

The Auditor-General
Auditor-General Report No.22 2023–24
Performance Audit

Management of Taxpayers' Use of Transfer Pricing for Related Party Debt

Australian Taxation Office

Australian National Audit Office

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Canberra ACT

17 April 2024

Dear President
Dear Mr Speaker

In accordance with the authority contained in the *Auditor-General Act 1997*, I have undertaken an independent performance audit in the Australian Taxation Office. The report is titled *Management of Taxpayers' Use of Transfer Pricing for Related Party Debt*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit to the Parliament.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's website — <http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, reading 'Rona Mellor'.

Rona Mellor PSM
Acting Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office (ANAO). The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits, financial statement audits and assurance reviews of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Australian Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Audit snapshot

Auditor-General Report No.22 2023–24

Management of Taxpayers' Use of Transfer Pricing for Related Party Debt



Why did we do this audit?

- ▶ Transactions between two entities in the same group are related party transactions. The pricing of these transactions is transfer pricing.
- ▶ Interest on related party loans is generally tax deductible, so transfer pricing should be consistent with what would be expected between independent parties.
- ▶ Transfer mispricing can lead to a loss of tax revenue for the Australian Government.
- ▶ The audit provides assurance to Parliament on the effectiveness of the Australian Taxation Office's (ATO's) management of transfer pricing for related party debt.



What did we find?

- ▶ The ATO is largely effective at managing taxpayers' use of transfer pricing for related party debt. Effectiveness is reduced by not assessing, meeting and reporting on assurance targets.
- ▶ The ATO is largely effective at identifying and managing transfer pricing risks for related party debt.
- ▶ The ATO has established a largely effective strategic framework to manage taxpayers' use of related party debt.
- ▶ The ATO is largely effective at managing taxpayers' use of transfer pricing for related party debt.



Key facts

- ▶ 2020–21 inbound international related party borrowings in Australia totalled \$520 billion, with \$13.2 billion in interest expenses.
- ▶ The ATO assesses a sample of taxpayers' largest and highest risk transactions.
- ▶ The ATO aims to review all 85 Top 100 and 250 Top 1,000 taxpayers annually.



What did we recommend?

- ▶ The Auditor-General made four recommendations to: determine the number of assurance reviews required to gain assurance, analysing and recording why entities may not lodge reporting, scrutinising taxpayers who choose not to use the ATO's primary engagement mechanism, and improving training.
- ▶ ATO agreed to three of the recommendations and in principle to one.

1,563

economic groups in the Top 100 and Top 1,000 in 2021–22, 85 and 1,478, respectively.

58%

of corporate income tax in 2021–22 was paid by Top 100 and Top 1,000 taxpayers.

~66% and 61%

completed annual target reviews of Top 100 and Top 1,000 taxpayers between 2020–21 and 2022–23.

Summary and recommendations

Background

1. The Australian Taxation Office (ATO) is the principal revenue agency responsible for administering the tax system and aspects of the superannuation system. As part of its duties, the ATO conducts compliance activities to ensure taxpayers are complying with tax requirements. The ATO's stated purpose is to contribute to the economic and social wellbeing of Australians by fostering willing participation in the tax, superannuation, and registry systems.
2. The ATO's Corporate Plan 2023–24¹ identifies multinational tax performance as a key focus area, with a number of deliverables, including:
 - address key risks to the corporate tax base and close tax loopholes so that the community has confidence that public and multinational businesses are paying the right amount of tax in Australia; and
 - support the integrity of the tax system by boosting tax transparency through better public reporting of large business tax information.²

Rationale for undertaking the audit

3. The latest publicly reported figures indicate that in 2020–21 inbound international related party borrowings in Australia totalled \$520 billion, with \$13.2 billion in interest expenses paid.³ The ATO monitors entities belonging to the Top 100 and Top 1,000 populations.⁴ Approximately 33 per cent of these inbound related party borrowings were attributed to the Top 100 entities and an additional 40 per cent were reported by the Top 1,000 entities.
4. The ATO has identified inbound related party borrowings as a key risk. In the ATO's 2022 assurance activities for the Top 100 entities, related party financing represented the highest proportion of unassured items receiving a red flag rating⁵ to indicate likely non-compliance with income tax laws.⁶ Similarly, amongst the Top 1,000 entities, financing assurance activities resulted

1 Australian Taxation Office, *ATO Corporate Plan 2023-24*, ATO, 2023, available from <https://www.ato.gov.au/about-ato/managing-the-tax-and-super-system/in-detail/corporate-plan-current-and-previous-years/ato-corporate-plan-2023-24> [accessed 30 November 2023].

2 *ibid.*, p. 6.

3 Australian Taxation Office, *IRPD Statistics Table 7*, ATO, 2023, available from <https://www.ato.gov.au/Business/International-tax-for-business/In-detail/International-dealings-statistics/International-related-party-dealings-statistics-2020-21/?anchor=IRPDstatistics#IRPDstatistics> [accessed 30 November 2023]. This figure is the average of the quarterly balances of debt interests on issue to related parties for both interest bearing and interest-free loans.

4 In 2021–22, 85 taxpayers were in the Top 100 program and 1,478 economic groups were in the Top 1,000 program. Top 100 taxpayers are not part of the Top 1,000 program. These entities account for 58 per cent of corporate income tax paid.

5 A transaction identified as a red flag means 'the taxpayer is not likely paying the right amount of tax.'

6 Australian Taxation Office, *Findings report – Top 100 income tax and GST assurance programs*, ATO, 2023, available from <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/large-business/in-detail/findings-report-top-100-income-tax-and-gst-program> [accessed 30 November 2023].

in a higher amount of low assurance and red flag ratings (22 per cent) than other areas reviewed.⁷ Interest bearing loans were the largest category of financing risks reviewed.⁸

5. This audit will provide assurance to the Parliament that the ATO effectively manages transfer pricing for related party debt, using sound strategies and processes to address risks and to ensure related party debt is appropriately priced. This audit was identified as a priority by the Parliament's Joint Committee of Public Accounts and Audit in the context of the ANAO's 2022–23 and 2023–24 Annual Audit Work Program.

Audit objective and criteria

6. The objective of the audit was to assess the effectiveness of the ATO's management of transfer pricing for related party debt.

7. To form a conclusion against the objective, the following criteria were adopted.

- Are the risks relating to transfer pricing for related party debt appropriately managed?
- Does the ATO have a sound strategic framework to manage the use of transfer pricing for related party debt?
- Does the ATO effectively manage transfer pricing for related party debt?

Conclusion

8. The ATO is largely effective at managing taxpayers' use of transfer pricing for related party debt. Effectiveness is reduced by not assessing, meeting and reporting on assurance targets.

9. The ATO is largely effective in identifying and prioritising risks to transfer pricing for related party debt. Its processes operate at the ATO business line level and are sound. The risk is primarily managed through use of the Top 100 Justified Trust Program and Top 1,000 Combined Assurance Program. However, management of risk is undermined by the ATO not meeting its stated taxpayer review targets to gain its desired level of assurance. Annually, the ATO seeks to review the entire Top 100 population, and 250 taxpayers within the Top 1,000 economic groups. This has not occurred during the audit period and the ATO has not conducted a process to determine whether an annual review of 250 Top 1,000 taxpayers provides sufficient oversight. There is no reporting to the Strategic Management Committee (SMC) on progress against targets for completed Pre-lodgment Compliance Reviews (PCRs) or Combined Assurance Reviews (CARs). The ATO does not conduct analysis on the reasons taxpayers may not be required to complete Country-by-Country local file reporting. Risk reporting occurs on a quarterly basis at the business level. As the risk has been rated as in tolerance, reporting has not been escalated to the enterprise level.

10. The ATO has established a largely effective strategic framework to manage the use of transfer pricing for related party debt. The principles outlined in Organisation for Economic Co-operation and Development (OECD) transfer pricing guidance are reflected in the ATO's guidelines

7 Australian Taxation Office, *Findings report – Top 1,000 income tax and GST assurance programs*, ATO, 2023, available from <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/large-business/in-detail/findings-report-top-1000-income-tax-and-gst-assurance-programs> [accessed 30 November 2023].

8 *ibid.*

for staff and taxpayers. The ATO has a sound strategy to engage with taxpayers with related party debt, primarily through the application of Practical Compliance Guideline 2017/4 (PCG 2017/4), though training for staff is not mandatory and records of staff training are not kept. Further, while the ATO aims to review all taxpayers using related party debt that do not apply PCG 2017/4, this does not occur in the majority of cases. The ATO effectively supports engagement with taxpayers through the completion of assurance reviews, though a lack of IT quality controls means it cannot be determined with certainty that the Top 1,000 population is complete and accurate.

11. The ATO is largely effective at managing transfer pricing for related party debt. Data and intelligence are gathered to monitor taxpayer behaviour. The ATO largely applies its framework to analyse related party finance, though there are some variations in how the Top 100 and Top 1,000 teams verify taxpayer application of PCG 2017/4, and record analysis of taxpayer financing and capital structures.

Supporting findings

Managing risks related to transfer pricing for related party debt

12. The ATO has sound processes for identifying and prioritising risks to transfer pricing for related party debt at the business level. Procedures governing the operation of the ATO's risk management framework are comprehensive and well-articulated. Data obtained through the Reportable Tax Position Schedule disclosures and the International Dealings Schedule is used along with self-assessments via PCG 2017/4 to monitor trends and detect risks. While Country-by-Country local file reporting provides further data, the ATO was unable to quantify the total number of taxpayers with a reporting obligation that had not complied with lodgment requirements. (See paragraphs 2.4 to 2.32)

13. The ATO uses the Top 100 Justified Trust Program and Top 1,000 Combined Assurance Program to engage with Top 100 and Top 1,000 taxpayers to manage transfer pricing risk. To gain assurance each year, the ATO aims to review all Top 100 taxpayers, and 250 Top 1,000 taxpayers. These targets have not been met over the last four years, and the ATO was unable to determine whether the Top 1,000 target provided sufficient oversight over the population. (See paragraphs 2.33 to 2.58)

14. As the business level risk relating to transfer pricing for related party debt has remained in tolerance, it has not been escalated for enterprise level consideration. At the business level the risk is monitored by the Public Groups SMC. The SMC receives quarterly reporting on the transfer pricing risk, but has not been provided with reporting on progress against targets for completed PCRs or CARs, meaning that the SMC cannot properly monitor the level of assurance the ATO has over the Top 100 and Top 1,000 populations' use of transfer pricing for related party debt. Until October 2023, the SMC was required to 'provide regular reports' to the Public Groups Executive. This did not occur. (See paragraphs 2.59 to 2.63)

Strategic framework to manage the use of transfer pricing for related party debt

15. The principles outlined in OECD transfer pricing guidance are reflected in legislation and ATO guidance for both its staff and taxpayers. The ATO has taken action to incorporate recent updates to the OECD guidance into Australian law. The ATO's approach to Country-by-Country reporting is largely consistent with its international obligations. (See paragraphs 3.3 to 3.27)

16. The ATO has developed a sound strategy to engage with taxpayers who use transfer pricing for related party debt. PCG 2017/4 forms the basis of the strategy. The ATO verifies taxpayer application of PCG 2017/4 through PCRs for the Top 100 population and CARs for the Top 1,000 population. Experts in the ATO's Economist Practice are consulted to determine that transfer pricing has occurred appropriately. Staff have access to training to analyse transfer pricing, though training is not mandatory. Support is available to assist taxpayers in applying PCG 2017/4. While the ATO aims to review taxpayers who do not apply PCG 2017/4 this does not occur for the majority of cases. (See paragraphs 3.28 to 3.67)

17. The ATO has a framework to support engagement with taxpayers using related party debt. The Action Differentiation Framework categorises taxpayers by size and applies a risk-based 'engagement experience'. These two factors determine the regularity and intensity of the ATO's review processes to gain assurance over taxpayers' income tax, including their use of related party debt. Case teams undertaking assurance reviews are supported by other ATO business lines when engaging taxpayers and finalising assurance outcomes. (See paragraphs 3.68 to 3.107)

Does the ATO effectively manage transfer pricing for related party debt?

18. The ATO has documented processes to gather data and intelligence on Top 100 and Top 1,000 taxpayers using related party debt. Profiling of taxpayers occurs early in the review process via internal and publicly available information. Data and intelligence are sourced from information disclosed by taxpayers as part of their responsibilities under Australian income tax law or from information requested by the ATO during the review process. (See paragraphs 4.3 to 4.13)

19. The ATO manages transfer pricing for related party debt largely as intended. There are some variations in how the Top 100 and Top 1,000 teams verify taxpayers' application of PCG 2017/4, and record analysis of taxpayers' financing and capital structures. (See paragraphs 4.14 to 4.32)

Recommendations

Recommendation no. 1 The Australian Taxation Office conduct further analysis to determine and monitor why taxpayers may not lodge Country-by-Country local file reporting.
Paragraph 2.29

Australian Taxation Office response: *Agreed.*

Recommendation no. 2 The Australian Taxation Office take action to:
Paragraph 2.54

- (a) determine the number of completed Tax Assurance Reports considered sufficient to gain assurance that Top 100 taxpayers are appropriately using transfer pricing for related party debt; and
- (b) determine how to gain sufficient assurance over the Top 1,000 population through the use of Combined Assurance Reviews and gap analysis, while also formalising how gap analysis should be conducted.

Australian Taxation Office response: *Agreed.*

Recommendation no. 3 The Australian Taxation Office take action to ensure all taxpayers with related party debt that do not apply Practical Compliance Guideline 2017/4 are reviewed in accordance with the Australian Taxation Office's goals.

Paragraph 3.43

Australian Taxation Office response: *Agreed in principle.*

Recommendation no. 4 The Australian Taxation Office:

Paragraph 3.60

- (a) make training in related party financing mandatory for new case officers where related party financing is likely to be relevant to their role; and
- (b) develop and maintain a register to ensure all staff are trained consistently and remain up to date in developments around transfer pricing for related party debt.

Australian Taxation Office response: *Agreed in principle with (a); Agreed with (b).*

Summary of entity response

20. The proposed audit report was provided to the ATO. The ATO's summary response is reproduced below. Their full response is included at Appendix 1. Improvements observed by the ANAO during the course of this audit are listed at Appendix 2.

The ATO welcomes this review and is pleased the report acknowledges the ATO has sound strategies and processes to address transfer pricing risk for related party debt.

Since the Tax Avoidance Taskforce commenced, we have transformed our approach to profit shifting related risks, including related party debt. We are very proud of the outcomes achieved and strive to continue this success. We continually look to evolve and improve our approach and welcome the input from the ANAO.

The ATO was one of the first tax administrations globally to release detailed guidance on our compliance approach. Further supported by litigation success, we have removed more than \$45 billion of interest deductions for past and future years from the system. Through our compliance programs we have coverage of over \$341 billion or 80% of all inbound interest bearing related party debt and this continues to increase.

Our range of programs are designed to encourage voluntary compliance by large businesses. Our increased guidance, detection of incorrect tax positions, litigation successes, and 'locking in' behavioural changes as part of settlements is driving permanent changes in taxpayers risk profiles. These programs also provide the Australian community with confidence that all large businesses are regularly reviewed to assure that they pay the right amount of tax.

Key messages from this audit for all Australian Government entities

21. Below is a summary of key messages, including instances of good practice, which have been identified in this audit and may be relevant for the operations of other Australian Government entities.

Performance and impact measurement

- Entities seeking assurance through the use of compliance work should ensure the target amount of work has been set with a clear evidence base, and that the target is met to obtain the assurance sought.

Policy/program design

- When designing a policy or program, entities should embed a review cycle to assess its continuing effectiveness.
- When designing a program, entities should ensure that relevant training is mandatory, and that a register is kept to record that staff have undertaken required training.

Audit findings

1. Background

Introduction

1.1 The Australian Taxation Office (ATO) is the principal revenue agency responsible for administering the tax system and aspects of the superannuation system. As part of its duties, the ATO conducts compliance activities to ensure taxpayers are complying with tax requirements. The ATO's stated purpose is to contribute to the economic and social wellbeing of Australians by fostering willing participation in the tax, superannuation, and registry systems.

1.2 The ATO's Corporate Plan 2023–24⁹ identifies multinational tax performance as a key focus area, with a number of deliverables, including:

- address key risks to the corporate tax base and close tax loopholes so that the community has confidence that public and multinational businesses are paying the right amount of tax in Australia; and
- support the integrity of the tax system by boosting tax transparency through better public reporting of large business tax information.¹⁰

Transfer pricing

1.3 Multinational groups operate on an international basis, dispersing business units across the globe for a variety of reasons. Transactions between two entities in the same group are called related party transactions. The pricing of these transactions is referred to as transfer pricing. The transactions must be priced as if the entities were independent parties operating wholly independently (at 'arm's length') from one another. The arm's length principle is outlined in Australian legislation in subdivisions 815-B and 815-C of the *Income Tax Assessment Act 1997* (ITAA 1997). The arm's length principle requires the terms of transactions between related parties to be comparable to transactions between independent and separate entities.

Related party debt

1.4 Interest expense on corporate debt is generally determined to be tax deductible in Australia under section 8-1 of the ITAA 1997. This creates the risk that loans may be made under conditions which are inconsistent with what would be expected when obtaining financing from an independent third party. These conditions may include artificially high interest rates or a lack of security and guarantees which would ordinarily reduce interest payable. Entities involved in mispricing may underpay their Australian tax liability by using related party arrangements. To combat this, the ATO monitors taxpayers' use of transfer pricing for related party debt to ensure those transactions satisfy Australia's transfer pricing laws, which are applied to best achieve consistency with the Organisation for Economic Co-operation and Development (OECD) *Transfer*

9 Australian Taxation Office, *ATO Corporate Plan 2023-24* [Internet].

10 *ibid.*, p. 6.

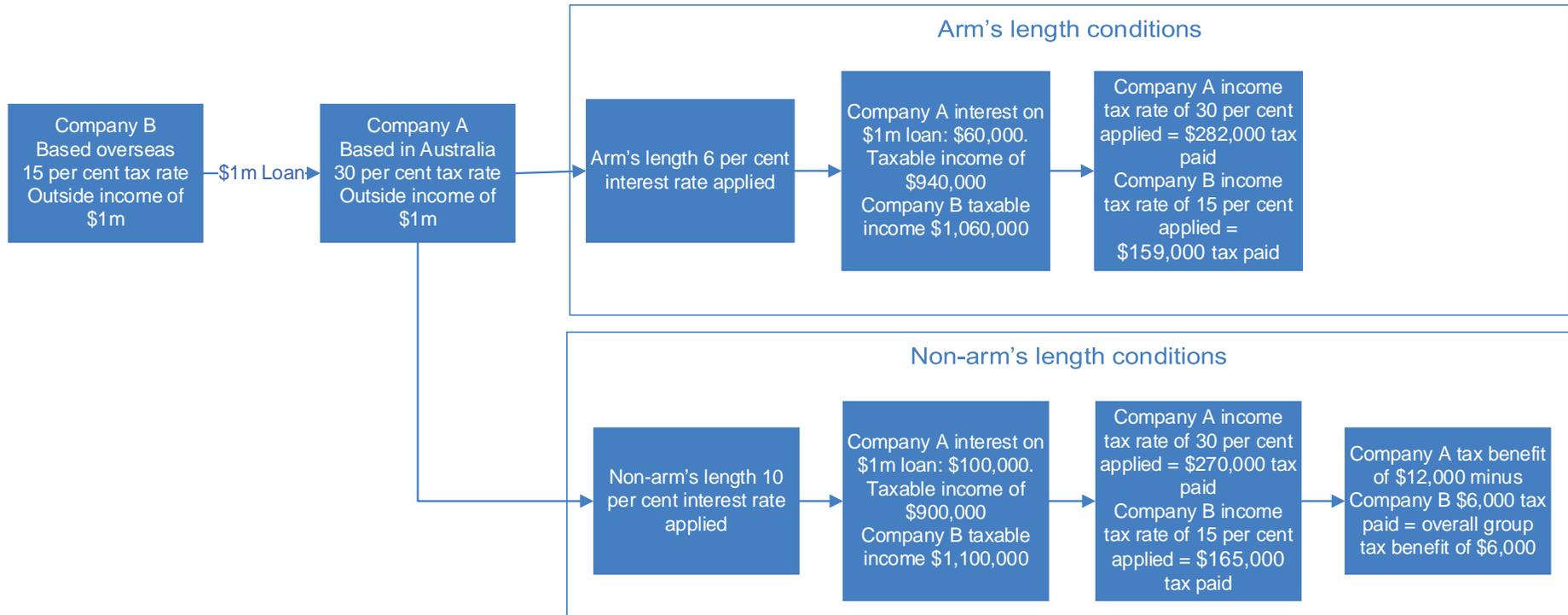
Pricing Guidelines 2017. The ATO has identified transfer pricing risk as a key focus for tax avoidance.¹¹ Box 1 describes hypothetical instances of transfer pricing.

Box 1: Hypothetical transfer pricing

1.5 Company A is an Australian subsidiary of an overseas parent company (company B), and company A enters a financing arrangement with company B. The interest repayments are a deductible expense on company A's financial accounts. If company B operates in a country with lower corporate tax rates, the interest income is taxed at a lower rate and the interest expense is deductible at a higher tax rate. Therefore, both companies gain an aggregate tax benefit. In the case of transfer mispricing, the interest rate is inflated, as a result, the deduction for company A is also inflated. If company A is encouraged to enter into more debt than reasonable then it will be highly geared. In other words, the capitalisation structure will be thin. Figure 1.1 contains two examples of hypothetical transfer pricing using an arm's length interest rate of six per cent, and a non-arm's length interest rate of 10 per cent to illustrate the tax effects of transfer pricing and transfer mispricing.

11 Mr J Hirschhorn (Second Commissioner, Client Engagement), *Transfer pricing a key focus for ATO*, ATO, 2019, available from <https://www.ato.gov.au/Media-centre/Speeches/Other/Transfer-pricing-a-key-focus-for-ATO/> [accessed 5 July 2023]. This is the 'Welcome address and opening remarks at the Tax Institute National Transfer Pricing Conference' in Sydney on 14 August 2019.

Figure 1.1: Hypothetical transfer pricing



Note: Overall group tax benefit is the difference between the total tax paid in non-arm's length and arm's length scenarios.

Source: ANAO analysis.

1.6 The ATO's Client Engagement Group (CEG) focuses on engagement to make it easy for taxpayers (including their representatives) to meet their obligations. CEG tailors engagement activities (such as reviews and audits) according to behaviour and risk level. The current CEG Group Plan has identified maintaining high levels of compliance across the tax systems and the avoidance of deterioration of tax performance as a critical outcome for the ATO. Within CEG, the Public Groups¹² division ensures taxpayers which are members of public groups pay the right amount of tax to meet their Australian obligations. Public Groups division provides oversight of the strategy for transfer pricing, and is responsible for the administration of a range of tax frameworks, including transfer pricing for related party debt.

Previous audits and review

1.7 Auditor-General Report No. 5 of 2014–15 *Annual Compliance Arrangements with Large Corporate Taxpayers* found that Annual Compliance Agreements¹³, which were viewed positively by participants, had a low take-up rate, with taxpayers preferring Pre-lodgment Compliance Reviews (PCRs). (For more information relating to PCRs see from paragraph 3.79)

1.8 Auditor-General Report No. 18 of 2019–20 *Tax Avoidance Taskforce — Meeting Budget Commitments* found that there had been a significant increase in compliance revenue over the life of the Tax Avoidance Taskforce, and that it was not clear the extent to which this was as a result of the Budget funding provided. Tax Avoidance Taskforce funding contributes to the ATO's work managing transfer pricing for related party debt.

