Banking on Tax
Focusing on the core issues
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1 Tax issues for interbank offer rate (IBOR) reform

There are a number of tax issues to consider as the market transitions to alternative risk-free rates for loans, bonds, derivatives and other financial contracts.

1.1 Interbank offer rate reform

Interbank offer rates underpin trillions of dollars in financial products. However, work is underway in multiple jurisdictions to transition to alternative almost risk-free rates to enable the reference index to be used by financial institutions to price floating or variable rates for loans, bonds, derivatives and other financial contracts.

At present, the interbank offered rate (IBOR) benchmarks are quoted for USD, GBP, EUR, JPY and CHF over multiple maturities. However, the UK Financial Conduct Authority (FCA) announced that it would no longer persuade or compel banks to submit IBOR benchmarks by the end of 2021. Therefore, it is essential for market participants that reference these rates in financial contracts to examine the future transition to the alternative risk-free rates (RFRs). Examples include the Secured Overnight Financing Rate (SOFR) for USD, the Sterling Overnight Index Average (SONIA) for GBP, and the Swiss Average Rate Overnight (SARON) for CHF.

While some other currencies (e.g. AUD, CAD, and JPY) already have credit-based benchmarks that are independent of LIBOR (e.g. Australia’s bank bill swap rate (BBSW) for AUD), we expect certain base rates to co-exist alongside alternative RFRs (e.g. the Reserve Bank of Australia’s cash rate for AUD).

In May 2019, ASIC wrote to major Australian financial institutions to understand how those financial institutions were preparing for IBOR transition and to seek assurance that management understand the impact and risks of transition.

It is critical that financial institutions determine whether the transition to alternative RFRs for their financial contracts will give rise to Australian tax consequences as part of its impact and risk assessment for transition.

1.2 Key Australian tax, accounting, and legal considerations

1.2.1 Amendments to contracts may trigger gains and losses for Australian tax purposes

A financial contract (e.g. loan, debt security, derivative etc.) that references a benchmark interest rate is likely to constitute a ‘financial arrangement’ that is subject to Australia’s taxation of financial arrangements (TOFA) rules.

If the financial institution has made an election to adopt the ‘reliance on financial reports’ method under the TOFA regime – and the method applies to the relevant contract – the Australian income tax consequences of the transition are expected to be largely driven by the accounting outcomes. There may be other methods that could also lead to this outcome.

Where a spread adjustment, or different term structure of a new RFR, results in a credit or debit adjustment to the profit and loss of the financial institution, it may trigger an assessable gain or deductible loss for tax purposes of this amount under the TOFA regime. If an overall net adjustment is made between the financial institution and a counterparty covering a number of financial arrangements, the net adjustment may be required to be allocated to each financial arrangement.
1.2.2 AASB accounting treatment and TOFA implications

If the relevant financial contract does not specify that a ‘fall-back’ rate is to be used should IBOR be unable to be determined, then the counterparties will have to re-negotiate an alternative index.

Where the parties agree to replace the benchmark rate in the financial contract with a new RFR, they will need to determine the accounting outcome under AASB 9 ‘Financial Instruments’ from the modification to the terms of the contract. Currently, there are two alternatives: either (a) an accounting modification to the existing contract; or (b) a termination of the existing contract and the start of a new one. (The IASB is currently reviewing the accounting implications of moving away from IBOR, which may lead to revisions to AASB 9.)

If it is an accounting modification to the existing contract, the modified contractual cash flows will be recognised on a prospective basis over the remaining term of the contract. The reset rate is also expected to be used to determine TOFA gains and losses for the financial institution during the remaining contract term under various TOFA methods.

On the other hand, if the change in terms amounts to a ‘substantial modification’, then the existing contract will be de-recognised or extinguished. A substantial modification of an existing contract may be recognised in profit and loss at the time of the change under AASB 9. By implication, a TOFA gain or loss may also arise under the TOFA regime.

Where the ‘hedge accounting’ method applies to a derivative under the TOFA regime, the transition to a new RFR that results in the termination of the existing hedge accounting relationship under AASB 9 may result in consequences under that TOFA method. For accounting purposes, the fair value balances previously deferred to the balance sheet would be recycled through profit and loss and this may trigger amounts being recognised for income tax purposes.

Financial institutions seeking to re-establish hedge accounting for their existing derivatives would no longer have a perfect hedge. It would most likely generate hedge ineffectiveness, which will need to be immediately recognised in profit and loss, and may therefore result in a tax impact.

