



# Life Sciences Tax Update Webinar

Important taxation issues for the Life Sciences sector





# Tax governance: Future directions

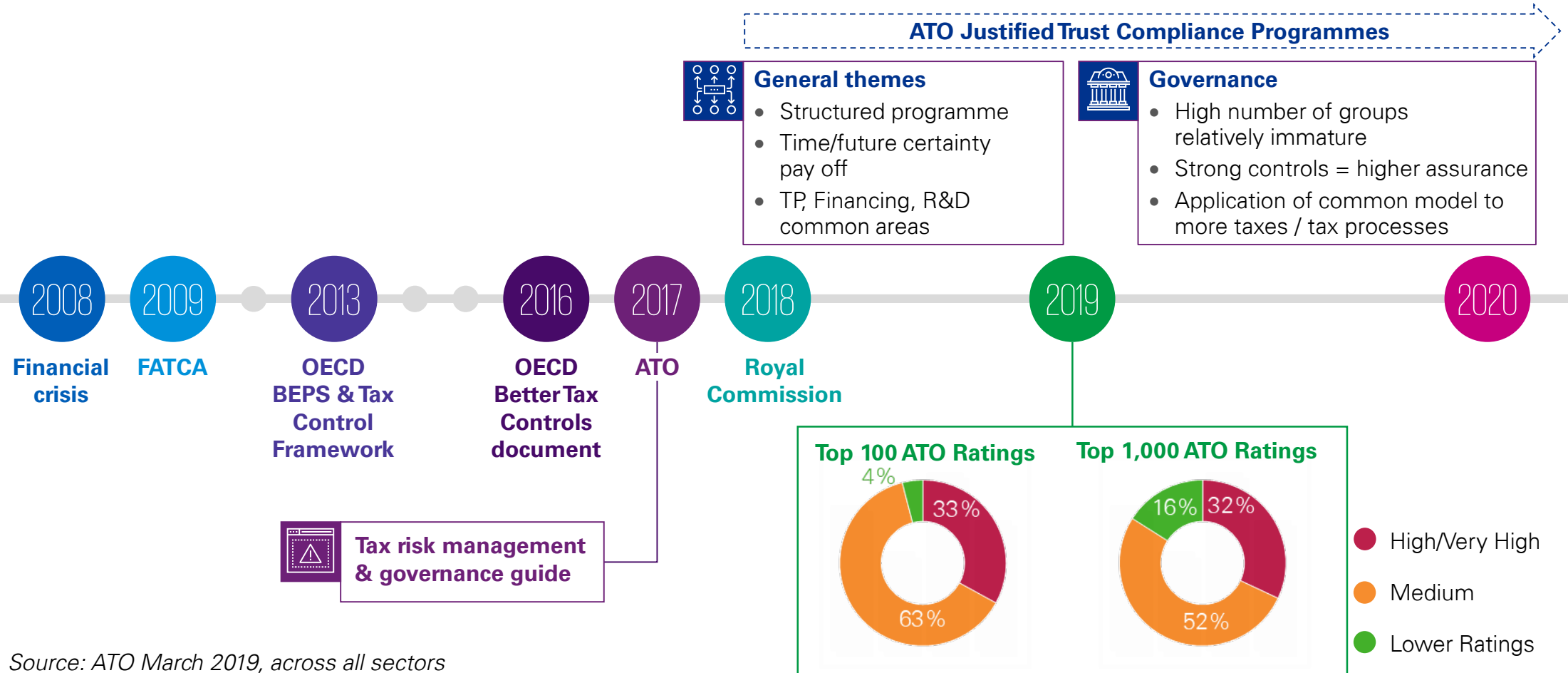
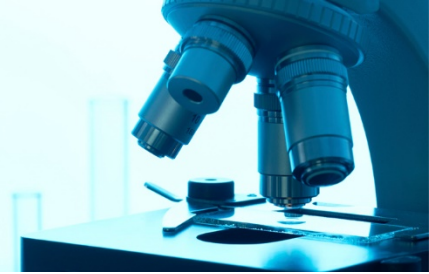


