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20 September 2024

Ms Stephanie Long
Assistant Commissioner
Australian Taxation Office

By email: LCMSFversion4@ato.gov.au

Dear Stephanie,

RE: Short Form Local File Changes

Thank you for the opportunity to provide further comments on the draft Short Form Local File (**SFLF**) instruction changes.

Context of the changes

Whilst we acknowledge consultation on the change has occurred and further changes to the instructions are possible, the extent of the changes as drafted only came to light to taxpayers at the last consultation meeting when the full draft instructions were released. The extent of the changes proposed are viewed as surprising given that they are an extension of data and/or information requests that occur in existing ATO processes. The working assumption of us and our has been that the schema changes would be mechanical and standardising existing data in a more structured way rather than the substantive changes that have been introduced.

This view is not isolated to the CTA as other industry associations and tax advisers have expressed the same level of surprise to us at the level of detail expected in the revised SFLF. The additional cost of compliance and associated uncertainty as to whether taxpayers can comply with the SFLF has now come to light.

We want to work with the ATO to develop something that can be complied with and that focuses on dealing with the perceived areas of concern that are not being addressed by existing compliance processes. This includes information provided under the International Dealings Schedule (IDS), Reportable Tax Positions (RTP) Schedule and other information requests issued under Justified Trust reviews.

The reasons for the changes are not warranted

The reasons given for the changes is the current SFLF:

- *" …isn't delivering a sufficient level of information for SF reporting. SF reporting is used to detect higher risk international tax structuring and profit shifting arrangements. The current design of the SF as an LCMSF attachment results in:*
    - *inconsistent reporting content*
    - *inconsistent reporting format or structure*
    - *incomplete information in some reports not satisfying the level of reporting required in the SF instructions."*

Firstly, we note that trying to report on data that is narrative and qualitative by nature and using a definition of significant restructure that is subjective (relying on the state of mind of an internal or external tax adviser) is inevitably going to be "inconsistent". This doesn't mean it is wrong or inconsistent, but rather it is different. We suggest that trying to convert LCMSF attachments to structured data is not going to change that inconsistency.

Secondly, whilst Part A and SFLF have been part of the compliance ecosystem since 2016, we struggle to understand that what has been provided in the past is now somehow insufficient for risk detection, particularly in the large market. This is particularly the case for taxpayers in the Top 100/Top 1000 Justified Trust program where related party restructures are routine questions.

We note that 2,934 "administrative solution" reports were lodged (27% of all IDS) in 2021. However, we could not identify how many restructures were identified in these reports or how many filings were felt by the ATO to be deficient.[1] In fact the most recent RTP finding reports says:

> *"Once again, there has been an increase in taxpayers making disclosures and an upward trend in low-risk disclosures for large public and multinational entities.[2]"*

Furthermore the most recent Top 100 and Top 1000 Finding reports are showing increases in the level of high assurance and ATO reviews of tax risks flagged to market and significant and new transactions in the Top 100 Group.[3]

Changes not reflective OECD guidelines

From the substantive changes proposed by the ATO (refer to detailed comments attached), it is clear these proposals go beyond the requirements of Annex II of the Transfer Pricing Guidelines as set out in the Action 13 report. We note that Annex II specifically deals with *'transfer pricing documentation'*.

As acknowledged by the ATO, new proposals are not limited to identifying transfer pricing risks and as such there is real concern that any approved form that does not reflect OECD guidelines is beyond powers and invalid.

[1] See IRPD statistics | Australian Taxation Office (ato.gov.au)

[2] See Findings report RTP – Public and multinational businesses | Australian Taxation Office (ato.gov.au)

[3] See Findings report summary | Australian Taxation Office (ato.gov.au)

In our view, the current proposal also appears to contradict the ATO's requirement in LCR 2015/3 and the EM supporting the initial CbC introduction (refer to detailed comments attached).

