

09TiF-023 – ATO Compliance Program 2009-10

6 August 2009

Contents

Introduction

Summary of Compliance Results 2008-09

Specific ATO Compliance initiatives 2009-10

KPMG Comment

How to Contact Us

Introduction

On 6 August 2009 the Australian Taxation Office (ATO) released its Compliance Program for 2009-10 including a summary of activities of the past year (Compliance Program).

The Compliance Program reflects an ever increasing sophistication in the ATO to risk-based compliance activity and what can be best described as a commercial approach to discharging its obligations as to revenue collection, taxpayer education and enforcement to increase voluntary compliance.

The ATO is leveraging its collective experience from the last economic downturn of the early 1990's to achieve its objectives.

In particular, the continued support via additional funding from the Government has enabled the ATO to focus its resources and refine this year's compliance program to adjust to the circumstances prevailing in the wake of the global financial crisis, by supporting those who need assistance and being vigilant in relation to those who seek to exploit the environment to their relative benefit.

The Compliance Program provides for:

- Increased scrutiny of executives and directors of local and multinational companies (particularly in relation to share and option based remuneration)
- Increased focus on employer performance in relation to employee tax obligations
- Renewed focus on the cash economy
- Extension of the successful compliance program applied to High Net Worth Individuals to 'Wealthy Individuals' (Net Wealth greater than \$5 million and less than \$30 million)

- A focus on generation of losses and their utilisation. An expectation that investors will seek to re-characterise losses from capital to revenue
- A focus on non compliance with thin capitalisation regime due to fall in asset values
- Increased focus in consultation with other revenue authorities on off shore income and use of tax havens, structured arrangements and transfer pricing
- Continued focus on GST compliance and refund applications
- An escalation of corporate governance and tax risk management to Boards and Stakeholders
- A monitoring of major infrastructure projects to ensure that asset and funding claims are appropriate.

For its part, the ATO has also announced a number of initiatives to support taxpayers in their efforts to comply with the requirements.

For corporate boards and audit committees, the key considerations should now encompass:

- An evaluation of the tax risk management profile of the business
- Identification of any exposures by reference to the above areas of focus of the ATO (for example, variations between tax performance and business performance, tax payments that don't match economic indicators and unexplained losses)
- The governance framework around taxation.

Summary of Compliance Results 2008-09

In 2008-09, large business income tax compliance activities raised over \$1 billion in additional cash collections, new income tax liabilities raised totalled \$1.4 billion and over \$1.1 billion was raised in notional tax adjustments (e.g. disallowance of carry forward losses).

The comparative numbers for 2007-08 were \$1.2 billion, \$2.6 billion and \$1.8 billion respectively. It is interesting to note that notwithstanding the increased levels of active compliance by the ATO, the income tax results for the large market are lower than last year. The ATO concludes this is due to the cyclical nature of the large audit program and the deferral of finalisation of some complex audits beyond 2008-09.

This was also the first year of the ATO's four-year program of tax risk assessments for all medium-sized businesses. The ATO has completed approximately 300 preliminary tax risk assessments and approximately half are subject to follow-up activity.

Specific ATO Compliance initiatives 2009-10

A key theme throughout the Compliance Program is the increase in the ATO's tax compliance activities across all segments of the taxpayer community. This reflects the significant additional funding commitment provided in the 2008-09 Federal Budget of \$700 million over four years and in the 2009-10 Federal Budget of \$595 million over a further four years. Approximately \$302 million of the 2009-10 Federal Budget commitment is focused at ensuring large business (generally those with annual turnover above \$250 million), medium-sized businesses (generally those with annual turnover greater than \$100 million but below \$250 million), and wealthy Australians meet their tax obligations.

A risk profile of a business: key areas of focus

In determining the exposures of a business and how to best manage tax compliance, a corporate (large and medium) should assess how an entity would fair if it were subject to the intended ATO program of risk review and audit; in particular where there are large book-to-tax differences.

The Compliance Program indicates an intention by the ATO to risk profile all large businesses over the next 12 months. There is a further expectation that a range of compliance activities such as risk reviews and audits shall cover one third of the large business market this year.

