



Australian tax authorities issue final compliance approach for cross-border related-party debt funding

Global Transfer Pricing Alert 2018-003

The Australian Taxation Office on 18 December 2017 released the final version of the [Practical Compliance Guide PCG 2017/4](#). The PCG sets out the ATO's risk assessment framework for related-party financing arrangements. The ATO's approach to the risk framework remains similar to that outlined in the draft version released on 16 May 2017. (For prior coverage, see [Global TP Alert 17-018](#)).

The PCG makes it clear that the risk-rating exercise is a separate exercise than determining whether a transfer pricing benefit has been obtained under the transfer pricing law, and it is not a safe harbor in that it does not relieve taxpayers of the legal obligation to self-assess their compliance with the transfer pricing laws.

Key changes to risk factors

While the underlying ATO risk indicators remain similar to those listed in the draft PCG 2017/D4, one major change in approach is that the ATO has split the scoring table into "pricing" risk factors and "motivational" risk factors. The pricing and motivational risk factor scores combine to generate an overall risk rating, aligned with a color zone, from "low" to "very high" risk. Some arrangements could be considered to be at least "moderate risk," irrespective of the interest rate being applied. Although provided in the context of risk assessment, the deeming of certain indicators as being

motivational risk factors could be seen to imply an unfair presumption by the ATO of a tax motive to an arrangement.

There have been some important changes to the scoring of the risk indicators, including:

- If certain features have *not* been factored into the interest rate, then taxpayers can score a '0' for that indicator. For example, if a loan is subordinated, but the subordination feature is not taken into account in pricing the instrument, a '0' can be scored.
- The interest cover ratios used by the ATO have been reduced to what could be considered to be more realistic outcomes. For example, if interest coverage is 2.5x, this would score 3 points, whereas in the draft PCG 2017/D4, this would have scored 10 points. Note, however, that there is no carve-out for asset-owning companies in development or construction phase (e.g., infrastructure, property) where interest coverage can commonly be very low or negative in the early years, although the ATO recognizes that an interest cover ratio may not be indicative of the underlying risk of these types of investments, and an application may be made by such companies for a white zone assessment if interest cover is the only reason why they fall outside of the green zone.
- Funding from a global treasury operation can now yield a '0' score, irrespective of whether it is in a low-tax jurisdiction (provided there is sufficient substance, evidenced through sufficient senior employees and capital).
- Further definitional guidance on "traceable third party debt," relevant third-party debt, and global group cost of funds. In addition, the definition of "leverage" has been more closely aligned to that in the thin capitalization rules (that is, tax debt/total Australian assets).

It is noted that "exotic features," which attract a high score of 10, include interest deferral clauses, promissory notes that do not provide rights to foreclose or accelerate payment, and differences between the borrowing currency and operating currency. Currency mismatches appear in both the "pricing risk scoring table" as well as the "motivational risk scoring table," which seems punitive.

Intercompany Agreements

The final PCG confirms the ATO's expectations regarding intercompany agreements, and notes that such agreements are recommended and will be the starting point of the ATO's review. Furthermore, the ATO notes (para 20): "The agreements do not need to be as extensive as arrangements involving independent parties, but should include the key terms and conditions that borrowers and lenders would require to enter into the arrangements."

Impact

Notwithstanding some favorable changes in the scoring tables, many taxpayers are still likely to fall in the high or very high risk zones. The ATO is putting such taxpayers on notice that it will seek to commence reviews as a matter of priority, and for red zone taxpayers (very high risk), the case might proceed directly to audit, and the taxpayer may be subject to formal powers for information gathering and will not be eligible to access the advance pricing agreement (APA) program.

The ATO's 18-month "amnesty" for transitioning existing arrangements into the "low risk" zone still applies, in that the Commissioner is willing to remit penalties and interest if taxpayers make a voluntary disclosure and adjust both the historic and prospective pricing into the green zone. The 18-month period commences on the PCG's date of publication -- 18 December 2017.

The PCG applies from 1 July 2017, with additional schedules for related-party derivative financial arrangements and interest-free loans between related parties expected to be released in draft form in March 2018.

[Back to top](#)

Contacts

Geoff Gill (Sydney)

gegill@deloitte.com.au

[Back to top](#)

Useful links

Resources

- [2016 Global Transfer Pricing Country Guide](#)
- [Arm's length standard](#)
- [Transfer pricing alerts](#)

Get Connected

- [Deloitte tax@hand](mailto:tax@hand)
- [Join Dbriefs](#)
- [Follow @Deloitte Tax](#)
- www.deloitte.com/tax

[Back to top](#)

 [Get in touch](#)



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

Deloitte provides audit & assurance, consulting, financial advisory, risk advisory, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries and territories bringing world-class capabilities, insights, and high-quality service to address clients’ most complex business challenges. To learn more about how Deloitte’s approximately 245,000 professionals make an impact that matters, please connect with us on [Facebook](#), [LinkedIn](#), or [Twitter](#).

This communication 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 communication, 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 communication.

© 2018. For information, contact Deloitte Touche Tohmatsu Limited.

30 Rockefeller Plaza
New York, NY 10112-0015
United States



Official Professional Services Sponsor

Professional Services means audit, tax, consulting, and advisory.

Copyright © 2016 Deloitte Development LLC. All rights reserved.
36 USC 220506

To no longer receive emails about this topic please send a return email to the sender with the word “Unsubscribe” in the subject line.