Further, the hedge documentation (which is critical for access to the hedging method under the TOFA regime) may need to be updated to reflect the change in terms of the arrangement.

Also, measuring the effectiveness of the hedge relationship for accounting purposes (and for TOFA purposes) at inception and on an on-going basis may be more challenging if new RFRs have to be used to conduct the effectiveness test.

1.2.3 Balancing adjustment under the TOFA regime

Irrespective of the accounting treatment, it will be necessary to determine whether contractual modifications give rise to a ‘balancing adjustment’ under the TOFA regime, and so result in TOFA gains or losses from a balancing adjustment. A balancing adjustment generally arises if, and when, all of the taxpayer’s rights or obligations cease under the relevant financial arrangement.

If a change from an IBOR to a new RFR is sufficiently material to constitute a cessation of all of the taxpayer’s rights and/or obligations under the existing financial arrangement and the commencement of a new financial arrangement at general law, then a balancing adjustment gain or loss may arise under the TOFA regime for the financial institution as a result of the contractual modifications. As such, the approach to drafting contracts is important.
1.2.4 Capital gains tax (CGT)
If the relevant financial contract falls outside the TOFA regime, the financial institution would need to consider the implications of any contractual modifications under the CGT provisions. It is likely that general law concepts regarding termination of an existing contract and the commencement of a new contract would still be relevant.

1.2.5 Transfer pricing
For contracts with related parties, the transfer pricing policies and contractual agreements with the financial institution's related parties may need to be re-drafted where analysis of intra-group funding is no longer based on an IBOR base rate.

Transfer pricing specialists should review any current and planned intra-group arrangements with related parties. This will assure that the new method of contract pricing on an RFR plus or minus a spread at a potentially different term structure – depending on the actual spread calculation mechanism adopted from central banks or ISDA or another regulatory body – is on an arm's length basis in accordance with the transfer pricing rules for the Australian financial institution and the related counterparty.

1.2.6 Other tax and legal issues
If the transition to a new RFR results in the termination of the existing financial contract and the commencement of a new contract at general law, grandfathering of historical tax treatments may no longer be available.

For example, it will be necessary to consider the continued availability of the ‘public offer’ exemption from Australian interest withholding tax in respect of debt instruments that transition to new RFRs, particularly if the change is seen to extinguish the existing contract and start a new contract at general law. Again, legal contract drafting is important.

Book carrying values (and tax values) of financial assets and financial liabilities may change due to the transition to new RFRs.

It will also be necessary to legally analyse the terms and conditions of existing financial contracts to determine whether any tax indemnity or redemption clauses in the contract are triggered as a result of the transition.

1.3 Key action points
Financial institutions should identify longer term instruments maturing after 2021 priced on an IBOR that might be affected by the above tax issues. Where an amendment of contracts is needed, a tax advisor should review the nature of the amendments to the existing contract, together with the envisaged accounting and legal treatment. Financial institutions should also consider the potential tax impact from the perspective of the counterparty, and address any potential tax and possible legal considerations for proposed amendments.
2 Tax uncertainties for initial margins on over-the-counter (OTC) derivatives

Initial margins for OTC derivatives can create a number of tax uncertainties when, as a matter of policy, none should exist.

2.1 Background

The initial margin (IM) requirements first came into operation in 2016 and are being phased in until 2020 (depending upon the amount of gross notional OTC derivatives outstanding). The IM requirements are directed towards financial firms (such as banks) and systematically important non-financial entities (basically APRA-regulated institutions, other than private health insurers).

The 2007 GFC highlighted the weakness of market participants to significant financial and economic adverse events. According to the September 2013 paper by the Basel Committee on Banking Supervision (BCBS) and the Board of the International Organisation of Securities Commissions (IOSCO) “over-the-counter (OTC) derivatives in particular ... demonstrated that improved transparency in the OTC derivatives markets and future regulation of OTC derivatives and market participants would be necessary to limit excessive and opaque risk-taking through OTC derivatives and to mitigate the systematic risk posed by OTC derivatives transactions, markets and practices”.

2.2 Guiding principles

The BCBS and IOSCO set out a number of principles for margin requirements for non-centrally cleared derivatives. These can be summarised as:

1. Appropriate margining practices for all non-centrally cleared derivatives (except for physically settled FX forwards and swaps – where margining is already common practice among market participants)
2. Financial firms and systematically imported non-financial entities that engage in OTC derivatives must have initial (future exposure) and variation (current exposure) margins
3. Each party should exchange margins (as appropriate) without netting.

