



Tax Insights

International intangibles arrangements

The ATO has released a new draft of its compliance approach to intangibles arrangements involving international related parties.

On 17 May 2023, the ATO released draft Practical Compliance Guideline [PCG 2023/D2](#) (the new draft PCG) relating to intangibles arrangements. The new 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. In the new draft PCG, a 'migration' refers to any restructure or change associated with intangible assets that allows another entity to access, hold, use, transfer, or benefit from the intangible assets.

The previous draft PCG, Practical Compliance Guideline PCG 2021/D4, was released for consultation in May 2021. It primarily focused on outlining the ATO's documentation and evidence expectations, requiring taxpayers to identify valuable intangible assets with specificity, to clearly demonstrate where DEMPE functions were performed, and to document commercial decision making in respect of material intangibles arrangements.

The new draft PCG, in addition to including a comprehensive list of the ATO's documentation and evidence expectations, now also includes a point based, risk assessment framework, designed to assist taxpayers to determine their risk rating (i.e., high, medium, or low risk).

Taxpayers should be aware that the structure of the new draft PCG (in comparison to the previous draft PCG) has fundamentally changed.

Since the previous draft PCG was issued, a new Government is in power with a commitment to tighten the rules around the taxation of Multinational Enterprises. Consequently, Australia has seen the introduction of draft legislation regarding the denial of deductions for payments relating to intangibles assets to low corporate tax jurisdictions, public country-by-country reporting, Government announcements that the proposed patent box legislation will not proceed, and the continued domestic progression towards the implementation of Pillar Two. Furthermore, the ATO has commenced litigation in respect of a Diverted Profits test case in the Courts, and has had two additional years of reviewing taxpayer positions in respect of intangibles arrangements and forming views on what it considers to be high risk intangibles arrangements.

The structure of the new draft PCG is as follows:

- **Part One: Compliance approach** – sets out the ATO’s compliance approach in respect of intangibles arrangements
- **Part Two: Risk assessment framework** – explains how the ATO assesses compliance risks associated with intangibles arrangements
- **Part Three: Evidence expectations** – outlines the types and level of evidence that the ATO will have regard to when examining intangibles arrangements
- **Appendix 1: Examples of intangibles arrangements** – provides examples of intangibles arrangements that are considered to be high, medium and low risk
- **Appendix 2: Evidence expectations** – lists the type of evidence that the ATO is likely to have regard to when examining intangibles arrangements.

This article summarises the key elements of the new draft PCG, focusing on fundamental changes between the previous draft PCG and the new draft PCG; and outlines our initial observations, and practical recommendations for taxpayers.

Key elements of the new draft PCG

Point based, risk assessment framework

The main change in the new draft PCG is the inclusion of a point based, risk assessment framework, based on risk factors set out in two tables:

- Table 1: Risk factors for the migration of intangible assets¹
- Table 2: Risk factors for the mischaracterisation of development, enhancement, maintenance, protection and exploitation (“DEMPE”) activities in connection with intangibles arrangements²

Under the new draft PCG, taxpayers will be required to self-assess each intangibles arrangement a taxpayer has during the relevant income year against each of the risk factors in the applicable table to determine if the arrangement is considered to be high, medium or low risk.

For each intangibles arrangement, the risk rating is determined by the number of points scored under either Table 1 or Table 2, noting that if an intangibles arrangement exhibits features or characteristics similar to the arrangements described in Taxpayer Alert TA 2020/1³, then that intangibles arrangement is

¹ “Migration” is broadly defined to include any restructure or change that allows an international related party to access, hold, use, transfer or benefit from an Australian taxpayer’s intangible assets. For example, simply entering into a license with an international related party qualifies as a “migration”

² Mischaracterisation and non-recognition is focused on situations where an Australian taxpayer (i) performs activities in connection with intangibles owned by an international related party or (ii) performs activities in connection with its own intangibles, which an international related party accesses or uses without a formal legal agreement

³ TA 2020/1: Non-arm’s length arrangements and schemes connected with the development, enhancement, maintenance, protection and exploitation of intangible assets

immediately rated high risk, without the need to assess the risk factors and points included in Tables 1 and 2.

The points ascribed to intangibles arrangements covered by **Table 1** (risk factors for the migration of intangibles assets) are based on risk factors associated with:

- A. Whether a restructure or change event has occurred
- B. The substance of the relevant international related party under the intangibles arrangement
- C. The tax outcomes of the intangibles arrangement.

The points ascribed to intangibles arrangements covered by **Table 2** (risk factors for the mischaracterisation of DEMPE activities in connection with intangibles arrangements) are based on risk factors associated with:

- A. The characterisation of the Australian taxpayer in respect of the intangibles arrangement
- B. The substance of the relevant international related party under the intangibles arrangement
- C. The tax outcomes of the intangibles arrangement.