Rationale for undertaking the audit

1.9 The latest publicly reported figures indicate that in 2020–21 inbound international related party borrowings in Australia totalled \$520 billion, with \$13.2 billion in interest expenses paid.¹⁴ The ATO monitors entities belonging to the Top 100 and Top 1,000 populations.¹⁵ Approximately 33 per cent of these inbound related party borrowings were attributed to the Top 100 entities and an additional 40 per cent were reported by the Top 1,000 entities.

1.10 The ATO has identified inbound related party borrowings as a key risk. In the ATO's 2022 assurance activities for the Top 100 entities, related party financing represented the highest proportion of unassured items receiving a red flag rating¹⁶ to indicate likely non-compliance with income tax laws.¹⁷ Similarly, amongst the Top 1,000 entities, financing assurance activities resulted

12 A 'public group' is a publicly listed company.

13 Annual Compliance Arrangements are directed at large corporate taxpayers, and offer potential benefits, such as greater practical certainty about their tax positions, concessional treatment for penalties and interest, and higher levels of accessibility to the ATO. In return, these taxpayers are required to have good governance arrangements and disclose tax risks in real time.

14 Australian Taxation Office, *IRPD Statistics Table 7* [Internet]. This figure is the average of the quarterly balances of debt interests on issue to related parties for both interest bearing and interest-free loans.

15 In 2021–22 85 taxpayers were in the Top 100 program and 1,478 economic groups were in the Top 1,000 program. Top 100 taxpayers are not part of the Top 1,000 program. These entities account for 58 per cent of corporate income tax paid.

16 A transaction identified as a red flag means 'the taxpayer is not likely paying the right amount of tax.'

17 Australian Taxation Office, *Findings report – Top 100 income tax and GST assurance programs* [Internet].

in a higher amount of low assurance and red flag ratings (27 per cent) than other areas reviewed.¹⁸ Interest bearing loans were the largest category of financing risks reviewed.¹⁹

1.11 This audit will provide assurance to the Parliament that the ATO effectively manages transfer pricing for related party debt, using sound strategies and processes to address risks and to ensure related party debt is appropriately priced. This audit was identified as a priority by the Parliament's Joint Committee of Public Accounts and Audit in the context of the ANAO's 2022–23 and 2023–24 Annual Audit Work Program.

Audit approach

Audit objective, criteria and scope

1.12 The objective of the audit was to assess the effectiveness of the ATO's management of transfer pricing for related party debt.

1.13 The audit focused on the ATO's management of transfer pricing for related party debt for the Top 100 and Top 1,000 populations from 2019–20 to 2022–23.

1.14 To form a conclusion against the objective, the following criteria were adopted.

- Are the risks relating to transfer pricing for related party debt appropriately managed?
- Does the ATO have a sound strategic framework to manage the use of transfer pricing for related party debt?
- Does the ATO effectively manage transfer pricing for related party debt?

Audit methodology

1.15 The audit methodology included:

- review of ATO documentation such as strategies, plans, risk documents, meeting papers and minutes, reporting and internal briefings;
- meetings with ATO officers; and
- detailed technical walkthroughs of processes and procedures with ATO officers.

1.16 The audit was conducted in accordance with ANAO Auditing Standards at a cost to the ANAO of approximately \$592,982.

1.17 The team members for this audit were Shane Armstrong, Ally Cerritelli, Michael Dean, Renae Lowden, Anthony Ditton, Alison Millea, and David Tellis.

18 Australian Taxation Office, *Findings report – Top 1,000 income tax and GST assurance programs* [Internet].

19 *ibid.*

2. Managing risks related to transfer pricing for related party debt

Areas examined

This chapter examined whether the Australian Taxation Office (ATO) identified and prioritised risks to transfer pricing for related party debt, and appropriately manages these risks.

Conclusion

The ATO is largely effective in identifying and prioritising risks to transfer pricing for related party debt. Its processes operate at the ATO business line level and are sound. The risk is primarily managed through use of the Top 100 Justified Trust Program and Top 1,000 Combined Assurance Program. However, management of risk is undermined by the ATO not meeting its stated taxpayer review targets to gain its desired level of assurance. Annually, the ATO seeks to review the entire Top 100 population, and 250 taxpayers within the Top 1,000 economic groups. This has not occurred during the audit period and the ATO has not conducted a process to determine whether an annual review of 250 Top 1,000 taxpayers provides sufficient oversight. There is no reporting to the Strategic Management Committee (SMC) on progress against targets for completed Pre-lodgment Compliance Reviews (PCRs) or Combined Assurance Reviews (CARs). The ATO does not conduct analysis on the reasons taxpayers may not be required to complete Country-by-Country local file reporting. Risk reporting occurs on a quarterly basis at the business level. As the risk has been rated as in tolerance, reporting has not been escalated to the enterprise level.

Areas for improvement

The ANAO made two recommendations: that the ATO take action to determine the number of completed Tax Assurance Reviews considered sufficient to provide assurance that the Top 100 population is appropriately using related party debt and to determine how to gain sufficient assurance over the Top 1,000 population through the use of CARs and gap analysis, while formalising the gap analysis process. The ANAO also recommended that the ATO conduct further analysis to monitor taxpayers who are not lodging Country-by-Country local file reporting.

The ANAO also suggested that the ATO should consider having a review cycle for the justified trust methodology for the Top 100 and Top 1,000 assurance programs.

2.1 The ATO's Corporate Plan 2023–24²⁰ identifies multinational tax performance as a key focus area, with a number of deliverables, including:

- address key risks to the corporate tax base and close tax loopholes so that the community has confidence that public and multinational businesses are paying the right amount of tax in Australia; and
- support the integrity of the tax system by boosting tax transparency through better public reporting of large business tax information.²¹

20 Australian Taxation Office, *ATO Corporate Plan 2023-24* [Internet].

21 *ibid.*, p. 6.

2.2 The Commonwealth Risk Management Policy notes that risk management is ‘fundamental to good governance’²², and that good risk management ‘supports the better delivery of government services through more effective decision-making, greater preparedness for unexpected events and supports innovation.’²³

2.3 This requires the ATO to manage risks relating to transfer pricing for related party debt.

Does the ATO have sound processes for identifying and prioritising risks to transfer pricing for related party debt?

The ATO has sound processes for identifying and prioritising risks to transfer pricing for related party debt at the business level. Procedures governing the operation of the ATO’s risk management framework are comprehensive and well-articulated. Data obtained through the Reportable Tax Position (RTP) Schedule disclosures and the International Dealings Schedule (IDS) is used along with self-assessments via Practical Compliance Guideline 2017/4 (PCG 2017/4) to monitor trends and detect risks. While Country-by-Country local file reporting provides further data, the ATO was unable to quantify the total number of taxpayers with a reporting obligation that had not complied with lodgment requirements.

The ATO’s risk management process

2.4 The documents that govern risk management at the ATO are the Enterprise Risk Management Framework (ERMF), the Risk Management Guide, and Risk Management Chief Executive Instructions.

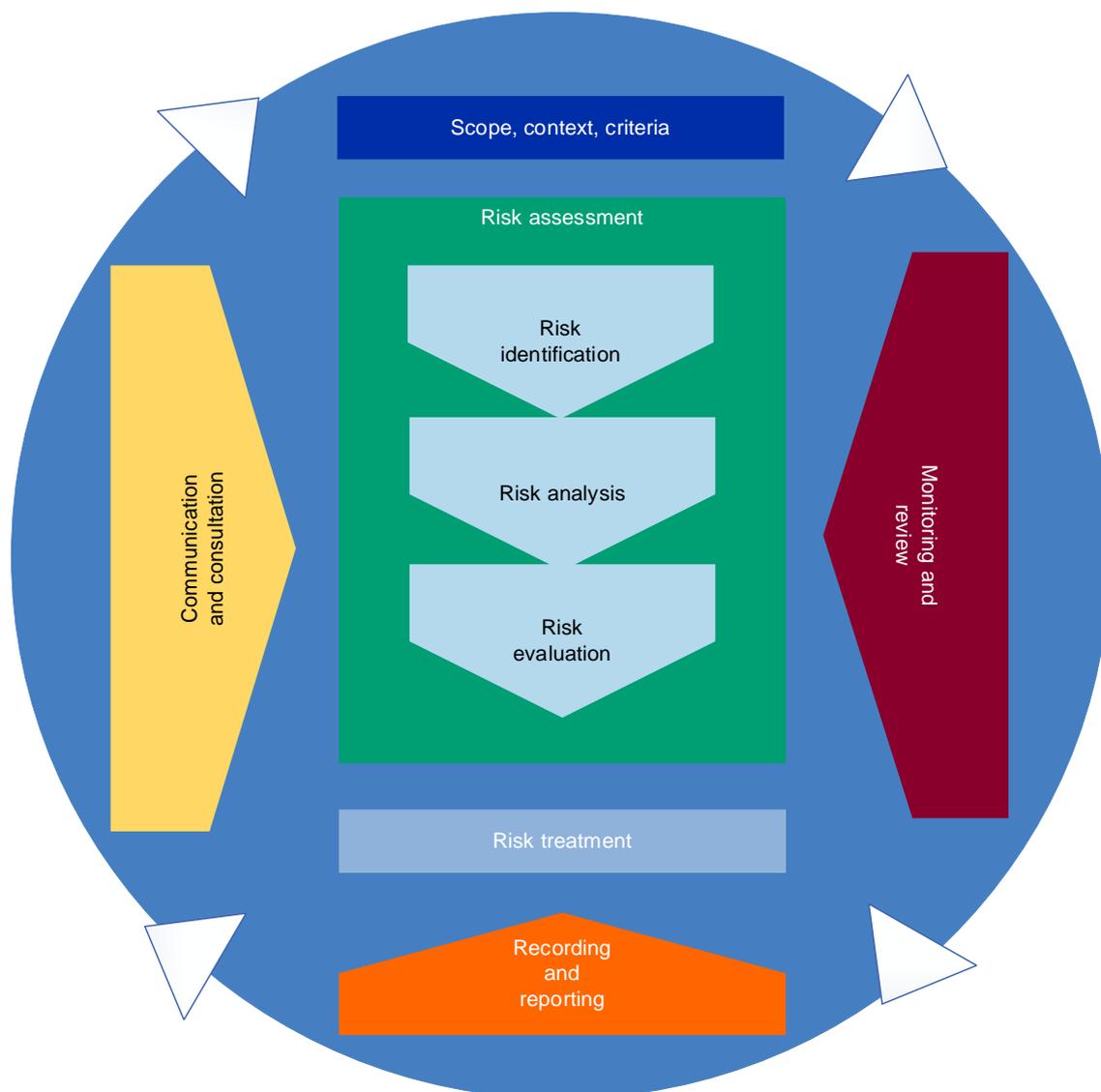
2.5 The ATO’s Risk Management Guide states that the ‘[ERMF] and risk management processes apply to all levels of risk across the ATO.’ The ATO’s risk management process was developed to meet the ATO’s obligations under the Commonwealth Risk Management Policy, and is based on ISO 31000:2018²⁴, outlining the cyclical nature of the process. This is depicted at Figure 2.1.

22 Department of Finance, *Commonwealth Risk Management Policy*, Department of Finance, 2022, available from <https://www.finance.gov.au/government/comcover/risk-services/management/commonwealth-risk-management-policy> [accessed 7 August 2023].

23 *ibid.*

24 International Organization for Standardization, *ISO 31000:2018 Risk management — Guidelines*, ISO, 2018, available from <https://www.iso.org/standard/65694.html> [accessed 7 August 2023].

Figure 2.1: The ATO’s risk management process



Source: ANAO analysis of ATO documentation.

2.6 The ERMF states that the risk methodology is ‘the practical tool that should be used in all planning activities to ensure a positive and proactive approach to risk management is applied.’ Guidance on risk management is made available to staff through internal risk management training courses, and risk management templates are provided on the ATO intranet. The ATO also uses a Chief Executive Instruction (CEI) on risk management, which outlines staff responsibilities for risk management.²⁵

²⁵ The CEI is a direction issued by the Commissioner of Taxation. It outlines the ATO’s principles for risk management, summarises the ERMF, describes the ATO’s risk appetite and tolerance, and outlines the roles and responsibilities of staff and risk specialists.

Risks relating to transfer pricing for related party debt

2.7 Transfer pricing for related party debt is considered at both the enterprise and business levels.

Enterprise level risks related to transfer pricing for related party debt

2.8 Enterprise level scrutiny of transfer pricing for related party debt risk has taken two different forms through the period of the audit. Until May 2021, the relevant enterprise level risk was ‘PMB²⁶ — International Risk’, and its short description was ‘Multinational entities use international related party or cross border arrangements to reduce Australian tax payable.’ This risk was endorsed in January 2018, and was closed in February 2022. The ATO advised the ANAO in November 2023 that it rationalised its enterprise level risks in May 2021.

2.9 As a result, the current enterprise level risk is ‘Tax and superannuation performance in accordance with the law’, and is described as:

There is a risk that performance of the tax and superannuation systems move out of tolerance due to our inability to identify and address in a timely manner lodgment and correct reporting issues resulting in reduced community confidence and willing participation and further reduced revenue performance.²⁷

2.10 The ATO describes the management strategy as:

...focused on sustained improvement in tax and superannuation compliance and, in turn, long-term system health. Strategies can be designed to improve correct participation in the system and to address non-compliance thereby improving both gross and net system performance.²⁸

2.11 The ATO’s handling of the risk of transfer pricing at the business level is consistent with this approach, and the ATO maintains a risk assessment and treatment plan for this enterprise level risk.

Business level risks related to transfer pricing for related party debt

2.12 The relevant business level risk is ‘Arm’s Length Conditions’. This business risk is managed by the Arm’s Length Conditions – Related Party Finance Risk Cluster (finance risk cluster) (see from paragraph 2.17). The Arm’s Length Conditions Risk and Issue Treatment Plan (the plan) notes that:

The risk of artificially inflating financing costs exists due to the absence of terms normally seen in a loan negotiated at arm’s length, such as security or guarantees. Alternatively, conditions are present which would not ordinarily exist in arm’s length transactions (e.g. the loan is denominated in a foreign currency, or the loan is deeply subordinated²⁹). The existence of the former, or absence of the latter, would ordinarily reduce the interest payable under the loan.

2.13 The plan notes that ‘the risk is already in existence’, and that the use of related party financing is ‘a common technique used to reduce or eliminate Australian company tax on Australian profits.’ This risk was created in July 2016, and the plan examines how the risk has evolved over

26 Public and Multinational Businesses.

27 Australian Taxation Office, *ATO Corporate Plan 2023-24*, ATO, 2023, available from https://www.ato.gov.au/about-ato/managing-the-tax-and-super-system/in-detail/corporate-plan-current-and-previous-years/ato-corporate-plan-2023-24/10-risk-management?anchor=BK_10Riskmanagement#ato-Enterpriserisks [accessed 6 December 2023].

28 *ibid.*

29 Debt which ranks after other debts in case of liquidation of bankruptcy.

time. Table 2.1 illustrates the population and revenue consequence of the risk. The approach to treating this risk is discussed in Chapter 3.

Table 2.1: Population and revenue consequence based on 2020 data

Population	Value of transactions	Tax at risk (or tax revenue effect)
3,968 taxpayers with 'inbound' loans.	The loan principal amount from IDS and Country-by-Country reporting data is \$29,782 million for 'inbound' loans.	Based on IDS and Country-by-Country data the estimated revenue consequence is \$3,981,572,345 ³⁰ for 'inbound' loans.

Source: ANAO analysis of ATO documentation.

2.14 The ATO advised the ANAO in November 2023 that it did not 'track how many [Full Time Equivalent (FTE)] or how much funding' was attributed to managing the risk, and that the only team fully dedicated to working on the risk was the finance risk cluster, which was five FTE. The ATO further advised the ANAO in November 2023 that the Top 100 Network was 24 FTE and the approximate FTE for case teams from Engagement and Assurance was 160 (see paragraph 3.82). For the Top 1,000 team FTE was 114, and Economist Practice³¹ (see paragraph 3.53) consisted of 100 FTE, with the ATO stating:

Related party financing is one of the focus areas of these programs, however, as they consider all tax risks, the true "cost" is some portion of this. In addition, there are resources that might work on transfer pricing for related party debt in [Economist Practice, Review and Dispute Resolution, Tax Counsel Network], and all of [Engagement and Assurance].'

2.15 The ATO's Risk Management Guide notes that endorsement of risks by risk owners can be maintained within the business area. Evidence of risk endorsement is indicated through the approval of risk assessment documents. Analysis of risk treatment plans between 2016–17 and 2022–23 indicates that the risk was considered, and largely appropriately endorsed³² by the SMC (see paragraph 2.62).

2.16 The Risk Management Guide states that 'Enterprise risks should be reviewed every twelve months as a minimum'. It is silent on a review timeframe for business level risks. Analysis of risk treatment plans between 2016 and 2023 indicates that the risk has been reviewed and updated annually.

Risk management

2.17 The focus on potential risks is examined by the ATO at the individual taxpayer level. The ATO manages business level risks through the use of 'risk clusters', which are used 'to treat and manage risks that exhibit common factors, characteristics or behaviours within a population in a consistent

30 In November 2023, the ATO provided the following context on this figure:

'The number [...] represents a high-level estimate of potential mispriced deductions for the inbound loan population. Given the size of the population and the dynamic nature of the related party loans, tax at risk cannot be calculated since it requires a specific assessment of each taxpayer's circumstances...'

31 Economist Practice is responsible for providing economic advice relating to the laws the ATO administers.

32 Minutes from the 2019 SMC meeting indicate the risk was noted rather than endorsed, and in 2020 and 2022, while the risk was reviewed in the SMC meeting, there was no clear endorsement or noting of the content articulated in the minutes.

manner.’ Table 2.2 outlines the broad functions of the finance risk cluster and provides examples of work done in each of these areas.

Table 2.2: Finance risk cluster functions and examples of activity

Finance risk cluster function	Examples of activity
Identify the need for external guidance and assist in design and delivery of such guidance	PCG 2017/4 ^a and additional Schedules.
Internal capability building and guidance	Training and development materials (see from paragraph 3.58).
Input into the development and refinement of risk filters	The ATO analyses RTP Schedule disclosures providing tailored guidelines to assist specialist teams to risk assess information provided by taxpayers.
Technical input into strategic compliance activities	The cluster encourages teams to seek technical advice when required.
Identifying strategic cases that are potential litigation test cases and providing technical input to those cases to be litigation ready	Identifying potential cases and assessing the strategic value of matters for litigation, contributing to the ATO’s preparation for an appeal to the Federal Court of Australia.
Advocating for law reform, as necessary	The cluster has not initiated any law reform advocacy. It has responded to requests about potential law reform.

Note a: Australian Taxation Office, *Practical Compliance Guideline 2017/4*, ATO, 2020, available from <https://www.ato.gov.au/law/view/document?docid=COG/PCG20174/NAT/ATO/00001> [accessed 19 October 2023].

Source: ANAO analysis of ATO documentation.

2.18 The ATO advised the ANAO in August 2023 that the transfer pricing risk was identified before the finance risk cluster was established. The ATO advised the ANAO in August 2023, that prior to the introduction of the Top 100 Justified Trust Program (see from paragraph 2.41) (and the Top 1,000 Combined Assurance Program, see from paragraph 2.46) there was a risk identification process involving analysis of tax return data, and that the approach could not be targeted.

2.19 The finance risk cluster was established ‘at a similar time’ to the Top 100 Justified Trust Program, to address the risk and test the extent to which it may manifest in the taxpayers using related party financing. The Top 100 Justified Trust Program was then used to obtain assurance as part of managing the risk. If assurance was not obtained, then further compliance activity may be undertaken.

2.20 The Top 100 Justified Trust Program and the Top 1,000 Combined Assurance Program, ‘at a case level, [form] a significant part of the treatment strategy’, and ‘for both the Top 100 and Top 1,000 populations, transfer pricing of related party debt is a significant part of the assurance program.’ The ATO advised the ANAO in August 2023 that individual taxpayer risks were identified and tested via justified trust and this then provided the ‘springboard’ for compliance activities.

2.21 The ATO advised the ANAO in August 2023 that justified trust enabled it to take the next step from risk identification, and that without justified trust, the ATO would not be able to target its work, meaning matters would be escalated to audits or reviews as required and without a clear structure in place. In November 2023 the ATO advised the ANAO that justified trust ‘builds and

maintains community confidence that taxpayers are paying the right amount of tax’, and that it enabled the ATO to focus the use of its resources into ‘the right areas.’

2.22 The treatment strategy contains three phases. Phase one, which has been finalised, focused on developing a compliance strategy, internal and external communications, development of a strategy on advisors, developing risk filters³³ and metrics, and internal engagement to ‘attempt to address associated legislative issues.’ Phases two and three are combined in the treatment plan³⁴, with the ATO advising the ANAO in September 2023 that the rollout of these phases is ‘ongoing with a particular focus being continuous improvement’.

2.23 The plan includes a delivery plan that outlines key milestones and months in which work on identified key milestones was scheduled to occur. Aside from providing technical support to internal clients, all delivery plan items are reported on in quarterly SMC reports. The plan contains five key performance indicators (KPIs) that seek to identify ‘indicators of success/key metric[s] for determining effectiveness.’ These, and reporting against these KPIs, are contained in Table 2.3.

Table 2.3: Finance risk cluster KPIs and internal reporting

KPI	Reporting
Active compliance	
1. Effectiveness is confirmed through assessment amendments to increase tax payable/reduce tax losses, and change in taxpayer behaviour as demonstrated by increased disclosure to the ATO on risky transactions.	‘The first KPI is the key KPI for which reporting is provided to the [Strategic Management Committee (SMC)]. For this purpose, key case outcomes are reported to the SMC on a quarterly basis in the SMC Quarterly report’ (see paragraph 2.62). Reporting on changes to taxpayer behaviour ‘[is] demonstrated by changes in disclosures and is tracked through the Reportable Tax Position (RTP) Schedule questions.’ RTP trends and insights are reported to the SMC on an annual basis.
2. a) Internationals ^a is engaged on fewer routine or non-high risk cluster cases as a result of internal guidance provided by Internationals on how to treat the cluster risk. b) Effectiveness of training by Internationals confirmed by positive feedback.	There is no formal reporting to the SMC against KPIs 2a and 2b. The ATO advised the ANAO in September 2023: ‘This is considered and assessed internally by the team along with the cluster SES [Senior Executive Service]’.
Prevention	
3. Effectiveness of external communication is confirmed through non-detection of risk through our risk identification processes.	This KPI is tracked via trends in the annual RTP analysis.

33 A risk filter is a model ‘used to select or prioritise candidates for further review’. An example of a risk filter is the ATO’s annual analysis of Reportable Tax Position schedules. See from paragraph 3.42.

34 Phases 2 and 3 focus on improving the quality, accuracy and effectiveness of the ATO’s work.

KPI	Reporting
Proof of absence	
4. Non-detection of risk through our risk identification processes.	These KPIs are tracked via trends in the annual RTP analysis.
5. RTP Schedule disclosures trend to lower risk zone arrangements.	

Note a: International, Support, and Programs division.

Source: ANAO analysis of ATO documentation.

Using monitoring processes to inform risk prioritisation

2.24 The plan notes that the ATO uses information in the RTP and other tax return schedules to ‘recommend appropriate active compliance activities on the higher risk arrangements that require assurance’, and that the growth of self-assessments via PCG 2017/4 (see from paragraph 3.40), provides a greater opportunity for the ATO to monitor trends and detect risks.