2.3 Compliance obligations

In order to comply with the IM principles set out by the BCBS and IOSCO, financial firms and systematically important non-financial entities will need to undertake a number of steps, including:

1. Entering into a series of agreements to effect IM
2. Nominating a custodian to hold IM assets
3. Implementing computer models which calculate/verify the IM exposure
4. Complying with the various onboarding requirements (KYC, AML, CRS, CTF, etc.) of the counterparty’s custodian
5. Implementing governance processes that deal with the provisions and receipt of IM collateral
6. Implementing governance and escalation processes that deal with disputes that may arise between the counterparties.
2.4 Income tax consequences

The income tax consequences would normally arise as a result of the execution of the compliance obligations. However, as a generalisation, it would be expected that merely providing collateral should not result in any material income tax issues. Unfortunately, not all generalisations are correct, and this one is no exception.

Without seeking to identify all the income tax consequences of complying with the IM requirements, some of the income tax issues that need to be considered include:

1. Collateral used to comply with the IM requirements will usually be provided to an offshore custodian (either to an offshore custodian acting for the owner of the collateral, who then transfers the collateral to the offshore custodian of the counterparty; or providing the collateral directly to an offshore custodian of the counterparty):
   
   • To the extent the collateral assets are revenue assets, a transfer of revenue assets from the owner to an offshore custodian of the owner has generally been ignored for income tax purposes (where the custodian is acting as a bare trustee). Similarly, a transfer of revenue assets directly from the owner to the offshore custodian of the counterparty has also generally been ignored for income tax purposes (where the custodian is acting as a bare trustee).
   
   • To the extent the collateral assets are capital assets, a transfer of the capital assets from the owner to an offshore custodian of the owner, or a transfer of the capital assets from the owner to an offshore custodian of the counterparty, or a transfer of the capital assets from the offshore custodian of the owner to the offshore custodian of the counterparty, should not result in a CGT event by virtue of Division 106 of the Income Tax Assessment Act 1997.

2. The deductibility of costs (such as consultant fees, software, etc.) associated with compliance of the IM obligation will vary, depending upon the nature of the expenditure and the ongoing advantage sought.

3. Consideration will need to be given to the income tax consequences in the offshore jurisdiction. Whether or not the activities of the offshore custodian of the owner amounts to a taxable presence. Consideration should also be given to whether there are any filing or withholding requirements in that offshore jurisdiction.

4. To the extent the collateral is Australian listed shares, the treatment of dividends paid by the listed company may result in withholding tax paid to the offshore custodian (if the dividend is unfranked and not conduit foreign income). Depending on the nature of the IM contractual agreements, it may be necessary to put processes into place to obtain a refund of that withholding by the ultimate Australian beneficial owner of that income. If the dividends paid by the listed company were to be franked, the IM contractual agreements should consider this aspect.

5. Again, subject to the nature of the IM contractual agreements, to the extent the IM collateral is Australian issued debt securities, similar considerations may need to be given to processes to recover any interest withholding tax deducted by the issuer (although debt securities may be the subject of an exemption under Section 128F of the Income Tax Assessment Act 1936).

6. Apart from the income tax issues, there are a range of stamp duties and value-added taxes that need to be considered where collateral transactions are undertaken across a number of countries.

IM for OTC derivatives can create a number of tax uncertainties when, as a matter of policy, none should exist. Tax engagement with the IM implementation team is essential, as will be engagement with the various revenue authorities to gain certainty on the taxation outcomes.

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1 Assuming Division 6AAA of the Income Tax Assessment Act 1936 has no application.
2 Assuming Section 99B of the Income Tax Assessment Act 1936 has no application.
3 Potential underpayment of superannuation guarantee

Employers should consider the impact of the ATO’s clarification of ordinary time earnings and leave loading for superannuation guarantee payments.

3.1 Superannuation guarantee legislative regime and background

Businesses in Australia are well aware of the requirement to make superannuation contributions for employees and directors under the Superannuation Guarantee (SG) legislation. In certain circumstances, there may also be obligations to make contributions for contractors. Notwithstanding, there have been many recent examples of businesses, including large financial institutions, that have not made sufficient contributions to avoid imposition of the Superannuation Guarantee Charge (SGC).