**Phil Beswick**

Tax Governance & Transparency  
KPMG Australia



# The Justified Trust programme



Source: ATO March 2019, across all sectors

# Tax governance ratings



## ATO Results to Date



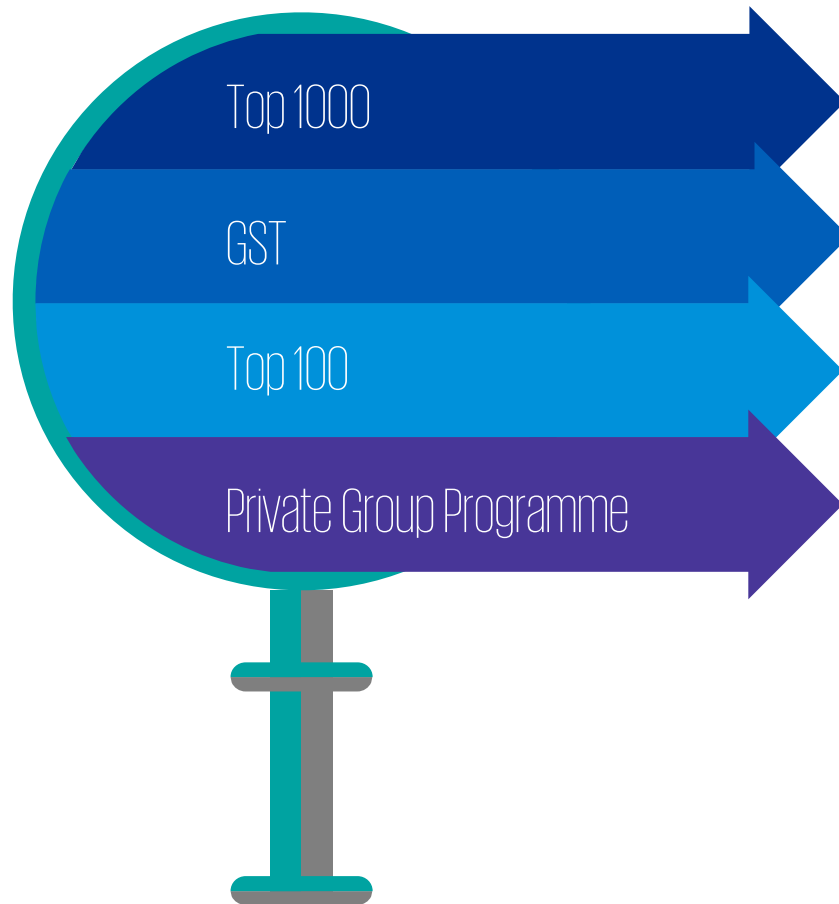
## Observations



		Top 1000	Top 100	
● ● ● Stage 3	Evidence exists that tax control framework exists, has been designed effectively and operates effectively	1%	0%	<ul style="list-style-type: none"> <li>• Test reports – operating effectiveness</li> <li>• Testing programme, test procedures</li> <li>• 6 Key controls</li> <li>• Independent testing</li> </ul>
● ● Stage 2	Evidence exists that a tax control framework exists and has been designed effectively	24%	43%	<ul style="list-style-type: none"> <li>• Testing of design of framework</li> <li>• Documented gap analysis</li> <li>• Documented compensating controls</li> </ul>
● Stage 1	Provide evidence that a tax control framework exists	70%	48%	<ul style="list-style-type: none"> <li>• Board endorsed tax governance document</li> <li>• Documented key tax processes</li> </ul>
🚩 Red Flag	Not evidenced or concerns	5%	0%	<ul style="list-style-type: none"> <li>• Significant errors identified</li> </ul>
Not rated			9%	

Source: ATO March 2019, across all sectors

# ATO Future Landscape



## Top 1000

- High assurance taxpayer partnering
- Action low assurance / red flag areas

## GST

- 52 reviews in progress (June 19) across
- Most Stage 1 for Tax Governance
- Risks surrounding incorrect reporting, & treatment of significant transactions
- Extend GST Assurance reviews
- GST Analytical tool

## Top 100

- Obtain high assurance for all
- Tailored monitoring

## Private Group Programme

- Expansion of Top 320 to 500
- Pilot programme commenced
- Information System Risk Assessment tool

# Governance: High level themes



## Mandate of tax function

- Governance strengthens the tax mandate
- Clarity and visibility of tax as a risk
- Accountability and responsibility
- Help with grey areas (reliance)

## Structured governance frameworks

- Governance as a discipline
- Across taxes
- Evidence
- Being able to engage ATO on the topic in a considered way

## Tax on the Board agenda

- Governance resonates
- Risk management resonates

## International

- Educating global heads of tax
- Leveraging Australian experience
- Tax transparency reporting developments

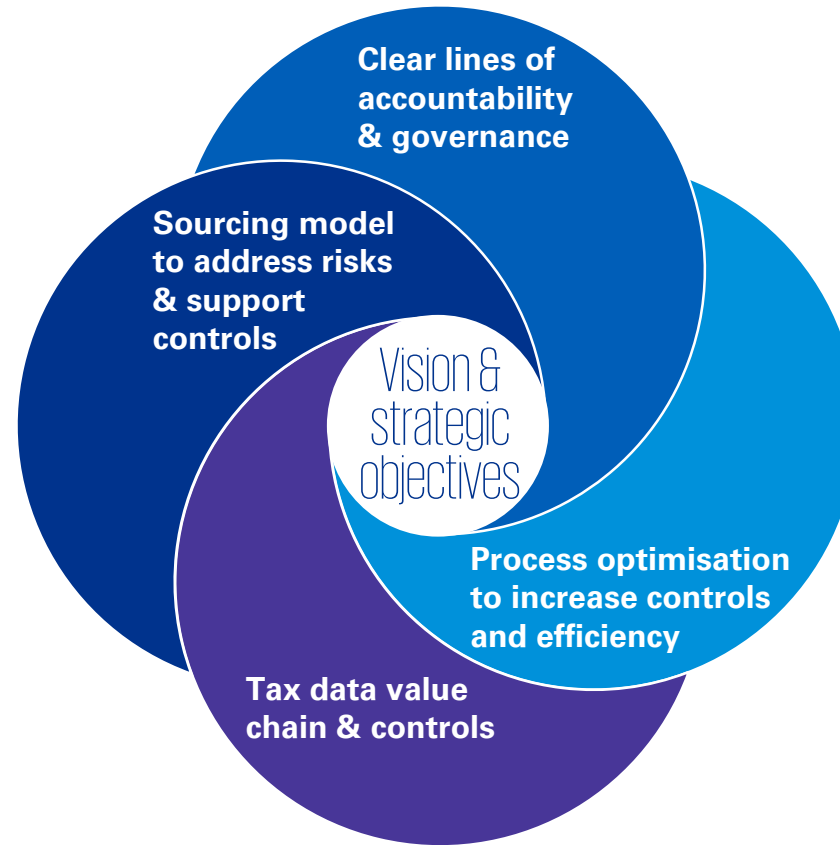
## Testing of controls

- Framework
- Processes
- Data / data reliance
- Design & Operating effectiveness
- Self assessment procedures