2.25 RTP Schedule disclosures (see from paragraph 4.7) collect information on taxpayers’ use of related party debt. Prior to 2021, taxpayers were only required to report the risk zone for their highest self-assessed risk zone arrangement. Since 2021, taxpayers are required to report the three most material arrangements. If the highest risk zone arrangement was not one of the three most material, this is also required to be reported. The ATO advised the ANAO in August 2023: ‘The RTP self-assessments disclosed by the taxpayers may only represent a portion of their related party financing transactions.’ For more information on RTP Schedule disclosures, see Figure 3.3 and Figure 3.4.

2.26 The ATO advised the ANAO in November 2023:

[T]he total number of related party transactions and the respective amount for each such transaction across all taxpayers that might use related party debt is not presently collected by the ATO.

2.27 Further data was acquired through taxpayer disclosures in the IDS.³⁵ Transaction-level information was only required to be provided by taxpayers completing local file³⁶ requirements. Table 2.4 outlines taxpayers who may be required to provide local file reporting and those that have provided it.

Table 2.4: Country-by-Country local file reporting 2019–20 to 2022–23

Year	May be required to lodge	Count of lodgers
2019–20	5,598	3,943
2020–21	6,921	4,033
2021–22	7,900	4,103
2022–23 ^a	5,884	2,775

Note a: 2022–23 data is incomplete as tax returns are lodged throughout the year.

Source: ATO documentation.

³⁵ The IDS forms part of the tax return for companies, trusts, and partnerships.

³⁶ The local file is part of the three-tiered reporting structure established by the OECD and requires taxpayers to complete questions regarding material transactions (see paragraph 3.25).

2.28 The ATO advised the ANAO in November 2023 that the difference in the number required to lodge and the total count of lodgers was due to a series of possible exemptions. The ATO was unable to provide a further breakdown of the reasons those who may be required to lodge had not lodged: ‘In relation to non-lodgment of the full local file, we do not have a definitive count of [taxpayers] with a reporting obligation that have not complied with lodgment requirements.’³⁷

Recommendation no. 1

2.29 The Australian Taxation Office conduct further analysis to determine and monitor why taxpayers may not lodge Country-by-Country local file reporting.

Australian Taxation Office response: *Agreed.*

2.30 *The ATO will conduct further analysis to determine and monitor why taxpayers may not lodge Country-by- Country local file reporting.*

2.31 The ATO advised the ANAO in August 2023 that transaction-level data on related party financing received through the IDS was unstructured, imperfect, and incomplete. As a result, the ATO focused on assessing the three biggest and highest risk transactions outlined in RTP Schedule disclosures.³⁸ The ATO was unable to verify that the transactions reported by taxpayers were the biggest and highest risk transactions. The ATO used the justified trust methodology to understand how individual taxpayers approached the use of related party debt (see from paragraph 2.35).

Updating strategies to account for new and emerging risks

2.32 The Arm’s Length Conditions Risk and Issue Treatment Plan is updated annually by the finance risk cluster taking into account how the risk has continued to evolve, and how the treatment approach should change.

Are risks to transfer pricing for related party debt managed in accordance with ATO requirements?

The ATO uses the Top 100 Justified Trust Program and Top 1,000 Combined Assurance Program to engage with Top 100 and Top 1,000 taxpayers to manage transfer pricing risk. To gain assurance each year, the ATO aims to review all Top 100 taxpayers, and 250 Top 1,000

37 In March 2024, the ATO further advised the ANAO:

The count of ‘May be required to lodge’ has no direct relationship to the ‘Count of lodgers’ for the same income year. The lodgment obligation for [Country-by-Country] reporting statements is tied to [Country-by-Country] reporting entity status in the previous income year.

The reference to ‘Count of lodgers’ does not clarify that it only shows those that have lodged a full local file, [that is] those that have lodged a Local File – Part A and/or Local File – Part B. It excludes those that only lodge a short form local file (due to meeting relevant criteria, master file, [Country-by-Country] report notification, or financial statements).

The difference between the figures in the 2nd and 3rd columns of Table 2.4 are not primarily due to exemptions. After adjusting for timing the difference primarily reflects [Country-by-Country] reporting entities that qualify for only lodging a short form local file, and Australian resident companies that qualify for local file administrative relief.

38 Seeking information on a limited number of transactions is consistent with the OECD’s guidance (see paragraph 3.20).

taxpayers. These targets have not been met over the last four years, and the ATO was unable to determine whether the Top 1,000 target provided sufficient oversight over the population.

Justified trust

2.33 To manage the risk to transfer pricing for related party debt, the ATO uses the broader justified trust concept to engage the members of its Top 100 (see from paragraph 2.41) and Top 1,000 (see from paragraph 2.46) populations³⁹ (see from paragraph 3.73 for details how the Top 100 and Top 1,000 populations are established). The ATO defines the concept of justified trust as:

A reasonable conclusion based on sufficient evidence that the taxpayer is complying with its tax obligations and paying the right amount of tax in relation to its business and economic activities connected or linked to Australia.

2.34 Further, justified trust is:

How we build and maintain community confidence taxpayers are paying the right amount of tax. Justified trust is a concept from the Organisation for Economic Cooperation and Development (OECD).⁴⁰

Justified Trust builds and maintains community confidence that taxpayers are paying the right amount of tax. It also allows us to focus our resources in the right areas.⁴¹

2.35 To achieve justified trust for both the Top 100 and Top 1,000 populations, the ATO focuses on four areas:

- understanding a taxpayer's tax governance framework;
- identifying tax risks flagged to market;
- understanding significant and new transactions; and
- understanding why the accounting and tax results vary.⁴²

2.36 The ATO's website describes the intended outcomes from its approach to justified trust:

Justified trust gives the community confidence that large businesses are paying the right amount of tax. This fosters broader willing participation and engagement across the tax and superannuation system.

Our approach helps us focus how we minimise the income tax and Goods and Services Tax (GST) tax gaps through:

- our engagement strategy (for example, identifying and resolving areas of concern at the earliest possible time)

39 The term 'justified trust' is used by the ATO to cover reviews of Top 100 taxpayers via the Top 100 Justified Trust Program and the Top 1,000 taxpayers via the Top 1,000 Combined Assurance Program.

40 Justified trust was outlined by the OECD as part of the 'tax assured' practical approach to measuring revenue outcomes in the 2014 report 'Measures of Tax Compliance Outcomes: A Practical Guide'. Tax assured is one of three approaches for 'measuring and attributing tax compliance outcomes' provided by the OECD as 'the best current and emerging practice for revenue bodies'. The OECD report states:

Tax assured measures the proportion of the tax base where the revenue body has 'justified trust' through its activities or others' activities that tax is 'under control' and so assured as accurate and paid.

41 Australian Taxation Office, *Justified Trust*, ATO, 2021, available from <https://www.ato.gov.au/Business/Large-business/Justified-trust/> [accessed 15 August 2023].

42 *ibid.*

- active compliance (for example, audit cases)
- active prevention across the market (for example, through Taxpayer Alerts, Practical Compliance Guidelines, or Public Rulings).⁴³

2.37 The importance of the justified trust approach to managing risk is noted in the Public Groups SMC charter. It states that the SMC's objective is to manage 'risks to the tax system relevant to Public and Multinational Businesses, providing justified trust that the right amount of tax is being paid.'⁴⁴

2.38 The threshold for assurance has been articulated in the Justified Trust Methodology Guide:

Assurance has been achieved where the team confirms that the taxpayer's tax treatment aligns with the income tax law and the ATO's view as to its application.

Assurance can be obtained where sufficient analysis has been conducted and/or supporting documentation obtained to confirm that the taxpayer's tax treatment accords with the income tax law.

Alternatively, assurance can be obtained through escalation (e.g. audit, objection, litigation) where the ATO and the taxpayer have a material difference of opinion in relation to the tax treatment. Once the ultimate outcome of an escalation procedure has been determined and applied (whether favourable or unfavourable to the taxpayer), assurance will have been obtained.

2.39 Three overall assurance ratings can be applied to Top 100 and Top 1,000 taxpayers: high, medium and low (see paragraph 3.80). Obtaining justified trust requires a taxpayer to meet two metrics:

- a minimum of 90 per cent of its tax activity and economic activity must be correctly reported; and
- meeting all seven qualifying factors for the income tax period covered by the Tax Assurance Report.⁴⁵

2.40 For both the Top 100 and Top 1,000 populations, of the seven qualifying factors, there is one directly related to transfer pricing for related party debt: 'International related party dealings and CFCs.'⁴⁶ As part of this qualifying factor, the ATO must have a medium level of assurance⁴⁷ that 'material or significant' international related party dealings satisfy the arm's length principle pursuant to subdivision 815-B of the *Income Tax Assessment Act 1997* (ITAA 1997). This includes that no further action is necessary. Top 100 taxpayers achieving justified trust are then subject to a 'Monitoring and Maintenance' approach. (See from paragraph 3.83).

Top 100

2.41 Figure 2.2 depicts how the ATO assesses Top 100 taxpayers as part of the Top 100 Justified Trust Program.

43 *ibid.*

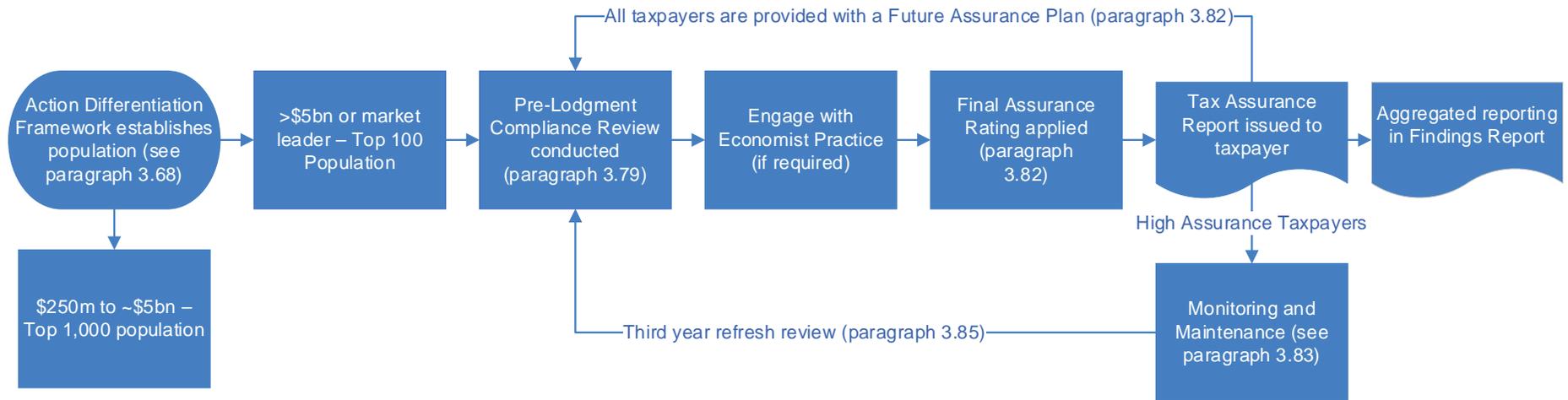
44 The ATO's Justified Trust Methodology Guide notes: 'the term "right" refers to the taxpayer complying with Australian tax law in all material aspects, rather than being a moral or value based judgement.'

45 The seven qualifying factors are: governance; tax risks flagged to market; international related party dealings and Controlled Foreign Corporations; losses, effective tax borne; reportable tax position schedule; and cooperative and collaborative behaviour.

46 CFCs stands for Controlled Foreign Corporations.

47 Australian Taxation Office, *Findings report – Top 1,000 income tax and GST assurance programs* [Internet]. 'More evidence or analysis is required to establish a reasonable basis to obtain a high level of assurance.'

Figure 2.2: Top 100 justified trust process



Source: ANAO analysis of ATO documentation.

2.42 The Justified Trust Methodology Guide for the Top 100 population states:

In the Australian context, the concept relates to the level of assurance we have that a taxpayer has paid the right amount of tax on its business and economic activities connected or linked to Australia. Justified trust does not represent absolute certainty that the taxpayer is complying with all their tax obligations and the amount of tax paid is completely accurate, as this level of certainty is not attainable. It reflects a level of confidence that the taxpayer is complying with its Australian tax obligations.

2.43 To obtain justified trust, the ATO conducts a PCR (see paragraph 3.81), which leads to the development of a TAR (see from paragraph 3.82).

2.44 Table 2.5 provides more insight into the total number of Top 100 taxpayers assessed via TARs and also those taxpayers who have achieved justified trust and are now subject to a 'Monitoring and Maintenance' approach.

Table 2.5: TARs and Monitoring and Maintenance Reports issued 2019–20 to 2022–23

Year	Population	TARs issued	Monitoring and Maintenance	Total population coverage	Population coverage (%)	First-time TARs	Improved assurance rating	Reduced assurance rating
2019–20	82	53	3	56	68	17	20	0
2020–21	84	35	22	57	68	5	15	0
2021–22	85	33	21	54	64	3	15	2 ^a
2022–23	85	37	18	55	65	5	10	2 ^a

Note a: In 2021–22, one taxpayer, and in 2022–23, two taxpayers had a rating change to 'not rated'.

Source: ANAO analysis of ATO documentation.

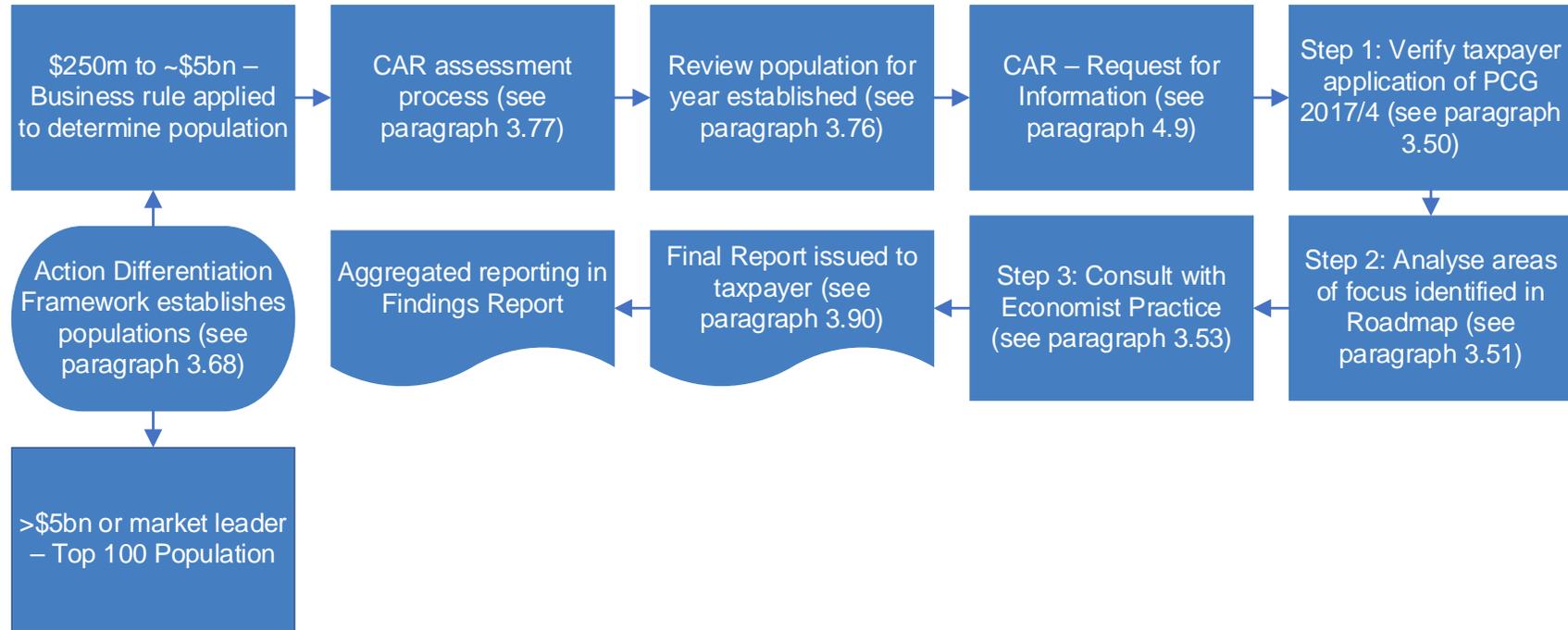
2.45 Even though the ATO aims to complete a TAR for each Top 100 taxpayer annually⁴⁸, it is not possible for this to be achieved, as some taxpayers have obtained justified trust and have moved into Monitoring and Maintenance. Taking into account TARs issued, and taxpayers subject to Monitoring and Maintenance, the ATO has annually scrutinised, on average, 66.25 per cent of Top 100 taxpayers over the last four years, and has therefore not achieved the level of assurance that it has sought. It should be noted that TARs may take more than a year to complete, and the ATO maintains a case coverage plan for the Top 100 population, planning and tracking taxpayer engagement. Further, TARs also examine multiple income years if a TAR was not issued in the year previously.

Top 1,000

2.46 Figure 2.3 depicts how the ATO assesses Top 1,000 taxpayers through CARs.

48 Australian Taxation Office, *Top 100 Justified Trust Program*, ATO, 2022, available from <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/large-business/top-100-justified-trust-program> [accessed 15 August 2023].

Figure 2.3: Top 1,000 CAR process



Source: ANAO analysis of ATO documentation.

2.47 Since 2021⁴⁹, the ATO has used CARs to ‘obtain assurance that large public and multinational groups are reporting the right amount of both income tax and GST. CARs also identify and address [income tax] and GST tax risk.’ CAR findings are recorded in Combined Assurance Reports. Transfer pricing for related party debt is a comparatively small part of the CAR process. The ATO identified the Tax Avoidance Taskforce⁵⁰ as a driver for the adoption of justified trust for the Top 1,000 population.

2.48 A CAR seeks to deliver a tailored experience for taxpayers that is influenced by their previous assurance ratings, leading to a trend of faster and more efficient reviews ‘and, in some cases, improved assurance ratings.’ The ATO aims to complete 250 CARs per year. Table 2.6 provides the number of CARs from 2019–20 to 2022–23.

Table 2.6: Combined Assurance Reports issued, 2019–20 to 2022–23

Year	Total completed	Percentage of target achieved	First-time reviews	Assurance rating improved	Assurance rating maintained	Assurance rating reduced
2019–20 ^a	212	N/A ^b	212	N/A	N/A	N/A
2020–21 ^c	104	41.6	49	4	35	16
2021–22	198	79.2	110	14	56	18
2022–23	158	63.2	54	26	63	15

Note a: 2019–20 relates to Streamlined Assurance Reviews (SARs) which were conducted prior to 2020–21.

Note b: There was no annual target for SARs.

Note c: First time reviews and changes to assurance ratings for 2020–21 are calculated from previously issued SARs.

Source: ANAO analysis of ATO documentation.

2.49 Even though the ATO aims to complete 250 CARs every year⁵¹, it has achieved, on average, 61.3 per cent of this target since CARs were developed. The ATO advised the ANAO in January 2024 that no formal process had been undertaken to determine whether 250 CARs provided sufficient assurance prior to the commencement of the program. The ATO advised the ANAO in March 2024 that between 2020–21 and 2022–23, 62 per cent of Top 1,000 taxpayers with High or Medium disclosures received a CAR and a further 10 per cent did not meet the CAR selection criteria based on Total Business Income (TBI) alone. The ATO further advised the ANAO in March 2024 that CARs covered 76 per cent of medium and high risk TBI.

2.50 While the ATO analyses RTP Schedule disclosures (see paragraph 3.41), it then uses this analysis to identify high and medium risk. Top 1,000 taxpayers not subject to CARs may require further scrutiny via a ‘gap analysis program’ (approved by the SMC (see paragraph 2.62) in September 2023) to allow the ATO to gain further assurance over taxpayer use of related party debt

49 Prior to this date, Streamlined Assurance Reviews were used. These reviews considered income tax assurance and used a justified trust methodology. CARs were developed to incorporate a GST risk review.

50 Australian Taxation Office, *Tax Avoidance Taskforce*, ATO, 2023, available from <https://www.ato.gov.au/about-ato/tax-avoidance/tax-avoidance-taskforce> [accessed 30 October 2023].

‘The Tax Avoidance Taskforce ensures multinational enterprises, large public and private businesses (and associated individuals) pay the right amount of tax in Australia. Formed in 2016, it enhances and extends our existing activities to eradicate illegal and fraudulent tax arrangements. The taskforce bolsters our pre-existing efforts in tackling tax avoidance.’

51 Australian Taxation Office, *Findings report – Top 1,000 income tax and GST assurance programs* [Internet]. The ATO states publicly that it aims to review Top 1,000 taxpayers once every four years.

(the 'T1,000 gap population'). This is done by identifying high risk financing arrangements based on the loan quantum and implied interest rate. Prior to this, there was no further methodical analysis of taxpayers, though the ATO advised the ANAO in January 2024 that issues may have been identified in the course of other work.

2.51 The ATO advised the ANAO in February 2024 that the data used by the team responsible for this gap analysis to assess Top 1,000 taxpayers with related party debt is disclosed via the RTP Schedule, the IDS, and [Country-by-Country] local file reporting 'where available'.

2.52 The ATO was unable to provide how many Top 1,000 taxpayers had been assessed since the introduction of the gap analysis process, with the ATO advising the ANAO in February 2024 that the 'gap analysis process is currently in its initial phase'.

2.53 The ATO does not have guidance and training material for staff to analyse transactions, as the material is 'currently under development.'

Recommendation no. 2

2.54 The Australian Taxation Office take action to:

- (a) determine the number of completed Tax Assurance Reports considered sufficient to gain assurance that Top 100 taxpayers are appropriately using transfer pricing for related party debt; and
- (b) determine how to gain sufficient assurance over the Top 1,000 population through the use of Combined Assurance Reviews and gap analysis, while also formalising how gap analysis should be conducted.

Australian Taxation Office response: *Agreed.*

2.55 *The ATO will review its current assurance approaches to ensure we are achieving our goals and formalise the findings.*

Amending the justified trust methodology to respond to changes in risks

2.56 The ATO advised the ANAO in December 2023 that no emerging risks had been identified that led to changes to how transfer pricing was assessed by the Top 100 Justified Trust Program, and there had been no formal process applied to review the Justified Trust methodology. The methodology was amended to incorporate GST and income tax in 2019, and changes to the Monitoring and Maintenance approach (see from paragraph 3.83) were made in 2020 and 2022. The ATO advised the ANAO in November 2023 that it 'typically [sought] feedback where significant modifications are made to the program' and evidence of consultation processes was provided, but there had been no changes to the Top 1,000 methodology since 2016.

Opportunity for improvement

2.57 The Australian Taxation Office could consider developing a review cycle for the Top 100 and Top 1,000 justified trust methodologies.