The ability for employers to meet their superannuation obligations can be complex and is heavily impacted by Australia’s Industrial Relations (IR) system. Many Enterprise Bargaining Agreements (EBAs) and/or Awards make it challenging to interpret employee entitlements and employer obligations. In addition, the interaction between time and attendance systems and payroll systems is complex to implement and maintain accurately.

There has been significant media attention in recent years on employers who have been found to underpay their employees. Whilst the vast majority have not done this wilfully, deliberately or through neglect, there has been a breakdown in process due to the complexities identified above, which can also be exacerbated by changes to payroll personnel and internal controls.

3.2 ATO position – leave loading

In Superannuation Guarantee Ruling SGR 2009/2 (SGR 2009/2), the ATO published its interpretation of the Superannuation Guarantee (Administration) Act 1992 in relation to the determination of Ordinary Time Earnings (OTE). In this ruling, the ATO changed its previous view in relation to ‘leave loading’ payments. From 1 July 2009, the ATO’s view is that these are included in OTE unless they are ‘demonstrably referable to a notional loss of opportunity to work overtime’.

Despite the publication of SGR 2009/2, information published on the ATO’s website continued to present the ATO’s earlier position that such payments were excluded from OTE in all circumstances. As a result, many employers and payroll system providers have erroneously relied on this non-binding general guidance in excluding leave loading payments from OTE in determining the amount of superannuation contributions to employees.

In March 2019, the ATO clarified this inconsistency with a further publication on leave loading, outlining its approach towards SG compliance for previous and future quarterly periods. To summarise:

- In the absence of written evidence (i.e. a stated intention in an industrial agreement or other relevant document), the ATO does not accept that leave loading is ‘demonstrably referable’ to a notional loss of opportunity to work overtime (i.e., excluded from OTE). The ATO accepts that appropriate documentation may reside in an employer’s HR policies. These documents must be known and accepted by employees.
• Given the prior uncertainty surrounding leave loading, the ATO will not initiate compliance resources (unless there are specific complaints raised by employees) to investigate earlier periods in which employers have self-assessed whether or not leave loading was demonstrably referable to a notional loss of opportunity to work overtime, provided that no evidence to the contrary exists (e.g., a loading paid to employees who cannot work overtime or a policy that prohibits overtime work).

• To support exclusion from OTE in future periods, employers must obtain written evidence. If an employer does not obtain such written evidence, then leave loading will form part of an employee's OTE.

3.3 Considerations

As a result of the ATO's clarification, all employers should consider the impact the ATO's position will have on their operations and employees. Despite the ATO stating it will not initiate an investigation into earlier periods, there exists a risk of an audit or investigation should an employee lodge a complaint or query with the ATO (which is obligated to review the SG shortfall claim) or possibly FairWork.

To the extent that employers have previously excluded leave loading payments from OTE, some analysis should be undertaken to determine whether SG shortfalls have arisen in previous quarterly periods.

Where SG shortfalls may not arise, it may still be necessary to address possible contractual shortfalls outside of the ATO's coverage under SGC.

3.4 Timeframe to be considered

Where shortfalls in SG are likely to exist, interest amounts on these shortfalls are accruing and will continue to do so until engagement with the ATO to undertake SG remediation activities. As such, it is important to address the issue as soon as possible given the growing costs involved, as well as potential adverse media scrutiny. As these issues become more widespread amongst employers, there is an increased risk of employees or unions becoming involved to initiate queries.

Additionally, the ATO's timeframe to conduct review/audit activity in relation to SG shortfalls is in theory unlimited. For leave loading it extends back to the publication of SGR 2009/2 – effective from 1 July 2009. As such, delaying any action to remediate will not provide any protection in terms of limits on the ability of the ATO to issue SGC assessments and will in fact likely lead to additional costs in the form of interest and potentially additional (Part 7) penalties of up to 200% of the SGC amount.

We note that this unlimited review period appears at odds with document retention requirements under the Corporations Act 2001 (7 years) and the Taxation Administration Act 1953 (5 years). Where changes to payroll systems have occurred and/or the necessary records are no longer held by employers that would otherwise enable historic SG shortfalls to be calculated, a practical solution may need to be considered and agreed with the ATO/FairWork on a case by case basis.