## Data

- Controlled model for sharing data
- Tax Data strategy
- Automation
- Data & Analytics

# Tax governance is the management of tax



Planning

Testing

Enhancing



# Tax Controversy: What are some of the evolving trends

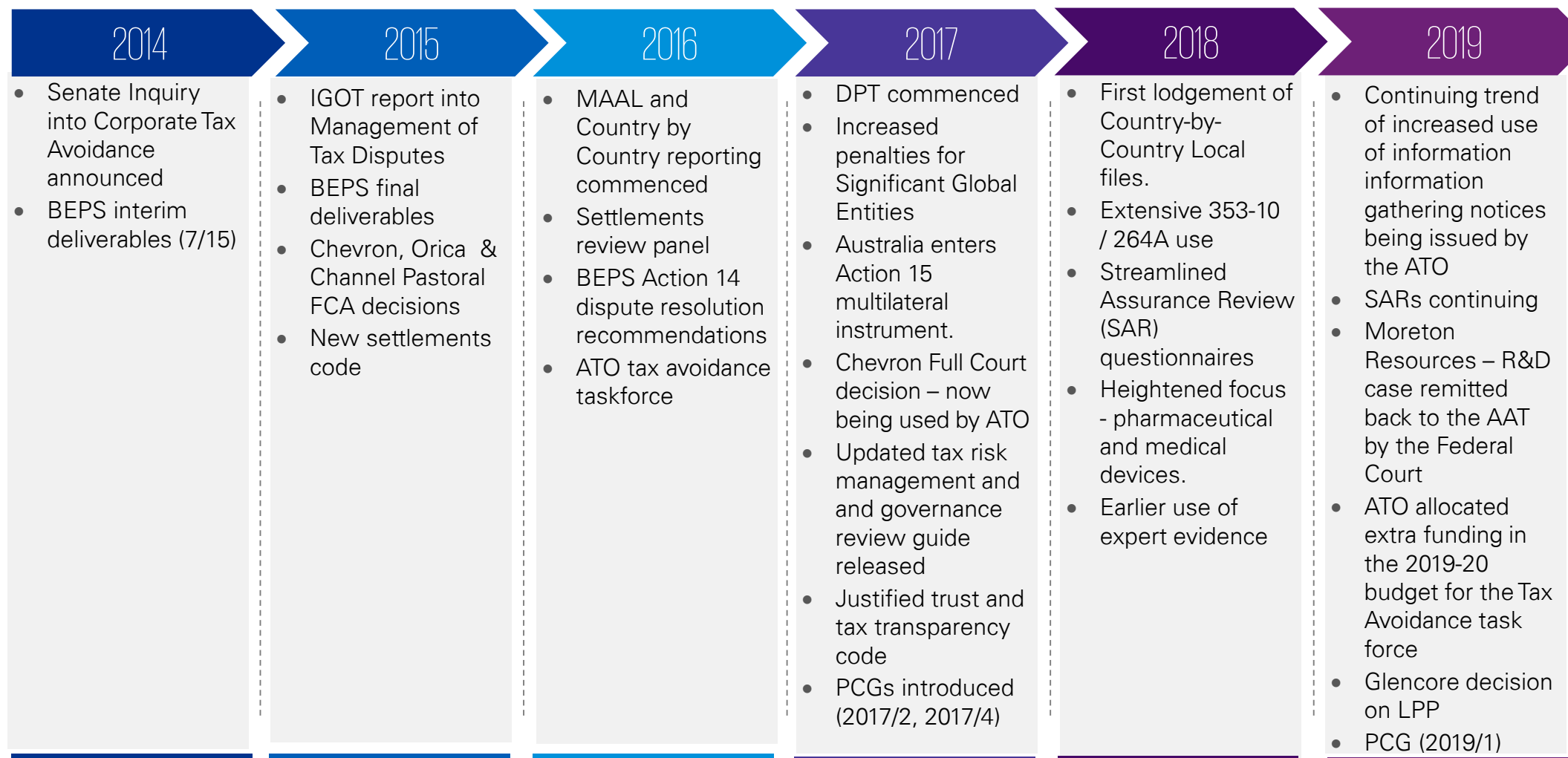


**Kristie Schubert**

Director,  
KPMG Law



# Tax Risk Landscape - Recent Developments



# Legal professional privilege



## What is Lpp?

- Right of the client
- Protects the confidentiality of communications
- Protection extends against courts and third parties - (e.g. the ATO or other regulator).

