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Law Council
OF AUSTRALIA
Business Law Section

Mr Chris Ferguson / Mr Hashani Dissanayake
Australian Taxation Office

By email: IntangiblesArrangements@ato.gov.au

Dear Sirs

Practical Compliance Guideline PCG 2021/D4 - Draft Practical Compliance Guideline – Intangible Arrangements

The Taxation Committee of the Business Law Section of the Law Council of Australia (the **Committee**) welcomes the opportunity to provide the following comments on draft Practical Compliance Guideline PCG 2021/D4 on Intangible Arrangements (**PCG 2021/D4**).

The Committee provides its observations on several specific issues, which it considers warrant further consideration in relation to PCG 2021/D4. Please note that this not intended to be a comprehensive response to **PCG 2021/D4** but one rather focussed on the specific issues raised below.

Role of PCG 2021/D4

1. We acknowledge that the core role of PCG 2021/D4 is, like all PCG's, a signal to the tax community on how the Australian Taxation Office (**ATO**) may allocate its compliance resources. It therefore cannot and is not intended to limit the operation of the law.

2. While that role is acknowledged, we do think it is appropriate to note that the PCG focuses on particular types of Intangible Arrangements, and the application of the law in particular respects. In that regard, we note and agree with the statement that:

> *4. It is not the intention of this Guideline to limit, deter or prevent arm's length dealings involving intangible assets. Rather it is intended that this Guideline will serve as a point of reference and assist you to understand arrangements which we see as representing a higher risk from a compliance perspective.*

3. The PCG is designed to help taxpayers identify arrangements which the ATO considers are not commonplace, for example where Intangibles are not transferred cross border by a transaction which is one adopted by parties acting at arm's length. The Committee suggests that Part One of the PCG might properly place a little more emphasis on the fact that dealings which are arm's length in nature ordinarily only raise questions concerning the ordinary application of conventional transfer pricing principles.

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4. There may of course be occasions when the reconstruction rules within Div 815-B, or the GAAR or DPT rules, should be considered, but it is submitted they should be the exception, not the norm.

5. That approach is consistent with the decision and reasoning of the Full Court in *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187.

6. Accordingly, the Committee considers that it would be desirable to focus PCG 2021/D4 on those circumstances which have a higher risk of application of those rules and which represent the greatest risk to revenue.

7. Of course, further guidance from the Commissioner on the application of the ordinary transfer pricing rules would be welcomed.

Materiality

8. The key focus of PCG 2021/D4 is on documentation. It is understood that what is sought is documentation which goes beyond "transfer pricing documentation" as contemplated by the tax legislation, and in particular the preference is for documentation to be prepared by non-tax representatives.

9. Implicit in this is that the ATO does not currently see such documentation being prepared, and wishes to encourage taxpayers to commence preparing such documentation. It is also clear that the documentation goes beyond what is ordinarily legally necessary to give effect to an arrangement.

10. There are of course practical challenges, as well as costs, in taxpayers, including their internal tax teams, causing such documentation to be created.

11. In those circumstances, the Committee considers that it would be highly desirable to deal with issues of materiality. In particular, the following could be further clarified:

    a. the particular typologies which cause concern for the Commissioner. That is, we do not think an Australian taxpayer undertaking a transaction which parties at arm's length regularly undertake should carry the same concerns as transactions which have more unusual features. By the same token, we understand a key concern for the Commissioner is where the foreign entity/entities do not have the necessary capability, financial capacity and/or assets to manage, perform and control DEMPE activities and assume associated risks, but rather those matters remain in Australia following the transaction. The compliance burden which the Commissioner seeks to encourage could be more focussed;

    b. similarly, there could be more weight given to the tax at risk. Simply put, the creation by the business of records which they would not otherwise create may not be justifiable if the tax at stake does not warrant it. The consideration of both risk and significance is an approach commonly adopted by the Commissioner.

Implementation

12. As noted above, we understand the key role of PCG 2021/D4 is to cause taxpayers to create documents they would not otherwise create, such that:

    a. the Commissioner is satisfied the relevant transaction does not create a compliance risk which warrants an audit or other investigation; and

b. accordingly, the taxpayer avoids the resource commitment that arises from such audit or investigation.