3.5 Availability and scope of an SG amnesty

On 18 September 2019, the Australian Government introduced a new Bill into Federal Parliament reintroducing a one-off amnesty to encourage employers to self-correct historical SG non-compliance. The Bill sets out a carrot and stick approach to collection – a further extension to the amnesty period together with legislative backing for remission of penalties during the amnesty period, counteracted by legislatively mandated minimum penalties for employers that do not voluntarily disclose historical non-compliance during the amnesty period.

Employers should however note that the new amnesty is not yet law and must pass through both houses of Parliament. It may not receive bi-partisan support on its passage through Parliament.
Under the proposed amnesty, employers:

- Can claim tax deductions for payments up to the amount of the SG charge, made during the amnesty period
- Can claim tax deductions for late contributions made during the amnesty period to offset the SG charge
- Will not be subject to the $20 administration charge per employee in respect of whom the employer has an individual SG shortfall
- Will not be subject to penalties under Part 7 in respect of amounts of SG shortfall that qualify for the amnesty (this concession will be legislated rather than at the Commissioner’s discretion).

From the day after the amnesty period ends, the Commissioner’s ability to remit Part 7 penalties will be curtailed by legislation. Under the amendments, the Commissioner will not be able to remit Part 7 penalties below 100% of the amount of the SG charge payable by the employer for a historical quarter that was covered by the amnesty where the employer did not disclose the shortfall as part of the amnesty.

### 3.6 Recommendations

Given the complexities, impact on employees and potential for media scrutiny, we recommend taking a proactive approach. The current environment is conducive in the short term to conducting a prudential review and, to the extent that SG shortfalls are identified, making disclosures to various interested parties which may include the ATO, FairWork, employees, unions and other regulators. The financial impact will increase by 100% if left until after the proposed SG amnesty has expired.

Key steps at a minimum would include:

- Review the pay codes used within the payroll system
- Undertake an SG tax technical diagnosis of OTE
- Undertake data analytical assessment of SG shortfalls (if any)
- Prepare SGC statements (where required)
- Engage with various interested stakeholders (where required)
4 Common Reporting Standard (CRS) compliance reviews – it’s time to prepare

As the transition period for financial institutions to implement the CRS is now complete, it’s time for financial institutions to shift their focus to preparing for tax authority compliance reviews.

Between 2018 and June 2019, more than 90 jurisdictions participating in the CRS exchanged information through a network of 4,500 bilateral relationships on 47 million offshore accounts, with a total value of around 4.9 trillion euros. Given the volume of information being exchanged and the reliance being placed on that information for audit and enforcement activities by receiving jurisdictions, the quality and consistency of the information being exchanged is important. The enforcement mechanism for CRS is peer review by the OECD.

The peer review for Australia is expected in 2020 and we understand that the ATO will be commencing their own compliance program shortly to prepare for the peer review.

4.1 OECD peer reviews

The OECD has provided guidance to tax authorities to assist participating jurisdictions to develop CRS compliance frameworks and prepare for peer review. For example, the OECD Implementation Handbook for the CRS was updated and Terms of Reference for peer reviews were published during 2018.

Included in the OECD guidance are suggested approaches and indicators for tax authorities to assess compliance by FIs, such as:

- Obtaining lists of FIs and cross-checking against entities that have lodged CRS reports
- Risk assessment of an FI’s policies, procedures and systems
- Investigations and sanctions imposed in relation to an FI’s compliance with AML and KYC procedures
- Reporting issues, such as:
  - Reporting a significant number of undocumented accounts
  - Reporting a significant number of account closures
  - Inquiries from other jurisdictions indicating underreporting or inaccurate reporting
  - Not lodging reports
  - Significant changes in the volume of reporting between years
  - Reporting TINs for significantly fewer accounts compared to other FIs.
- Key risk areas identified during implementation and consultation
- Review of FI’s internal controls, including documentation of internal controls, and sample reviews.

In preparing for peer reviews, the OECD issued CRS compliance questionnaires to all participating jurisdictions. The initial questionnaire, which was due in June 2019, covered a number of questions regarding implementation and enforcement to date.

Recently, a second questionnaire was sent by the OECD to all jurisdictions that received information exchanged regarding the accuracy of information from partner jurisdictions.
We also understand that the OECD is developing additional guidance for tax authority reviews, taking into account issues raised in various forums and consultations undertaken by the OECD.

