



Tax Insights

International Intangibles Arrangements: Documentation, documentation and more documentation

The ATO has created an exhaustive framework to assess compliance risks relating to international Intangible Arrangements in the new draft PCG 2021/D4.

On 19 May 2021, the ATO published the highly anticipated draft Practical Compliance Guideline (draft PCG) 2021/D4 on 'Intangibles Arrangements'.

The draft PCG sets out the ATO's compliance approach to international arrangements connected with the development, enhancement, maintenance, protection and exploitation (DEMPE) of intangible assets and/or involving the migration of intangible assets (referred to throughout the draft PCG as 'Intangibles Arrangements').

"We use the framework set out in this Guideline to assess the compliance risks associated with your Intangibles Arrangements and tailor our engagement with you."

Draft PCG 2021/D4, paragraph 5

The draft PCG is designed to focus on 'tax risks' associated with the potential application of Australia's provisions regarding transfer pricing, withholding tax, Capital Gains tax (CGT), capital allowances, the general anti-avoidance rule (GAAR), and the Diverted Profits tax (DPT).

The draft PCG has been prepared to accompany the release of the ATO's Taxpayer Alerts (**TA**) 2018/2¹ and TA 2020/1² and is a further element in the ATO's increasing focus on international Intangibles Arrangements.

Helpfully, the draft PCG gives taxpayers an insight into the ATO's expectations and risk assessment framework relating to Intangibles Arrangements. However, if finalised as currently drafted, the draft PCG would create an extremely high administrative burden on taxpayers to identify, analyse and document their Intangible Arrangements with specificity. There is no materiality boundary for the application of the draft PCG. The extent of source documents the ATO expects taxpayers to have exceeds what is commercially realistic for multinationals' decision-making and record-keeping processes. We also consider that the draft PCG, in some situations, will require more than what is appropriate under Australia's transfer pricing record keeping legislation.

We recommend that taxpayers consider risks posed by their Intangible Arrangements in light of the draft PCG's risk assessment framework, and take appropriate steps to place them in the best position to defend those arrangements in the event of future engagement with the ATO.

In brief

The draft PCG uses a qualitative risk framework where the level of documentation supporting the Intangibles Arrangements determines the risk rating. The documentation expectations are categorised into four key areas of ATO focus in respect of Intangibles Arrangements:

1. **Understand and evidence the commercial considerations and decision-making:** the ATO requires contemporaneous documents to identify and evidence the commercial objectives and considerations underpinning the Intangibles Arrangements, including other or alternative arrangements that were considered and the reasons why those alternative arrangements were not pursued. Documents the ATO may require could include cost-benefit analyses, forecasts, modelling, quantifiable productivity gains, cost savings, synergistic benefits, location / jurisdiction-specific benefits, reduction of non-income tax costs and documents created by personnel or tax advisers disclosing potential Australian tax effects of the Intangible Arrangements (Paragraph 50 sets out the full list of documents).
2. **Understand the legal form of the Intangibles Arrangements:** the ATO requires documents that detail the legal form of the Intangibles Arrangements. Documents the ATO may require could include legal agreements, details of ownership of intangible assets, internal guidelines, manuals, policies, procedures, governance and like documents (Paragraphs 52 - 60 set out the full list of documents).
3. **Identify and evidence the intangible assets and connected DEMPE activities:** the ATO will seek to identify and/or clarify relevant intangible assets and connected DEMPE activities with specificity, including how such activities generate value in the context of a companies' value chain. Documents the ATO may require include intangible assets registers, (internal or external) database extracts, meeting minutes, manuals and policies, valuation reports and like documents that identify and evidence intangible assets and DEMPE activities (Paragraphs 62 - 70 set out the full list of documents).
4. **Analyse the tax and profit outcomes of the Intangibles Arrangements:** the ATO will evaluate whether the tax and profit outcomes are consistent with the commercial or economic substance of the Intangible Arrangements. Documents the ATO may require include comparability studies, valuations, projections, cash flow statements in accordance with the Intangibles Arrangements and tax information for domestic and offshore entities (Paragraph 72 sets out the full list of documents).

The draft PCG raises a number of questions, including around scope, materiality thresholds, and documentation availability, creating additional uncertainty for taxpayers in respect of their Intangibles Arrangements.

¹ Mischaracterisation of activities or payments in connection with intangible assets

² Non-arm's length arrangements and schemes connected with the DEMPE of intangible assets

Further detail - Introduction

Intention

The draft PCG sets out the ATO's compliance approach to taxpayers that have international Intangibles Arrangements. The draft PCG explains how the ATO assesses the risk posed by Intangibles Arrangements, enabling taxpayers to self-assess and mitigate their compliance risk associated with their Intangibles Arrangements.