## Policy/ Objective

- Fundamental common law immunity which attaches to legal advice or confidential communications in respect of actual or reasonably anticipated litigation (litigation privilege).
- Client – Lawyer relationship - full and frank disclosure

## When does it apply?

- Confidential communication - may include letter of advice, emails, notes or a memorandum
- Prepared either for:
  - Dominant purpose of obtaining legal advice; or
  - in relation to actual or reasonably anticipated litigation.

# ATO's formal information gathering powers



Formal information gathering notices issued by the Commissioner across all markets

Formal information gathering notices	2015-16	2016-17	2017-18
Information or document	11,564	16,004	20,612
Attend and give evidence	319	327	352
Formal offshore requests	39	35	32
<b>TOTAL</b>	<b>11,922</b>	<b>16,366</b>	<b>20,996</b>

*Source: ATO Annual reports 2016, 2017 and 2018*

# Disputes litigated to finality



The table below sets out the total number of disputed cases resolved by litigation

Year	Litigation	% Of total cases
2014-15	750	60%
2015-16	480	38%
2016-17	450	36%
2017-18	480	38%
<b>TOTAL</b>	<b>2160</b>	<b>100%</b>

# 5-year litigation trend



The table below sets out the total number of objections resulting in litigation

Year	Litigation (per 000's)	% Of total cases
2013-14	36	40%
2014-15	22	21%
2015-16	16	15%
2016-17	15	14%
2017-18	17	16%
<b>TOTAL</b>	<b>106</b>	<b>100%</b>

# Settlement statistics 2017-18



The table below sets out the total number of cases settled during 2017-18 and at what stage they were settled

Stage	Settlement cases	% Of total cases
Pre-audit	287	43%
Audit	273	41%
Objection	89	13%
AAT	12	2%
Federal Court	12	2%
High Court	0	0%
<b>TOTAL</b>	<b>673</b>	<b>100%</b>

# Questions to consider



Have you considered the advantages of proactively approaching the ATO to manage a tax risk

Are relevant witnesses available and willing to assist?

Do you have access to sufficient documented and/or oral evidence throughout the period under review or audit?  
If not, start collecting – especially as key personnel may move on.

Have you obtained relevant tax technical advice and do you have a reasonably arguable position?

Have you considered the extent to which a tax risk will be required to be disclosed to the ATO in a Streamlined Assurance Review, RTP or in your publically available financial accounts?

Will you be able to respond within tight deadlines on requests for information?





# Transfer Pricing: Adapting to the new world



**Jeremy Capes**

International Tax Advisory – Transfer Pricing  
KPMG Australia



# Where have we come from - Quick recap



## Increased Transfer Pricing focus and compliance



## Evolving focus on tax governance, taxpayer behaviour and engagement

# Where are we now - increased compliance and disclosure



There have been significant developments in the Australian transfer pricing landscape over the past few years

## **CbC Report, Master File and Local File\***

- 3 statements (CbC Report, Master File and Local File) required to be lodged by SGEs, detailing international related party dealings, revenues, profits and taxes paid by jurisdiction
- Applies for income years starting on or after 1 Jan 2016, with filing due within 12 months of end of income year (i.e. first filings due 31 Dec 2017)

## **Diverted Profits Tax\***

- Effective 1 July 2017, for Significant Global Entities (SGEs) carrying on business in Australia
- 40% tax on diverted profits using arrangements that have a principal purpose of avoiding Australian tax
- Exceptions: \$25m turnover test; Sufficient foreign tax test; Sufficient economic substance test

## **ATO Compliance Activities (and RTPS consideration)**

- PCG 2017/1: ATO's compliance approach to offshore related party hubs
- PCG 2017/2: Simplified Transfer Pricing Record Keeping
- PCG 2017/4: ATO's compliance approach to cross-border related party financing arrangements
- PCG 2019/1: Transfer pricing issues related to inbound distribution arrangements

## **Increased admin penalties for SGEs\***

- Applies from 1 July 2017 to SGEs who do not take reasonable care, take a tax position that is not reasonably arguable, or fail to lodge (FTL) on time.
- FTL penalties apply to all documents required to be lodged, and can be as high as \$525,000

## **Adoption of 2015 OECD transfer pricing recommendations**

- Div 815 Transfer Pricing rules have been updated to reflect the OECD's 2015 transfer pricing guidelines (BEPS Actions 8-10).

## **What to consider/ action?**

- With an increasingly onerous transfer pricing and administrative environment, it is critical that multinational groups review their arrangements in light of the changing environment and current ATO focus and political/public scrutiny

Chevron lost its Full Federal Court appeal, and withdrew its special leave application to appeal to the High Court in 2017.

The Chevron case centred around whether the orphan theory or twin principle should underlie the arm's length principle. This case has implications beyond debt.

\* The above items apply to Significant Global Entities – defined as multinational groups with annual turnover greater than AUD1bn.