Consideration of other compliance approaches is needed

As observed above, we have significant concerns that the proposed changes have not been fully explained and/or are warranted given the myriad of other compliance processes dealing with the same matters for large businesses are used. We understand that the changes are aimed at providing structured data to facilitate the ATO in its risk assessment of transfer pricing risks but the current design of the form is an overreach. This is consistent with the discussion at the last Large Business Stewardship Group meeting.

It is not clear what the ATO see as the failings in the current process or why it is felt the changes are needed and information requests expanded. For example, we do not understand why the ATO feel it now requires the full name and personal tax residency of foreign individuals by function employed by publicly listed groups to whom Australian operatives report and in fact how the ATO can go beyond the requirements of the OECD final report on Action 13.

We can only assume this request goes to the tax residency of the overseas entity. This is not something that publicly listed corporates track and we don't understand what risk assessment benefit is achieved in knowing the name or personal tax residency status of an offshore employee employed elsewhere in a publicly listed group. It seems completely at odds with the years of work that have gone into the development of rulings and PCGs on corporate tax residency since *Bywater* where the ATO acknowledge the outcomes of tax residency are low risk for public groups and, subject to there being instances of fraud or evasions, would not otherwise be reviewed.

We suggest there are other options for the ATO to "flush out" bad behaviour than a siloed approach to adjusting the SFLF into granular data for all SGEs without regard for the other avenues through which the ATO obtains the same information. This could include adjusting RTP schedules, or via Top 100 or Top 1000 reviews, business bulletins, tax practitioner steering groups, Tax Alerts, penalties for individual cases of misrepresentation or other means ordinarily used by the ATO to change taxpayer behaviour.

Consideration of overlaps and duplication with the RTP Schedule, Master Files and disclosures under the Top 100 Pre-lodgement disclosure framework

As you are aware, the Category C RTP Schedule is an annual disclosure of matters the ATO require to be completed by taxpayers with turnover greater than $250 million. Of the 29 active questions, nearly 50% relate to cross-border restructures, including hybrid mismatches, intangibles, related party debt, marketing and procurement hubs, round-robin financing and withholding tax. No explanation is given as to how also reporting such restructure questions would be useful as a means for the ATO to risk assess the cases via the SFLF.

The ATO's Top 100 Justified Trust program provides an annual pre-lodgement compliance review (PCR) for these taxpayers. Under the PCR, Top 100 taxpayers disclose business changes for the income year, including any material changes to economic activity and legal structure, with the disclosures required to be made during the year and also up to the lodgement of the relevant income tax return. For these taxpayers, disclosures within the SFLF would duplicate the work already performed under the PCR, providing information that is already to hand for the ATO.

Timing and governance

In our view, these changes are being introduced at a time when the current ability to comply is stretched as more pressing issues on the government's agenda have taken precedence. These are still being worked through and include Pillar Two, Thin Cap, Debt Deduction Creation Rules and Public CbC reporting. Whilst the ATO may have been given additional resources for additional compliance activities, corporates as a general rule have not.

In this regard, we would appreciate an explanation of the internal governance processes around the rollout and timing of the proposed changes, including for example if the Law and Practice business line:

- is aware of the proposed changes to web based guidance and the approved form.
- has views on whether this has strayed from public guidance in the LCR 2015/3 on the CbC reporting regime and the clear direction in the EM to closely follow the OECD standard.

We would also like to understand if the Top 100/Top 1000 programs and the wider CbC reporting team were involved in the design of the SFLF as there is a definite sense of a siloed rather than a whole of system approach to the design.

In our view, the gains from reaching high assurance (including the ATO client engagement teams being more light touch and tailored in their approach) from the justified trust program are being undermined and being replaced with another part of the ATO wanting the same taxpayers to fill out more detail in forms dealing with the same matters.

Inadequate consultation

Whilst we acknowledge the ATO team has worked on the changes, from our view, the consultation process has been inadequate. Up to the last meeting, it seems more focussed on Transfer Pricing practitioners and digital service providers and developing the background structured "schema" rather than first landing the content and the expected changes to the schema with impacted taxpayers.

