



The Australian Tax Office (ATO) continued focus on MNEs and arrangements with intangible assets

The ATO has released an updated draft Practical Compliance Guideline (PCG) on Intangible Arrangements ([PCG 2023/D2](#)) for public consultation and comments. The original draft ([PCG 2021/D4](#)) was released two years ago in May 2021, and there are significant changes in the current version.

The release of the updated draft PCG coincides with other proposed tax integrity measures, focused on multinationals and treatment of intangible assets, including:

- Deduction denial for royalties paid to low tax jurisdictions – The proposed bill on denying deductions for payments relating to intangibles connected with low tax jurisdictions. This measure is acknowledged in draft PCG but is not covered
- Public disclosure of country-by-country (CbC) reporting – The proposed bill to publicly disclose CbC reporting information to the public requires providing the book value and list of intangible assets held in each jurisdiction.

While the overall position of this draft has not changed from the prior version, this draft outlines the compliance approach of the ATO regarding intangible arrangements involving international parties with respect to:

1. Arrangements involving the migration of intangible assets
2. Arrangements involving mischaracterisation of Australian activities related to the development, enhancement, maintenance, protection, and exploitation (DEMPE) of intangible assets.

The draft PCG continues to provide comprehensive guidance and sets out the ATO's compliance approach including its risk assessment framework under Table 1 (migration of intangibles) and Table 2 (Australian DEMPE of intangible assets) adopting a points-based assessment relating to all types of intangible arrangements and DEMPE activities performed both on and offshore. The inclusion of the ATO risk assessment framework is probably the biggest change to the guidance in comparison to the previous draft. When finalised, the PCG will have retrospective application as it would apply both to future and historic arrangements involving intellectual property migration.

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Due to the inherently complex nature of the topic, the draft PCG focuses on qualitative factors as part of the assessment and, therefore, introduces a high degree of subjectivity in the application of the risk assessment framework. Although the existence of documentation is no longer driving the risk rating, a high focus is placed on the supporting documentation and evidence to be able to substantiate the assessment, including:

- Commercial considerations and decision-making processes
- Understanding the substance of the activities
- Identifying and evidencing the intangible assets and connected DEMPE activities
- The tax and profit outcomes.

In addition to application of transfer pricing principles, the draft guidance considers other tax risk areas arising from intangible arrangements such as withholding tax, capital gains tax, general anti-avoidance provisions (GAAR), diverted profits tax (DPT) and also supplements the existing Taxpayer Alerts ([TA 2018/2](#) and [TA 2020/1](#)) surrounding arrangements involving intangible mis-characterisation and non-arm's length arrangements and schemes.

Unlike the tax integrity measures noted above that apply only to Significant Global Entities (SGEs)/Country-by-Country reporting entities, the draft PCG guidance applies to all types of taxpayers and does not provide any materiality threshold. As such, the ATO expects taxpayers to maintain a high level of analysis and documentation to support their intangible arrangements in addition to documents which evidence arm's length outcomes.

Once the PCG is finalised, for those taxpayers required to lodge a reportable tax position (RTP) schedule, additional reporting obligations will include the need to self-assess and disclose the taxpayer's assessment of each of the risk factors identified by the ATO under part two of this guidance.

DATE OF APPLICATION

As noted above, once finalised the PCG will apply to both prior and future years. In the meantime, the current draft is subject to a public consultation process and all submissions are due by 16 June 2023.

BDO COMMENTS

- In addition to having a points-based assessment framework, this draft PCG is more comprehensive than the previous draft. However, we observe that the application of the risk assessment framework outlined under Table 1 and Table 2 is subjective in nature and therefore will be highly dependent on the quality of evidence collected when substantiating the assessment.
- The draft PCG makes it clear that the transfer pricing provisions operate separately and independently of the risk assessment framework provided under this PCG and, as such, this creates additional compliance expectations for taxpayers to maintain a laundry list of evidence to support their intangible arrangements, including disclosures in the RTP schedule. Importantly, there is currently no materiality threshold for the application of this guideline.
- The ATO's expectations concerning contemporaneous evidence required to support transfer pricing arrangements is consistent with a global trend whereby tax authorities are increasingly expecting more analysis and evidence to be created at the time arrangements are entered into and maintained to support these arrangements at a later point in time.