The new draft PCG notes that if a taxpayer's intangibles arrangement relates to, or is intrinsically linked to, intangible assets that have previously been subject to a migration, then an assessment of that intangibles arrangement should be performed against the risk factors in both Tables 1 and 2. If a different risk rating is achieved under the two tables, the higher risk rating would be the overall risk rating for the intangibles arrangement. Further comments on this point are made below.

Greater clarity on the ATO's evidence expectations

The main criticism of the previous draft PCG was the significant administrative burden that the PCG would place on taxpayers in producing and collating documentation and evidence to substantiate their intangibles arrangements. In our view, the ATO's expectations in respect of documentation and evidence exceeded what is commercially realistic for multinationals' decision-making and record-keeping processes.

In the new draft PCG, the ATO has taken on board comments received through the previous public consultation process. Unlike the previous draft PCG, the new draft PCG does not link the existence of documentation or evidence substantiating an intangibles arrangement with the risk associated with the intangibles arrangement.

Instead, in Part Three, the new draft PCG sets out (in Appendix 2) a list of the types of evidence that the ATO are likely to have regard to when examining a taxpayer's intangibles arrangements and would typically expect taxpayers to be able to produce to substantiate their arrangements. The purpose of this list, as suggested in the new draft PCG, is that it may assist taxpayers mitigate the level of compliance risk posed by a taxpayer's intangibles arrangements and ensure that any engagement with the ATO is as efficient as possible. Such evidence will not however, directly reduce the risk rating of any intangibles arrangements.

The new draft PCG clarifies that it does not intend to unnecessarily impose arduous expectations on taxpayers in respect of the type and level of documentation and evidence required to substantiate their intangibles arrangements. Furthermore, the ATO recognises that certain evidence listed in Appendix 2 may not be relevant to the facts and circumstances of a taxpayer's intangibles arrangements or that it may be difficult for taxpayers to assess the degree of evidence that is expected. In such a situation, the new draft PCG suggests that a taxpayer's substantiation should focus on whether there is sufficient information to enable the ATO to verify the information and to reach a proper assessment of the intangibles arrangement in question.

In addition, whilst there is no materiality threshold within the new draft PCG to determine in-scope intangibles arrangements, the new draft PCG clarifies that the type and level of documentation expected by the ATO will be influenced by the complexity of the taxpayer's arrangements and the extent to which intangible assets contribute to their business. The new draft PCG also allows for intangible assets associated with a particular product to be grouped as a single intangibles arrangement for purposes of applying the risk assessment framework, which may help reduce the number of self-assessments a taxpayer is required to perform. Furthermore, the ATO will take into consideration a taxpayer's natural

business systems and governance processes, including any appropriate materiality thresholds the taxpayer applies in managing its global group's intangible assets.

It also noted that the new draft PCG contemplates that the evidence expectations listed in Appendix 2 are to support, and not replace, existing legal obligations such as those found in Subdivision 284-E of Schedule 1 to the *Taxation Administration Act 1953*.

Practical examples of intangibles arrangements and the application of the risk assessment framework

The new draft PCG includes examples of high-risk, medium risk and low-risk intangibles arrangements to illustrate the kinds of matters that the ATO will generally consider in assessing the compliance risks relating to intangibles arrangements. In addition to the twelve examples included in the previous draft PCG, the new draft PCG includes an additional example (six high-risk examples, three medium-risk examples, and four low-risk examples).

Against each of the examples, the new draft PCG also provides illustrations of the application of the Table 1 and Table 2 risk assessment framework. Whilst the examples provided are relatively straightforward, they do provide an indication of the ATO's expectations of the analysis required to substantiate a particular self-assessed risk rating.

Deloitte perspective – Our initial insights

The following points summarise Deloitte's initial insights in relation to the new draft PCG:

- There is currently no materiality threshold or exemption for intangibles arrangements which would ordinarily be considered low risk from an Australian tax perspective. As such, due to the broad definition of migration, any new intangibles arrangement (whether that be an intangible asset transfer/sale, entering a licence, or entering into a cost contribution arrangement (CCA)) will need to be assessed under the Table 1 risk assessment framework. Further, based on the existing criteria in Table 1, it is difficult to see how any new intangibles arrangement will receive anything but a medium-risk or high-risk rating, including vanilla licensing arrangements and contract R&D services arrangements. Such an outcome appears to be of little use to the ATO from a risk identification perspective, whilst it creates an unnecessary administrative burden on taxpayers.
- There is a broader concern as to whether this new draft PCG creates an unnecessary compliance burden for taxpayers, for very little administrative gain to the ATO. For example, consider a migration that also falls within the definition of a 'Business Restructure' in the OECD Transfer Pricing Guidelines. Such an event is already required to be disclosed by taxpayers on existing approved forms lodged with the ATO (e.g., the International Dealings Schedule and / or the Australian Local File). If the ATO's intention with the new draft PCG is to assist with identifying arrangements that warrant dedicated compliance resources, we believe that this information is already available to the ATO, and accordingly the scope of the PCG should be refined to only those arrangements that are not currently picked up in existing disclosure requirements.
- It also appears to be difficult for taxpayers to avoid performing a Table 1 risk assessment as the first paragraph of Table 2 requires taxpayers to return to apply Table 1 where there has been a past migration based on the circumstances at the time of the migration. This includes all intangibles arrangements at the point they were entered into or where there was a change. Clarity is required regarding the retrospective nature of this requirement and how far back taxpayers must go in considering a past migration.
- The risk assessment criteria in Table 1 have no regard to a migration occurring for commercial purposes, implying that the ATO has concerns with every instance of a migration, even if undertaken for genuine commercial reasons. Migration for a genuine commercial purpose does impact the overall risk of the event from an Australian tax perspective irrespective of the fact it is to a related party and should be reflected in the risk assessment criteria in the new draft PCG.