Date of effect

The PCG is proposed to apply both before and after its date of publication. The current version has been released in draft and is subject to public consultation to 18 June 2021. However, we are already seeing the documentation expectations included in the draft PCG applied by the ATO in live Streamlined Assurance Reviews, Next Actions Reviews and Audit proceedings.

Intangibles' definition

The draft PCG defines intangible assets (consistent with paragraph 6.6 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TP Guidelines)) to include something which is not a physical or financial asset, which is capable of being owned or controlled for use in commercial activities and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances. This definition is intentionally broad, acknowledging that intangibles for transfer pricing purposes extend significantly beyond accounting or legal concepts or definitions. Examples of these 'non-traditional' intangibles can include know-how, data, (exclusive) contracts, (unique) software, etc. In this regard, it is critical for taxpayers to understand that the recognition of intangibles for transfer pricing purposes do not always reflect those recognised for accounting and/or legal purposes, often creating a challenge for taxpayers.

Overview of the draft PCG

The draft PCG is divided into two parts: (1) The ATO's compliance approach for Intangibles Arrangements, and (2) the ATO's risk assessment framework.

Part One - Compliance Approach

Australia's income tax law places an onus on taxpayers to self-assess their compliance with relevant tax laws, including the transfer pricing rules. The draft PCG's compliance approach follows the principles discussed in Chapter VI of the OECD TP Guidelines regarding the identification and ownership of intangibles, the undertaking and control of DEMPE activities in connection with intangibles, and transactions involving the use or transfer of intangibles (or the rights to exploit them). The draft PCG also has regard to the business restructuring principles as included in Chapter IX of the OECD TP Guidelines, especially in situations where the migration of intangible assets is involved. Finally, the draft PCG considers the application of other income tax provisions such as the GAAR and/or DPT, especially in situations where a taxpayer has obtained a tax benefit in connection to its Intangibles Arrangements.

The level of engagement taxpayers can expect from the ATO depends on the level of risk determined under the risk-assessment framework. The draft PCG further notes that it does not relieve taxpayers of their obligation to self-assess their compliance with all relevant taxation laws; rather, it is designed to explain how the ATO assesses risk associated with Intangibles Arrangements. Finally, the draft PCG requires taxpayers that are obligated to complete a reportable tax position (RTP) schedule to be able to disclose how their Intangibles Arrangements compare to each of the risk factors and to the examples of arrangements – see below.

Part Two - Risk assessment framework

The risk assessment framework explains how the ATO assesses the risk of Intangibles Arrangements, enabling taxpayers to self-assess and mitigate their compliance risk. The ATO has deviated from the objective and quantitative risk rating frameworks in other, recent PCGs,³ to a more subjective, documentation-based risk framework.

The framework includes an assessment of the risk based on the following components:

- **Risk Factors:** Includes high, medium and low risk factors used to assess the level of risk posed by a taxpayer's Intangibles Arrangements. It also outlines examples of arrangements that are used to assess the level of risk posed by a taxpayer's Intangibles Arrangements.
- **Documentation and Evidence Expectations:** Includes the level of documentation (including source documents) that the ATO will have regard to when assessing a taxpayer's Intangibles Arrangements against the risk factors and examples. More specifically, the information will be used by the ATO to:
 - Understand and evidence the commercial considerations and decision-making;
 - Understand the legal form of the Intangibles Arrangements;
 - Identify and evidence the intangible assets and connected DEMPE activities; and
 - Analyse the tax and profit outcomes of the Intangibles Arrangements.

Our observations

Helpfully, the draft PCG refers to and emphasises a number of the key technical concepts outlined in Chapter VI of the OECD TP Guidelines, giving taxpayers some confidence that properly applying the concepts in the OECD TP Guidelines to their Intangibles Arrangements, to the extent relevant and applicable, should be acceptable to the ATO.

However, the draft PCG makes it clear that the ATO will look beyond the OECD TP Guidelines when assessing compliance risk, creating additional record-keeping expectations and further uncertainty for taxpayers. Our comments in this regard are set out below.

Onerous expectations of taxpayers

The draft PCG outlines the ATO's high expectations of taxpayers when it comes to self-assessing the compliance risk associated with their Intangibles Arrangements.

The word 'expect' (or variants thereof) is made a significant number of times throughout the draft PCG, with some specific examples including:

- When seeking entry into the APA program, the ATO would *expect* documentation of the nature set out in the draft PCG to be produced and maintained (Paragraph 27)
- The ATO *expects* taxpayers to self-assess the level of risk posed by their intangible arrangements in accordance with the draft PCG's risk assessment framework in any engagement or assurance activities with the ATO. If a taxpayer is unable to provide adequate evidence to support its Intangible Arrangements, the ATO may undertake further engagement and assurance activities (Paragraph 32)
- The ATO *encourages* taxpayers to engage with them if the taxpayer concludes there is a potential compliance risk associated with their Intangibles Arrangements (Paragraph 26).