- The requirement to maintain the expected documentation and evidence outlined in the draft PCG at the time of seeking entry to an advance pricing arrangement (APA) program could demotivate taxpayers looking for certainty on their intangible arrangements. This is disappointing given the inherently complex nature of dealing with intangibles and the desire by taxpayers to utilise the APA program to achieve greater tax certainty.
- With respect to any intangible assets migrated/transferred in earlier years, the guidance is not clear on the number of prior years the ATO expects a taxpayer to complete the risk assessment framework for. This naturally creates greater uncertainty for historic arrangements and taxpayers will need to consider the materiality and potential risk if they choose not to backfill historic arrangements with additional/robust evidence.
- The PCG states that the ATO will consider the taxpayers business systems and governance processes, including any appropriate materiality threshold that a taxpayer applies in their businesses in order to determine a reasonably expected documentation level. While this is a welcome move, in practice it is often the case that a business may adopt a different measuring stick to a tax authority, leaving room for uncertainty.
- We strongly recommend taxpayers assess their intangible arrangements, given there is now a substantial body of guidance issued on the subject and it's clear that the subject of intangibles is one of the ATO's key focus areas. It is also critical for taxpayers to be aware of the risk rating of their intangible arrangements, and ensure they have sufficient evidence to support their arrangements.
- The risk rating of intangible arrangements, including whether the arrangement falls within one of the examples provided by the ATO in [Appendix 1](#) of this PCG, should be maintained on file, together with the documents and evidence outlined in [Appendix 2](#) of the draft PCG.
- The ever-increasing administrative burden placed on taxpayers seems to be here to stay and taxpayers will need to continue to assess the group's risk appetite and tax governance policies to decide how to deal with these ongoing demands.

HOW CAN BDO HELP YOU?

Given the retrospective application of the PCG when finalised, and the similarity of its risk assessment framework with other transfer pricing guidance, it is clear the ATO will expect all affected taxpayers to self-assess their intangible arrangements. We encourage impacted taxpayers to start considering all arrangements within scope of the PCG to ensure they have sufficient evidence to support positions adopted.

We encourage you to contact a BDO adviser if you think you may be affected by this guidance or are unsure of your risk profile under this new guidance.

For a detailed analysis of this draft PCG, please read on.

The Australian Tax Office (ATO) continued focus on MNEs and arrangements with intangible assets – in detail



This PCG is structured into three parts:

- Part one – provides the ATO's compliance approach
- Part two – provides the risk assessment framework and how the ATO will assess the risks
- Part three – provides the types and level of evidence that the ATO expects taxpayers to maintain for further examination.

PART ONE – COMPLIANCE APPROACH

The theme of the ATO's compliance approach is largely based on evidencing the substance of the transaction as well as satisfying the onerous transfer pricing reconstruction provisions contained in subsections 815-130(2) to (4) of the Income Tax Assessment Act 1997 (the Act).

The ATO seeks to review intangible arrangements focusing on aspects such as mischaracterisation of DEMPE activities, non-arm's length outcomes and structures or restructures that avoid or reduce Australian tax obligations. The draft guidance compliance approach aims at consistency with Australian legislation, such as the GAAR, DPT and CGT provisions, as well as the transfer pricing guidelines published by the OECD, in particular, Chapters I, VI and IX.

Consistent with previous PCG's, the level of engagement from the ATO will be dependent on high-risk factors applicable to the intangibles arrangement. Where one or more of the risk factors are determined as high, as per the PCG, the ATO will likely conduct further engagement including review or audit.

As with all transfer pricing arrangements, taxpayers may request access to the ATO's advance pricing arrangement program (APA program) to obtain certainty with respect to their intangible arrangements, however, the ATO has indicated that documentation and analysis in accordance with this PCG will be required for access to the program and taxpayers with low risk factors will more likely be accepted.

PART TWO – RISK ASSESSMENT FRAMEWORK

The risk assessment framework has been further sub-divided into two tables as follows:

- Table 1: to assess the risks in relation to a migration of intangible assets
- Table 2: to assess the risks associated with the Australian DEMPE activities; in particular, any risks of mischaracterisation and non-recognition of Australian DEMPE activities.

Taxpayers are expected to identify each intangible arrangement including aggregating those where more than one arrangement is identified in connection with the same intangible assets under one intangible arrangement (for example, performing contract research and development services as well as licensing of the same intangible assets).

The draft PCG provides a total of 13 examples under Appendix 1 that are bifurcated into high, medium and low risk arrangements covering various intangible arrangement scenarios including:

- Centralisation of intangible assets
- Mischaracterisation of intangible assets and DEMPE activities
- Migration of pre-commercialised intangible assets or rights to use intangible assets
- Contract R&D arrangements and cost contribution arrangements.

The outcome of this exercise should provide the risk rating of a particular intangible arrangement with:

- 25 points or higher considered as high risk
- 19 to 24 points considered as medium risk
- Less than 19 points considered as low risk.

Arrangements covered by [TA 2020/1](#) dealing with mischaracterisation of intangible arrangements are considered to be high risk.

TYPE OF ARRANGEMENT	EXAMPLE PROVIDED	RISK
1. Arrangements involving the bifurcation of intangible assets and mischaracterisation of Australian DEMPE activities	AusCo owns existing intangibles but enters into a contract R&D arrangement where it provides services to a foreign company in relation to new intangibles owned overseas. Initially the two intangibles are linked but with time, the value of existing intangibles diminished due to lack of continued DEMPE functions and a new intangible substitutes the existing intangible.	High
2. Arrangements involving the non-recognition or reduced recognition of Australian DEMPE activities for tax purposes	Cost Contribution Arrangements (CCA) whereby the expected benefit of the CCA to AusCo does not reflect the value of its contributions.	High

For completeness, the risk assessment under Table 1 and Table 2 are independent of each other and the highest risk rating under the two tables would be taken to be the overall risk rating for the intangible arrangement.