4.2 ATO compliance reviews

The ATO is expected to commence CRS compliance reviews of FIs from November 2019 in the lead up to Australia's peer review. The ATO has not publicly released detailed information for its upcoming FI reviews. However, the reviews will be undertaken with reference to the OECD guidelines and the Australian legislative requirement for an FI to keep written records of the procedures applied to determine if it has reportable accounts and the information reported to the ATO.

In a recent presentation with Deloitte, the ATO outlined some information regarding its approach to date and the compliance review activity the ATO will be commencing soon.

4.2.1 CRS approach to date

The ATO approach to date has recognised CRS has involved a transition to a new regime, and we are not aware of any penalties having been applied for late lodgements or reporting data issues. The ATO noted that data quality is already an issue and there will be increased focus by the ATO going forward.

4.2.2 ATO streamlined reviews

The ATO will be undertaking 90 day streamlined reviews, starting in November 2019, with a focus on the CRS business rules, end to end processes, progress by FIs to obtain self-certifications and data quality.

The streamlined reviews are anticipated to be undertaken with a sample of FIs across all parts of the financial services industry (e.g. banks (large, mid-tier and credit unions), funds, private equity, custodians, etc.). In determining which FIs to review and what the ATO is particularly concerned about, we understand that the ATO will focus on FIs with one or more of the following:

- High percentage of accounts without taxpayer identification numbers
- High percentage of accounts with no dates of birth
- High percentage of undocumented accounts
- Other data quality issues identified by foreign jurisdictions.

As well as enabling the ATO to prepare for the OECD reviews, the ATO expects to achieve a number of other outcomes from its CRS streamlined reviews, including:

- Improved data quality
- Improved matched rates from foreign jurisdictions
- Identification of industry issues
- Understanding of the challenges faced by FIs
- Voluntary disclosures by FIs.

The ATO confirmed that it expects to commence the streamlined reviews in 2019, continuing into 2020.

4.2.3 Future developments

The ATO also flagged some future CRS developments, such as an updated XML schema for 2020, a new data quality schema and increased focus on CRS avoidance schemes.

4.3 Singapore guidance

In the Asia-Pacific region, the Singapore tax authority (IRAS) recently released guidance for its upcoming FI reviews, including compliance guidelines and a self-review toolkit. As the guidance is quite detailed, it may provide a useful reference point for Australian FIs preparing for ATO reviews.
The guidance clarifies IRAS’ expectations on the approach that Singapore Financial Institutions (SGFIs) should take when demonstrating their compliance with CRS in Singapore. In particular:

1. Robust controls exist at the entity, process and reporting levels. The guidance explains how SGFIs are expected to put in place a set of internal controls to manage their CRS regulatory risks when complying with the CRS requirements in Singapore. To that end, IRAS has established 23 hallmarks or desired outcomes that SGFIs should achieve to demonstrate the sufficiency and robustness of the SGFI’s operating environment, how it fulfils its CRS due diligence obligations, and the manner in which the SGFI fulfils its CRS reporting obligations.

2. Sufficient documentation is maintained and records kept of the steps taken.

3. A periodic review program should be part of the FI’s existing internal risk management framework and performed by independent reviewers who are not involved in the policy formulation and day-to-day CRS operations of the FI (e.g. internal compliance teams, internal auditors or external auditors).

4. Remedial actions are taken to address any gaps identified through the independent review process or from an IRAS review.

In addition, the following points should be noted:

- An FI remains responsible for outsourced CRS functions carried out on its behalf by a service provider. It is expected that the FI has oversight and governance of the outsourced work, there are internal controls to manage the outsourcing risks and the FI should ensure it has access to all records, documentary evidence and information in the service provider’s possession.

- For a trust, practically, it is the trustee that is expected to adopt the CRS compliance approach for the trust.

The guidance concludes with a section on the CRS compliance activities that IRAS will commence in the second half of 2019. The more targeted compliance activities will be directed at SGFIs that pose a higher risk of non-compliance with the CRS.

Additionally, the guidance contains a self-review toolkit (as an appendix to the guidance) to assist SGFIs in meeting the hallmarks or desired outcomes, which IRAS has designed, containing recommended internal controls that a SGFI may implement.

4.4 Preparing for reviews

FIs should consider its approach and preparedness if selected for an ATO review. Whether or not an FI is selected for review, an FI should consider undertaking compliance activities as part of its CRS governance. Activities may include:

- Documenting, reviewing and updating FATCA and CRS policies and procedures, including for current systems and related procedures (e.g. AML/KYC). Procedures should set out how the FI is applying the client onboarding, due diligence and reporting requirements in the context of its activities and systems.