Reporting on risk

2.58 The ATO publicly reports the aggregate findings from its Top 100⁵² and Top 1,000⁵³ programs on an annual basis. These findings reports include reporting on transfer mispricing for both the Top 100 and Top 1,000 populations. The ATO also advises taxpayers of risks for large corporate groups.⁵⁴

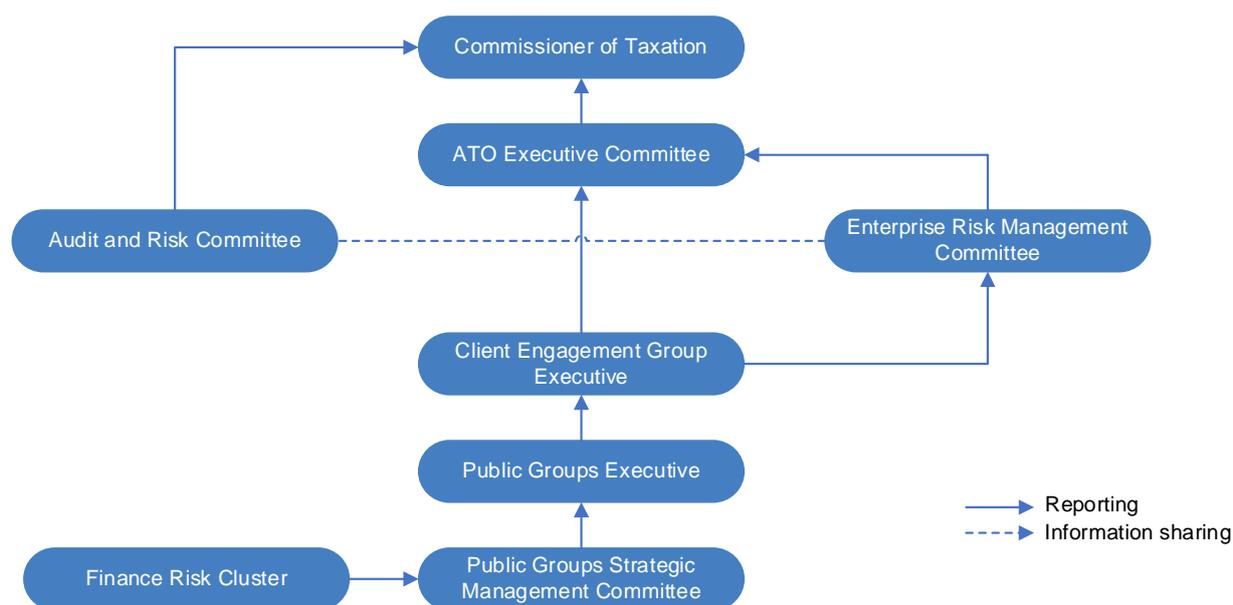
Is oversight of the management of risks to transfer pricing for related party debt fit for purpose?

As the business level risk relating to transfer pricing for related party debt has remained in tolerance, it has not been escalated for enterprise level consideration. At the business level the risk is monitored by the Public Groups SMC. The SMC receives quarterly reporting on the transfer pricing risk, but has not been provided with reporting on progress against targets for completed PCRs or CARs, meaning that the SMC cannot properly monitor the level of assurance the ATO has over the Top 100 and Top 1,000 populations' use of transfer pricing for related party debt. Until October 2023, the SMC was required to 'provide regular reports' to the Public Groups Executive. This did not occur.

Risk oversight bodies

2.59 Figure 2.4 illustrates the ATO's governance structure around risk. Oversight of risks occurs at the enterprise and business levels. As the related party debt risk is primarily addressed at the business level, oversight is also focused on the business level.

Figure 2.4: Risk governance structure



Source: ANAO analysis of ATO documentation.

- 52 Australian Taxation Office, *Findings report – Top 100 income tax and GST assurance programs*, [Internet].
 53 Australian Taxation Office, *Findings report – Top 1,000 income tax and GST assurance programs*, [Internet].
 54 Australian Taxation Office, *Key compliance risks for large corporate groups*, ATO, 2022, available from <https://www.ato.gov.au/about-ato/learn-about-tax-and-the-ato/tax-and-corporate-australia/in-detail/key-compliance-risks-for-large-corporate-groups> [accessed 30 November 2023].

Enterprise level

2.60 Oversight of enterprise level risks is undertaken by the ATO's Enterprise Risk Management Committee. Its objective is: 'To positively influence the ATO's ability to manage priority areas of risk associated with achieving its strategic objectives.' The Committee seeks to ensure priority risks are being managed consistent with the ERMF, to consider advice provided in relation to effectiveness of the ATO's risk management regime, and to consider emerging risks in the context of the ATO's strategic objectives.

2.61 The Enterprise Risk Management Committee's charter states that the committee will escalate significant risks to the ATO Executive Committee, and provide regular advice to the Audit and Risk Committee via the Chief Risk Officer. The ATO advised the ANAO in September 2023 that the relevant risk 'has not been rated out of tolerance and so it has not been escalated to the [Client Engagement Group] Executive or the ATO Risk Committee as part of the escalation procedures.'

Business level

2.62 Oversight of the business level risks to transfer pricing for related party debt is the responsibility of the Public Groups SMC. Its objective is to '[manage] risks to the tax system relevant to Public and Multinational Businesses, providing justified trust that the right amount of tax is being paid.' The committee seeks to satisfy itself that a sound approach has been followed to manage risks, that emerging risks are actively identified and managed, that risk management is consistent with the enterprise risk framework, and to set the direction for Public Groups' strategic approach. The SMC receives reporting on transfer pricing for related party debt on a quarterly basis (see from paragraph 2.23). This reporting does not include information on the number of PCRs or CARs completed against the ATO's target of annual review of the entire Top 100 population and annual review of 250 Top 1,000 taxpayers.

2.63 The SMC's charter states that the committee will 'Provide regular reports to the [Public Groups] Executive, tracking the treatment of the priority risks', and 'provide risk investment recommendations to the [Public Groups] Executive to ensure resources are allocated in accordance with risk priorities and treatment strategies.' The ATO advised the ANAO in November 2023 that as the risk remained within tolerance, there had been no escalation of matters to the Public Groups Executive. The terms of the charter require the committee to 'provide regular reports', rather than to report on an as-needs basis. The SMC charter was revised and endorsed by the SMC in October 2023. The requirement to provide regular reporting to the Public Groups Executive was removed from this version of the SMC charter.

3. Strategic framework to manage the use of transfer pricing for related party debt

Areas examined

This chapter examined whether the Australian Taxation Office (ATO)'s strategic framework to manage the use of transfer pricing for related party debt was sound, and whether implementation and oversight arrangements were appropriate.

Conclusion

The ATO has established a largely effective strategic framework to manage the use of transfer pricing for related party debt. The principles outlined in Organisation for Economic Co-operation and Development (OECD) transfer pricing guidance are reflected in the ATO's guidelines for staff and taxpayers. The ATO has a sound strategy to engage with taxpayers with related party debt, primarily through the application of Practical Compliance Guideline 2017/4 (PCG 2017/4), though training for staff is not mandatory and records of staff training are not kept. Further, while the ATO aims to review all taxpayers using related party debt that do not apply PCG 2017/4, this does not occur in the majority of cases. The ATO effectively supports engagement with taxpayers through the completion of assurance reviews, though a lack of IT quality controls means it cannot be determined with certainty that the Top 1,000 population is complete and accurate.

Areas for improvement

The ANAO made two recommendations: that the ATO ensure that all taxpayers who do not apply PCG 2017/4 are reviewed as the ATO states will occur, and that the ATO make training mandatory for new case officers and develop and maintain a register to ensure all staff are trained consistently.

The ANAO also suggested that the ATO ensure experienced case officers undertake refresher training, and that the ATO develop clearly defined metrics that qualify an economic group for inclusion within the Top 100 population.

3.1 The ATO's Corporate Plan 2023–24 identifies multinational tax performance as a key focus area, with the following key deliverables:

- address key risks to the corporate tax base and close tax loopholes so that the community has confidence that public and multinational businesses are paying the right amount of tax in Australia;
- support the integrity of the tax system by boosting tax transparency through better public reporting of large business tax information;
- positively influence the behaviours of advisors in the provision of tax advice and their interactions with the ATO; and
- support large business through the timely provision of tailored advice and guidance, and other contemporary services.⁵⁵

55 Australian Taxation Office, *ATO Corporate Plan 2023-24* [Internet].

3.2 This requires the ATO to develop a strategic framework that has been properly implemented, and is appropriately oversighted, to ensure transfer pricing for related party debt is managed effectively.

Are the principles outlined in OECD guidance reflected in the ATO's transfer pricing guidelines?

The principles outlined in OECD transfer pricing guidance are reflected in legislation and ATO guidance for both its staff and taxpayers. The ATO has taken action to incorporate recent updates to the OECD guidance into Australian law. The ATO's approach to Country-by-Country reporting is largely consistent with its international obligations.

The OECD Transfer Pricing Guidelines

3.3 The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines)⁵⁶ promote a consistent approach to transfer pricing matters for tax administrations and taxpayers across jurisdictions.⁵⁷ OECD member countries periodically provide input to review and revise the Guidelines in response to emerging issues. The ATO advised the ANAO in July 2023 that it is 'actively involved in OECD work programs'. The OECD Guidelines aim to ensure countries secure an appropriate tax base and avoid double taxation, encouraging international trade and minimising conflict.⁵⁸

3.4 The 2017 edition of the OECD Guidelines is provided as a guidance document in the *Income Tax Assessment Act 1997* (ITAA 1997) subdivision 815-B, paragraph 815-135(2)(a). Subsection 815-315(1) of the ITAA 1997 states:

For the purpose of determining the effect this Subdivision has in relation to an entity, identify arm's length conditions so as best to achieve consistency with the documents covered by this section.

3.5 The OECD Guidelines centre around the arm's length principle.⁵⁹ This provides that where the conditions of a transaction between related parties are not what would be expected from independent parties, then:

any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

3.6 Under the OECD Guidelines, the appropriate transfer price is to be determined through comparability analysis. This analysis compares the conditions of a controlled transaction⁶⁰ to the

56 Organisation for Economic Co-operation and Development, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD, 2017, available from https://www.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en [accessed 20 October 2023].

57 The OECD Guidelines were originally published in 1995. Prior to this, the Transfer Pricing and Multinational Enterprises (1979) Report provided guidance on the OECD's view on transfer pricing issues. This was repealed by the OECD Council in 1995.

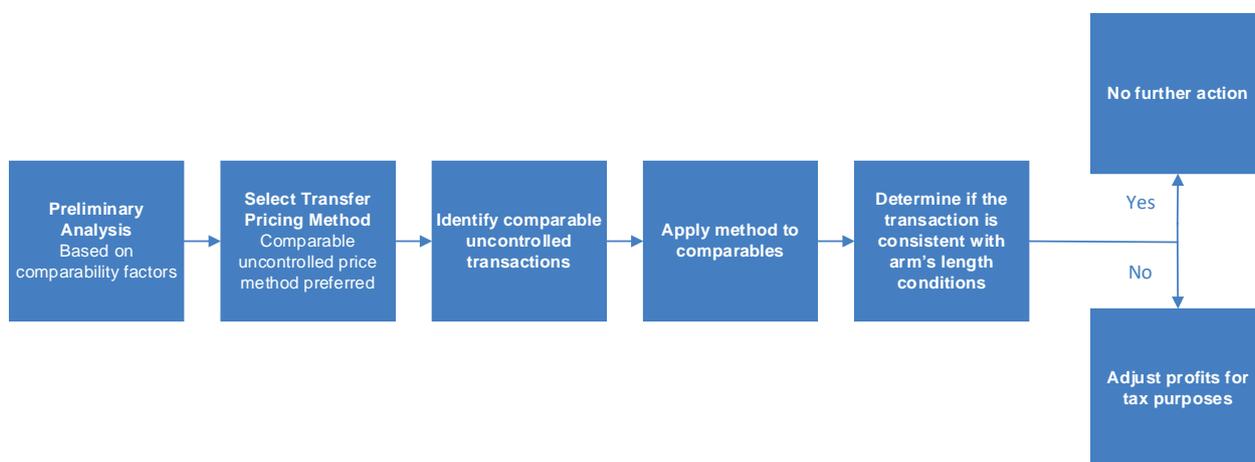
58 Organisation for Economic Co-operation and Development, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, [Internet].

59 The arm's length principle is defined in Article 9 of the OECD Model Tax Convention.

60 A controlled transaction is a transaction between two related parties.

conditions that would be expected in a comparable uncontrolled transaction between independent parties. Figure 3.1 depicts the steps undertaken in comparability analysis to determine the appropriate arm's length conditions of a transaction.

Figure 3.1: Comparability analysis



Source: ANAO analysis of OECD documentation.

3.7 The initial preliminary analysis requires identifying the commercial or financial relationship between parties to understand the underlying transaction. The OECD Guidelines provide five comparability factors to inform this analysis.⁶¹ This preliminary analysis informs the selection of a transfer pricing method using criteria outlined by the OECD Guidelines. The five comparability factors are also considered when selecting comparable transactions.⁶² Applying the selected transfer pricing method to comparables determines if the transaction is consistent with the arm's length conditions. When a transaction is inconsistent with the arm's length conditions, the taxpayer's profits may be adjusted for tax purposes to correct distortions.

3.8 In addition to the comparability analysis process, the OECD Guidelines cover administrative approaches to avoiding and resolving transfer pricing disputes and transfer pricing documentation.

3.9 In January 2022, the OECD published a new version of the Guidelines, incorporating an additional chapter on Transfer Pricing Aspects of Financial Transactions (Chapter X of the OECD Guidelines).⁶³ This additional guidance has not yet been introduced into Australian law (see from paragraph 3.21). The ITAA 1997 continues to reference the 2017 edition of the OECD Guidelines.

61 The comparability factors are:

- (a) The contractual terms of the transaction;
- (b) The functions performed by each of the parties to the transaction, taking into account assets used and risks assumed;
- (c) The characteristics of property transferred or services provided;
- (d) The economic circumstances of the parties and of the market in which the parties operate; and
- (e) The business strategies pursued by the parties.

62 Comparables may be internal (between one party to the controlled transaction and an independent party) or external (between two independent parties).

63 This chapter was initially published in the OECD 'Transfer Pricing Guidance on Financial Transactions' 2020 report addressing BEPS actions 4, 8-10.

Consistency of ATO guidance with OECD principles

3.10 Justified trust (see paragraph 2.33) applies a tailored engagement policy where the assurance activities undertaken for a taxpayer will differ based on taxpayers' individual circumstances. The OECD Guidelines state that effective risk identification and assessment are essential in the early stages of transfer pricing enquiries to identify which arrangements warrant an in-depth review and the commitment of resources.

3.11 Subdivision 815-B of the ITAA 1997 establishes the arm's length principle for cross-border conditions between entities. The definition of arm's length conditions, comparability factors, considerations for selecting a transfer pricing method and comparable circumstances contained in the legislation are consistent with OECD statements on these concepts. Table 3.1 summarises the consistency of ATO guidance for staff and taxpayers against the principles of the OECD Guidelines.

Table 3.1: Assessment of the consistency of ATO guidance with OECD principles

OECD principle	Level of consistency
Comparability analysis internal ATO guidance	◆
Comparability analysis public guidance	◆
Dispute resolution	◆
Documentation	◆

Key: ◆ Consistent ▲ Partially consistent ■ Inconsistent

Note: There was a minor departure from the OECD's guidelines in PCG 2017/4, however, it was immaterial to the overall finding.

Source: ANAO analysis of ATO and OECD documentation.

Comparability analysis internal ATO guidance

3.12 Case teams engage Economist Practice to conduct comparability analysis and determine the appropriate arm's length conditions (see from paragraph 3.53 for more information on Economist Practice). Top 1,000 case teams complete a Standard or Streamlined Toolkit to provide Economist Practice with information to determine the intensity of review required and to conduct analysis.⁶⁴

3.13 The information requested in these Toolkits identifies the relationship between parties and the economically relevant characteristics of the transaction in line with the comparability analysis process in the OECD Guidelines. The Standard Toolkit provides a template for the ATO to complete its own analysis of the taxpayer's transfer pricing method selection. There is no equivalent documentation completed by Top 100 teams as these cases are 'a more bespoke product'. The ATO applies a 'more streamlined approach' to the Top 1,000 population.

3.14 The ATO's Guide to Analysing Related Party Debt assists case officers in their examination of related party finance arrangements and identification of arm's length conditions. This Guide directs staff to three areas of focus — understanding the group's global and local business funding profiles, understanding the commercial and financial relations between parties and understanding the taxpayer's approach to determining arm's length conditions. The first two areas of focus assist

64 For Low/Targeted intensity or Targeted/high intensity taxpayers with no Economist Practice referral the case team completes the Streamlined Toolkit. For targeted/high intensity taxpayers with an Economist Practice referral or high/targeted intensity new entrants to the Top 1000 the Standard Toolkit is to be completed.

with the accurate delineation of the controlled transaction as suggested by the OECD Guidelines. The third area of focus, ‘understanding the taxpayer’s approach to determining arm’s length conditions’, considers evidence provided by the taxpayer supporting their approach to applying transfer pricing methods and determining the arm’s length conditions (see paragraph 3.53).

Comparability analysis public guidance

3.15 The ATO website provides a general explanation of the arm’s length principle and comparability analysis for taxpayers. It states the arm’s length principle:

involves comparing what a business has done and what an independent party would have done in the same or similar circumstances. This principle is supported by all Organisation for Economic Co-operation and Development (OECD) countries.⁶⁵

3.16 The ATO website also reflects the OECD Guidelines in its definition of comparable transactions. The ATO’s public guidance regarding transfer pricing methods⁶⁶ identifies that where comparable transactions are available, the CUP method⁶⁷ ‘is the most direct and reliable way to apply the arm’s length principle’ in line with the OECD Guidelines.⁶⁸

Dispute resolution

3.17 The mutual agreement procedures (MAPs)⁶⁹ Minimum Standards are outlined in the OECD Making Dispute Resolution Mechanisms More Effective Report⁷⁰ (the Minimum Standards) and covered in Chapter IV of the OECD Guidelines. The ATO advised the ANAO in July 2023 that five MAPs have been undertaken in relation to the Top 100 and Top 1,000 populations for related party debt in the years between 2017–18 and 2021–22.

3.18 Australia has published MAP statistics, peer review reports and a MAP country profile in accordance with the Minimum Standards. The published MAP statistics show cases have been on average resolved within the 24-month timeframe provided by the Minimum Standards across

65 Australian Taxation Office, *The arm's length principle and comparability*, ATO, 2022, available at <https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Transfer-pricing/International-transfer-pricing---introduction-to-concepts-and-risk-assessment/?anchor=TheArmsLengthPrinciple#TheArmsLengthPrinciple> [accessed 20 October 2023].

66 Australian Taxation Office, *Appendix 5: Main pricing methodologies*, ATO, 2023, available at <https://www.ato.gov.au/forms-and-instructions/international-dealings-schedule-2023-instructions/appendixes/appendix-5-main-pricing-methodologies> [accessed 14 December 2023].

67 The Comparable Uncontrolled Price method compares the price of a related party transaction with the price of a comparable transaction between independent parties in comparable circumstances.

68 The ATO guidance provide taxpayers with 14 potential transfer pricing method codes, including methods outside of those identified by the OECD. The OECD Guidelines allow for this, stating:
groups retain the freedom to apply methods not described in these Guidelines (hereafter “other methods”) to establish prices provided those prices satisfy the arm’s length principle in accordance with these Guidelines.

69 A mutual agreement procedure (MAP) involves tax administrations consulting to resolve disputes regarding the application of double tax conventions. Taxpayers may initiate a MAP if they feel they have been taxed not in accordance with the provisions of a Convention. MAPs may also be initiated without a taxpayer’s involvement to resolve questions regarding the interpretation or application of the Convention or to address double taxation matters not provided for in the Convention.

70 Organisation for Economic Co-operation and Development, *Making Dispute Resolution Mechanisms More Effective Action 14 - 2015 Final Report*, OECD, 2015, available at <https://www.oecd.org/tax/making-dispute-resolution-mechanisms-more-effective-action-14-2015-final-report-9789264241633-en.htm> [accessed 20 October 2023].

2017–18 to 2021–22. The ATO also provides guidance for taxpayers on its website in accordance with the Minimum Standards requirements.

3.19 The OECD Guidelines provide additional guidance for conducting advance pricing arrangements (APAs)⁷¹ under the MAP article (bilateral and multilateral APAs) in Annexure II to Chapter IV. The ATO advised the ANAO in July 2023 that there are no currently active APAs which apply to transactions involving related party debt.⁷²

Documentation

3.20 Taxation Ruling 2014/8 sets out the Commissioner’s opinion on the transfer pricing documentation requirements in subdivision 284-E of Schedule 1 of the *Taxation Administration Act 1953*. This is consistent with the OECD Guidelines statement that ‘requirements should balance the tax administration’s need for information and the compliance burdens on taxpayers.’ The OECD Guidelines also state that transfer pricing documentation requirements should be reasonable and focused on material transactions to ensure mindful attention to the most important matters. This should balance the tax administration’s need for information with the compliance burden on taxpayers.

Process for adopting updates to the OECD Guidelines

3.21 The ATO has commenced a Minor and Technical Amendment (MTA) process to update references in the ITAA 1997 to incorporate the 2022 OECD Guidelines, in place of its current reference to the 2017 Guidelines. An MTA process is used to achieve minor law changes, such as updating references in tax law. It involves the ATO submitting an application for the inclusion of an amendment in an MTA schedule in a Treasury omnibus bill. At the time of this audit, the ATO had engaged with Treasury to include minor technical amendments to incorporate the 2022 OECD guidelines in the next available bill.

Country-by-Country reporting obligations

3.22 The OECD’s three-tiered Country-by-Country reporting approach, comprising of a master file, local file and Country-by-Country report, aims to address a lack of quality data in transfer pricing matters.⁷³ Country-by-Country reporting applies in Australia to income years commencing from 1 January 2016, as recommended by the OECD Guidelines.

71 An advance pricing arrangement (APA) is an agreement between a taxpayer and tax administration which determines, in advance, an appropriate set of criteria for determining transfer pricing matters over a fixed time period.

72 The ATO advised the ANAO in November 2023 potential reasons for the lack of APAs involving related party debt may include instances where taxpayers are relying on PCG 2017/4 to achieve a degree of tax certainty, loans which are structured through countries Australia does not have a tax treaty with, transactions which are already dealt with under audit or where transactions contain hybrid elements.

73 The master file contains information relevant to all group members, the local file covers material transactions of the local taxpayer and the Country-by-Country report contains the global allocation of the group’s income and taxes paid, including the location of the economic activities.

3.23 Subdivision 815-E of the ITAA 1997 requires ‘CBC reporting entities’⁷⁴ to give statements corresponding to the three tiers in the OECD Guidelines annexures. The OECD Guidelines recommend all multinational enterprise groups should be required to file an annual Country-by-Country report with an exemption for groups with a consolidated group revenue below €750 million. The ITAA 1997 requires entities to file a Country-by-Country report if they are a parent company with an annual global income of at least \$1 billion, or a member of a group with such a parent.

3.24 The OECD Guidelines state: ‘no exemptions from filing the Country-by-Country Report should be adopted apart from the exemptions outlined in this section.’ The ATO provides exemptions for all three reporting tiers on the grounds of administrative relief, fast-track exemptions or exemptions on formal request in certain circumstances.⁷⁵ For the period up to 30 June 2023, 11 Top 100, and 28 Top 1,000 taxpayers have been granted an exemption for the Country-by-Country report.

3.25 The ATO provides its own local file form for taxpayers to complete, comprising of a short form, Part A and Part B.⁷⁶ The short form includes questions addressing the local entity information required by the OECD Guidelines. Part A captures some information on the controlled transactions set out in Annexure II of the OECD Guidelines, including a description of the transactions, the amount of payment and receipts and identification of associated enterprises. Part B requires the taxpayer to provide attachments in line with the OECD Guidelines.⁷⁷

3.26 Both Part A and Part B require the taxpayer to identify the transfer pricing methodologies used. The local file does not contain questions requiring a more detailed description of the comparability and functional analysis performed, including assumptions made, comparable uncontrolled transactions used, comparability adjustments required and the use of financial data as suggested by the OECD Guidelines. The ATO advised the ANAO in November 2023: ‘Those aspects of a transfer pricing analysis generally form part of transfer pricing documentation. They can be quite lengthy and detailed therefore not appropriate for a Local File’.

