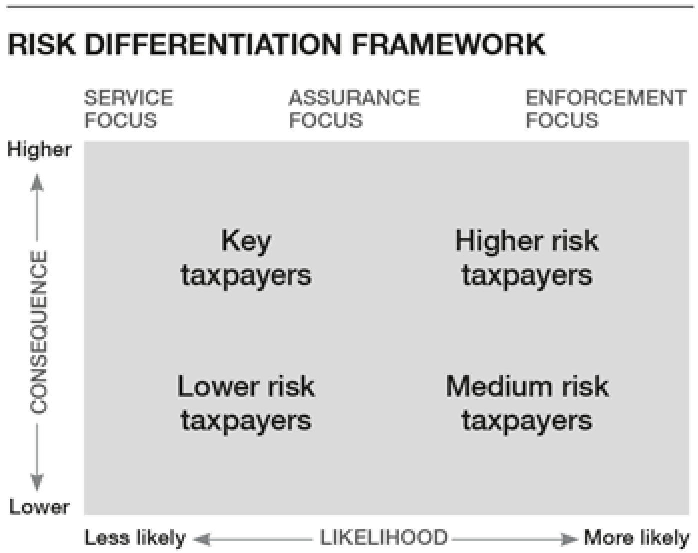
In connection with this change in approach, the ATO has also changed the way it is communicating with taxpayers. The ATO has moved away from its traditional annual document outlining identified risk areas in favour of a continuous and timely disclosure of what it sees as the new and emerging areas of compliance risk.

In line with this revised approach, the ATO issued a Large Business Bulletin in September 2014 (the Bulletin) which identifies the key risk areas for a number of large business sectors – banking and finance, energy and resources, insurance and superannuation.

Taxpayers operating within these industries should be aware of the particular strategies being deployed in order to counteract any non-compliant activities. Without doubt, taxpayers in these industries should be expecting closer scrutiny in the coming financial year and prepare themselves accordingly.

Risk Differentiation Framework

Although the ATO continues to use its Risk Differentiation Framework (RDF) to help assess tax risk and determine its approach to tax compliance, it will no longer be sending out individual risk classification notifications to every large business taxpayer. Instead, the ATO will streamline its notification approach and only send individual RDF classification letters to higher consequence taxpayers. This means that lower to medium risk taxpayers will no longer receive any risk classification letters to inform them of their individual risk rating.



Tax risks from internationalisation of the Australian economy

The ATO recognises that the large market segment is important to Australia's tax system with the public groups and international (PG&I) taxpayer segment reporting $257 billion in taxable income, $28.2 billion in losses and $49.6 billion in net income tax in 2013 income tax returns.

The ATO intends to maintain a higher level of engagement with these taxpayers to provide greater levels of assurance, but with targeted and tailored compliance activities using a weighted risk-management approach.

In line with governments around the world focussing on base erosion and profit shifting (BEPS), once again we see the ATO has multinationals in its sights.

For the 2014-15 year the ATO has identified the following as key risk areas PG&I taxpayers:

- Base erosion - working collaboratively to implement changes to the domestic and international legislative and administrative frameworks to ensure the full economic value of activities associated with Australia is taxed.
- Profit shifting - looking at tax planning that structures business operations for shifting assets, risks and functions to low tax jurisdictions.
- The cessation of Australian operations - understanding the risks of major manufacturing exits from Australia.
- Planned public infrastructure sales and investments - understanding the risks from public infrastructure sales and major investments in infrastructure development.
- Petroleum resource rent tax (PRRT) starting base - reviewing large starting base returns to identify any systemic risks.

The Bulletin further details the ATO's intentions to maintain an active role in influencing the international tax agenda, including hosting the 44th annual Study Group on Asian Tax Administration and Research (SGATAR) conference commencing next month. The conference will focus on international tax issues and closely align with the work of the G20, Organisation of Economic Cooperation and

Development (OECD) and Forum on Tax Administration priorities including BEPS, tax transparency, capability development and international collaboration between revenue authorities.

The ATO is clearly positioning itself to contribute and be at the forefront of the international debate on these important issues sure to develop in coming years.

Banking and finance industry

The ATO's stated compliance approach for the banking and finance industry for 2014-15 is to primarily focus on assistance and resolution strategies, including monitoring the global environment and using internal and external data and intelligence to continually develop its understanding of compliance risks.