Therefore, large taxpayers should assess whether any of the following pose an exposure:

- Tax driven business structures. The ATO is particularly concerned about companies seeking to maximise their competitive advantage as the economy starts to recover through tax minimisation strategies. The ATO shall take particular interest in apparent differences between a business' economic and commercial performance and its tax outcomes.
- Loss generation and loss usage. Given the economic downturn, the removal of foreign loss quarantining, and the significant increase in tax loss disclosures on the 2009 Losses Schedules, the ATO's focus on tax losses comes as no surprise.

Areas of attention for the ATO include non genuine losses, errors and miscalculations, arrangements that inappropriately attribute foreign losses to Australia, incorrect claiming of finance related tax deductions, and the ability of taxpayers to satisfy the loss recoupment and deductibility tests.

- Cost setting under tax consolidation when entities join or leave a group; especially where there has been restructuring, the use of financing products, intra-group movements of assets, liabilities and tax attributes, and interactions with other aspects of the tax laws to achieve outcomes that are inconsistent with the legislative intent. The ATO is also focusing on the acquisition, transfer and use of losses by tax-consolidated groups.
- Interaction of Capital Gains Tax (CGT) with other provisions of the taxation laws; particularly international and tax consolidation measures. The ATO is also focusing on non-disclosure or incorrect reporting of capital gains or capital losses, including re-characterisation issues, transactions involving disposals or economic interests with no taxing point, and CGT cost base irregularities. The ATO is also targeting arrangements designed to circumvent foreign resident CGT obligations as outlined in recent taxpayer alerts.
- Cross border financial arbitrage including the use of hybrid instruments to obtain tax benefits in Australia. The ATO intends to issue information requests to taxpayers who present a high-risk in this area.
- Profit shifting through the use of transfer pricing, thin capitalisation, and other tax driven business structures. Transfer pricing is also high on the agenda of other tax authorities; an indication that each country wants to ensure they are collecting their fair share of taxes on global transactions.
- In respect of transfer pricing, the ATO will continue to examine transactions between related Australian and offshore entities that shift profits from Australia to other countries, through a program of reviews and audits together with its Advanced Pricing Arrangements (APA) program. The areas of profit shifting that the ATO are focusing on include:
 - Restructuring Australian-based operations to shift functions, assets and risks offshore on a non-arm's length basis, such as the sale of intellectual property at a nominal price.
 - Paying excessive interest, guarantee and other fees.
 - Provision of services by Australian-headquartered companies to overseas subsidiaries at no charge.
 - Allocating income and expenses to Australian businesses which are inconsistent with the economic activities conducted in this country.
 - Transactions that seek to re-characterise interest, dividend or royalty income.

- Non-lodgement of thin capitalisation schedules and reviews of the application of thin capitalisation safe harbour rules. As a result of the economic downturn, the ATO is concerned that many businesses may have experienced significant reductions in asset values or significant increases in liabilities and may be in serious risk of failing this test.
- Continued focus on merger and acquisition activities and eligibility of claims for the investment allowance and research and development.

In the medium-sized business segment, the ATO shall continue with its four-year program of risk assessments of all businesses.

For the medium-sized business segment other areas of particular ATO focus include:

- Fringe Benefits Tax (FBT) compliance and employer obligations with a particular focus towards motor vehicles.
- Capital management and compliance with the untaxed private company distribution provisions.
- CGT including reviewing claims for exemptions, rollovers and pre-CGT status as well as raising awareness of the general value shifting integrity measures.
- Tax planning for business exits.
- A continuing focus on alienation of income via the use of service trusts.

Indirect tax

The indirect tax focus of the 2009-2010 Compliance Program contains continuing and new initiatives. There is the usual focus on unreporting or incorrect reporting of property transactions as well as GST refund integrity checks, coupled with a new focus on emerging areas of risk, such as retirement villages, loyalty reward programs, asset financing, the non-commercial activities of charities and government grants.

Where the ATO has identified emerging risk areas in the Compliance Program, the ATO must provide better guidance to business taxpayers than they have provided in relation to emerging risk areas in the past. By way of example, a few years ago the ATO included the GST treatment of deposits in its Compliance Program at a time when the law was unresolved, ultimately having to be tested in the High Court. There is a clear need for all stakeholders to ensure that there is not a repetition of this imposition of uncertainty on business. The ATO should see the need for education and consultation first rather than addressing the uncertainty through enforcement action.