# Where are we going - Taxpayer behaviour and engagement



## BEPS

- Focus on the global value chain and Australia's contributions
- Focus on taxpayer motives and behaviours

## Justified Trust Initiative

- Focus on the process behind Transfer Pricing Documentation and technical positions
- Focus on governance

## Chevron and the law

- Focus on onus of proof
- Focus on CUPs and arm's length interactions

## Review and audits

- Focus on review timeframes and behaviours
- Focus on Commissioner's obligations (technical positions and penalties)

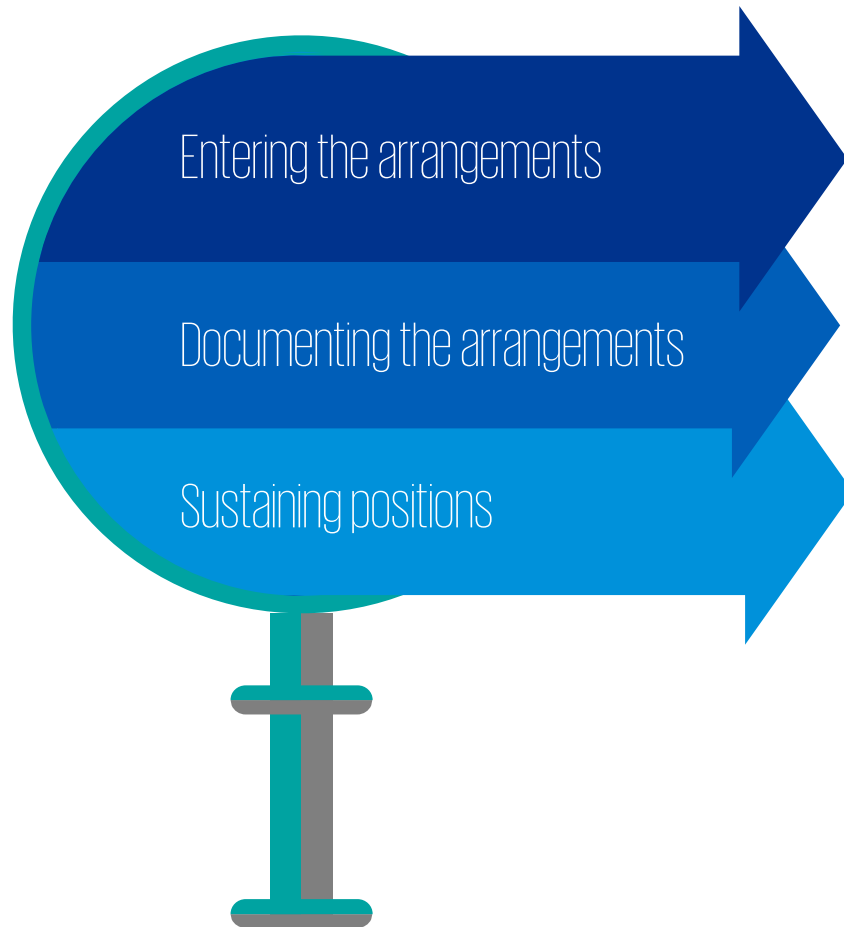
## Evidence and data

- Focus on contemporaneous evidence
- Focus on systems, processes and data retention

## Resolution and settlement

- Focus on strength of technical case
- Focus on overall strategy to resolution

# Where to from here – key learnings



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## Entering the arrangements

- Commercial rationale
- Arm's length structuring and pricing
- ATO's focus areas (e.g. Debt, hubs, inbound supply chain)

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## Documenting the arrangements

- Contemporaneous evidence – process and decision making
- Robust transfer pricing analysis
- Support files

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## Sustaining positions

- Governance framework and processes to review/update
- ATO engagement and behaviour
- Defence and/or settlement strategies



# Compliance with the evolving tax landscape



**Kelly Chong**

Director, Tax Advisory Services  
KPMG Australia



# Tax is changing: We're changing tax



# Tax residency: Previous view



**TR 2004/15 (now withdrawn)**

# Tax residency: Previous view



## When

- TR 2018/5 (from 15 March 2017)



## Who

- Foreign subs of Australian parent
- Reporting line to Australian management
- Australian directors / underqualified local directors



## What

- Australian company with foreign branch
- Australian tax compliance obligations
- Significant late filing penalties