- Liaising with service providers to obtain assurance regarding their policies and procedures and compliance activities.

- Seeking an independent review to test policies, procedures and controls (e.g. desktop review of procedures, forms, checklists and other documents; a questionnaire that covers all of the requirements and provides an assessment of completeness; walk-throughs and interviews; sample testing). Each FI is different and activities to prepare for an ATO review should also take into account issues particular to the industry sector and market practice, the extent to which third parties fulfil some of the obligations and the risk profile of the entity.

Whatever approach is taken, the aim should be to identify areas of risk that may arise during a review and how to approach those issues with the tax authority, including whether or not there are gaps to be remediated prior to a tax authority review or by making a voluntary disclosure.
5 Tax whistleblower disclosures

The new tax whistleblower regime requires organisational preparedness.

5.1 Tax and general whistleblower provisions

On 1 July 2019, the new tax and general whistleblower provisions become operative. The new tax whistleblower regime is intended to encourage individuals to disclose information on actual or potential breaches of the tax law, by providing them with protections that are consistent with the Corporations Act 2001.

Financial institutions should prepare for increased whistleblower disclosures in respect of taxation, particularly given the following factors:

- High community interest in taxpayers of all sizes paying their “fair share of tax”
- An increased focus on conduct particularly in the financial services sector
- Misconceptions that there may be rewards in whistleblowing
- ATO calculations of significant collection gaps in superannuation guarantee, PAYG remittance, GST and income tax.

Accordingly, financial institutions should consider how they communicate, respond, record and investigate tax disclosures.

5.2 Eligible whistleblowers and recipients

Only disclosures made by an “eligible whistleblower” may qualify for protection. Broadly, an individual is eligible if they have a current or former relationship with the relevant entity, such as officers, employees, suppliers (and their employees), and associates together with spouses, children or dependents of any of the above.

A disclosure may only be protected if made to an “eligible recipient” or the Commissioner of Taxation. Eligible recipients include auditors and tax agents, persons authorised by the entity to receive such disclosures, company officers or senior managers, employees with tax functions or duties, trustees of a trust or partners of a partnership.

5.3 Scope of disclosures

If an eligible whistleblower provides information to the Commissioner of Taxation, that disclosure will qualify for protection if the whistleblower subjectively considers that the information may assist the Commissioner to perform his or her functions or duties under a taxation law in relation to the entity (or its associate) to which the information relates.

If a disclosure is made to an eligible recipient, the whistleblower must have reasonable grounds to suspect that the information indicates misconduct or improper circumstances relating to the entity’s tax affairs; and that the information may assist the recipient to perform their functions and duties in relation to those tax affairs.

Eligible information could include non-compliance with a tax law, tax evasion, a tax avoidance scheme, unexplained wealth or any other tax-related misconduct. Whistleblowers do not require knowledge of specific tax laws to be afforded protection.
5.4 Financial institution preparedness

5.4.1 Communication, training and record keeping systems

The front line recipients of tax disclosures will be company officers, senior managers, and employees with tax functions or duties. To prepare these recipients, organisations should consider what training and support should be provided to them.

Broader awareness training should also be considered for employees generally.

5.4.2 Investigation and resolution

Given the subjective nature of the disclosures and that the whistleblower does not need to have knowledge of specific tax laws, it is possible that many disclosures will not in fact result in a finding of tax-related misconduct. But the process of reporting, investigating and managing these disclosures will need to be no less rigorous than more substantiated claims. Accordingly financial institutions should consider what systems and resources could potentially be diverted to deal with such claims.

Notably, the tax whistleblower regime allows eligible whistleblowers to make disclosures to eligible recipients internally, that is, within the organisation. This affords the opportunity for companies to implement a system to encourage such tax disclosures and resolve potential issues.

5.4.3 Whistleblower policies and protection

Although an entity is not required to have a whistleblower policy under the tax whistleblower provisions, public companies, large proprietary companies and corporate trustees of registrable superannuation entities must implement a whistleblower policy and make it available to their officers and employees by 1 January 2020. This requirement was introduced as part of the reforms to the corporate sector whistleblower regime that commenced on 1 July 2019. On 7 August 2019, ASIC released a consultation paper on its proposed guidance on the new legal obligation on companies to implement a whistleblower policy.