A dialogue between the ATO, Treasury and taxpayers with a view to obtaining a better understanding of the reasons why non-compliance in these emerging areas is strongly urged; as non-compliance may well have nothing to do with evasion or deliberate non-compliance, and everything to do with unnecessary complexity and GST outcomes which are at odds with commercial operations.

Although the Compliance Program categorises issues in terms of different market segments, the GST issues tend to focus more on specific industry groups or activities.

Property

The ATO is working with state revenue and land titles offices to identify unreported property sales and taxpayers who fail to register for GST or lodge Business Activity Statements accounting for GST on sales.

What is new to the Compliance Program is a focus upon retirement villages. This is a concern. The ATO has issued very little guidance in this area, despite industry requesting confirmation of the ATO's position on a number of technical issues over an extended period of time. The issues

affecting retirement villages will impact not only on the calculation of GST liabilities (such as whether GST is payable on the sale of a village by reference to the price paid, or the price together with the value of resident loans which are assumed), but also on input tax credit entitlements (in particular, in the context of the construction of retirement villages for the dual purpose of letting to residents and sale).

Another area of ATO focus is the correct GST treatment of commercial residential premises and residential premises. As the recent case of *South Steyne Hotel Pty Ltd v FCT* [2009] FCA 13 (on appeal) demonstrates, this is a complex area where the distinction between these concepts can sometimes blur. The problem here is not with a willingness to comply, but with a lack of clarity as to the law itself.

The ATO is also continuing its focus upon property transactions where the margin scheme is being applied. It is hoped that the proposed introduction of a new margin scheme valuation determination to cater for circumstances where there is a dispute with the Commissioner, and a review of these provisions by the Board of Taxation, will result in a renewed level of certainty for taxpayers in this area.

Financial services

The Compliance Program has again identified incorrect claims for GST credits in relation to financial supplies as an area of concern. However, rather than focusing upon apportionment methodologies in general terms, the ATO will be undertaking compliance activity in relation to certain specific transactions, including:

- Initial public offers, capital raisings and share buy backs
- Costs incurred by credit card and charge card issuers, including acquisitions made under loyalty reward programs
- Securitisation and asset financing, including hire purchase.

The focus on capital raisings is not surprising given the prevalence of these in the marketplace.

The continued focus on securitisation is disappointing particularly given the history of ATO u-turns in relation to its position on these transactions. Securitisation is clearly suffering commercial upheaval and the continuing technical uncertainty in relation to GST, including its interaction with income tax, is unhelpful.

The focus on asset financing is a concern given recent submissions made by industry bodies about the inequity of some of the ATO's rulings. Rather than focusing upon compliance activities, the ATO might be better served by revising its treatment of cash basis hire purchase transactions.

International transactions

The focus on the GST treatment of certain international transactions is pretty much the same as in past years. The usual trifecta appears - supplies made to non-residents but provided in Australia (section 38-190(3) of the GST Act), non-residents making supplies which are connected with Australia (section 9-25), and reverse charge transactions (Division 84).

The Board of Taxation has only just issued consultation papers in this area. Again, it is hoped that meaningful reform rather than compliance and enforcement action will be the order of the day.

Government

GST compliance is a major area of focus for the government sector.

The ATO will continue to focus on the correct treatment of grants and will look to revise its public rulings in this area. Along similar lines, the GST treatment of subsidies has proven to be a difficult and contentious area of the law, as recently evidenced by the Federal Court decision

in *TT-Line Company Pty Ltd v FCT* [2009] FCA 658 (on appeal). Continued focus by the ATO is expected for some time to come.

The significant investment by government in infrastructure projects has not gone unnoticed, with the ATO to provide assistance to government organisations to manage their GST obligations.

Also in the government arena, the ATO will be looking to develop further information and guidance products to assist government agencies undertaking restructures, or to handle 'machinery of government' changes.

Finally, the government sector will be subject to reviews and audits in relation to property transactions. While there are only a few special rules dealing with property transactions by government agencies, the unique ways in which governments transact can give rise to complex issues.

Charities

The ATO is continuing the focus from last year's Compliance Program on supplies made by charities and whether they are GST-free under the non-commercial supplies provisions. The ATO has published further guidance on the market value rules which underpin these concessions, and will undertake reviews and audits to test compliance, particularly in relation to supplies of accommodation.