# Tax residency: The new order



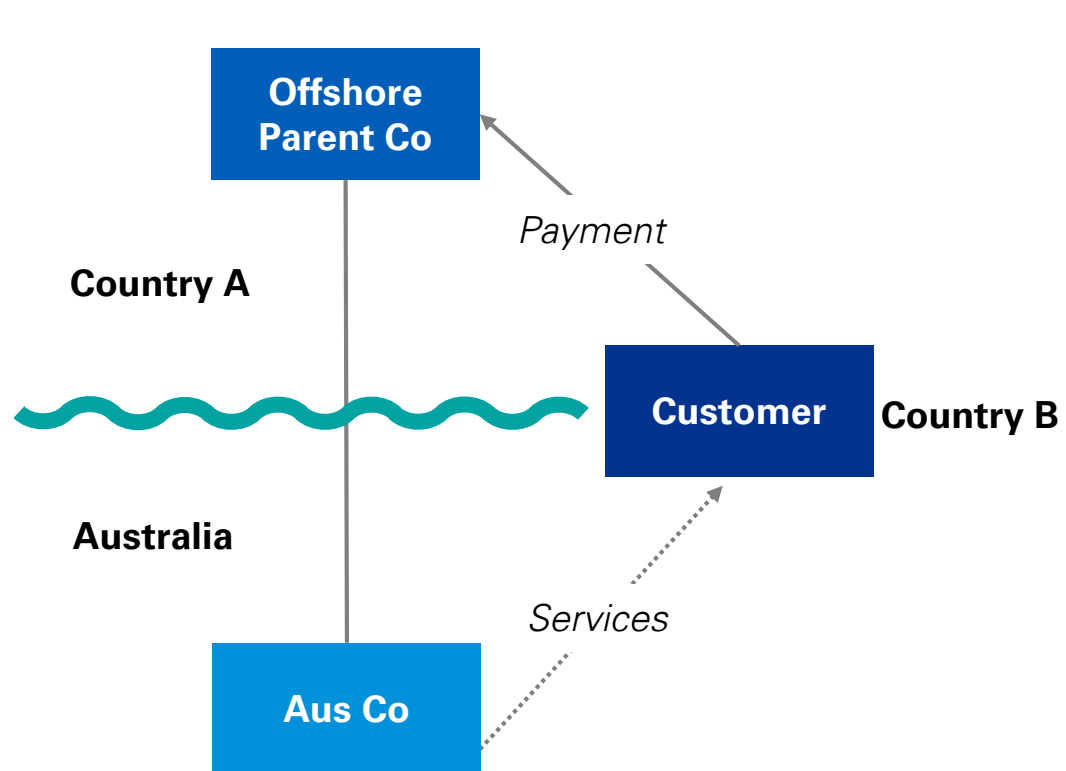
## Assess

- Directors: roles, responsibilities, qualifications, experience
- Board meetings: participation, location, content
- Senior management: roles, responsibilities, qualifications, experience
- Key decision making
- Supporting documentation

## What's next?

- Remedial action
- Further guidance

# Permanent establishment risk



# Permanent establishment risk: The change



- Not 'habitually concluding' contracts
- Preparatory and auxiliary activities
- Independent agent



- Principal role in concluding contracts
- Combined activities essential to overall activity
- Agent working exclusively for principal



# Permanent establishment risk: The new order



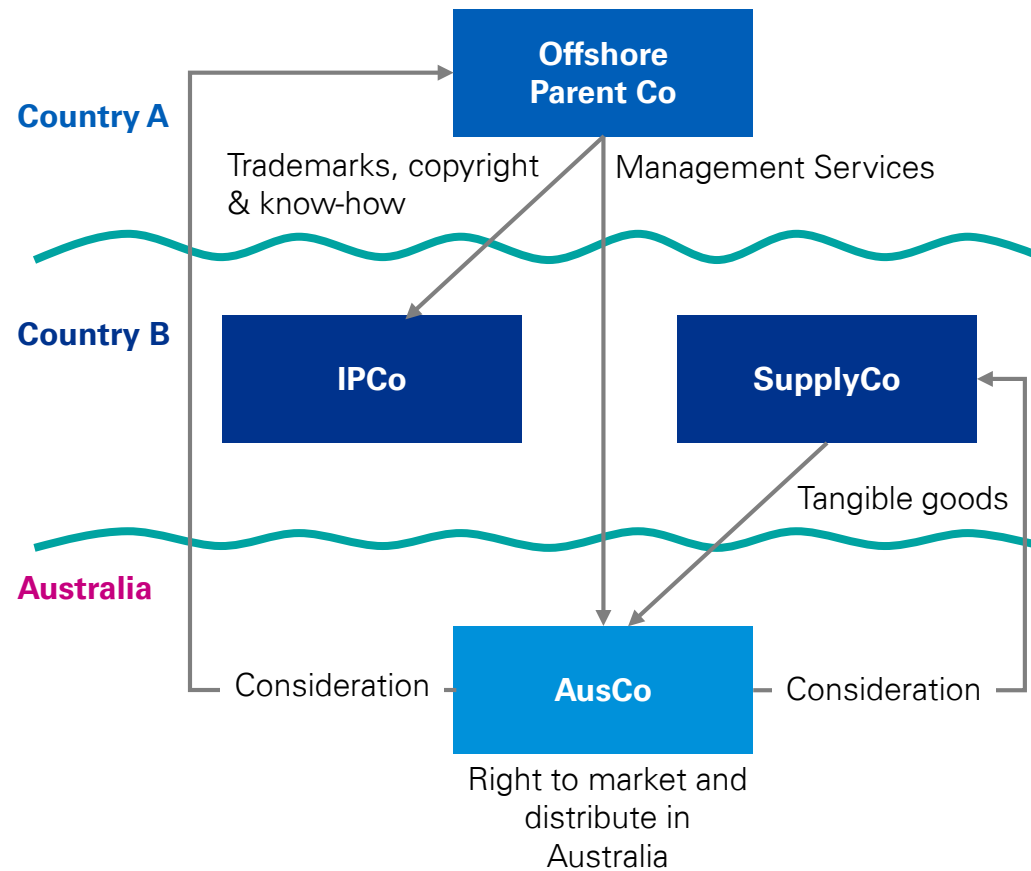
## Assess

- Involvement in process leading to contract conclusion
- Activities carried out by Australia for offshore entities
- Essential / significant part of the business
- Frequency

## What's next?

- Compliance process
- Communicate
- Continuous due diligence

# Embedded royalties: The change



## Australia / Foreign Co agreement

Australia has right to:

- Market & distribute in Australia
- Use trademarks
- 'Know-how' (products & processes)
- Purchase from Supply Co
- Management services

Australia pays single amount to:

- Foreign Co as consideration
- Supply Co for tangible goods

## TA 2018/2

Characterisation does not recognise:

- Use of intangible assets
- Functions performed
- Risks assumed

Concerns:

- RWHT (unlimited review)
- Deductions denial
- TP benefits obtained
- Part IVA / DPT
- RTP disclosures?