The documentation outlined in the draft PCG is consistent with the type of information being requested by the ATO in current and recent audit proceedings. The burden on taxpayers of producing and maintaining ATO-standard documentation is significant, and we are concerned about taxpayers having to adhere to such a high

³ E.g. PCG 2017/1 (Centralised operating models), PCG 2017/4 (Related party financing), PCG 2020/7 (Arm's length debt test)

standard for self-assessing the risk of potential compliance, particularly without a materiality threshold below which self-assessment is not required.

Moreover, the draft PCG's paragraph 43 notes that the documents outlined in the draft PCG are intended to serve as a general guide and should not be treated as an exhaustive list - suggesting that the ATO may expect even more documentation than that outlined in the draft PCG to be produced and maintained.

Finally, the draft PCG does not appear to align with the commentary in the ATO's Taxation Ruling (**TR**) 2014/8, which sets out the Commissioner's views on the transfer pricing documentation an entity should have kept in order to meet the requirements of Subdivision 284-E of the *Tax Administration Act 1953*. Paragraph 27 of TR2014/8 states that the requirements under Subdivision 284-E should be approached with a practical and commercially realistic sense of what entities can reasonably be expected to include in their records. Our view is that this statement is at odds with the documentation expectations included in the draft PCG, despite the comment in the draft PCG's paragraph 45 that "[t]he type and level of documentation we will expect from you will be influenced by the complexity of the arrangement."

Uncertainty

The draft PCG raises a number of questions, creating additional uncertainty for taxpayers in respect of their Intangibles Arrangements. For example:

- **Scope of the draft PCG:** The draft PCG defines an Intangibles Arrangement as an international arrangement connected with the DEMPE of intangible assets and/or involving a migration of intangible assets. The implication from this is that all Intangibles Arrangements entered into by taxpayers fall within the scope of the risk assessment framework in the draft PCG, requiring taxpayers to perform a detailed self-assessment against the draft PCG in even relatively straightforward examples of Intangibles Arrangements (e.g. standard licensing arrangements, contract R&D activities, etc.).
- **No materiality threshold:** There is no materiality threshold referred to in the draft PCG, again leading to the conclusion that the ATO expects taxpayers to assess all their Intangibles Arrangements against the compliance risk framework included in the draft PCG.
- **Documentation availability:** It is unclear whether the ATO expects taxpayers to create / produce documentation of the type outlined in the draft PCG solely for the purpose of self-assessing the compliance risk associated with their Intangibles Arrangements.
- **Link between documentation and risk rating:** As noted above, there is a direct link between the quality and adequacy of a taxpayer's documentation and the overall risk rating they receive regarding their Intangibles Arrangements. This link may lead to the situation where an Intangibles Arrangement is considered to be low risk under the transfer pricing provisions but still receives a high-risk rating under the draft PCG if the associated documentation does not meet the ATO's standards – potentially resulting in an inappropriate allocation of ATO resources and an unreasonable compliance burden for taxpayers.
- **Imperfect examples:** Intangibles Arrangements are notoriously facts and circumstances specific and although the examples provided in the draft PCG do provide a useful guide for taxpayers (particularly in respect of which arrangements should be avoided), it is unlikely that the fact patterns presented in the draft PCG examples will be perfectly replicated in real-life Intangibles Arrangements entered into by taxpayers. The associated ambiguity and subjectivity may result in disagreements between a taxpayer's self-assessed rating and the rating the ATO might expect.
- **Lack of guidance on identification of intangibles and DEMPE:** Throughout the draft PCG, it is assumed that a taxpayer can identify the individual intangible assets and the relevant DEMPE activities relating to that intangible asset with specificity. However, there is no guidance within the draft PCG to assist taxpayers with this difficult and complex exercise.

- **Risk factors:** The self-assessment framework is based on terminology such as 'substantiate', 'incomplete' and 'does not substantiate', with no further definitions of these terms provided. The subjectivity involved in interpreting these terms may result in a misalignment between a taxpayer's self-assessed rating and the rating the ATO might expect.
- **Resultant risk score:** The ATO has not published a risk scale as it has with other PCGs. The draft PCG indicates that if a taxpayer exhibits one or more of the High-Risk Factors as outlined in the draft PCG, there is likely to be further engagement with the ATO. It is also indicated that even if a taxpayer is not exhibiting any of the High-Risk Factors, there is nothing to suggest that the ATO will not engage further in any event.

What should taxpayers do?