Business systems and processes

The ATO shall maintain a focus on the integrity of business systems by conducting reviews and audits which seek to identify errors arising from:

- One-off transactions which are outside normal business dealings
- Inaccurate processing of transactions following changes in business structures, accounting systems or related party dealings
- Poor internal controls and reconciliation processes.

Consistent with KPMG's own experiences with clients, the ATO has identified that business restructures, and the significant rationalisation of key accounting staff during the economic downturn, are a root cause of potential non-compliance.

Refund claims

The ATO's Compliance Program contains a staggering statistic, which is that 85 percent of GST refund claims made prior to 1 July 2008 involving section 13 of the GST Transition Act were invalid. These claims generally involved the reclassification of transactions from taxable to GST-free, thereby potentially triggering a refund claim.

Such was the avalanche of claims just prior to 1 July 2008 that the ATO issued a Taxpayer Alert, and followed it up with a number of public rulings and enhanced compliance activity.

In a similar vein, the ATO has indicated it is concerned with taxpayers seeking to reclassify taxable transactions as being outside the scope of GST so as to trigger refund claims. The ATO has indicated it will scrutinise such refund claims carefully, conduct compliance activities on industries with high risk transactions, and litigate where appropriate.

High Net Worth Individuals and Wealthy Individuals

Generally, high net worth individuals (HNWI) translate to those that control wealth of \$30 million or more. However, it is interesting to note that the ATO is also expanding its focus on senior company executives, directors, and individuals with a *net wealth* of between \$5 million to \$30 million (Wealthy Individuals). The ATO feels there are material levels of non-

compliance by some wealthy individuals who fall within this net wealth range mirroring that encountered in the engagement with HNWI.

This year the ATO will focus on the identification of individuals in this net wealth range with verification activities to follow next year.

The ATO will expand its program of audit and review of high wealth individuals (HNWI and Wealthy Individuals) to ensure better coverage of complex arrangements and structures. In the high wealth individuals segment, areas of particular ATO concern include use of losses and tax outcomes from property development that are inconsistent with economic outcomes. The ATO expects at least 120 audits will be underway in 2009-10, an increase of 19 audits from the prior year. In addition the ATO expects to carry out over 420 risk reviews.

The ATO is using various risk profiling software as well as expanding its use of external data, for example records of property sales, share transactions, and media reports, to target its compliance activities.

In respect of senior executives, the ATO is strengthening its data matching activities around remuneration with a focus on correct reporting of shares and options, and remuneration paid from overseas entities or into overseas accounts.

Tax and corporate governance

The ATO mirrors the focus of other regulators in seeking assurance from boards and management that the appropriate tax risk management framework is embedded in the business and thus can look to the internal reporting, accountability, structure and processes to determine what verification activities are necessary for that entity.

For its part, the ATO has sought to implement a number of initiatives to support large business to best use the Compliance Program to make key decisions. The services offered by the ATO include:

- Leading the preparation of a Draft Guideline submitted to the OECD Forum on Tax Administration, Paris May 2009; on Corporate Governance and Tax Risk Management.
- Lead relationship manager (LRM) - As part of the ongoing initiative to increase voluntary compliance the ATO is piloting a new role of LRM with a small number of the largest businesses, particularly those that have shown a genuine desire to work collaboratively with the ATO. The LRM will be a single primary point of contact to help coordinate and streamline dealings with the ATO.
- Large business phone service and key client managers – These services are aimed at improving the day-to-day operational support to the top 150 companies. The program of visitation of the top 100 companies is also continuing.
- Good governance guide – Through the National Tax Liaison Group, the ATO is developing a good governance guide on promoter penalties.
- Advanced Pricing Arrangements (APA) – APAs provide assurance on the risk of transfer-pricing review or audit and potentially double taxation. The ATO recently commissioned an independent review of the APA program and is reviewing the program to make it more relevant and attractive to industry.
- Annual Compliance Arrangements (ACA) - The ATO is continuing to encourage the take up of ACAs as a key strategy to improve real-time sign-off with the top 50 corporates and is planning to increase coverage this year. The objective of ACAs is to provide greater practical certainty in respect of areas requiring clarification and involves the business providing assurances that it meets the tax risk governance requirements set down in the ATO's publication *Large business and tax compliance 2006*. So far, two income tax ACAs

in the financial sector and one GST ACA have been finalised. Negotiations for others are continuing.