3.27 Australia is one of 100 signatories to the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (MCAA).⁷⁸ This convention was based on one of the

74 CBC (Country-by-Country) reporting entities are required to give statements under section 815-355 of the ITAA 1997. CBC reporting entities (defined in section 815-370 of the ITAA 1997) include a parent entity with an annual global income for the period of \$1 billion or more (CBC reporting parent under section 815-375 of the ITAA 1997), or an entity which is a member of a group with a CBC reporting parent (section 815-380 of the ITAA 1997).

75 Section 815-365 of the ITAA 1997 provides the Commissioner may, by notice in writing, exempt an entity from giving statements under section 815-355 or giving statements of a particular kind under that section. The Commissioner may also, ‘by legislative instrument, determine section 815-355 does not apply to a specified class of entity’.

76 Taxpayers that meet a set of requirements may lodge the short form only. Reporting entities with international dealings must complete the whole local file form (including the short form) as international related party debt interests are on the ‘short form exceptions list’.

77 Related party agreements, APAs related to controlled transactions and financial accounts are to be attached to the local file.

78 The MCAA is only applicable to Country-by-Country reports, it does not facilitate the automatic exchange of local file and master file reports.

Declaration on the Effective Date for Exchanges of Information Under the Multilateral Competent Authority Agreement on the Exchange of Country-By-Country Reports, signed 3 Jun 2015, [2017] ATS 25 (entered into force 2 November 2017).

model Competent Authority Agreements provided in the OECD Guidelines Annexure IV to Chapter V.⁷⁹ The ATO has internal documentation and restrictions on data access to ensure information received under Country-by-Country agreements remains confidential and is used appropriately by staff.⁸⁰ Australia has additional bilateral exchange arrangements⁸¹ and Tax Information Exchange Agreements⁸² in place for jurisdictions not party to the MCAA.

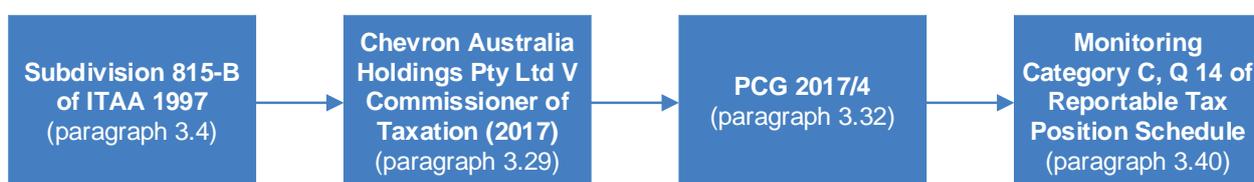
Does the ATO have a sound strategy to engage with taxpayers who use transfer pricing for related party debt?

The ATO has developed a sound strategy to engage with taxpayers who use transfer pricing for related party debt. PCG 2017/4 forms the basis of the strategy. The ATO verifies taxpayer application of PCG 2017/4 through Pre-lodgment Compliance Reviews (PCRs) for the Top 100 population and Combined Assurance Reviews (CARs) for the Top 1,000 population. Experts in the ATO’s Economist Practice are consulted to determine that transfer pricing has occurred appropriately. Staff have access to training to analyse transfer pricing, though training is not mandatory. Support is available to assist taxpayers in applying PCG 2017/4. While the ATO aims to review taxpayers who do not apply PCG 2017/4 this does not occur for the majority of cases.

Engaging with taxpayers using transfer pricing for related party debt

3.28 Engagement with taxpayers using transfer pricing for related party debt primarily occurs through taxpayer application of *PCG 2017/4: ATO compliance approach to taxation issues associated with cross-border related party financing arrangements and related transactions*⁸³ (PCG 2017/4). The purpose of PCG 2017/4 is to enable the ATO to assess risk and tailor its engagement with the taxpayer according to the features of the taxpayer’s related party financing arrangement, the profile of the parties to the related party financing arrangement and taxpayer choices and behaviour.⁸⁴ Figure 3.2 illustrates the development of the ATO’s strategic framework for managing transfer pricing risk.

Figure 3.2: Development of the ATO’s strategic framework



Source: ANAO analysis of ATO documentation.

79 Annexure IV to Chapter V contains an implementation package to assist tax administrations. This includes model legislation and three model Competent Authority Agreements -based on the Convention on Mutual Administrative Assistance in Tax Matters (the model used for the MCAA), bilateral tax conventions and Tax Information Exchange Agreements. All three model Competent Authority Agreements include the same sections and obligations with minor variances.

80 These measures include instructions for staff on data management and access to information, restricted access to the Country-by-Country database and a mandatory training course on appropriate use of Country-by-Country information to gain access.

81 With the United States and Taiwan.

82 The Treasury, *Tax Information Exchange Agreements*, the Treasury, available at <https://treasury.gov.au/tax-treaties/tax-information-exchange-agreements> [accessed on 20 October 2023].

83 Australian Taxation Office, *Practical Compliance Guideline 2017/4* [Internet].

84 *ibid.*

Chevron

3.29 The legislation regarding transfer pricing was applied by the Full Court of the Federal Court in the *Chevron* case⁸⁵ in April 2017 (see Appendix 3), which initiated the development of PCG 2017/4.

Development of PCG 2017/4

3.30 In January 2017, the ATO began to design a PCG for transfer pricing for related party debt. The ATO conducted an internal consultation process, considering key principles and risk indicators, leading to the development of a risk assessment framework and a series of risk zones.

3.31 A ‘targeted consultation’ was then conducted with a capital markets consultant and a banking consultant⁸⁶ to ensure the draft PCG, was based on ‘real-world commercial practices’, prior to its public release. The ATO also consulted with Treasury prior to public consultation to ensure there were no concerns from a policy perspective. Following the ‘targeted consultation’ the ATO provided a draft copy of PCG 2017/4 for public comment. The ATO advised the ANAO in May 2023 that it consulted with various stakeholders⁸⁷, via face-to-face meetings, telephone discussions, or via email. The outcomes of the public consultation process led to the development of a consultation compendium.

Guidance governing taxpayer engagement

3.32 On 18 December 2017, the ATO published PCG 2017/4. It consists of a set of general principles relevant to the framework for considering risk and applying compliance resources to related party financing arrangements.

3.33 The ATO’s transfer pricing strategy is primarily focussed on the taxpayer conducting a self-assessment of its risk position. The ATO then applies an assurance or risk-based approach to assess the disclosures of a selection of taxpayers.⁸⁸ (see from paragraph 3.46) Applying the principles contained in PCG 2017/4 allows taxpayers to self-assess their compliance risk of their related party finance arrangements. The PCG is available on the ATO’s website.⁸⁹

3.34 Section 4 of PCG 2017/4 explains how the taxpayer can use the framework to: assess the tax risk of its related party financing arrangement; understand the compliance approach the ATO is likely to adopt; work with the ATO to mitigate the transfer pricing risk; and understand the type of analysis and evidence the ATO requires when assessing the risk outcomes of the taxpayer’s related party financing arrangements.

3.35 Taxpayers assess features of their arrangements against specific criteria. This assessment results in an overall risk score, with scores falling within risk level zones. The risk zone then reflects the likely compliance approach the ATO will take. When a potential risk is identified, details of the

85 *Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation* [2017] FCAFC 62.

86 Confidentiality agreements were completed by the consultants prior to the commencement of work.

87 Stakeholders included: tax advisory bodies, including representatives from the Chartered Accountants Australia and New Zealand, Corporate Tax Association, Tax Justice Network, and The Tax Institute. Several minerals industry bodies were also consulted: the Australian Petroleum Production and Exploration Association and the Minerals Council of Australia.

88 The ATO verifies whether PCG 2017/4 was properly applied through the Pre-lodgment Compliance Review (see paragraph 3.81) and Combined Assurance Review (see paragraph 3.88) processes.

89 Australian Taxation Office, *Practical Compliance Guideline 2017/4* [Internet].

arrangement are confirmed via PCRs (see paragraph 3.82) and CARs (see paragraph 3.88), further profiling is undertaken, and an assessment as to whether the risk exists needs to be made before escalating to Next Actions or an audit, where Alternative Dispute Resolution (ADR) processes are used. Table 3.2 illustrates the ATO's approach.

Table 3.2: PCG 2017/4 risk assessment framework

Risk level zone	ATO activity
White: arrangements already reviewed	No review, will monitor.
Green: low risk	A review will be conducted by the ATO under exceptional circumstances where: <ul style="list-style-type: none"> the risk zone assessment is not adequately supported with evidence; ATO data and analysis suggests the scores for certain indicators are inaccurate or there is a 'drift' within a range for an indicator; and the arrangement relates to a broader set of circumstances being reviewed.
Blue: low to moderate risk	Monitor arrangements using available data and review arrangements by exception.
Yellow: moderate risk	Work with taxpayer to resolve areas of difference, potentially seek ADR. ⁹⁰
Amber: high risk	Work with taxpayer to resolve areas of difference, potentially seek ADR. A review is likely to be undertaken.
Red: very high risk	Review using formal powers for information gathering and taxpayer subject to audit and potentially subject to litigation.

Source: ANAO analysis of ATO documentation.

3.36 It is not compulsory for taxpayers to apply PCG 2017/4.⁹¹ Reportable Tax Position (RTP) Schedule instructions⁹² require taxpayers who meet the lodgment criteria to disclose any arrangements relating to PCG 2017/4. Taxpayers that make a disclosure for these questions are required to self-assess their risk zone based on PCG 2017/4 guidelines. A non-disclosure is

90 Australian Taxation Office, *ATO plain English guide to alternative dispute resolution*, ATO, 2023, available from <https://www.ato.gov.au/individuals-and-families/your-tax-return/dispute-or-object-to-an-ato-decision/options-for-resolving-disputes/ato-plain-english-guide-to-alternative-dispute-resolution#WhatisalternativedisputeresolutionADR>, [accessed 24 October 2023]. ADR is a term for all processes, other than judicial or tribunal determination, in which an impartial person assists those in dispute to resolve or narrow the issues between them. Examples include mediation and in-house facilitation; conciliation; and early neutral evaluation. The ATO advised the ANAO in November 2023 that early neutral evaluation is a process in which the parties to a dispute present arguments and evidence to a dispute resolution practitioner in an attempt to resolve the matter at an early stage of the dispute.

91 Australian Taxation Office, *Practical Compliance Guideline 2017/4* [Internet]. See paragraph 39. If the taxpayer is unable to (or chooses not to) the taxpayer will need to advise the ATO by disclosing this information on the RTP Schedule.

92 Australian Taxation Office, *Reportable tax position schedule instructions 2023*, ATO, 2022, available from <https://www.ato.gov.au/forms-and-instructions/reportable-tax-position-schedule-2023-instructions> [accessed 19 October 2023].

considered red zone or high risk and the ATO will review why the taxpayer has not applied PCG 2017/4. The ATO details these disclosures in the findings report⁹³ which is published annually.

3.37 The ATO states that as ‘practical compliance guidelines are intended to outline sensible and efficient approaches to ongoing tax administration, rather than interpretive views of the law, it is considered particularly important that they be subject to periodic review.’⁹⁴ PCG 2017/4 has been reviewed to ‘improve clarity’ and to ‘reflect RTP Schedule changes’.⁹⁵ The ATO advised the ANAO in November 2023 there is an APA review underway which may lead to changes in PCG 2017/4. The ATO advised the ANAO in June 2023 that a ‘positive behavioural shift in taxpayer behaviour’ occurred after the release of PCG 2017/4, with some taxpayers engaging early with the finance risk cluster or case teams to review their arrangements.

Support for taxpayers to apply PCG 2017/4

3.38 PCG 2017/4 is not a guide for taxpayers on how to appropriately price related party debt, and ‘does not provide advice or guidance on the technical interpretation or application of Australia’s transfer pricing rules or other taxation provisions’.

3.39 Taxpayers or their advisors are able to contact the ATO for assistance on how to apply PCG 2017/4. In PCG 2017/4, the ATO advises taxpayers that it has a dedicated team responsible for the oversight and management of related party financing arrangement risks.

3.40 The RTP Schedule is a schedule to a company tax return. It gathers information on uncertain tax positions from the largest companies.⁹⁶ RTP Schedule Category C Question 14 requires taxpayers to disclose the outcome of their self-assessment using PCG 2017/4 for cross-border related party finance arrangements. Figure 3.3 and Figure 3.4 show changes in RTP Schedule disclosures from 2017–18 to 2021–22 for the Top 100 and Top 1,000 populations respectively. The ATO advised the ANAO in January 2024 that:

The Full Federal Court’s decision in the Chevron case, guidance provided by PCG 2017/4, PG’s Top 100 and Top 1000 compliance strategies, and increased transparency through RTP disclosures are arguably positively influencing taxpayer behaviour away from high-risk transactions.

93 Australian Taxation Office, *Findings report – Top 100 income tax and GST assurance programs* [Internet].

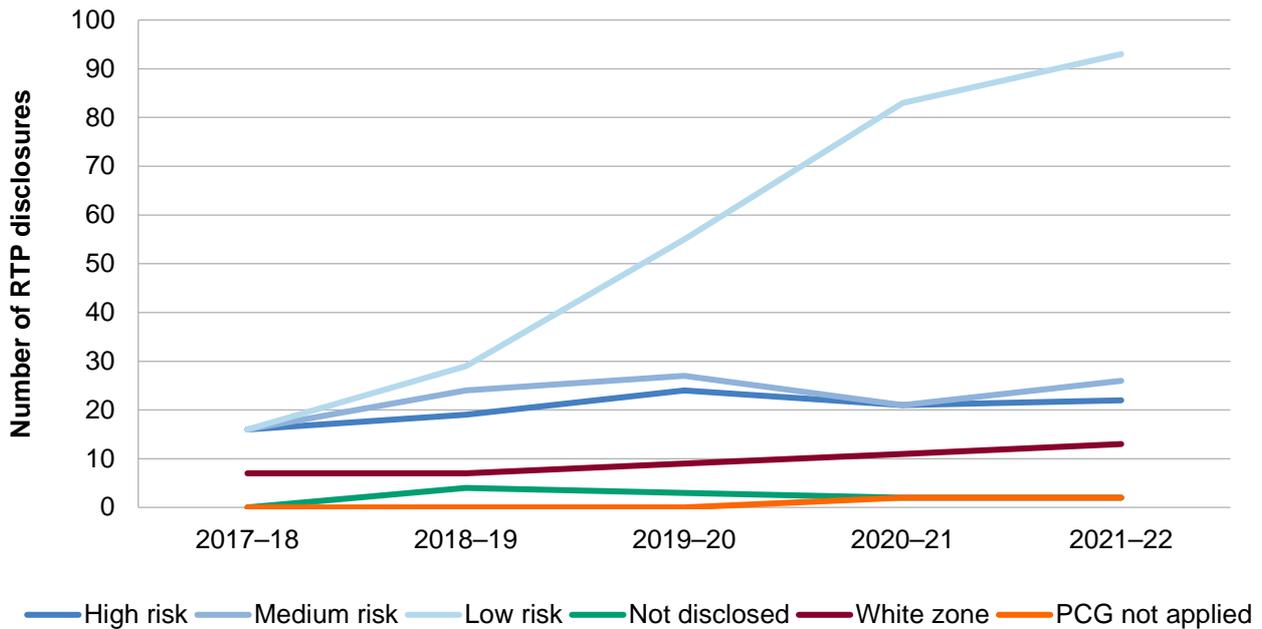
Australian Taxation Office, *Findings report – Top 1,000 income tax and GST assurance programs* [Internet].

94 Australian Taxation Office, *PCG 2016/1 – Practical Compliance Guidelines: purpose, nature and role in ATO’s public advice and guidance*, ATO, available at <https://www.ato.gov.au/law/view/print?DocID=COG%2FPCG20161%2FNAT%2FATO%2F00001&PiT=20200528000001>, [accessed 23 October 2023].

95 Between 2018-2020 there have been seven reviews of PCG 2017/4.

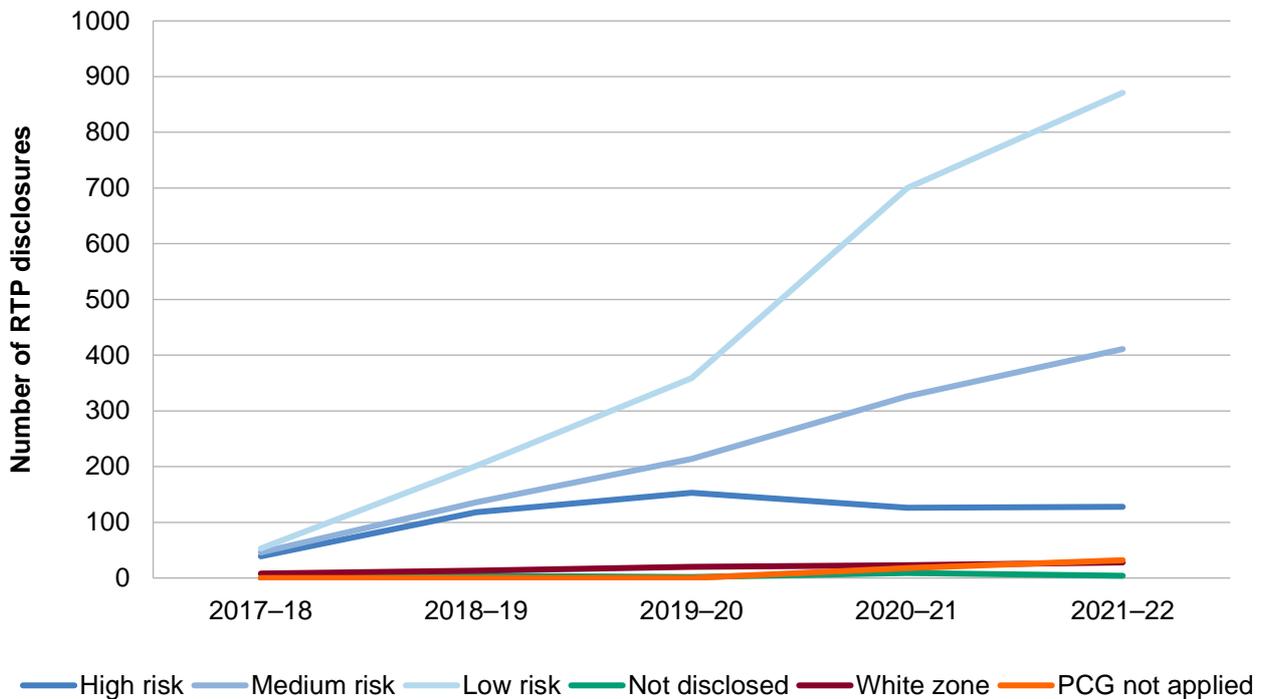
96 Australian Taxation Office, *Reportable tax position schedule*, ATO, 2016, available from <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/large-business/compliance-and-governance/reportable-tax-positions> [accessed 25 October 2023].

Figure 3.3: RTP disclosures for the Top 100 population, 2017–18 to 2021–22



Source: ANAO analysis of ATO documentation.

Figure 3.4: RTP disclosures for the Top 1,000 population, 2017–18 to 2021–22



Source: ANAO analysis of ATO documentation.

3.41 The application of PCG 2017/4 is monitored through RTP Schedule responses provided by taxpayers as part of their tax returns. The ATO advised the ANAO in May 2023 that work was done with the Strategy, Economist Practice, and Engagement and Assurance case teams to gain insights

on taxpayer attitudes to known risks and to identify material residual or emerging related party financing issues. RTP Schedule disclosures are used to identify overall trends in taxpayer behaviour. Annual RTP disclosures are examined to select taxpayers who have riskier arrangements that require assurance for referral to Medium/Emerging and Top 1,000 strategy teams for prioritising for further action. The ATO advised the ANAO in April 2023 that taxpayers who do not apply PCG 2017/4 will be reviewed as part of the ATO's assurance and compliance programs.

3.42 Table 3.3 outlines the number of taxpayers who did not apply PCG 2017/4 between 2020–21 and 2022–23. Of a total of 43 individual taxpayers that did not apply the PCG, eight reviews have been completed, six are in progress, and one was in planning as at February 2024. The ATO did not review 28, or 65 per cent of taxpayers who did not apply PCG 2017/4.

Table 3.3: Taxpayers who did not apply PCG 2017/4

Year	2020–21	2021–22	2022–23
Number of taxpayers ^a	19	26	17 ^b

Note a: Data for 2019–20 is not available as this subcategory was introduced in 2020–21. Some taxpayers did not apply PCG 2017/4 in multiple years.

Note b: 2022–23 data is incomplete as tax returns are lodged throughout the year.

Source: ATO documentation.

Recommendation no. 3

3.43 The Australian Taxation Office take action to ensure all taxpayers with related party debt that do not apply Practical Compliance Guideline 2017/4 are reviewed in accordance with the Australian Taxation Office's goals.

Australian Taxation Office response: *Agreed in principle.*

3.44 *All taxpayers that report they did not apply Practical Compliance Guideline 2017/4 are assessed by the ATO for further action. The ATO will formalise this existing approach in relevant frameworks.*

Taxpayer reporting requirements

3.45 PCG 2017/4 is the primary communication tool in which the ATO provides guidance to taxpayers. The ATO advised the ANAO in November 2023 that PCG 2017/4 'communicates the way the ATO views the risk', and does not 'collect comprehensive information'. The base level of information is contained in company tax returns, within schedules to the return. Along with the RTP Schedule (see paragraph 3.40), taxpayers with aggregate international related party dealings exceeding \$2 million⁹⁷ are also required to complete the International Dealings Schedule (IDS). Some taxpayers (see paragraph 3.23) are also required to provide information through Country-by-Country reports.⁹⁸

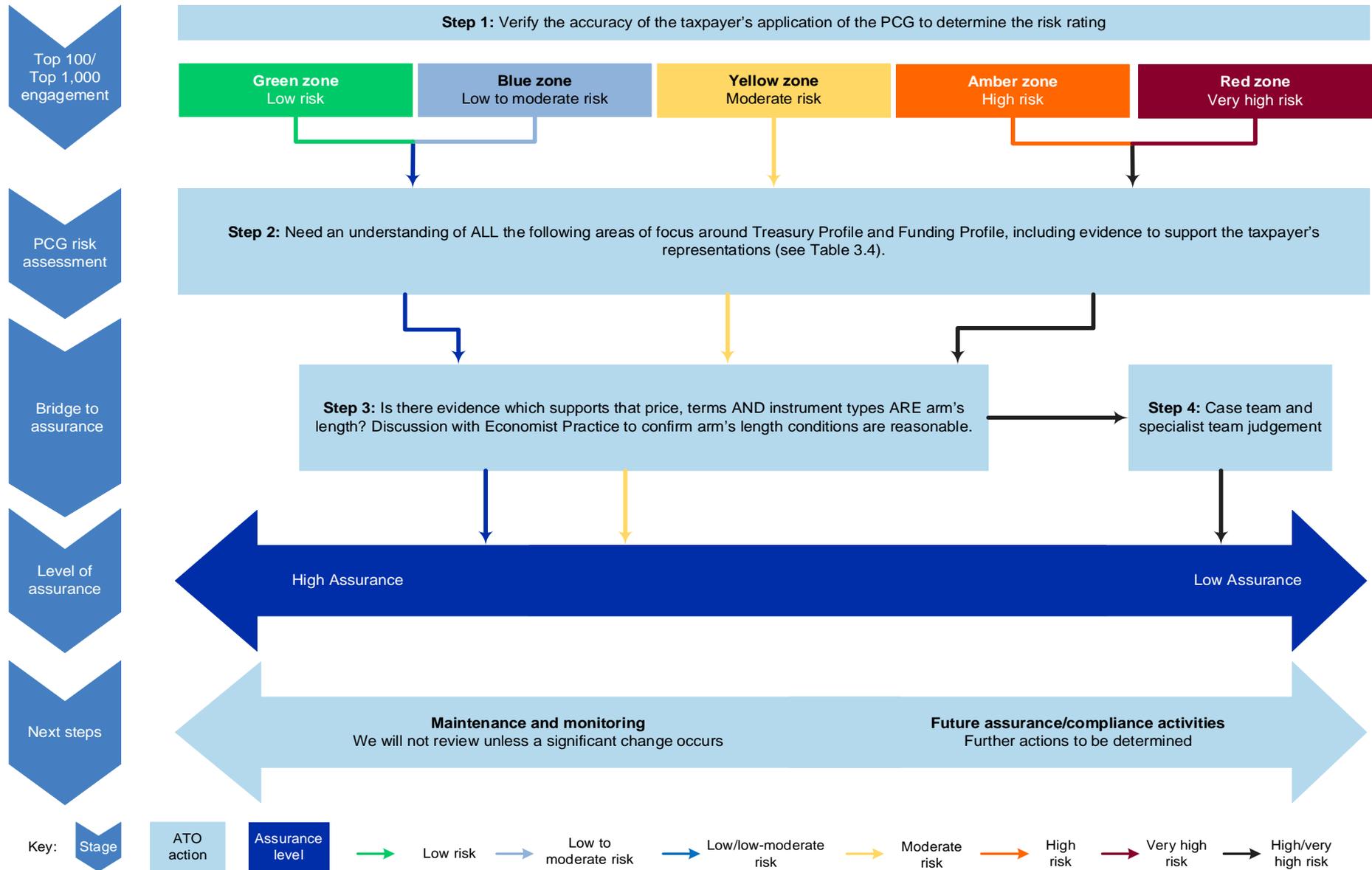
97 Australian Taxation Office, *Section A, International Related Party Dealings*, ATO, 2022, available from <https://www.ato.gov.au/Forms/International-dealings-schedule-instructions-2022/?anchor=SectionA#SectionA> [accessed 30 October 2023].