We suggest that targeted ATO-taxpayer consultation occur in the first instance where the failings of the current system can be articulated with precision before designing a "schema". This will allow taxpayers to help the ATO develop something that meets the ATO's needs and can be complied with, without duplication of information being collected via other means including the RTP and justified trust review processes.

We have attached further details of our concerns on the instructions and examples to this letter as an Appendix.

Summary of key recommendations

1. Further detailed explanation of the reasons why the changes, including data to show the inconsistency, is needed and how these changes accord with Annex II of the Final Report of Action 13.
2. All information requests on individual residency status of direct and effective reports are removed .
3. The definition of significant should be objective and financial, not subjective.
4. The definition of restructure needs to be explained with more low risk examples, rather than a focus on the obvious high risk cases and clearly aimed at international related party matters.
5. A removal of the expansion to SFLF reporting on IP created in Australia before it is potentially transferred overseas
6. An explanation of why duplication of reporting of restructures is seen as necessary in risk detection where taxpayers are already answering questions in the RTP and via Justified Trust Reviews and other direct engagement processes.

Should you have any questions, please contact me in the first instance.

Yours sincerely

Paul Suppree

Cc Rebecca Saint, Hector Thompson, Fiona Dillon

Attachment - Detailed Comments

In our view, there is a need for a reset. In no particular order, we note the revised SFLF instructions:

- go beyond the requirements of Annex II of the Final Report on Action 13
- go beyond the ATO's requirement in LCR 2015/3 and the EM supporting the initial CbC introduction
- defines "restructuring" too broadly and strays into operational changes and as acknowledged by the ATO is not confined to transfer pricing concepts
- defines "significant" in a way that is not objective and contrary to the Action 13 Final Report with no effective materiality
- duplicates some reporting that is done via the RTP schedule for intangibles transfers/changes to related party financing arrangements and other relevant international related party RTP questions
- duplicates what is already disclosed in Parts A and B of the Australian Local File for introduction of / changes to cross-border related party financing arrangements
- seems at odds with processes adopted for taxpayers in the Top 100/Top 1000 Justified Trust programs who provide explanations of new and significant transactions as part of such reviews, particularly for high-assurance taxpayers
- expands the existing short form requirements by asking for:
    - Tax residency of the employing entity
    - Name and tax residency of the effective reporter at the individual employee level even if the employee is employed by a publicly listed group entity
    - The TFN and/or ABN of the entity that employs the individual reporting overseas, without any explanation of why this is needed or its relevance to transfer pricing risk assessment
    - Requires constant monitoring of reporting changes during the relevant year rather than at the end of the relevant year
- goes beyond question 17 of the IDS by asking for all restructures not the top 3
- expands question on intangibles development to its creation before any transfer or migration to an offshore related party
- applies from 1 January 2024, when systems have not been established to collate some of the information from this date and have not suggested transitional rules for taxpayers in such cases
- provides insufficient examples of routine business transactions that need to be reported as restructures. Of the 10 examples, 8 focus on the "obvious cases" of reportable restructures and do not shed any light on more common low-risk cases that don't need reporting as significant restructures.

Significant restructures

In essence, the main concern is the subtle differences in the definition of "significant restructures" which goes beyond OECD requirements and existing ATO rulings and is also at variance with Question 17 of the IDS.

- Restructures
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- We note Question 17 of the IDS uses a similar (but not the same definition) of restructure. It uses the reference to "not being limited to the generally accepted financial definition". By contrast, the draft instructions use the term "is not limited to the financial definition". We could not find what the financial definition (and thus non-financial definition) of a restructure is. It would be useful if this is explained or references to what this term means are provided.
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- Significant is subjective
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- Despite the fact that Action 13 uses the terminology "material", current short form reporting talks about "significant". The OECD final report in para 32 notes:
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- *"we acknowledge individual countries should establish their own materiality standards for local file purposes, based on local conditions. The materiality standards should however be objective standards that are commonly understood and accepted in commercial practice" (Emphasis added).*
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- In the EM accompanying the introduction of the CBC reporting it notes:

