



# KPMG Tax Now

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## Intangibles Arrangements: ATO releases draft practical compliance guideline

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*The much-anticipated draft PCG on Intangibles Arrangements has been released for public comment.*

The draft [practical compliance guideline \(PCG\)](#) continues the trend of the Australian Taxation Office (ATO) to provide a framework to assist taxpayers in assessing the level of risk, this time associated with their intangibles arrangements.

With investment in intangible assets surpassing investment in tangible assets across developed economies, intangible assets have become the key driver of value, innovation and growth for many companies.

The ATO is cognisant of this trend, with the PCG further expanding the Commissioner's suite of products focused on intangibles, following the Tax Alerts published in the last few years (e.g. TA2018/2 and TA2020/1) and the soon to be released update to Taxation Ruling TR1993/12 (dealing with the application of Withholding Tax to software arrangements).

This draft PCG's focus is on identifying intangibles arrangements that mischaracterise Australian activities connected with the Development, Enhancement, Maintenance, Protection and Exploitation (DEMPE) of intangible assets.

As such it covers a wide breadth of arrangements from licensing intangibles, research and development (R&D) activities, cost contribution arrangements and intangibles migrations.

While the key focus is on the transfer pricing provisions, the PCG also covers other tax risks that may be associated with intangibles arrangements such as withholding tax, capital gains tax, general anti-avoidance and diverted profits tax (with the latter provisions being highlighted where arrangements lack evidence of commercial rationale and/or substance).

### Assessment framework

The ATO sets out a risk assessment framework.

This framework is a combination of two components, being:

- **Risk factors** which outline features and examples of arrangements used to inform an assessment of risk; and
- **Documentation and evidence expectations** which sets out the level of evidence the ATO will look to when assessing the intangibles arrangements against the risk factors.

The first four risk factors are:

- commercial considerations and decision making;
- understanding the legal form of the intangibles arrangements;
- identifying and evidencing the intangible assets and connected DEMPE activities; and
- analysing the tax and profit outcomes.

These risk factors are assessed as high, medium or low risk depending on a subjective, qualitative assessment of the level of supporting documentation and evidence.

The draft PCG provides extensive details of the type of evidence and documentation the ATO will look to. However, it goes well beyond what is usually prepared as part of transfer pricing documentation.

While the ATO acknowledges the level and type of documentation will be influenced by the complexity of the arrangement and that not all the documents may be relevant, it is clear that the ATO has a high bar when it comes to evidentiary records and documentation it expects taxpayers to maintain and retain, consistent with the governance approach the ATO has taken in its Justified Trust/assurance products.

The final risk factor sets out twelve examples of arrangements the ATO views as high, medium and low risk.

The ATO notes that these will continue to be updated as it becomes aware of new examples. Not surprisingly high-risk examples include migration, bifurcation and non-recognition (and reward) of intangibles and DEMPE activities.

There is a strong focus on the commercial (non-tax) rationale for entering into these arrangements and the consideration of commercial options realistically available, particularly where DEMPE activities are still carried out in Australia.

Each example also includes examples of the type of evidence the ATO would request/review in assessing the arrangement.

Pleasingly, the ATO does recognise that low risk scenarios do exist, for example contract R&D where there is clear substance in and direction from the offshore entity to the Australian R&D service provider, supported by robust documentation, evidence and analysis.

Helpfully, the ATO also provides some medium risk scenarios which might be more relevant to many taxpayers.

In the event of potential risk in their intangibles arrangements, the ATO encourages taxpayers to engage with it early to assure their arrangements or resolve issues up front.

## Reviewing arrangements

With the release of the draft PCG and proposed application to intangibles arrangements both before and after the date of its issue, taxpayers should begin to take steps to review their arrangements.

This review should be undertaken with the understanding that taxpayers may be required to disclose their self-assessment of the risk in relation to their intangibles arrangements in the Reportable Tax Position Schedule and/or as part of ATO assurance/compliance reviews.

If the PCG is finalised in its current form, taxpayers will face a significant compliance burden in gathering/preparing the required documents and analysis to apply the risk assessment framework.

The compliance burden is further highlighted by the fact that there is no materiality threshold, which is likely to result in significant time and effort being dedicated to avoid a high-risk outcome under the PCG.

This also requires a multi-disciplinary perspective as the PCG crosses over transfer pricing, anti-avoidance and unique documentary and evidentiary requirements.

The consultation period for the draft PCG runs to 18 June 2021.

Should taxpayers have comments or would like to discuss during the consultation period, please contact one of the authors or your regular KPMG advisory team.

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