It is therefore timely to consider whether your organisation should have a whistleblower policy in place by 1 January 2020. If a policy already exists, it may be beneficial to review and update this policy.

In addition, the tax whistleblower regime provides broad protection and remedies against the victimisation of, or detrimental behaviour to, eligible whistleblowers or their supporters, involved in protected disclosures or investigations of related matters. Corporations can be liable for a range of victimisation related conduct and also have a duty to prevent a third person from engaging in victimisation. As such, organisations should consider what training and support mechanisms should be put in place to protect whistleblowers within the organisation and to ensure officers and senior management are aware of their responsibilities in protecting whistleblowers from victimisation and detriment.

... the whistleblower must have reasonable grounds to suspect that the information indicates misconduct or improper circumstances relating to the entity’s tax affairs ...

... Whistleblowers do not require knowledge of specific tax laws to be afforded protection.
6 Expansion of director penalties to unpaid GST liabilities

Directors will need to be across whether the company is meeting its GST obligations in a timely way.

6.1 Changes before Parliament

Taxation-related measures in a Bill currently before Federal Parliament will add an extra layer of responsibility and potential personal financial exposure for company directors. While the Bill is broadly concerned with addressing illegal phasing activity, the tax measures are not worded in a way that will confine their application to circumstances involving phasing.

Among other measures, the Bill amends the taxation administration law by extending the existing director penalty regime to companies with unpaid goods and services tax (GST), (LCT) and wine equalisation tax (WET) liabilities (collectively, the ‘net amount’). The director penalty regime currently applies to companies’ unpaid pay as you go (PAYG) withholding and superannuation guarantee charge (SGC) obligations.

This measure will apply to outstanding net amounts that have been assessed, as well as net amounts estimated by the Commissioner of Taxation under the expanded estimates regime (see below). The director penalty measure will also apply in relation to companies that remit GST on a quarterly instalment basis. The amount of a director penalty will equal the company’s unpaid net amount or GST instalment.

This change has the potential to substantially increase the level of financial exposure for individual directors. It is clearly intended to focus directors on whether their company is meeting its GST, LCT and WET obligations in a timely way, and if not, to take speedy and appropriate action to address the situation – either by ensuring payment to the Commissioner or the company entering administration or starting to be wound up.

An example of a possible timeline for a Director Penalty Notice (DPN) issuing is set out below.

While a timely response to a DPN can result in the remission of director penalties, a lockdown rule can apply to prevent remission. Broadly, this rule will apply in circumstances where a director responds to a DPN by the company entering administration or winding up is commenced, but does so more than three months after the day the company was required to pay the net amount or GST instalment for the tax period (i.e. the due day). In such cases, the director will remain liable to pay the director penalty.

**Example DPN timeline**

<table>
<thead>
<tr>
<th>GST annual turnover &lt;$20M (quarterly GST taxpayer)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Jul 20xx</td>
</tr>
<tr>
<td>• Quarterly tax period begins</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>
The Bill also expands the taxation estimates regime (currently applicable to taxpayers’ PAYG withholding and SGC liabilities), to enable the Commissioner to make an estimate of an entity’s net amount for a tax period, without having to delay recovery by waiting for an assessment to be issued.

Several additional measures are included in the Bill. Broadly, these will:

- Enable the Commissioner to retain a tax refund that is otherwise payable to an entity if the entity has any outstanding tax returns or has failed to provide other information that it is required to provide to the Commissioner.
- Limit the backdating of director resignations and prevent resignations which would leave a company without any directors.
- Introduce new phoenixing-related offences to prohibit creditor-defeating dispositions of company property.

6.2 Next steps

Provided the Bill is passed by Parliament before the end of 2019, the taxation-related measures should take effect from 1 January 2020. In the interim, all directors, regardless of their company’s size, listing status or business sector, should:

- Familiarise themselves with the scope and potential impact of the tax measures, both for the company and for themselves personally.
- Understand the key timing aspects of the measures, particularly in relation to taking appropriate action promptly to avoid director penalties becoming locked down in the event a DPN is issued.
- Understand the potential exposure to a DPN in circumstances of accepting appointment as a new director of an existing company and/or retiring as a director.
- Reflect on their level of comfort that the company is fully compliant with its GST reporting and payment obligations (and any LCT and/or WET obligations). If the company has not already reviewed its GST risk management and governance framework, and the efficacy of its GST compliance systems and processes, this is a timely point to do so.
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