# RTP: The change



2018

2019



## RTP Timeline Recap

2018 ATO RTP Guide applies to June / late balancers 2018 returns & early balancers 2019

2019 ATO RTP Guide applies to June / late balancers 2019 returns & early balancers 2020



## Who needs to lodge?

- ATO Notification
- Public or foreign owned company with turnover greater than \$250 million

- Self determine if RTP required
- Public or foreign owned company with total business income of \$25 million or more and part of an economic group with turnover greater than \$250 million
- Not if have Annual Compliance Agreement for the year



“Economic group” defined by reference to majority controlling interest - broad interpretation

# RTP: The new order



Disclosure category	Description	Assess & document
<b>Category A *</b>	<ul style="list-style-type: none"> <li>Tax return position as likely to be incorrect or correct, or less likely to be correct than incorrect</li> </ul>	<ul style="list-style-type: none"> <li>Start with materiality, not by exception</li> <li>Cite specific provision &amp; basis</li> </ul>
<b>Category A transfer pricing *</b>	<ul style="list-style-type: none"> <li>TP position not covered by s284-255 compliant TP documentation</li> </ul>	<ul style="list-style-type: none"> <li>Compliant TP documentation requires sign off by an "appropriately experienced professional"</li> </ul>
<b>Category B *</b>	<ul style="list-style-type: none"> <li>Position in regards to uncertainty about taxes payable / recoverable</li> </ul>	<ul style="list-style-type: none"> <li>Review financial statements for you and all related parties</li> <li>Disclose if a global parent / other related entity has made an uncertain tax position in relation to Australia</li> </ul>
<b>Category C</b>	<ul style="list-style-type: none"> <li>Specific questions</li> </ul>	<ul style="list-style-type: none"> <li>If <b>Yes</b> must disclose</li> <li>Check taxpayer alerts</li> </ul>

**i**  
Revisit what it means to have a 'reasonably arguable position': a position as likely to be correct as incorrect may need to be disclosed

**i**  
Interpretation 23

**\* Materiality:** can differ for Cat A TP

# Key takeaways



## Getting it right:

1

**Compliance: Have processes in place & internal safeguards to manage tax compliance obligations**

2

**Communicate early and often**

3

**Continuously demonstrate due diligence**

## Penalties:

Offense	Non-SGE	SGE
Intentional disregard	\$12,600	\$25,200
Recklessness	\$8,400	\$16,800
No reasonable care	\$4,200	\$8,400



# Hybrid Mismatches



**Peter Madden**

Partner, International Tax Advisory  
KPMG Australia



# Hybrid Mismatches



## What are groups doing?

Due to the breadth of the rules, groups are now reviewing their potential exposures to:

- Ensure they understand the potential impact of uncertain and broad rules
- Confirm deductibility positions are robust
- Manage tax risks appropriately and document that they have exercised diligence
- Provide comfort to statutory auditors that financial statement positions are appropriate

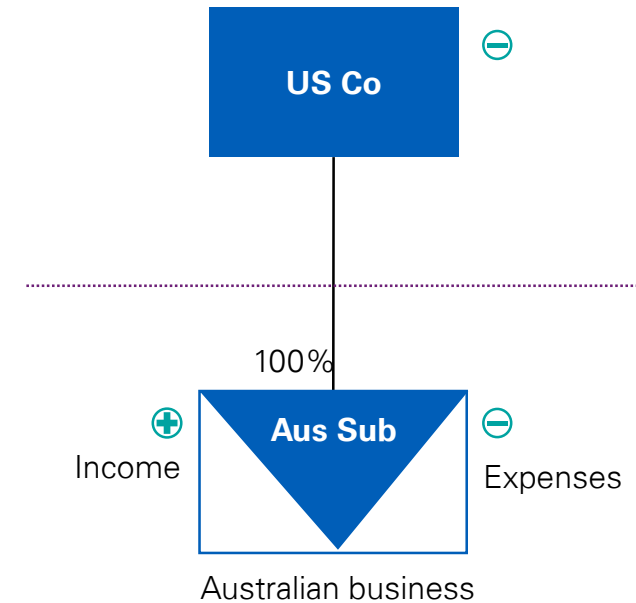
# Deducting Hybrid Mismatch

## Facts

- Aus Sub is treated as a branch of US Co for US tax purposes.
- Aus Sub's expenses are deductible in Australia and in the US, which results in a deduction/deduction mismatch.

## Imported mismatches impact

- Aus Sub's expense deduction will be denied unless there is dual inclusion income or the US dual consolidated loss rules are substantially the same effect as Australia's hybrid mismatch rules.