98 Australian Taxation Office, *Country-by-country reporting*, ATO, 2023, available from <https://www.ato.gov.au/business/international-tax-for-business/in-detail/transfer-pricing/country-by-country-reporting/> [accessed 30 October 2023].

Analysing related party debt, staff guidance, and training and development

3.46 Taxpayers provide case teams with documentation as part of the PCR (see paragraph 3.81) and CAR (see paragraph 3.88) processes to understand and analyse related party debt. Process roadmaps provide guidance to staff and provide consistency in the assessment of transactions that include transfer pricing. This roadmap is summarised at Figure 3.5. The Guide to Analysing Related Party Finance, and the Framework of Enquiry to Understand Global and Domestic Treasury Functions provide further detail on both processes. The roadmaps for the Top 100 and Top 1,000 are almost identical, differing only in what happens after a level of assurance has been established.

Figure 3.5: ATO approach to analysing related party finance



Note: This figure does not depict white zone taxpayers (see Table 3.2).

Source: ANAO analysis of ATO documentation.

Analysing related party debt and staff guidance

3.47 The analysis of related party debt is broken down into four steps for case teams. Case teams must verify the taxpayer’s application of PCG 2017/4, understand the taxpayer’s treasury function and funding profile, determine whether the arm’s length principle has been observed, and, if assurance has not yet been obtained, then exercise judgement to determine the level of assurance.

Step 1: Verify the accuracy of taxpayer’s application of the PCG to determine the risk rating

3.48 ATO guidance states that case teams need to have a thorough understanding of the taxpayers’ overall financing structure to evaluate transfer pricing arrangements and arrive at an appropriate assurance rating. ATO staff need to understand PCG 2017/4 and be able to assess the information required to verify the PCG was properly applied by the taxpayer.

3.49 The taxpayer’s risk zone is one of the indicators of the level of risk posed by an arrangement, along with information obtained during the review, to independently verify the risk rating and influence the ATO’s compliance approach.

3.50 Taxpayers’ responses to PCG 2017/4 are reviewed by the ATO in TARs and Combined Assurance Reports for the Top 100 and Top 1,000 populations respectively. Testing outcomes against these matters are discussed further from paragraph 4.22.

Step 2: Staff need an understanding of taxpayer’s treasury and funding profile

3.51 Table 3.4 outlines the matters ATO staff are required to understand and evidence consideration of to demonstrate that they fully understand a taxpayer’s treasury and funding profiles.

Table 3.4: Evidence gathered by the ATO to understand a taxpayer’s profile

Evidence required by the ATO
Group’s treasury function
Global structure: <ul style="list-style-type: none"> • legal and functional structure, geographical segments and business units.
Global and Australian financial planning and reporting structure and functions, and the differences: <ul style="list-style-type: none"> • reporting structures and functions under the CFO, Authority manuals, and the • policies/guidelines/procedures/ manuals and functions performed by the following: Treasury, Accounting, Tax and Economics (if applicable).
Global and Australian treasury structure and functions, and the differences: <ul style="list-style-type: none"> • whether centralised or decentralised, and key entities (their profiles, functions and interactions with treasury).
Capital and finance, and cash management policies/guidelines: <ul style="list-style-type: none"> • financing of group activities (debt or equity, gearing, intragroup or external), and wealth extraction (dividends).
Exposure identification and management systems: <ul style="list-style-type: none"> • such as exchange rates, interest rates, and commodity prices.

Evidence required by the ATO
Group's funding profile
Global and Australian funding profiles, and the differences: <ul style="list-style-type: none"> what is mandated, how are operations funded, capital structure, and internal governance processes, what is done with excess cash.
Commercial and financial relations: <ul style="list-style-type: none"> character and purpose of the funding, contractual terms and clauses, and substance and commercial practices.
Taxpayer's approach to determining the arm's length conditions: <ul style="list-style-type: none"> transfer pricing documentation, legal agreements, and credit rating assessment.

Source: ATO documentation.

3.52 Consideration and the evidencing of these matters are the way case teams verify whether or not the taxpayer is properly applying PCG 2017/4 and appropriately pricing related party debt. Testing outcomes against these matters are discussed further from paragraph 4.23.

Step 3: Determining whether arm's length conditions are reasonable

3.53 At this step, for both PCRs and CARs, case teams engage Economist Practice to determine whether there is evidence which supports the price, terms and instrument type to demonstrate that the arm's length principle has been observed. Testing outcomes against these matters are discussed further from paragraph 4.31. The ATO provides additional toolkit templates for Top 1,000 case officers engaging Economist Practice (testing outcomes against these matters are discussed further from Paragraph 4.32).

Step 4: Case team and specialist team judgment

3.54 If a taxpayer's risk profile is in the yellow risk zone or above, and the ATO determines that arm's length principles have not been observed, case team and specialist team judgement is required. After the evidence has been considered, the case team can determine an assurance rating between medium and red flag, with further action generally considered to be required. The ATO documents this in TARs and Combined Assurance Reports.

3.55 All Top 100 taxpayers who receive a TAR are provided with a Future Assurance Plan which outlines actions required to be taken by the taxpayer to either maintain or increase their assurance ratings (see paragraph 3.86). For taxpayers who have not obtained high assurance, this includes a section on the 'pathway to justified trust' outlining areas the taxpayer must address so the ATO can gain assurance.

3.56 From commencement of the Top 1,000 Combined Assurance Program to 30 June 2023, the ATO identified 64 Top 1,000 taxpayers that had a rating of 'low' or 'red flag', of which 10 of these matters were flagged as requiring escalation to the Next Actions Program (see paragraph 3.104), and the taxpayer was informed in their Combined Assurance Report. The ATO has completed a Combined Assurance Report for 213 taxpayers during this period.⁹⁹

⁹⁹ 49 in 2020–21, 110 in 2021–22, 54 in 2022–23.

3.57 When a taxpayer is not escalated to the Next Actions Program, the Combined Assurance Report outlines recommended actions to ‘better align with the ATO’s position’¹⁰⁰ and advises the ATO may follow up to see what steps the taxpayer has taken in future engagement.

Training and development

3.58 Technical training on transfer pricing has been provided to case officers since 2017, initiated by the judgment in the Chevron court case¹⁰¹ and the release of PCG 2017/4. The ATO developed a training program which was designed to be undertaken between 2019 and 2021. The ATO advised the ANAO in July 2023 that an advanced training course is in development. Formal training capability development packages have included face-to-face presentations, podcasts, guides and self-directed learning packages.

3.59 Staff training is updated in response to the outcomes of significant litigation. For example, staff were made aware of lessons learned from the Chevron court case via a webinar. Further, self-paced e-learning is available for staff in various formats including videos and podcasts. Training is not mandatory for new or existing non-graduate case officers, and refresher courses are not required. The ATO could not provide details of how many times foundation and intermediate levels of training have been delivered since the release of PCG 2017/4.

Recommendation no. 4

3.60 The Australian Taxation Office:

- (a) make training in related party financing mandatory for new case officers where related party financing is likely to be relevant to their role; and
- (b) develop and maintain a register to ensure all staff are trained consistently and remain up to date in developments around transfer pricing for related party debt.

Australian Taxation Office response: *Agreed in principle with (a); Agreed with (b).*

3.61 (a) *Agree in principle. The ATO will ensure training in related party financing is mandatory for specialists where related party financing is likely to be substantially relevant to their role.*

3.62 (b) *Agree. The ATO will monitor training completion via existing training registers.*

Opportunity for improvement

3.63 Refresher courses could be offered to experienced case officers to ensure they continue to apply ATO guidance appropriately.

100 These recommendations include actions such as performing and documenting a transfer pricing analysis of their arrangements, continuing to apply PCG 2017/4, transitioning their transactions to a lower risk zone and preparing contemporaneous transfer pricing documentation.

101 *Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation* [2017] FCAFC 62.

Arrangements in place to communicate with individual taxpayers and advisors

3.64 The ATO's Public Groups division provides oversight of the strategy for transfer pricing for related party debt (see from paragraph 1.6). Public Groups is responsible for the administration of a range of taxes and tax frameworks, including transfer pricing.

3.65 Engagement for both taxpayers and advisors, takes place at a population level, via Public Advice and Guidance¹⁰², with PCG 2017/4 functioning as the 'primary communication tool'. Engagement at the case level primarily occurs through PCRs and CARs. While the ATO has a communication strategy to engage with public and multinational businesses, there is no specific communication strategy to engage with advisors who provide advice to taxpayers using related party debt.

3.66 Top 100 taxpayers are assigned a Key Client Manager¹⁰³ and can also be assigned a Key Account Manager.¹⁰⁴ All Top 100 taxpayers subject to ongoing compliance work have a Senior Relationship Manager available for communication. They also function as an escalation point for issues that cannot be resolved between the case team and the taxpayer. Top 100 taxpayers engage continuously with the ATO through a dedicated case team and via an annual PCR. A finalisation meeting is held with the taxpayer to discuss the outcomes of the PCR and the resulting Tax Assurance Report (TAR).

3.67 Top 1,000 taxpayers engage with the ATO through a CAR (see from paragraph 4.9). Top 1,000 taxpayers are not assigned a direct contact in the ATO. Engagement with Top 1,000 taxpayers occurs via a CAR, through the case team responsible for the delivery of the CAR. This relationship does not extend beyond the completion of the CAR. Once a CAR is complete, a case team meets with Top 1,000 taxpayers to discuss their assigned assurance rating and potential improvements. The ATO receives feedback from taxpayers on this process via a Client Feedback Survey. Top 1,000 taxpayers do not have dedicated relationship managers.

Does the ATO have sound implementation and oversight arrangements to support engagement with taxpayers using related party debt?

The ATO has a framework to support engagement with taxpayers using related party debt. The Action Differentiation Framework (ADF) categorises taxpayers by size and applies a risk-based 'engagement experience'. These two factors determine the regularity and intensity of the ATO's review processes to gain assurance over taxpayers' income tax, including their use of related party debt. Case teams undertaking assurance reviews are supported by other ATO business lines when engaging taxpayers and finalising assurance outcomes.

102 Australian Taxation Office, *Public Advice and Guidance*, ATO, available from <https://www.ato.gov.au/general/ato-advice-and-guidance/> [accessed 30 October 2023].

103 Key Client Managers undertake a Top 100 taxpayer's income tax compliance work. They are often the main point of contact between the taxpayer and the ATO, tasked with improving service delivery and relationship building, as well as resolving all administrative and transactional requests from taxpayers. Taxpayers without a dedicated Key Account Manager will liaise with their Key Client Manager.

104 Key Account Managers assist taxpayers with administrative issues not able to be resolved by using self-service channels, as well as ensuring the 'time servicing' of a taxpayer's account or transactional issues.

Action Differentiation Framework

3.68 The ATO's engagement with the Top 100 and Top 1,000 taxpayers is tailored based on the ADF.¹⁰⁵ This is the ATO's 'strategic approach to engaging with public and multinational businesses'. The ATO's understanding of, and engagement with, a taxpayer is informed by a taxpayer's size, transparency in its engagement with the ATO, choices and behaviours in its tax affairs, risk, and the level of assurance it has previously obtained. The ATO aims for the ADF to allow the ATO to use its resources efficiently, target priority areas and 'to focus on the principles of obtaining justified trust' (see from paragraph 2.33).

3.69 Under the ADF, Public Groups taxpayers are categorised into four populations based on their total business income (TBI).¹⁰⁶ The two relevant to the audit are Top 100 (greater than \$5 billion or a 'market leader'), and Top 1,000 (greater than \$250 million to \$5 billion).¹⁰⁷ The ATO advised the ANAO in July 2023 that business rules applied by the Business Market Table define the Top 1,000 population (see paragraph 4.5 for more information on the Business Market Table). Testing indicated that there were no quality controls in place to verify the completeness and accuracy of the Top 1,000 population. This is consistent with the finding made in Auditor-General Report No.26 2022–23, *Interim Report on Key Financial Controls of Major Entities*.¹⁰⁸

3.70 Table 3.5 outlines the size of the Top 100 and Top 1,000 populations.

Table 3.5: Size of Top 100 and Top 1,000 populations, 2021–22 to 2023–24

Population	2021–22	2022–23	2023–24
Top 100	82	84	85
Top 1,000 ^a	1,195	1,269	1,478
Total	1,277	1,353	1,563

Note a: The Top 100 population is not part of the Top 1,000 population. The Top 1,000 population is in addition to the Top 100 population.

Source: ANAO analysis of ATO documentation.

3.71 There are three ADF 'engagement experiences'. From highest to lowest, these are partnering; encouraging; and influencing.¹⁰⁹ To have a better ADF engagement experience, a taxpayer has less chance of significant tax risks if it possesses one or more of the following qualitative characteristics: transparency and willingness to engage with the ATO, and less complex

105 Australian Taxation Office, *Action Differentiation Framework*, ATO, 2021, available from <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/large-business/action-differentiation-framework> [accessed 30 October 2023]. Prior to 2021, the ATO used the Risk Differentiation Framework to categorise Top 100 taxpayers.

106 The ATO advised the ANAO in June 2023 that '[TBI] is calculated by the ATO system (Business Market Table) using the latest tax return, activity statement, business registration data lodged by all entities within the group that shares the same Ultimate Holding Company (UHC)'.

107 The other two populations are Medium (\$10 million to \$250 million) and Emerging (less than \$10 million).

108 Auditor-General Report No.26 2022–23 *Interim Report on Key Financial Controls of Major Entities*, paragraphs 3.26.14 to 3.26.16.

109 There should 'generally' be a correlation between the Justified Trust assurance ratings and the ADF engagement experiences. A 'partnering' taxpayer will have a high assurance rating, an 'encouraging' taxpayer will have a medium assurance rating, and an 'influencing' taxpayer will have a low assurance rating. There are also 'not rated' (or 'unrated') taxpayers, which are those that cannot be assigned an engagement experience due to a lack of information. This rating is 'usually' applied because a taxpayer is a new entrant to the population.

tax arrangements. ADF engagement experiences have been communicated to Top 100 taxpayers since 2020–21 in an annual ADF letter. The ATO advised the ANAO in November 2023 that Top 1,000 taxpayers are not informed of their ADF engagement experience.

3.72 Table 3.6 outlines the number of Top 100, and Table 3.7 outlines the number of Top 1,000, taxpayers by their ADF engagement experience.

Table 3.6: Number of Top 100 taxpayers by ADF engagement experience 2021–22 to 2023–24

Top 100	2021–22	2022–23	2023–24 ^a
Partnering	41	44	44
Encouraging	26	27	29
Influencing	7	7	8
Not rated	8	6	4
Total	82	84	85

Note a: 2023–24 data has not been finalised as tax returns are lodged throughout the year.

Source: ANAO analysis of ATO documentation.

Table 3.7: Number of Top 1,000 taxpayers by ADF engagement experience, 2021–22 to 2023–24

Top 1,000	2021–22	2022–23	2023–24 ^a
Partnering	428	371	425
Encouraging	523	521	751
Influencing	237	328	268
Not rated	7	49	34
Total	1,195	1,269	1,478

Note a: 2023–24 data has not been finalised as tax returns are lodged throughout the year.

Source: ANAO analysis of ATO documentation.

Top 100 population and review priority

3.73 A TBI of greater than \$5 billion or being a ‘market leader’ is necessary for an economic group¹¹⁰ to be considered for inclusion in the Top 100 population and consequent PCRs.

Opportunity for improvement

3.74 The Australian Taxation Office could develop clearly defined metrics that qualify an economic group for inclusion within the Top 100 population.

110 The ATO defines an ‘economic group’ as including ‘all entities (companies, trusts and partnerships, etc) that lodge an Australian tax return under a direct or indirect Australian or foreign ultimate holding company or other majority controlling interest. This includes all entities under a single ultimate holding company or under the ownership of a single individual, trust or partnership.’

Top 1,000 population and review priority

3.75 The Top 1,000 population comprises those economic groups not in the Top 100 with a TBI of greater than \$250 million and up to \$5 billion. The ATO advised the ANAO in November 2023 that ‘there are some economic groups in the Top 1,000 population with TBI over \$5 billion’.¹¹¹ Regardless of individual TBI, all entities within a Top 1,000 economic group are part of the Top 1,000 population. TBI is determined by a business rule calculated by the ATO’s Business Market Table (see from paragraph 4.5).

3.76 After a case list of Top 1,000 taxpayers to undergo a CAR in a given period is finalised, it is reviewed and endorsed by the Top 1,000 Assistant Commissioner. Endorsed case lists are then allocated to case teams. A reserve case list of ‘generally smaller taxpayers with less complex arrangements’ who can be reviewed when resourcing permits was provided from the 2022 case selection process, though evidence for previous years was not provided.

3.77 CAR case selection principles were finalised in February 2022. The case selection pool is divided into a ‘Strategy Referral Group’ consisting of three industries¹¹² and a ‘General Group’ consisting of all other taxpayers. Prioritisation of taxpayers within the Strategy Referral Group is based on the insights of industry-specific strategy teams. General Group selection is based against defined criteria, followed by a triage process for prioritisation. Prior to the finalisation of the CAR case selection principles, a taxpayer’s selection was based on criteria considering the impact of COVID-19, previous Streamlined Assurance Reviews, other ATO activity and taxpayer performance.

3.78 The ATO manages its population via a live document maintained by the Top 1,000 program. In November 2023 the ATO advised the ANAO that ‘data is refreshed regularly for taxpayer lodgments and ADF changes, as well as with [manual] updates containing case selection notes.’ A triage process is conducted and the Top 1,000 Case Selection Principles document is then applied (for more information on CARs see from paragraph 3.88).

Introduction to PCRs and CARs

3.79 The ATO aims to verify taxpayers’ self-assessments under PCG 2017/4 during PCRs (which lead to the issue of a TAR of Top 100 taxpayers) and CARs (which lead to the issue of a Combined Assurance Report) of Top 1,000 taxpayers.¹¹³ Transfer pricing for related party debt is assessed by the ATO as part of obtaining assurance over Top 100 and Top 1,000 taxpayers’ income tax within the ATO’s broader assurance program. The ATO aims to conduct a PCR on Top 100 taxpayers annually (see from paragraph 3.81 for further discussion of PCRs). The ATO also aims to complete 250 CARs of Top 1,000 taxpayers annually (see paragraph 2.48). PCRs and CARs are undertaken by

111 The ATO further advised the ANAO in December 2023 that those economic groups with a TBI above \$5 billion in the Top 1,000 population are ‘mostly due to’ being:

- new entrants to Public Groups;
- previously in the Top 100 population ‘and may have achieved high assurance for a number of years and/or had a drop in their TBI’;
- ‘Large APRA funds with high turnover given the nature of the business’; and
- ‘moderated as less strategically and financially important to warrant a Top 100 status.’

112 The Strategy Referral Group consists of taxpayers within three industries: Superannuation Funds and Managed Investment Trusts; Insurance; and the Banking and Finance industry.

113 PCRs are part of the Top 100 Justified Trust Program and CARs are part of the Top 1,000 Combined Assurance Program.

case teams from Engagement and Assurance. The Top 100 Justified Trust Program and the Top 1,000 Combined Assurance Program are part of the ATO's Tax Avoidance Taskforce.¹¹⁴

3.80 In terms of income tax assurance, three overall assurance ratings can be applied to Top 100 and Top 1,000 taxpayers: high, medium and low (for more information on assurance ratings, see from paragraph 2.39). The ATO does not record data on the total number of related party finance transactions assessed by the ATO for the Top 100 and Top 1,000 populations from 2019 to 2022.

PCR summary

3.81 Undertaken annually, PCRs are the ATO's 'primary income tax assurance product' for managing engagement with the Top 100.¹¹⁵ Top 100 taxpayers receive an annual ADF letter¹¹⁶ advising how the ATO will tailor its engagement with them and offering Key Account Managers (Top 100 taxpayers are assigned a Key Client Manager and can also be assigned a Key Account Manager — see paragraph 3.66).¹¹⁷

3.82 Engagement and Assurance case teams are responsible for the day-to-day management of a PCR and for the final assurance rating. Engagement and Assurance teams record analysis and document supporting evidence in a TAR to capture the results of a PCR.¹¹⁸ A TAR is divided into a Permanent File and an Executive Summary. The Permanent File is the 'corporate memory/repository' of the ATO's engagement with the taxpayer intended for internal use. The Executive Summary is provided to the taxpayer summarising assurance outcomes and includes a Future Assurance Plan on work needed to obtain or maintain high assurance (see from paragraph 3.86 for further discussion of Future Assurance Plans).

Monitoring and Maintenance approach

3.83 Top 100 taxpayers who have achieved overall high assurance ('justified trust') are not subject to further PCRs for the following two income years. The ATO monitors their disclosures and tax outcomes for the following two income years via the 'Monitoring and Maintenance' approach. During a Monitoring and Maintenance Review, the ATO seeks only to verify the tax outcomes from any significant new transactions or material changes to a taxpayer's business activities, including the tax treatment of those activities. A Monitoring and Maintenance Review results in a Monitoring and Maintenance Review Assurance Report.¹¹⁹

114 Australian Taxation Office, *Tax Avoidance Taskforce* [Internet].

'The Tax Avoidance Taskforce ensures multinational enterprises, large public and private businesses (and associated individuals) pay the right amount of tax in Australia. Formed in 2016, it enhances and extends our existing activities to eradicate illegal and fraudulent tax arrangements. The taskforce bolsters our pre-existing efforts in tackling tax avoidance.'