- Group restructures that occur between related parties outside of Australia, and which have no impact on the group's Australian operations, may nonetheless impact the points assessed under either a Table 1 or Table 2 risk assessment and may increase the risk rating of an Australian taxpayer's intangibles arrangements, e.g. if there is a change in the Relevant Entity under an intangibles arrangement (which may occur for commercial reasons) and the new Relevant Entity is in a jurisdiction that the ATO has flagged as high risk (e.g. in a specified jurisdiction). This appears to reflect similar concerns as outlined in recent draft legislation regarding the denial of deductions for payments relating to intangible assets to low corporate tax jurisdictions.
- One of the key risk factors under both Tables 1 and 2 is the substance of the Relevant Entity under the intangibles arrangement. To accurately assess the category which best describes the Substance of the Relevant Entity in Tables 1 and 2, Australian taxpayers will be required to have conducted a detailed functional and DEMPE analysis of the global value chain relevant to the intangibles arrangements in question, which arguably goes beyond what taxpayers are expected to do in preparing transfer pricing documentation in accordance with Subdivision 284-E of Schedule 1 to the *Taxation Administration Act 1953*.
- Further clarity is required to answer items found in under both Tables 1 and 2, e.g., Table 1 - Item 4 in order for taxpayers to appropriately establish where products or services related to the relevant intangible assets are 'predominantly' sold.
- While the preparation and maintenance of documents supporting the arm's length nature of the intangibles arrangements does not directly reduce the risk profile of a taxpayer's intangibles arrangement according to the risk assessment framework, the ATO continues to place a strong emphasis on such materials as part of their review and assessment process. Notwithstanding the ATO's comments, such emphasis does create a risk that taxpayers will prepare and obtain documents purely to meet the ATO's expectations, which are listed in Appendix 2 of the new draft PCG.

What should taxpayers do?

Notwithstanding that this PCG is still in draft and subject to a public consultation process, we recommend that taxpayers consider their intangibles arrangements in light of the new risk assessment framework included in the new draft PCG and the examples of high, medium and low risk arrangements provided.

To the extent that the assessment results in high-risk ratings for certain intangibles arrangements, it will be important for taxpayers to have high quality documentation and evidence to support and defend these arrangements, having regard to the ATO evidence expectations included in the new draft PCG. Taxpayers should therefore take appropriate steps to ensure that documentation and evidence exists and that there are governance processes in place to support high-risk intangibles arrangements. Relevant considerations may include:

1. Undertaking a detailed discovery process to specifically identify and document the key value-driving intangible assets within global businesses, having regard to the OECD TP Guidelines' definition of intangible assets (i.e., considering both traditional intellectual property assets (e.g., patents, trademarks, etc.) and other non-traditional intangible assets that drive significant business value). Consideration should also be given to historical intangibles arrangements as part of this process given the retrospective nature of the new draft PCG.
2. Assessing existing transfer pricing policies associated with intangible assets against Chapter VI of the OECD TP Guidelines and refining as necessary, or establishing new transfer pricing policies for any new intangibles identified in the discovery process.
3. Ensuring that the concepts included in the new draft PCG are considered prior to entering into any new intangibles arrangements or prior to making changes to existing intangibles arrangements (e.g., arrangements involving the centralisation, bifurcation, migration or functionality changes relating to intangible assets).

4. Performing a gap analysis of existing documentation and evidence relating to intangibles arrangements against the ATO's expectations in the new draft PCG, 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).
5. Collating documentation and evidence regarding intangibles arrangements contemporaneously.

We also recommend that taxpayers establish and maintain a global intangible asset strategy. A global intangible asset strategy, within a broader corporate framework, ensures alignment of the intangible asset portfolio with long term business objectives and helps drive overall value. Maintaining an intangible asset strategy that considers tax, transfer pricing, legal and governance issues is an imperative in the current challenging tax and legal landscape multinationals face where tax authorities globally are increasingly scrutinising intangible arrangements.

The new draft PCG makes it clear that the ATO continues to have high expectations of taxpayers in respect of their intangibles arrangements, and represents a further example of the ATO's clear focus on the Australian tax risks associated with intangible assets. Taxpayers should proactively consider the risks posed by their intangibles arrangements, but also the opportunities that may present themselves with a more dedicated intangible asset identification and management process.

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