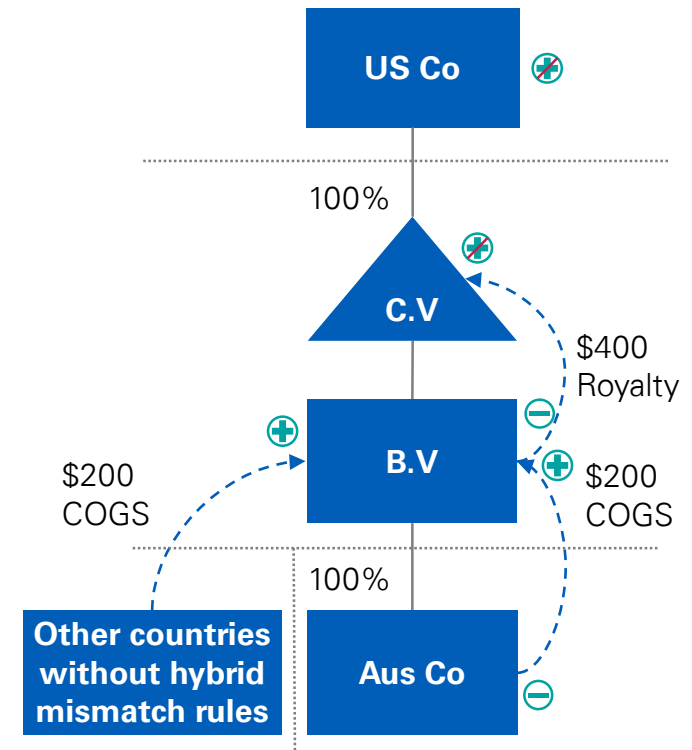
# Imported Hybrid Mismatch

## Facts

- C.V is regarded as a transparent entity for Dutch tax purposes, and a company for US tax purposes.
- C.V owns the rights to manufacture goods and licensing these rights to B.V.
- B.V manufactures goods and sells the goods to global entities.
- B.V makes a deductible royalty payment of \$400 to C.V. The royalty income is non-assessable income in the hands of C.V as C.V is a reverse hybrid mismatch.
- The \$400 royalty paid from B.V to C.V is an offshore hybrid mismatch.
- The \$200 COGS made by Aus Co to B.V is an importing payment in relation to the offshore hybrid mismatch.

## Imported mismatches impact

- As there are no other countries that have hybrid mismatch rules, the full \$200 deduction is denied in Australia.
- The imported hybrid mismatch would be carried forward if the original mismatch is only partly neutralised.



**Cost of Sales  
Deduction Denied?**

**Carry forward of residual offshore hybrid  
mismatch?**

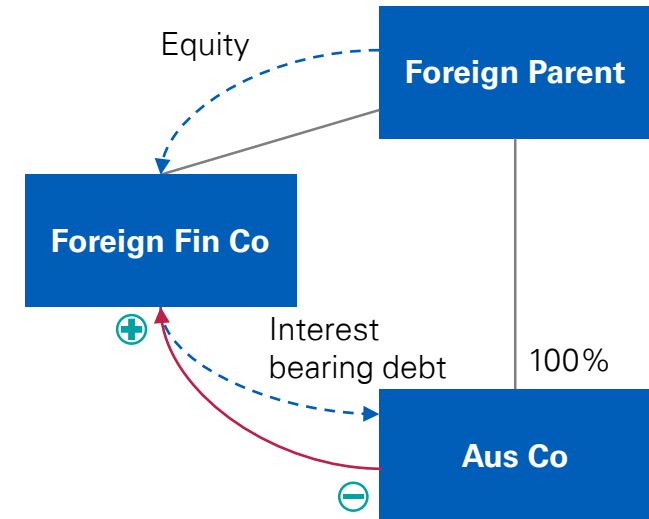
# Financing Integrity Measure

## Facts

- Foreign Parent advances equity to Foreign Fin Co.
- Foreign Fin Co advances Vanilla Loan to Aus Co.
- Foreign Fin Co is either not taxed or taxed at a rate of 10% or less (e.g. Caymans), or taxed on a territorial basis (e.g. Singapore or Hong Kong).
- Aus Co entitled to interest deduction under Vanilla Loan.

## Imported mismatches impact

- Equivalent in effect to Foreign Parent directly advancing Hybrid Loan to Aus Co (which would be a hybrid mismatch)
- ***Does Aus Co know how Foreign Fin Co is taxed and whether its substance is sufficient?***



**Interest (subject to tax in Foreign Fin co jurisdiction at 10% or less)**

# International Dealings Schedule 2019



The International Dealings Schedule (“IDS”) is an additional compliance requirement for Australian corporate entities that engage in international dealings with related parties.

Section G was introduced in the IDS this year, in respect to hybrid arrangements:

- *Question 45:*  
“Did the hybrid mismatch rules affect you?” (Yes/No)
- *Question 49:*  
“Did you restructure or replace an arrangement which would have been subject to any of the hybrid mismatch rules in the current year or the prior year if the arrangement was still in place?” (Yes/No)
- If yes, the taxpayer must:
  - Provide a detailed description of the restructuring event (as per the IDS instructions); and
  - Disclose whether, as a result of the restructure, the taxable income of the entity remained the same or decreased if compared to the replaced arrangement.

Each of these disclosures require careful consideration, particularly considering the significant administrative penalties applicable to SGEs that make false or misleading statements, fail to have a Reasonably Arguable Position and/or fail to provide a document when required (from 1 July 2017).





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