13. In order to achieve that aim, the PCG 2021/D4 needs to provide a measurable signal to the tax community. The Committee is concerned that at present the PCG 2021/D4 does not provide that signal:

    a. first, Appendix 1 appears to separate documentation on a High, Medium and Low risk basis, being primarily based on whether documentation either does not substantiate, is incomplete as to, or substantiates, the relevant considerations. Assuming documentation exists, it is unclear when the Commissioner will consider that it "substantiates" the relevant matters. That signal can be contrasted to other PCG's which adopt a quantitative or scorecard approach which allows taxpayers to more easily understand their compliance risk position. Acknowledging that the issue raised by Intangibles Arrangements may be more qualitative, nevertheless we think more focus could be given to typologies and tax risk, as well as examples of what the Commissioner regards as substantiating or not substantiating, as the case may be. The present approach does not give clarity to the consequences of one or more "high" risk ratings in the "Risk focus areas". How many high risk ratings, and in which areas, lead to an overall high risk rating? A scorecard approach would allow a more nuanced focus; and

    b. secondly, it is not clear what the consequence would be if the documentation is considered to be substantial.
        i. Presumably there will be cases where the Commissioner might receive documentation, but nevertheless proceed to audit.
        ii. Similarly, there should be cases where an absence of documentation nevertheless does not lead to further review, because the transaction is of a low risk character in qualitative and quantitative terms.

14. A related issue which arises from the approach adopted in PCG 2021/D4 compared to the other PCGs is the guidance given to ATO compliance teams in relation to its application. As noted above, the documentation contemplated is beyond that which the legislation passed by Parliament has considered necessary in order to have a reasonably arguable position. The position is covered in Taxation Ruling 2014/8 which confirms that:
    a. subdivision 284-E of the TAA 1953 sets out special rules about unarguable positions for cross-border transfer pricing. If an entity does not have documentation as prescribed in section 284-255, section 284-250 provides that Division 284 has effect as if the entity's transfer pricing treatment was not reasonably arguable for the purposes of applying administrative penalties;
    b. thus, if an entity's records do not meet the requirements of Subdivision 284-E and the Commissioner makes a transfer pricing adjustment, the entity will be treated as if a transfer pricing treatment was not reasonably arguable for penalty purposes and will be liable for a higher base penalty amount than it would have otherwise been, had it been eligible to take a reasonably arguable position; and
    c. accordingly, the legal benefit of keeping records in accordance with Subdivision 284-E, is that an entity will not be precluded, in the event of a transfer pricing adjustment, from arguing that it had a reasonably arguable position on its transfer pricing treatment for penalty purposes, thereby potentially reducing its base penalty amount exposure.

15. In those circumstances, it is suggested that the different, and higher, standard of documentation contemplated by PCG 2021/D4 is likely to lead to confusion for taxpayers. It is submitted that the ATO should be cautious in effectively expecting taxpayers to create documents higher than the standard adopted by Parliament.

16. In that regard, we are not saying that the Commissioner cannot have regard, in making decisions about the allocation of his risk compliance functions, to such matters, but it is important not to infer that because documentation does not exist (or is not adequate under PCG 2021/D4) that the integrity provisions of the transfer pricing rules or Part IVA apply. The application of those laws remains fundamentally objective, and the presence or absence of contemporaneous documentation is not decisive.

17. That is, in the event that cases go to audit or objection, the taxpayer may present its case as it chooses and the ATO will need to be objective in assessing that case – that is, at that point, the resource allocation role of PCG 2021/D4 will have been exhausted and there would be no basis to have resort to it.

18. Further, in the event of review by the AAT or appeal to the Federal Court, the taxpayer generally bears the burden of proof and it is up to the taxpayer how to run their case and the approach of the AAT or Court will be objective and based on evidence adduced. Again, PCG 2021/D4 would have no ongoing role in such circumstances.

19. Accordingly, the Committee considers that PCG 2021/D4 should record the approach to be adopted by ATO compliance teams where they consider that documentation is not adequate. It should not be presumed in that case that the relevant laws apply. Further, compliance teams should be cautioned that the PCG does not give guidance on the determination of any penalties in the case of any adjustment.

Thank you again for the opportunity to provide comments. The Committee would be pleased to discuss any aspect of this submission.

Please contact the chair of the Committee, Angela Lee, at angela.lee@vicbar.com.au, or Committee Member Hugh Paynter at hugh.paynter@hsf.com if you would like to do so.

Yours faithfully

Greg Rodgers
Chair, Business Law Section