115 Top 100 taxpayers with an Annual Compliance Arrangement are not subject to a Pre-lodgment Compliance Review and are not required to lodge a reportable tax position (RTP) schedule. The Top 100 GST Assurance Program is responsible for seeking assurance that Top 100 taxpayers are reporting the right amount of GST.

116 The ADF letter also outlines the ATO's understanding of a taxpayer and the assurance obtained over a taxpayer, including its ADF engagement experience.

117 The ATO advised the ANAO in July 2023 that it cannot commit such resources to all taxpayers with a TBI over \$5 billion.

118 A Tax Assurance Report outlines the level of assurance obtained over a taxpayer's tax paid; the tax consequences of the taxpayer's economic activities; and potential tax risks.

119 Also referred to as an Income Tax Monitoring and Maintenance Report.

3.84 Table 3.8 outlines the number of Monitoring and Maintenance reviews undertaken between 2019–20 and 2021–22.

Table 3.8: Number of Monitoring and Maintenance Reviews, 2019–20 to 2022–23

2019–20	2020–21	2021–22	2022–23	Total
0	20	20	15	55

Source: ATO documentation.

3.85 As part of the Monitoring and Maintenance approach, a ‘more comprehensive’ justified trust review (or ‘refresh’ review) is then conducted every third income year. As at 30 June 2023, 13 refresh reviews have been completed. A refresh review ‘generally’ focuses on the current income year and eventuates in a TAR. If the taxpayer maintains overall high assurance at the conclusion of the refresh review, the Monitoring and Maintenance approach recommences.¹²⁰ The ATO can conduct a refresh review prior to the third income year if there has been a ‘fundamental business change’ or if it considers trust can no longer be maintained with a taxpayer.

PCR escalation

3.86 A Future Assurance Plan is the pathway developed by a case team to increase or maintain the ATO’s assurance level over a taxpayer. This includes areas over which assurance could not be obtained during a PCR due to further evidence and analysis being required.

3.87 A Future Assurance Plan is a ‘visual snapshot’ of actions to be completed in future engagements, such as further work or behavioural changes required to obtain justified trust. It is located within the Executive Summary of a TAR (see paragraph 3.82 for more information on the Executive Summary).

CAR summary

3.88 A CAR assesses whether a Top 1,000 taxpayer is reporting the correct amount of income tax and GST.¹²¹ CARs commenced in 2021, replacing Streamlined Assurance Reviews.¹²² A CAR is conducted jointly by income tax and GST case teams responsible for their respective income tax and GST components. The income tax component of a CAR covers a four-year period. For a Top 1,000 taxpayer to be eligible for a CAR, ATO documentation suggests it will generally have three or more years of income tax not assured with a TBI above \$250 million in three of the last four years lodged.¹²³ Table 3.9 outlines how many first time and repeat CARs were conducted between 2019–20 and 2022–23.

120 If a taxpayer fails to maintain high assurance at the conclusion of a refresh review, then it will exit the Monitoring and Maintenance approach and be subject to annual PCRs. The ATO advised the ANAO in November 2023 that this has not yet occurred.

121 CARs covered income tax assurance and a GST risk review when introduced in 2021. If a concern was identified in a GST risk review, a separate GST assurance review would then be undertaken. They were expanded from April 2022 to provide assurance of GST.

122 Streamlined Assurance Reviews were part of the Top 1,000 Tax Performance Program. The ATO advised the ANAO in November 2023 that the first RFI issued for a CAR was in September 2020 and that the last Income Tax Streamlined Assurance Review was issued in October 2021.

123 Based on taxpayer TBI, not on economic group TBI.

Table 3.9: First time and repeat CARs, 2019–20 to 2022–23

Year	Total completed	First-time reviews	Percentage of first-time CARs	Repeat CARs	Percentage of repeat CARs
2019–20 ^a	212	212	N/A	N/A	N/A
2020–21	104	49	47	55	53
2021–22	198	110	56	88	44
2022–23	158	54	34	104	66

Note a: 2019–20 relates to Streamlined Assurance Reviews which were conducted prior to 2020–21. As all CARs completed in 2020–21 were first time CARs, there is no data for that year on changes to assurance ratings.

Source: ANAO analysis of ATO documentation.

3.89 A CAR results in two products: an Internal Combined Assurance Report (ICAR) and an External Combined Assurance Report (XCAR). The income tax component of the ICAR is generated by the Public Groups Assurance Profiling Dashboard accessed via the Enterprise Client Profile (ECP) (see Table 4.1). This occurs during the planning stage of a CAR.

3.90 The generated ICAR includes ‘all base level information’, such as the taxpayer’s details, tax performance and profile, alignment between accounting and tax results, and previous engagement history. To complete the Internal Combined Assurance Report, manual intervention and further analysis is required with additional information incorporated as a CAR progresses. In terms of related party financing arrangements, this occurs in line with the Top 1,000 Assurance Roadmap for Related Party Financing Arrangements (see from paragraph 3.46). The XCAR is the product issued to the taxpayer at the completion of a CAR.

Internal engagement

3.91 Multiple branches within Public Groups, as well as Economist Practice within International, Support and Programs, provide support and assistance to the Top 100 Justified Trust Program and the Top 1,000 Combined Assurance Program. This consultation can occur at any stage during a review. When reviewing significant or new transactions or tax risks as a part of a PCR, ATO guidance suggests engaging internal experts to assist and sign off on assurance ratings.¹²⁴ Internal guidance recommends that Engagement and Assurance case teams hold an initial workshop with an internal stakeholder to discuss the nature of the engagement between them.

3.92 To ensure decision making ‘reflects’ the ATO’s perspective, case teams consult internal stakeholders such as Economist Practice, International Tax Structuring, the Arm’s Length Conditions – Related Party Financing Cluster (‘finance risk cluster’) and the Tax Counsel Network.

- Economist Practice provides advice on arm’s length conditions for related-party debt, including arm’s length interest rates (see from paragraph 3.53 for more information on engagement with Economist Practice).

124 Such experts include Economist Practice, International Tax Structuring and ‘Other internal specialists and Clusters’.

- International Tax Structuring provides technical advice and practical insight on broader international tax risks, including transfer mispricing.¹²⁵
- The finance risk cluster (within International Tax Structuring) provides a coordinated strategic approach to the management of related party financing risks and works with other areas of the ATO to provide advice (see paragraph 2.17).
- Tax Counsel Network assists with the interpretation or application of tax law provisions, as well as with legal precedents relevant to their current work.¹²⁶

3.93 A case team's decision making for considering the appropriateness of a taxpayer's transfer pricing methods and comparability analysis is informed by engaging Economist Practice. The respective assurance roadmaps for related party financing arrangements for both the Top 100 Justified Trust Program and Top 1,000 Combined Assurance Program states case teams are to confirm with Economist Practice that arm's length conditions are reasonable (see Figure 3.5).

Oversight and sign-off

Top 100

3.94 A TAR and the assurance ratings it contains are reviewed and endorsed at the SES QA Finalisation Panel.¹²⁷ An SES QA Finalisation Panel is required for full and refresh TARs. After the SES QA Finalisation Panel, case teams record and address any action items and feedback.

Top 1,000

3.95 The ICAR and XCAR are reviewed and endorsed at the Finalisation Panel.¹²⁸ The XCAR is sent by the case team to its team or technical leader for final approval.

Reporting

3.96 Guidance on the Top 100 Justified Trust Program states there is a 'commitment' to report to internal and external stakeholders. Information from reviews is tracked by the Top 100 network and reported to 'various stakeholders', such as the Public Groups Executive and the Tax Avoidance Taskforce reports. The ATO does not produce dedicated reporting on transfer pricing for related party debt. The ATO advised the ANAO in November 2023 that Top 1,000 Combined Assurance Program reporting requirements and guidance are embedded in procedures. The ATO did not stipulate which procedures these were.

125 International Tax Structuring has an engagement strategy for the Top 100 Justified Trust Program. The engagement strategy states that it works collaboratively with case teams to provide support in scoping engagements with taxpayers and to assist case teams in delivering assurance.

126 Tax Counsel Network is also involved in high-risk issues or matters related to the application of anti-avoidance rules as outlined in Australian Taxation Office *PS LA 2021/1 (GA)*, available from: <https://www.ato.gov.au/law/view/document?docid=PSR/GA20121/NAT/ATO/00001>

127 Panel attendees include the Engagement and Assurance case team, the relevant Engagement and Assurance SES (responsible for final sign-off), the Top 100 Justified Trust Program Assistant Commissioner, a Justified Trust Network site representative and a National Tax Governance Specialist.

128 Held one to three weeks before the issuing of the External Combined Assurance Report to the taxpayer. Panel attendees include the Engagement and Assurance case team, the relevant Engagement and Assurance SES, a Top 1,000 Combined Assurance Program income tax representative and Economist Practice, when international related party dealings are involved.

3.97 Reporting on the Top 100 Justified Trust Program and the Top 1,000 Combined Assurance Program includes:

- a monthly paper detailing its outcomes to the PG Executive Forum;
- a monthly update with ‘anything of note’ to the Minister’s office for the Tax Avoidance Taskforce; and
- a quarterly update to the Minister’s office on its overall status under the Tax Avoidance Taskforce.¹²⁹

3.98 Aggregated data is reported publicly via annual findings reports (see paragraph 2.58).

External engagement

3.99 The ATO has attended the TP Minds (‘Transfer Pricing Minds’) Australia conference from 2020 to 2023. TP Minds Australia is the local iteration of a global series of annual conferences dedicated to ‘insights and gain[ing] best practice advice on the latest global [transfer pricing] challenges from authoritative experts’. An ATO Deputy Commissioner also attended TP Minds International in London in March 2018 and delivered a speech at the event. The Deputy Commissioner of Public Groups was a keynote speaker at TP Minds Australia in 2020, 2022 and 2023.

Assurance mechanisms and review processes

3.100 The ATO advised the ANAO in August 2023 that it ‘continually’ reviews and adapts its assurance programs. Examples for the Top 100 Justified Trust Program include the following.

- The guide produced for the Top 100 Assurance Approach to Taxation Determination TD 2022/9¹³⁰ is an example of the Top 100 network supporting case teams with the assessment of transactions after new legislation or guidance has been enacted.
- The implementation of the Monitoring and Maintenance approach, which allows for ‘more tailored, less intense’ reviews for high assurance taxpayers (see from paragraph 3.83). At the Large Business Stewardship Group meeting in March 2020 it was agreed that a paper would be prepared outlining options for consideration and consultation. This led to a draft consultation note presented to the Public Groups Executive Forum, then a process of receiving and responding to internal and external feedback over the following two years.

3.101 Examples for the Top 1,000 Combined Assurance Program include the following.

- Responding to feedback that taxpayers would benefit from clarity on governance expectations, a working group was established at the Large Business Stewardship Group¹³¹

129 The ATO advised the ANAO in July 2023 that this includes ‘commitment to government summary, status of deliverables and key tasks, issues and risks’.

130 The full title of Taxation Determination TD 2022/9 is ‘Income tax: is section 951A of the US Internal Revenue Code a provision of a law of a foreign country that corresponds to sections 456 or 457 of the *Income Tax Assessment Act 1936* for the purpose of subsection 832-130(5) of the *Income Tax Assessment Act 1997*?’. Australian Taxation Office, TD 2022/9, ATO, 2022, available from <https://www.ato.gov.au/law/view/document?DocID=TXD%2FTD20229%2FNAT%2FATO%2F00001&PiT=99991231235958&path=law&path=view&path=document> [accessed 19 December 2023].

131 The ATO advised the ANAO in August 2023 that the Large Business Stewardship Group is a key channel for feedback for the Top 1,000 Combined Assurance Program.

meeting in April 2021. This led to a workshop, published guidance and post-publication feedback.

- Responding to feedback at its May 2022 meeting that the testing requirements for stage three governance ratings would not always enable all taxpayers to align to their broader enterprise testing programs, the Large Business Stewardship Group established a working group to determine whether any changes were required to the testing requirements. A report of the working group’s findings was reported to the Large Business Stewardship Group meeting in August 2022.

Escalation to audit

Top 100

3.102 The endorsement of the Audit Panel is required to progress issues within a PCR to audit in the case of a tax matter dispute. Internal documentation states that Panel membership consists of three Assistant Commissioners (Senior Executive Service Band 1s) from Law Advice and Resolution, International Risk and Domestic Risk. Additional members who can be invited when needed include an Assistant Commissioner from Economist Practice and Directors from International Risk, Domestic Risk and Case Leadership.¹³²

3.103 Engagement and Assurance case teams complete an audit business case template for submission to the Audit Panel. The Audit Panel convenes monthly to review business cases presented to it and determine if an escalation to audit is necessary. If an escalation to audit has been recommended, a PCR is not closed until a decision has been made by the Audit Panel and this decision is communicated in the TAR cover letter.

Table 3.10: Number of times an issue from a PCR was escalated to audit, 2019–20 to 2022–23

	2019–20	2020–21	2021–22	2022–23
Transfer pricing issue	2	1	1	0
No transfer pricing issue	3	5	1	2
Total	5	6	2	2

Source: ANAO analysis of ATO documentation.

Top 1,000

3.104 Areas of concern identified in a CAR are escalated to the Next Actions Program.¹³³ Taxpayers are notified if they need to undertake further action or if the ATO will undertake further

¹³² The ATO advised the ANAO in November 2023 that the Audit Panel’s membership in practice differed from that outlined in internal documentation. The Audit Panel consisted of five Assistant Commissioners from Case Leadership (Law Advice and Resolution), International Risk, Domestic Risk, International Tax Structuring and Next Actions (with a sixth Assistant Commissioner from Economist Practice attending if there is a transfer pricing issue), as well as Directors (EL 2s) from Case Leadership (Law Advice and Resolution), International Risk and Domestic Risk which ‘would be invited to attend.’

¹³³ Internal ATO guidance states that a potential Next Action review is identified when there is one or more of the following conditions:

- the ATO considers it likely the taxpayer will have overall low assurance;
- the ATO plans on rating an issue or any control/s with a red flag; and
- there is a material tax risk that the case team considers might need further compliance action.

intervention. If the ATO decides a Next Actions Review is necessary, the XCAR will outline to the taxpayer what it needs to do to prepare for this engagement. The matter can then be further escalated to an audit.¹³⁴ XCARs also include a 'Future areas attracting our attention and potential engagement' section which outlines to the taxpayer any areas beyond the review's period that are likely to be examined in future reviews.

3.105 Tables 3.11 to 3.13 contain data on CARs escalated to the Next Actions Program and to audit. The ATO's evidence for this data consists of commencement letters and finalisation letters for Next Action reviews, audit business case referrals and communications from the ATO to the relevant taxpayer. As the evidence provided does not consist of completed Next Action reviews or audit reports, this data cannot be assured.

Table 3.11: Number of CARs escalated to the Next Actions Program, 2020–21 to 2022–23

	2020–21	2021–22	2022–23
Transfer pricing issue	0	5	7
No transfer pricing issue	10	19	8
Total	10	24	15

Source: ATO documentation.

Table 3.12: Number of CARs escalated directly to audit, 2020–21 to 2022–23

	2020–21	2021–22	2022–23
Transfer pricing issue	0	1	1
No transfer pricing issue	0	0	1
Total	0	1	2

Source: ATO documentation.

Table 3.13: Number of CARs escalated to the Next Actions Program further escalated to audit, 2020–21 to 2022–23

	2020–21	2021–22	2022–23
Transfer pricing issue	0	0	2
No transfer pricing issue	0	0	1
Total	0	0	3

Source: ATO documentation.

Post-audit escalation processes

3.106 Alternative dispute resolution processes are approaches 'other than judicial or tribunal determination' involving an impartial person. They can be used during settlement negotiations with the aim of resolution or at least minimising areas of disagreement.¹³⁵ One of the ATO's guiding

¹³⁴ The ATO also advised the ANAO in November 2023 that a Top 1,000 case team can recommend an audit be undertaken during a CAR if a taxpayer is 'displaying certain behaviours, not providing timely or complete responses and is generally disengaged'.

¹³⁵ Alternative dispute resolution can include processes run or initiated by courts or tribunals.

principles when conducting litigation is to ‘attempt to resolve disputes early to avoid unnecessary litigation and related costs’.¹³⁶ In terms of transfer pricing for related party debt, the ATO advised the ANAO in June 2023 the forms of alternative dispute resolution used typically are settlement by direct negotiation¹³⁷ and, to a lesser extent, in-house facilitation.¹³⁸ The ATO advised the ANAO in June 2023 that 12 financing matters were resolved by settlement for the three years ending 30 June 2022.

3.107 The ATO advised the ANAO in November 2023 that penalties ‘may’ apply when an adviser has promoted a tax exploitation scheme (such as transfer mispricing) or made false or misleading statements to the ATO.¹³⁹ Since the current promoter penalties were enacted in 2006¹⁴⁰, there have been seven Federal Court of Australia cases concerning promoter penalties. None of the seven cases involved transfer mispricing.

136 Practice Statement Law Administration 2013/3 affirms that under Appendix B of the Attorney-General’s Legal Service Directions 2005, the ATO is required to consider alternative dispute resolution as a ‘continuing obligation from the time litigation is contemplated and throughout the course of litigation’.

137 Direct negotiation is when the different parties are comfortable conversing with each other and do not require an additional party to assist their negotiations.

138 In-house facilitation (IHF), a free service involving a trained independent ATO facilitator who assists parties during negotiations, is more common to disputes with taxpayers outside the remit of Public Groups.

139 The ATO also advised the ANAO in November 2023 that it can refer matters to the Australian Federal Police or the Tax Practitioners Board.

140 Australian Taxation Office, *PS LA 2021/1*, ATO, 2021, available from: <https://www.ato.gov.au/law/view/document?DocID=PSR/PS20211/NAT/ATO/00001&PiT=99991231235958> [accessed 29 January 2024]. ‘Division 290 applies to conduct within Australia occurring on or after 6 April 2006 and to conduct outside Australia occurring on or after 28 June 2013.’

4. Does the ATO effectively manage transfer pricing for related party debt?

Areas examined

This chapter examined whether the Australian Taxation Office (ATO) effectively manages transfer pricing for related party debt through the use of data and intelligence to monitor taxpayer behaviour, and whether the ATO properly applied its framework.

Conclusion

The ATO is largely effective at managing transfer pricing for related party debt. Data and intelligence are gathered to monitor taxpayer behaviour. The ATO largely applies its framework to analyse related party finance, though there are some variations in how the Top 100 and Top 1,000 teams verify taxpayer application of Practical Compliance Guideline 2017/4 (PCG 2017/4), and record analysis of taxpayer financing and capital structures.

Area for improvement

The ANAO suggested that the ATO could harmonise relevant parts of the Combined Assurance Report Template with the Tax Assurance Report to ensure considerations of related party financing are recorded consistently by case teams.

4.1 The ATO's Corporate Plan 2023–24 identifies multinational tax performance as a key focus area, including the following deliverable:

- Address key risks to the corporate tax base and close tax loopholes so that the community has confidence that public and multinational businesses are paying the right amount of tax in Australia.¹⁴¹

4.2 This requires the ATO to use data and intelligence to monitor taxpayer behaviour, and for the ATO to properly apply its strategic framework to effectively manage transfer pricing for related party debt.

Does the ATO have sound processes to use data and intelligence to monitor the behaviour of taxpayers using related party debt?

The ATO has documented processes to gather data and intelligence on Top 100 and Top 1,000 taxpayers using related party debt. Profiling of taxpayers occurs early in the review process via internal and publicly available information. Data and intelligence are sourced from information disclosed by taxpayers as part of their responsibilities under Australian income tax law or from information requested by the ATO during the review process.

4.3 The ATO gathers information formally and informally¹⁴², and 'generally' seeks to request information on an informal basis. The ATO's uses its formal powers when necessary, such as when

141 Australian Taxation Office, *ATO Corporate Plan 2023-24* [Internet].

142 Australian Taxation Office, *Gathering Information*, ATO, 2016, available from: <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/public-business-and-international/tailored-engagement/tax-assurance/gathering-information> [accessed 11 December 2023].

an informal approach is no longer considered ‘productive’ or when requested by a taxpayer. A taxpayer will be advised by the ATO in advance of formal information-gathering powers being used.

Profiling

4.4 Prior to the ATO submitting requests for information (RFIs), a Top 100 case team profiles a taxpayer when commencing a Pre-lodgment Compliance Review (PCR). For a Combined Assurance Review (CAR), a Top 1,000 case team profiles a taxpayer after the first RFI has been issued (see from paragraph 3.79). This process involves the use of multiple ATO systems to better understand the taxpayer. Table 4.1 outlines the internal sources of profiling information and Table 4.2 outlines the external sources of profiling information.¹⁴³

Table 4.1: Internal sources of profiling information for PCRs and CARs

Source	Function
Enterprise Client Profile	A centralised information platform providing a ‘single, consolidated, whole-of-client view’ of a taxpayer’s ‘personal, obligation and risk information’ based on their tax and superannuation position. Its intent is to: ‘support a co-ordinated approach for providing tailored engagement [for taxpayers] (across all tax and super obligations) based on their choices, behaviour, circumstances and risk.’
Public Groups Assurance Profiling Dashboard	Part of the Enterprise Client Profile. It assists case teams with the completion of engagement and assurance activities, providing tailored insights, analysis and alerts for taxpayers. It allows evidence of assurance and risk from internal and external sources to be gathered and compiled by case teams. This includes access to risk models and case histories to support Top 100 and Top 1,000 assurance processes.
Siebel	Used to record and manage all work on taxpayers, including reviews and audits, thereby proving a ‘whole of client view’. The Consolidated Client View within Siebel contains identification information for taxpayers, and is where case teams can access details of a taxpayer’s interactions with the ATO.
Scout	A search platform used to find information, such as a case or documents, within Siebel. This includes information relevant to risk identification, analysis and decision making.

Source: ANAO analysis of ATO documentation.

143 The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations states that common sources of transfer pricing information are commercial databases comprising accounts filed by companies with the relevant administrative bodies. It also states there are proprietary databases that are developed and maintained by advisory firms.

Table 4.2: External sources of profiling information for PCRs and CARs

Source	Function
MASCOT	The Mirrored Australian Securities Commission On Time (MASCOT) is part of the Australian Securities and Investment Commission (ASIC) database and contains information for determining corporate structures and company ownership. It includes details of all Australians Company Numbers, Australian Registered Body Numbers and Australian Registered Scheme Numbers issued by ASIC.
IBISWorld	Contains information on company profiles and corporate structures, including information leveraged from economic, demographic and market data. It contains up to five years of company financial data.

Source: ANAO analysis of ATO documentation.

4.5 ASIC data and intelligence is used by the ATO for the Business Market Table. It captures the details of all taxpayers with standardised information to support taxpayer profiling and reporting.¹⁴⁴ The Business Market Table applies agreed business rules to allocate taxpayers to client experience segments, business market segments and business lines.¹⁴⁵ The ATO advised the ANAO in July 2023 that these business rules define the Top 1,000 population (see from paragraph 3.75 for more information on the Top 1,000 population). The Action Differentiation Framework was designed to align with the Business Market Table (see from paragraph 3.68 for more information on the Action Differentiation Framework).