Table 1 – Risk factors considered in migration of intangible assets:

The draft PCG will apply to past migrations as well as new migrations, and as such, is applicable to all intangible arrangements where there was a sale or other transfer of intangibles in the past.

PART	RISK FACTORS	-5	0	5	9	10	15
A	<ul style="list-style-type: none"> Transferring, assigning or otherwise making available the intangible assets The intangible asset is licensed or otherwise made available to an international related party There is a cost contribution agreement (or a similar agreement) Writing off some or all of the intangible assets, or discontinuation of DEMPE activities while the international related party obtains access to the asset Transferring functions, assets or risks relating to DEMPE activities 		No	Yes			
	Substance of the international related party						
	Category 1: the international related party is newly established or in the initial stages of becoming established and has no or limited capacity to assume risks associated with DEMPE, and completely or predominantly outsources DEMPE.						Yes
	Category 2: the international related party is working towards transitioning to controlling and performing DEMPE with different staff from those who previously performed activities. It outsources some DEMPE activities and has limited oversight and supervision.				Yes		
	Category 3: the international related party has always managed, owned and controlled DEMPE activities and employs staff with relevant expertise and skills or provides a high degree of oversight and supervision from the international related party.		Yes				
Category 4: if the international related party is based in the jurisdiction in which the products or services related to the intangible assets are predominantly sold.	Yes						
Tax outcomes of the intangibles arrangement							
B	If there is one or more of the following for an international related party or arrangement: <ul style="list-style-type: none"> Subject to a preferential tax regime considered to be harmful according to the OECD Forum on Harmful Tax Practices Tax holiday, exemption or concession in relation to income from the intangible assets or more broadly Is resident or is a branch in a 'specified jurisdiction' as defined in the instructions to the International Dealings Schedule Has available to it R&D offsets or credits, amortisation or depreciation deductions in relation to the intangible assets, or has significant tax losses Is a foreign hybrid company under Division 830, and a member of the taxpayer's tax consolidated group or multiple entry consolidated group Has different income tax treatment in two or more jurisdictions. 					Yes	
	As a result of the restructure or change in the intangible assets, the taxpayer's taxable income is reduced or loss increased or there is a mismatch in treatment.					Yes	

Table 2 – Risk factors considered in connection with the DEMPE of intangible assets that do not involve a migration of intangible assets in the current year.

PART	RISK FACTORS	POINTS
	<p>Overall characterisation:</p> <ul style="list-style-type: none"> • If the taxpayer does not own the intangible assets and an international related party holds the intangible assets legally or beneficially; or • If the taxpayer owns the intangible assets where an international related party is granted access to, or use of, the intangible assets without entering into a legal agreement for the transfer, cost and benefit sharing, or licensing of these assets. 	
A	<p>If the taxpayer:</p> <ul style="list-style-type: none"> • Conducts or performs R&D activities in Australia • Performs business activities or functions which might reasonably be expected to enhance or add value to the intangible assets in Australia (for example manufacturing activities, marketing activities, installation, customisation or other support services for digital products, conducting regulatory functions to seek market access and authorisation, etc.) • Performs other development, enhancement, maintenance or protection activities in connection with those intangible assets in Australia. 	<p>Add 20 points if all three apply Add 15 points if any two apply Add 10 points if only one applies</p>
B	<p>Substance of the international related party</p> <p>Refer to Table 1 above for risk factors</p>	Refer to Table 1
C	<p>Tax outcomes of the intangibles arrangement</p> <p>Refer to Table 1 above for risk factors</p>	5 points

In the case where the above intangible arrangement (i.e. DEMPE of intangible assets) is in relation to intangible assets migrated from Australia in a prior year, the taxpayer is also required to complete the risk assessment framework provided in Table 1 based on the circumstances as at the time of the migration.

PART THREE – EVIDENCE EXPECTATIONS

This section and Appendix 2 of the PCG provides a non-exhaustive list of documents which the ATO may consider as evidence when reviewing the intangible arrangement.

The evidence required remains similar to the original PCG and includes (among others) transfer pricing documentation, supplementary analysis, valuation reports, R&D tax incentive claims, minutes of board and other meetings as well as correspondences with tax advisers, correspondence with persons identified as involved in DEMPE activities as well as any financial modelling or projections.

While the type and level of evidence expected by the ATO depends on the complexity of the intangible arrangement, the ATO acknowledges that certain evidence listed in Appendix 2 may not be relevant or it will be difficult to assess the level of detail expected. The focus in these situations should be on the sufficiency of the information available to reach appropriate assessment of the intangible arrangement.

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