ATO sharpens focus on Large Business

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In brief

- The Australian Taxation Office (ATO) has outlined its specific areas of focus for large business in 2016.
- Large business taxpayers can expect the ATO to want more information than before, particularly if they have operations falling within the ATO's focus areas for review.
- Large business taxpayers need to understand the ATO's new engagement model and to meet higher expectations around tax governance and transparency.

In detail

Large businesses pay 65 per cent of total income tax in Australia and 59 per cent of total indirect taxes paid. While the ATO recognises that large businesses play an important role in the tax system, it wants to work more closely with them in 2016 in order to:

- understand the size of the tax gap between the theoretical tax gap and the tax actually paid, and
- obtain assurance that provides the ATO with justified trust that large businesses are paying the right amount of tax.

A large part of the ATO focus will be on international tax and responses to the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) initiatives. In the wake of the Senate Inquiry into tax avoidance, extensive media coverage of tax structuring by large corporates and the release of tax data showing that approximately one-third of large business paid no tax in the 2014 tax year, the ATO goal is to provide the community with greater assurance that large businesses are paying their fair share of tax.

Sensibly, the ATO says it will work more co-operatively with large business to do this. The system cannot work any other way because the ATO simply does not have the resources to deal with the large corporate sector if there are more than a handful of complex audits and large disputes on the table at any point in time. Accordingly, the ATO needs to offer large business a degree of certainty and cooperation in their relationship in exchange for more assurance on tax governance and more transparency around tax positions and tax structures.

In order that large businesses understand what the ATO's view of them is, the ATO will be proactive in advising them of their risk rating in accordance with the ATO risk differentiation framework. This is an overall assessment of the risk that a large corporate group presents and the rating dictates how much focus and scrutiny the ATO will have on that group for the coming year. The higher the risk rating, the more scrutiny from the ATO.

We have already seen some large corporates being notified of their ratings and expect that the ATO will continue to advise other corporates in the coming weeks. In most cases the risk ratings are notified in a draft letter that contains the ATO reasons for the risk rating, and the taxpayer has the opportunity to engage with the ATO if there are factual errors with the letters.

The ATO will be publishing increased guidance to help large businesses know what areas are lowest risk and what areas the ATO will be targeting. The ATO uses surf lifesaving metaphors to describe an approach where the guidance will indicate a safe harbour where it is low risk and 'safe to swim between the flags'. This guidance will be by way of Public Rulings, Determinations and other public statements by the ATO.

The ATO will also use Taxpayer Alerts to notify where there are areas of risk that it will focus on – described as 'pointing out the rips'. The ATO will approach these risk areas by way of small project teams that it calls 'clusters'. Two current risks being examined in clusters (referred to further below) are cross-currency swaps and offshore procurement hubs.

Focus areas

The ATO has outlined the areas of focus that it has in sight for 2016. These are split between indirect tax and income tax.

Indirect Taxes

The ATO's main areas of concern in relation to indirect taxes are in goods and services tax (GST) and excise. The GST issues include:

- the integrity of business systems, including the ability to deal with one-off or unusual transactions,
- compliance with GST obligations relating to the sale, transfer and acquisition of real property,
- financial supplies apportionment and the practical application of the law to the apportionment of input tax credits,
- the importance of digital products and low value goods, where new law has been announced to commence from 1 July 2017, and
- cross-border transactions, particularly to do with the domestic and international implications associated with the sharing economy and peer to peer and e-commerce models.

In relation to other indirect taxes, the ATO has identified issues with maintaining high levels of voluntary compliance with excise, wine equalisation and luxury car tax obligations. The ATO will improve its guidance products to make them clearer and simpler and online information easier to access. Specific examples include:

- the ATO will continue to pilot approaches in the fuel industry that rely on advisor/auditor reports to assess risk,
- the ATO will also focus on third party service providers (such as transport entities and warehouse operators) in relation to imported tobacco products,
- changing the approach to apportioning fuel use for fuel tax credit claims,
- simplifying the process for correcting wine equalisation tax errors, and
- developing online registration through the business portal for fuel tax credits, wine equalisation and luxury car tax.

Income taxes

The ATO considers that while the overall income tax risks and issues have remained stable, global tax planning risks will remain in focus in 2016, with increasing complex global business structures and value chains.

The ATO will continue to allocate significant resources to these risks and focus on these issues through the International Structuring and Profit Shifting (ISAPS) program. This program has a heavy emphasis on compliance (risk reviews and audits) and also includes international collaboration and clustering similar cases to determine patterns, drivers and appropriate strategies for treatment.

The ATO will also continue to implement the action items stemming from the BEPS project, including Country by Country reporting, hybrid mismatches, exchange of information dealing with double non-taxation and mandatory disclosure of aggressive tax structures.

The ATO will provide large business with guidance material on specific profit shifting and international tax issues, including through alerts and bulletins on more specific areas of concern such as procurement hubs and related party swap arrangements.

The main areas of concern for the ATO fall into these categories:

- **International tax and profit shifting –** the use of related party or back-to-back cross border activities, transactions or dealings, or contracting via non-resident entities to reduce Australian tax. Profit shifting risk manifestations include thin capitalisation, offshore procurement and marketing hubs, hybrid entities and instruments, asset transfers to offshore related parties, transfer mis-pricing and the use of structures or business processes to prevent the income from Australian customers or businesses from being taxable in Australia.
- **Schemes and arrangements to minimise tax** – The ATO will look closely at higher risk arrangements and trust schemes which aim to extract profit through concealment of income, mischaracterisation of transactions, or to artificially reduce trust income and reduce tax.
- **Business structuring and restructuring** – The ATO will monitor and identify restructure events such as mergers and acquisitions, demergers, share buybacks, return of capital and major divestments that may give rise to a range of capital gains tax (CGT), consolidation, losses and other incorrect tax outcomes. This focus will extend to wealthy individuals and their private groups that have complex structures and utilise flow through entities such as trusts, partnerships and companies.
- **Exploitation or misapplication of the law –** these focus areas include Research and Development, CGT, tax consolidation and certain industries such as Liquefied Natural Gas, foreign banking, insurance, superannuation, mining and petroleum exploration and the privatisation of public infrastructure.

In each of these areas, the ATO will promote early engagement on issues, a co-operative relationship, and tailored services for large business. The focus is increasingly on prevention before correction and encouraging large business to seek ATO advice before entering major transactions.

The ATO encourages large business to have adequate tax governance and tax risk management controls in place, and in 2016 will continue to undertake tax governance reviews of large businesses that are considered to be of high risk consequence to the tax system.

The ATO will also strongly promote transparency with large business and international transparency with other tax authorities around the globe. Finally, the ATO will share its assessment of risk with the highest risk corporates.

The takeaway

The amount of tax paid by large business has become a critical discussion point for the community, the government and the media. It will be a necessary component of the much needed policy debate on Australia's tax system in the lead up to the next Federal election which will occur in 2016.

The primary ATO goal in relation to large business in 2016 is to provide the community with greater assurance that large businesses are paying their fair share of tax. The ATO will work more co-operatively with large business to do this.

This means that if businesses want to satisfy the ATO and their own stakeholders that they are paying their fair share of tax, they will need to be prepared to explain:

- their approach to tax
- their tax governance framework
- their local and global tax profile and operating environment, and
- why their tax payments represents the correct level of tax.

Let's talk

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

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