- Large Business Advisory Group (LBAG) – This is intended to be the ATO's peak consultative forum for large business.

For the medium-sized business segment, tax risk management initiatives include:

- The design of a tool to assist medium-size businesses to complete a Schedule 25A.
- Review of the APA program to make it easier for medium-sized businesses to enter the program.

KPMG Comment

The increase in active compliance by the ATO comes at a time when Business is resource and cost constrained; with many businesses in survival mode.

Income tax is not a high priority for a business currently generating real economic losses in the most significant global economic downturn since the great depression.

The cornerstones of the 2009-10 Compliance Program of supporting those in financial distress and promoting a level playing field have to be extended to all taxpayers including small and large business.

The contributions to uncertainty by the ATO changing longstanding practices and differing views as to the intent of Parliament relative to the literal interpretation of legislation seeking to give effect to that intent must be addressed as part of enhancing taxpayers' ability to voluntarily comply at less cost.

In the current economic environment, the ATO must recognise that the mutual quest by the ATO and taxpayers alike for certainty and voluntary compliance, through a risk based approach, must yield a demonstrable cost benefit to those who are recognisably voluntarily compliant.

The ATO Compliance model seeks to drive taxpayers toward voluntary compliance to enable the ATO to direct its limited resources to those who choose not to comply.

It is not enough that those who choose not to comply suffer adverse consequences; those who choose to voluntarily comply must derive a compliance cost benefit.

Those businesses subject to reporting under IFRS should be following the progress of Exposure Draft Accounting Standard 2009-2: Income Taxes with submissions to the IASB having closed on 31 July 2009 and its projected application in 2011.

The future interaction for proposed accounting in relation to tax uncertainties and a risk based approach to compliance by revenue authorities needs to be recognised by any business undertaking a review of the efficiency and effectiveness of its corporate tax function in managing tax risk and simultaneously creating value for that business (i.e. in driving the tax performance of the business).

How to Contact Us

Tax Management Services

Carl Dilena

+61 3 9288 5195

cdilena@kpmg.com.au

David Drummond

+61 2 9335 8695

ddrummond@kpmg.com.au

Michael Charles

+61 3 9288 6671

mcharles@kpmg.com.au

Grant Wardell-Johnson

+61 2 9335 7294

gwardelljohn@kpmg.com.au

Indirect Tax

Nick Kallinikios

+61 3 9288 6714

nkallinikios@kpmg.com.au

Lachlan Wolfers

+61 2 9335 7515

lwolfers@kpmg.com.au

Transfer Pricing

Jane Rolfe

+61 3 9288 6341

janerolfe@kpmg.com.au

Anthony Seve

+61 2 9335 8728

aseve@kpmg.com.au

International Executive Services

Martin Morrow

+61 3 9838 4600

mmorrow@kpmg.com.au

Rosheen Garnon

+61 2 9335 7255

rgarnon@kpmg.com.au

State Contacts

Adelaide**Con Tragakis**

+61 8 8236 3237

ctragakis@kpmg.com.au

Brisbane**John Irwin**

+61 7 3233 3196

johnirwin@kpmg.com.au

Canberra**Craig Sloan**

+61 2 6248 1301

cjsloan@kpmg.com.au

Perth**Carlo Franchina**

+61 8 9263 7239

cfranchina@kpmg.com.au

Tasmania**Michael Hine**

+61 3 6230 4000

mhine@kpmg.com.au

Australian Tax Centre

Matthew Hayes

+61 2 9335 7503

mwhayes@kpmg.com.au

Gaye Proberts-Camp

+61 2 9335 7873

gproberts@kpmg.com.au

KPMG's Tax practice is not licensed to provide financial product advice under the Corporations Act and taxation is only one of the matters that must be considered when making a decision on a financial product. You should consider taking advice from an Australian Financial Services Licence holder before making any decision on a financial product.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation. Additional information may be obtained from our offices.

Liability limited by a scheme approved under Professional Standards Legislation.

© 2009 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved.

KPMG and the KPMG logo are registered trademarks of KPMG International. [Privacy Statement](#)