The main risks that the ATO has identified it will target are:

- taxation of permanent establishments and attribution issues, including global derivative trading businesses, allocation of debt and capital, intra-entity interest charges and the allocation of expenses in relation to capital management and liquidity requirements.
- thin capitalisation issues, including the application of the provisions to outward investing authorised deposit-taking institution (ADI) entities that have a conglomerate business with one consolidated tax group.
- transfer pricing, including related-party arrangements associated with outsourcing IT and other services on an inbound and outbound basis such as guarantee fees and other credit management arrangements
- the offshore banking unit (OBU) regime, including issues associated with the allocation of income and expenses, structuring, funding and eligible activities, and
- issues related to Taxation of Financial Arrangements (TOFA) and consolidation.

The ATO has also identified that new risks associated with digitisation, for example, peer-to-peer lending, trading platforms (high frequency trading), electronic payment and investment services and virtual currencies have emerged.

Energy and resources sector

The specific risks that the ATO will target in the energy and resources sector for 2014-15 are:

- transfer pricing, including:
    - intra-group financing and derivatives
    - marketing/procurement and service hubs
    - freight and logistic charges
    - cross-border restructuring activities
    - exit charges for transfer of business activities
    - inbound and outbound technical services
    - commodity pricing
- financing, including large capital investment cycles with increased levels of debt, derivatives and swaps
- permanent establishments, including the use of and payment for plant and equipment
- mergers, acquisitions and divestments

- losses, including the failure to meet the continuity of ownership test, same business test or recoupment tests
- research and development tax incentive, including looking at the nature, purpose and timing of the activities conducted
- exploration expenditure under income tax and PRRT
- thin capitalisation issues including the proposed new safe harbour threshold (which is currently before Parliament in *Tax and Superannuation Laws Amendment (2014 Measures No 4) Bill 2014*), arm's length debt rules and assets revaluations
- PRRT deductible expenditure and starting base, and
- other risks, including disposal of mining rights and project pools.

Insurance industry

For taxpayers in the insurance industry that are classified as higher-consequence the ATO's compliance approach will continue to utilise compliance reviews and audits, annual compliance arrangements, advance pricing arrangements and pre-lodgment compliance reviews. For lower-consequence taxpayers, the ATO will focus on project-based risks.

The main risks that the ATO will target for this sector are:

Life insurance

- TOFA, consolidation and Division 320 of *Income Tax Assessment Act 1997* (*ITAA 1997*) interaction
- segregation mechanism under Division 320 of the *ITAA 1997*, including transfer values and annual valuations
- consolidation treatment of intangible assets and treatment of deferred tax assets
- foreign investment, foreign exchange (forex) gains/losses and foreign income tax offset (FITO) calculations
- profit shifting and thin capitalisation safe harbour, and
- permanent establishments and attribution - intra-entity derivative transactions or risk transfers.

General insurance

- Valuation and documentation of insurance liabilities under Division 321 of *ITAA 1997* for tax purposes
- international taxation of insurance business, including branches, subsidiaries and re-insurance, and
- interaction with consolidation and TOFA legislation.

Health insurance

- Establishing the income tax treatment of underwriting profits or losses arising from health insurance business, given the scope of the term ‘general insurance company’ for Division 321 purposes
- transition from non-taxable to taxable status, including Division 57 of Schedule 2D to the *Income Tax Assessment Act 1936 (ITAA 1936)*, consolidation issues and demutualisation, and
- income tax treatment of overhead expenses attributable to both non-taxable health insurance business and other taxable business within a single economic group.

Managed Investment Trusts/Public Unit Trusts

- Capital account and fund payment withholding rules
- general application of Division 6 of the *ITAA 1936*, and
- treatment of trust distribution amounts in excess of the net income.

Superannuation industry

The specific risks that the ATO will target for the superannuation industry are:

- new, unusual or significant transactions, such as large infrastructure investment and mergers
- exempt current pension income claims
- correct tax treatment of expenses, including those arising from changes to the super industry environment, such as SuperStream and merger costs
- over-claiming of imputation credits
- tax treatment of offshore investments, including limited partnerships
- the application of the FITO limit to hedging transactions
- capital gains reporting and capital loss utilisation
- tax treatment of repurchase and securities lending arrangements, and
- tax deferrals from the pay as you go (PAYG) instalment system

Don't forget tax transparency measures

Large corporate taxpayers should also remember that certain tax information relevant to the 2013-14 and later income years will now be publicly reported by the Commissioner of Taxation in accordance with laws enacted in July last year.

The information to be disclosed will notably include the individual taxpayer's name and ABN, their total income reported, their total taxable income and their total amount of tax payable for the applicable income year.

Although it is not expected that information for the 2013-14 years will be published before late 2015, affected taxpayers should assess whether the general information to be disclosed should be supplemented with additional information prepared by the taxpayer so as to better inform the public about the true nature of their operations.

Let’s talk

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

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