We recommend that taxpayers with Intangibles Arrangements consider their positions in light of this new guidance and take appropriate steps to best place them to defend those positions in the event of future engagement with the ATO. Relevant considerations may include:

- Identifying Intangible Assets that have migrated prior to the publication date of the draft PCG, as the ATO may apply the principles of the draft PCG to such transactions
- Assessing existing transfer pricing policies associated with intangible assets against Chapter VI of the OECD TP Guidelines⁴ and refining as necessary
- Performing a gap analysis of existing documentation relating to their Intangibles Arrangements against the ATO's expectations in the draft PCG and addressing those gaps as appropriate (in particular, having regard to what is reasonable in light of the complexity of the arrangements and potential level of associated tax risk)
- Collating documentation / evidence regarding Intangibles Arrangements contemporaneously, to avoid retrospectively having to create or produce documentation to satisfy the ATO's expectations
- Determining the appropriateness of preparing documentation that is not already in existence, to assist with mitigating the risk as presented in the draft PCG. This may include feasibility studies, meeting minutes, position descriptions, etc.
- Ensuring that the concepts included in the draft PCG are considered prior to entering into any new / making changes to existing Intangibles Arrangements.

If this draft PCG is finalised as is, it will place a significant administrative burden on taxpayers in respect of their Intangibles Arrangements, and represent a further example of the ATO's clear focus on the Australian tax risks associated with intangible assets – a continuation of the trend we have seen over recent years, and one which is likely to be mirrored by offshore tax authorities in the near term. Taxpayers should be proactively considering the risks posed by their Intangible Arrangements. Given the focus by the ATO in this space, to not do so could lead to unwanted (and difficult) engagement with the ATO in the future.

We highly recommend that potentially impacted taxpayers provide their feedback on this draft PCG to the ATO during consultation period. As Deloitte will be providing the ATO with its comments on the draft PCG we welcome the opportunity to consult with you to obtain a broader view of the implications of this PCG. Comments are due by 16 July 2021 and at this stage it is unclear when the ATO intends to issue the finalised PCG. This can be relevant for taxpayers that are required to complete the RTP schedule, as the finalisation of the PCG could lead to an obligation to self-assess the taxpayers' Intangible Arrangements against the PCG's risk assessment framework.

⁴ Paragraph 20 of the draft PCG confirms the risk assessment approach follows the principles discussed in Chapter VI of the OECD TP Guidelines.

Contacts

Jacques Van Rhyn

Partner – Transfer Pricing
Brisbane
Tel: + 61 7 3308 7226
Email: jvanrhyn@deloitte.com.au

Cam Smith

Partner – Transfer Pricing
Melbourne
Tel: + 61 3 9671 7440
Email: camsmith@deloitte.com.au

David Bell

Principal – Transfer Pricing
Melbourne
Tel: + 61 3 9671 6535
Email: davibell@deloitte.com.au

Claudio Cimetta

Partner – International Tax
Melbourne
Tel: + 61 3 9671 7601
Email: ccimetta@deloitte.com.au

Amelia Teng

Partner – International Tax
Melbourne
Tel: + 61 3 8486 1118
Email: amteng@deloitte.com.au

Mark Hadassin

Partner – International Tax
Sydney
Tel: + 61 2 9322 5807
Email: mhadassin@deloitte.com.au

Geoff Gill

Partner – Transfer Pricing
Sydney
Tel: + 61 2 9322 5358
Email: gegill@deloitte.com.au

Aparna Rao

Partner – Transfer Pricing
Sydney
Tel: + 61 2 9322 5832
Email: aprao@deloitte.com.au

Paul Riley

Partner – Transfer Pricing
Melbourne
Tel: + 61 3 9671 7850
Email: pbriley@deloitte.com.au

Ockie Olivier

Partner – Transfer Pricing
Perth
Tel: + 61 8 9365 7158
Email: oolivier@deloitte.com.au

Neil Pereira

Partner – Legal
Sydney
Tel: +61 2 9840 7219
Email: npereira@deloitte.com.au

Annalie Mitchelson

Partner - Legal
Sydney
Tel: +61 2 62637292
Email: amitchelson@deloitte.com.au

Liam O'Brien

Director – Transfer Pricing
Melbourne
Tel: + 61 3 9671 7905
Email: liobrien@deloitte.com.au

Jurre Moormann

Manager – Transfer Pricing
Brisbane
Tel: + 61 7 3308 1239
Email: jumoomann@deloitte.com.au

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is, by means of this publication, rendering professional advice or services.

Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte has in the region of 244,000 professionals, all committed to becoming the standard of excellence.

About Deloitte Australia

In Australia, the member firm is the Australian partnership of Deloitte Touche Tohmatsu. As one of Australia's leading professional services firms, Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, and financial advisory services through approximately 7,000 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit Deloitte's web site at www.deloitte.com.au.

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited © 2021 Deloitte Touche Tohmatsu.