Data and intelligence sources

4.6 The main sources of ‘initial data’ for related party debt are:

- the International Dealings Schedule (IDS) (see from paragraph 3.45) or the Country-by-Country Australian local file for significant global entities (see from paragraph 3.22);
- loan agreements (provided as part of the Country-by-Country local file for significant global entities);
- disclosures at Category C, Question 14 of the Reportable Tax Position (RTP) Schedule (see from paragraph 2.25); and
- transfer pricing documentation, via RFIs (see paragraph 4.9) during PCRs and CARs.

4.7 RTP Schedule disclosures are used to gather information on ‘uncertain tax positions’ and identify overall trends in Top 100 and Top 1,000 taxpayers’ behaviour.¹⁴⁶ An RTP Schedule is a schedule to a taxpayer’s annual income tax return. These taxpayers are required to disclose their

144 Taxpayers self-assess their industry on their tax return (including their Australian and New Zealand Standard Industrial Classification code — see from paragraph 4.16), which is then stored in the ATO’s tax return tables and in the Business Market Table, as well as being ‘reflected’ in the Enterprise Client Profile.

145 Market segmentation is implemented in the Enterprise Data Warehouse and then made available through Siebel.

146 RTP Schedule disclosures apply to large business as a whole (those taxpayers with a total business income greater than \$250 million). This also includes taxpayers covered by the Top 500 Private Groups Tax Performance Program and the Next 5,000 Private Groups Tax Performance Program.

Like with PCRs, RTP Schedules do not apply to Top 100 taxpayers with an Annual Compliance Arrangement. An RTP Schedule disclosure was originally only required by Top 100 taxpayers. It has applied to Top 1,000 taxpayers since 2017/18.

‘most contestable, material tax positions’ in their RTP Schedule.¹⁴⁷ This includes arm’s length conditions of related party finance arrangements. Category C, Question 14 of the RTP Schedule asks taxpayers to disclose their self-assessment of any cross-border related party finance arrangement under PCG 2017/4 (see paragraph 3.40).

4.8 An IDS is required to be completed by businesses with more than \$2 million in international related party dealings.¹⁴⁸ It is lodged with a taxpayer’s annual income tax return (paragraph 3.45).

Requests for information

4.9 The ATO seeks information for PCRs and CARs via written RFIs and discussions with taxpayers or their representatives.¹⁴⁹ Internal guidance for PCRs and CARs provides information for case teams on the conduct of RFIs throughout the review process.

4.10 The ATO has publicly available guidance for Top 100 taxpayers on the stages of the PCR process.¹⁵⁰ The document is a timeline across eight quarters showing multiple potential meeting points with possible meeting subjects and the information sources the taxpayers should have available.¹⁵¹ ‘Significant related party and third party deals’ is listed as a potential meeting subject in the first four quarters.

4.11 The ATO advised the ANAO in November 2023 that PCR RFIs are not as structured as those for CARs, which have one, two (if required) or three (if required) RFIs. As evidenced by the publicly available guidance, PCRs involve ongoing dialogue and regular meetings between the ATO and the taxpayer. A ‘milestone template’ is used by PCR and CAR case teams to record the points in the review process, including the issuing of RFIs and taxpayers’ responses to them.

Verification of data

4.12 Opportunities to improve the ATO’s data are identified ‘in the course of ongoing data analysis activities’ by the finance risk cluster (see from paragraph 2.17), as well as by International Risk and Projects and the RTP Insights Team. For example, a data quality review was undertaken in July 2023 regarding the RTP Schedule Question 14 responses provided for the 2021 and 2022 years of income. The findings and recommendations of this review were provided to the RTP Team for consideration and further action. The ATO advised the ANAO in March 2024 that action on this matter was still in progress.

147 The ATO advised the ANAO on 13 October 2023 that in 2019 RTP Schedules transitioned to a ‘self-assessment regime’ where taxpayers determined the requirement to complete one (which ‘vastly expanded’ the number who lodged an RTP Schedule).

148 An IDS is also required to be completed by businesses with the lesser of \$5 million or 50 per cent of aggregated turnover in international related party dealings.

149 If information cannot be obtained from a taxpayer, the ATO will request it from third parties when appropriate.

150 Australian Taxation Office, *Engaging early with you*, ATO, 2016, available from: <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/public-business-and-international/excellent-working-relationships/engaging-early-with-you> [accessed 11 December 2023].

151 The guidance also assists case teams in preparing RFIs.

Visibility of transactions in non-OECD countries

4.13 The ATO has visibility of international related party dealings by Australian taxpayers in jurisdictions which are not signatories to OECD Country-by-Country reporting requirements via a taxpayer's IDS and Country-by-Country local file. The ATO advised the ANAO in September 2023 that information might be exchanged between the ATO and foreign tax authorities in OECD member countries in relation to cases or risks (in accordance with relevant treaties). The ATO participates in international exchange of information (EOI) mechanisms, where taxpayer-related information is shared between jurisdictions either by request or under automatic EOI agreements between tax treaty partners.

Are instances of transfer pricing for related party debt being managed as intended?

The ATO manages transfer pricing for related party debt largely as intended. There are some variations in how the Top 100 and Top 1,000 teams verify taxpayers' application of PCG 2017/4, and record analysis of taxpayers' financing and capital structures.

Selection of taxpayers for testing

4.14 To assess whether the ATO managed transfer pricing for related party debt as intended, ATO reviews of taxpayers from both the Top 100 and Top 1,000 population were examined.

Top 100

4.15 Fourteen individual taxpayers from the 84 members of the Top 100 population from 2018–19 to 2020–21 were selected to assess whether transfer pricing for related party debt was being assessed by case officers as required by ATO guidance.

4.16 The ANAO selected taxpayers for testing, seeking to ensure that all risk ratings and ATO industry segments and Australian and New Zealand Standard Industrial Classification (ANZSIC) divisions¹⁵² were included. To ensure a relevant range of risk ratings, industry segments and ANZSIC divisions were included, a selection matrix was developed to ensure full coverage across these areas. Taxpayers were separated by ATO industry segment and ANZSIC division. In some cases, there was only one qualifying taxpayer in an ANZSIC division, so they were automatically selected for testing. Once these taxpayers were selected, ANZSIC divisions containing multiple taxpayers were examined, and taxpayers were selected to ensure all three risk ratings were represented. Through this process, of the fourteen selected taxpayers, four were high assurance, six were medium assurance, and four were low assurance.

152 ANZSIC divisions were developed by the Australian Bureau of Statistics to enable comparability of industry statistics between Australia and New Zealand, and with the rest of the world. Australian Bureau of Statistics, *Australian and New Zealand Standard Industrial Classification (ANZSIC)*, ABS, 2013, available from: <https://www.abs.gov.au/statistics/classifications/australian-and-new-zealand-standard-industrial-classification-anzsic/latest-release> [accessed 18 October 2023].

Top 1,000

4.17 From the population of Top 1,000 taxpayers with related party debt from 2018–19 to 2020–21, a representative random sample of 75 taxpayers was taken¹⁵³ to assess whether transfer pricing for related party debt was being assessed by case officers as required by ATO guidance. Through this process, of the 75 sampled taxpayers, 16 were high assurance, 51 were medium assurance, and eight were low assurance.

Methodology

4.18 As noted from paragraphs 3.46 to 3.57, ATO staff are guided by process roadmaps outlining the approach to analysing related party debt used by Top 100 and Top 1,000 taxpayers. Step 1 of the roadmap is to verify the accuracy of taxpayers' application of PCG 2017/4 to determine the risk rating. Step 2 of the roadmap outlines the matters case officers are required to understand and evidence consideration of, to demonstrate that they fully understand a taxpayer's treasury and funding profiles to establish that related party debt is being appropriately priced. The ATO advised the ANAO in November 2023:

We do not reference, or necessarily follow, the stepped instructions in a step-by-step fashion, nor record the outcomes of each step, in the 'Top 100 Assurance Roadmap for Related Party Financing Arrangements'.

4.19 For both the Top 100 and Top 1,000, these processes are the same, though the documents used to record this work vary in format.

4.20 Step 3 requires case teams to engage Economist Practice to confirm if a taxpayer's arm's length conditions are reasonable. The ATO's application of these steps is analysed in the Findings section below. Step 4 requires case team and specialist team judgment in cases with medium assurance to red flag ratings requiring further action. The ATO documents this in Internal Combined Assurance Reports (ICARs) and Tax Assurance Reports (TARs) as part of the transfer pricing analysis so this could not be separately tested.

Findings

4.21 A sample of 14 TARs and 75 ICARs was examined to assess the ATO's management of related party debt (see paragraph 4.14). The ATO's management of the selected instances of transfer pricing for related party debt in the Top 100 and Top 1,000 populations is largely effective.

153 For the purposes of selecting the sample for detailed examination, 318 taxpayers in the Top 1,000 population were identified as having related party debt transactions across the period 2018–19 to 2021–22. Of this total of 318, the ANAO randomly selected 75.

Step 1: Verify the accuracy of taxpayer's application of the PCG to determine the risk rating

Table 4.3: Assessment of the ATO's verification of taxpayers' PCG 2017/4 responses^a

	PCG 2017/4 applied by taxpayer	PCG 2017/4 assessment verified by ATO ^b	ATO analysis increased PCG 2017/4 risk rating	ATO analysis decreased PCG 2017/4 risk rating
Top 100 TARs	12	9	2	1
Top 1,000 ICARs	67	36	3	3

Note a: Testing is based on the most recent TAR or ICAR completed for each taxpayer, with report issue dates ranging from 2018 to 2023.

Note b: These figures include one Top 100 case and three Top 1,000 cases where the taxpayer did not apply PCG 2017/4 and the ATO made its own assessment.

Source: ANAO analysis of ATO documentation.

4.22 All ICARs and TARs analysed mentioned PCG 2017/4 and its applicability to some extent. ATO verification of the taxpayer's PCG 2017/4 assessment was clearly articulated in nine (64 per cent) of the sample (14) of Top 100 TARs and 36 (48 per cent) of the sample (75) of Top 1,000 ICARs analysed. A justification for why the taxpayer's PCG 2017/4 self-assessment was not verified was included in 12 ICARs and two TARs.¹⁵⁴

Step 2: Staff need an understanding of taxpayer's treasury and funding profile

4.23 Analysis of the ATO's application of Step 2 of the roadmap is at Table 4.4.

Table 4.4: Assessment of the ATO's management of selected instances of transfer pricing for related party debt

Item	Top 100 assessment	Top 1,000 assessment
Group's treasury functions		
Global Structure <ul style="list-style-type: none"> Legal and functional structure, geographical segments and business units 	●	●
Global and Australian financial planning and reporting structure and functions, and the differences <ul style="list-style-type: none"> Reporting structures and functions under the CFO, Authority manuals, and the policies/guidelines/procedures/manuals and functions performed by the following: Treasury, Accounting, Tax and Economics (if applicable). 	●	◐
Global and Australian treasury structure and functions, and the differences <ul style="list-style-type: none"> Whether centralised or decentralised, and key entities (their profiles, functions and interactions with treasury) 	●	●

¹⁵⁴ This included instances where the taxpayer had provided insufficient information to verify the accuracy of their responses, the related party debt transaction was subject to an Advanced Pricing Arrangement (see paragraph 3.19), an ATO audit was ongoing, the taxpayer was eligible for simplified transfer pricing record-keeping and the transaction was a cash pooling arrangement which PCG 2017/4 does not apply to.

Item	Top 100 assessment	Top 1,000 assessment
Capital and finance, and cash management policies/guidelines <ul style="list-style-type: none"> Financing of group activities (debt or equity, gearing, intragroup or external), and wealth extraction (dividends) 	●	●
Exposure identification and management systems <ul style="list-style-type: none"> Such as exchange rates, interest rates, and commodity prices 	●	◐
Funding profile		
Global and Australian funding profiles, and the differences <ul style="list-style-type: none"> What is mandated, how are operations funded, capital structure, and internal governance processes, what is done with excess cash 	●	◐
Commercial and financial relations <ul style="list-style-type: none"> Character and purpose of the funding, contractual terms and clauses, and substance and commercial practices 	●	●
Taxpayer's approach to determining the arm's length conditions <ul style="list-style-type: none"> Transfer pricing documentation, legal agreements, and credit rating assessment 	◐	◐

Key: ○ Negligible ◐ Partially complete ◑ Half complete ● Mostly complete ● Complete

Source: ANAO analysis of ATO documentation.

4.24 The matters outlined for analysis in Step 2 of the roadmap are primarily documented in TARs for Top 100 taxpayers and ICARs for Top 1,000 taxpayers (See from paragraphs 3.82 and 3.89).

4.25 While information required to assess Top 100 and Top 1,000 taxpayers is the same, there are some inconsistencies in how information has been recorded between TARs and ICARs.

4.26 In the tested Top 1,000 population, 31 cases did not include documented consideration of treasury authority manuals, policies, guidelines, procedures or functions. This should be included in consideration of the taxpayer's global and Australian financial planning and reporting structure and functions. Further, ATO documentation for 27 of the assessed Top 1,000 cases did not identify what is mandated in the taxpayer's Australian and global funding profiles.

4.27 These two considerations were documented in all analysed Top 100 cases, often in the 'financing and capital structure' section of the TAR template. A comparable section of analysis is not present in the Top 1,000 ICARs. The location of financing information in these reports differs between cases.

Opportunity for improvement

4.28 The ATO could harmonise relevant parts of the ICAR template with the TAR to ensure considerations of related party financing are recorded consistently by case teams.

4.29 Where applicable, exposure identification and management systems were covered in all Top 100 TARs assessed.¹⁵⁵ In the tested Top 1,000 population, 10 of the 21 ICARs where commodity prices were deemed relevant to a taxpayer's operations did not consider this factor.

4.30 The ATO documents for all tested Top 100 and Top 1,000 cases included a section analysing transfer pricing for related party debt transactions entered into by the taxpayer. However, of those tested, six Top 100 and 29 Top 1,000 cases did not include consideration of the taxpayer's credit rating assessment. A credit rating assessment should be considered in analysis of the taxpayer's approach to determining the arm's length conditions where applicable. In some cases the ATO documented a decision to not consider all factors regarding the taxpayer's approach to determining arm's length conditions.¹⁵⁶

Step 3: Determining whether arm's length conditions are reasonable

4.31 Table 4.5 contains results of testing performed on the ATO's engagement with Economist Practice for Step 3.

Table 4.5: Assessment of ATO case teams' engagement with Economist Practice

	Economist Practice engaged (number and %)	Economist Practice not engaged (number and %)
Top 100 TARs	12 (86%)	2 (14%)
Top 1,000 ICARs	73 (97%)	2 (3%)

Source: ANAO analysis of ATO documentation.

4.32 Within the sample of Top 1,000 files, 59 required case teams to complete the Economist Practice Streamlined Toolkit and 16 required a Standard Toolkit (see from paragraph 3.12).¹⁵⁷ The Streamlined Toolkit was completed in 19 cases and the Standard Toolkit was completed in 18 cases, including six cases where a Streamlined Toolkit was required.¹⁵⁸ It is common practice for case teams to engage Economist Practice by emailing a draft ICAR and a summary of the taxpayer's activities rather than a completed Toolkit template. There is no document equivalent to the toolkits used for the Top 100 Justified Trust Program.



Rona Mellor PSM
Acting Auditor-General

Canberra ACT
17 April 2024

155 Consideration of exchange rates was considered non-applicable for taxpayers with related party financing in Australian dollars and commodity prices were determined to be non-applicable for taxpayers that did not operate in commodity-related industries.

156 Cases where a taxpayer's approach to determining the arm's length conditions was not fully analysed include where an assessment under the PCG 2017/4 found the transaction was low risk, where the taxpayer could not provide the required documentation, where the transaction was incorrectly classified and where a related party financing arrangement was to be reviewed in the next period due to low materiality.

157 The Streamlined Toolkit is to be completed for low/targeted intensity taxpayers or targeted/high intensity taxpayers with no Economist Practice referral required. The Standard Toolkit is to be completed for targeted/high intensity taxpayers with an Economist Practice referral.

158 In November 2023 the Streamlined Toolkit was discontinued and the Standard Toolkit replaced with the ICAR TP template. See Appendix 2 for further details.

Appendices

Appendix 1 Australian Taxation Office's response

Second Commissioner of Taxation



Australian Government
Australian Taxation Office

Rona Mellor
A/g Auditor-General
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Ms Mellor,

Re: ANAO s19 draft report for the *Australian Taxation Office's management of taxpayers' use of Transfer Pricing and Related Party Debt*

Thank you for your letter/email dated 20 February 2024 and for the opportunity to comment on the Section 19 draft report for the audit into the *Australian Taxation Office's management of taxpayers' use of Transfer Pricing and Related Party Debt*.

The ATO is extremely proud of the work we have done to transform our approach to transfer pricing risk associated with cross-border related party financing arrangements. The ATO has achieved important legal precedents that have underpinned our strategy, notably the decision in Chevron and most recently in the case against Singtel. The ATO was one of the first tax administrations globally to release detailed guidance on our compliance approach and since then, more than \$45 billion of interest deductions for past and future years have been removed from the system.

Our range of compliance programs provide the Australian community with confidence that all large businesses are monitored and reviewed to ensure that they pay the right amount of tax, and we take firm action against those that don't. The combination of these programs, and our detailed guidance, allows us to focus our resources in the right areas, tailored to the unique business profile of the taxpayer.

We are pleased that the ANAO finds the ATO's compliance framework for related party finance to be largely effective, noting that the review also identified some governance opportunities for improvement. Attached is the ATO response to recommendations (Annexure 1) and summary of our comments to be included in the report (Annexure 2). The ATO agrees with Recommendations 1, 2 and 4, as well as in principle, agreeing with Recommendation 3 as presented in the Section 19 draft report.

I would like to thank the Australian National Audit Office team for the cooperative and professional manner they have adopted in working with us on this matter. I look forward to continuing the good working relationship developed in this audit.

PO Box 900 Civic Square ACT 2608 Australia ato.gov.au

If you require further information on this matter, please contact Assistant Commissioner Vy Tran on 03 9285 1024.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jeremy Hirschhorn', written in a cursive style.

Jeremy Hirschhorn
Second Commissioner of Taxation

18 March 2024

Appendix 2 Improvements observed by the ANAO

1. The existence of independent external audit, and the accompanying potential for scrutiny improves performance. Improvements in administrative and management practices usually occur: in anticipation of ANAO audit activity; during an audit engagement; as interim findings are made; and/or after the audit has been completed and formal findings are communicated.
2. The Joint Committee of Public Accounts and Audit (JCPAA) has encouraged the ANAO to consider ways in which the ANAO could capture and describe some of these impacts. The ANAO's corporate plan states that the ANAO's annual performance statements will provide a narrative that will consider, amongst other matters, analysis of key improvements made by entities during a performance audit process based on information included in tabled performance audit reports.
3. Performance audits involve close engagement between the ANAO and the audited entity as well as other stakeholders involved in the program or activity being audited. Throughout the audit engagement, the ANAO outlines to the entity the preliminary audit findings, conclusions and potential audit recommendations. This ensures that final recommendations are appropriately targeted and encourages entities to take early remedial action on any identified matters during the course of an audit. Remedial actions entities may take during the audit include:
 - strengthening governance arrangements;
 - introducing or revising policies, strategies, guidelines or administrative processes; and
 - initiating reviews or investigations.
4. In this context, the below actions were observed by the ANAO during the course of the audit. It is not clear whether these actions and/or the timing of these actions were planned in response to proposed or actual audit activity. The ANAO has not sought to obtain assurance over the source of these actions or whether they have been appropriately implemented.
 - The ATO advised the ANAO in November 2023 that the Economist Practice Standard Toolkit (see from paragraph 3.12) is now referred to as the Internal Combined Assurance Review Transfer Pricing (ICAR TP) template, with minor changes made to the template including updates to terminology and case team instructions. The Streamlined Toolkit 'will no longer be used by case teams'. The ATO advised the ANAO in November 2023 the ICAR TP template was finalised and uploaded to the ATO's intranet on 6 November 2023. The sections requiring case teams to complete a summary of global and domestic operations have been shortened, with only a summary of the taxpayer's profit and loss and balance sheet required in the new template. Two additional guidance documents dated 25 October 2023 have also been added to the ATO intranet that include references to the ICAR TP template and a 'Top 1,000 TP specialist'. These are the 'Top 1,000 – Top 1,000 Case Team and Top 1,000 TP Specialist responsibilities' and 'Top 1,000 CAR TP flowchart'.
 - The ATO advised the ANAO in October 2023 that the Audit Panel ceased in June 2023. From July 2023, it was replaced by the Audit Authorisation process. Internal guidance on the income tax component of PCRs was updated on 12 October 2023 to reflect this change. Under the Audit Authorisation process, the Case Leadership Assistant Commissioner and the Operational Assistant Commissioner (responsible for the proposed audit) convene to consider and potentially endorse a business case (see from paragraph 3.102).

Appendix 3 Litigation

1. The ATO provided three litigation cases relevant to the management of transfer pricing for related party debt concerning publicly listed companies. Principles from the judgments in these cases have informed the ATO's approach to managing related party debt matters. The ATO has produced in-house training for staff on the Glencore¹⁵⁹ and Singtel¹⁶⁰ cases. Summaries of the three litigation cases are included below.

Chevron

2. The Court found that Chevron Australia Holdings Pty Ltd gained a greater tax benefit than would otherwise be possible in an ordinary transaction between two unrelated entities.¹⁶¹ Chevron Australia and a US-based subsidiary, Chevron Funding Corporation, entered into a loan agreement, where the agreed interest rate was higher than that of an arm's length transaction.

Glencore

3. In this case the court found that Glencore had produced adequate evidence to establish the pricing terms between Glencore international AG and Cobar Management Pty Ltd were reasonably expected between independent parties and were dealings at arm's length.¹⁶² The transaction was an intra-group arrangement to sell copper concentrate that appeared to be unreasonably disadvantageous to Glencore, triggering the arm's length transaction question. The court upheld the notion that the transaction was sufficiently arm's length as it had the effect of risk sharing between the two entities.

Singtel

4. In this case, the Commissioner of Taxation argued the effective overall interest rate exceeded arm's length conditions.¹⁶³ Originally the interest rate was to be equal to the Australian Bank Bill Swap Rate (BBSW) plus a margin of 1 per cent, with interest only payable after the lender issued a variation notice. In 2003 the agreement was amended to increase the premium to 4.552 per cent and the borrower was not required to pay interest until a profitability benchmark was met. Singtel argued the increase in premium was to compensate for the interest free period resulting from this benchmark.

5. This premium was later amended to a 6.835 per cent fixed component plus a margin of 1 per cent. The profitability benchmark was met earlier than expected, meaning the borrower paid more interest than would have been required under the original agreement. Singtel's effective interest rate was 13.26 per cent following the third amendment to the agreement.

6. The Commissioner of Taxation issued notices of amended assessment disallowing interest deduction payments for the final three years of the agreement as the amendments were inconsistent with arm's length conditions. The taxpayer objected to these assessments and

159 *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187.

160 *Singapore Telecom Australia Investments Pty Ltd v Commissioner of Taxation* [2021] FCA 1597.

161 *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62.

162 *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187; Australian Taxation Office, *Decision impact statement*, ATO, 2021, available from <https://www.ato.gov.au/law/view/document?DocID=LIT/ICD/NSD1636of2019/00001> [accessed on 20 March 2024].

163 *Singapore Telecom Australia Investments Pty Ltd v Commissioner of Taxation* [2021] FCA 1597.

brought an appeal before the Federal Court of Australia which was unsuccessful. A further appeal was made to the Full Court of the Federal Court of Australia and dismissed by a joint judgment on 8 March 2024.¹⁶⁴

164 *Singapore Telecom Australia Investments Pty Ltd v Commissioner of Taxation* [2024] FCAFC 29.