5.27 Entities must provide each statement to the Commissioner in the 'approved form'. The concept of approved forms is used in the tax laws to provide administrative flexibility to specify the precise form of information required and the manner of providing it. This allows the Commissioner to take into account entities' existing reporting obligations when determining the information to be provided in the approved form. It also allows for any agreed future updates to the standards in Annexes I to III of Chapter V of the Transfer Pricing Guidelines as set out in the Action 13 report to be implemented administratively. [Schedule 4, item 1, subsection 815-355(1) of the ITAA 1997]

5.28 The information required to be provided in the approved form will take account of the guidance provided in Chapter V of the Transfer Pricing Guidelines as set out in the Action 13 report, which recognises that there is a balance to be struck between gathering useful information and imposing a disproportionate compliance burden on taxpayers. (Emphasis added)

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- In LCR 2015/3 the ATO notes at paragraph 27 that the:
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"approved forms will not require information that goes beyond what the OECD guidance recommends for each type of file or report". (Emphasis added)

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- Similarly, LCR 2015/3 at paragraph 33 the ATO notes:

"To ensure the right balance is struck between the compliance burden imposed on the significant global entity and the usefulness of the information for tax administration purposes, we will be following the OECD guidance closely, including the scope of the information that is required to be disclosed in the master file. For example, the description of the supply chain in the master file will be limited to the group's products and/or service offerings amounting to more than 5 percent of the group's turnover " (Emphasis added)

Similarly at paragraph 48 of the same LCR, the ATO note:

"The OECD guidance recommends that the local file be designed to focus on information that is relevant to a transfer pricing analysis in a jurisdiction and the transactions that are material in the context of a

local country's tax system.[i]It also recommends that individual countries establish their own materiality standards for local file purposes, based on local conditions"

- Current Local file instructions say:
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- *"Whether a change is significant includes consideration of the anticipated impact on your Australian tax liabilities (including Australian withholding tax liabilities) for the reporting period or following income years compared to the circumstances before the change.*
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- *Where there has not been any significant changes in your ownership or related party funding structures, disposals or acquisitions, or commencement or cessation of operations, you should positively state this in your short form local file."*
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- Despite assurances the changes are about standardising existing requirements, the draft instructions now note restructures:
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- *"[are] not limited to the financial definition" (page 27) and "for the avoidance of doubt, transactions or change that involved assessment of Australia tax impacts or tax risk by internal or external advisers should be treated as significant regardless of whether it is determined…there would not be any Australian tax adjustment or tax impact of the changes" (Emphasis added).*

- With respect, "significant" being defined by consideration by an inhouse or external adviser thinking about the tax consequences (particularly where there are none) is too broad and subjective and contrary to OECD guidance. For example, if an offshore Head of Tax has considered something that he/she knows has no tax impact in Australia, that an Australian Head of Tax may not even know about, this infers something needs to be reported simply because someone considered it.
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Cross border related party financing arrangements

The instructions include changes in related party financing as a restructure and state that the introduction or termination (other than at maturity) of new cross-border related party financing would be considered significant. While Example 5, indicates an increase or a repayment under a pre-existing related party borrowing would not be reportable, it does appear the instructions will require disclosure of new loans or the termination of a loan (other than at maturity). It appears to us that this level of reporting is not appropriate for the following reasons:

- For many taxpayers (for example, taxpayers in the financial services industry), cross-border related party financing will be a regular occurrence and should not be considered to be a "significant restructure"
- The ATO will already be aware of any new loans/borrowings through Part A of the Local File and will receive copies of the relevant legal agreements for intercompany financings and will receive details of any amendments to existing loan agreements in Part B.
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- **More Examples of Business As Usual (low risk) Transactions Are Needed**

We note of the 10 examples given in the draft instructions, the 8 reportable examples are so obviously complicated (and thus reportable) they provide no practical guidance to the myriad

arrangements in the ordinary course of business that may need to be reported as a significant "restructure" as defined.

Examples 3 and 5 are seen as non-reportable, and with respect add little by way of practical guidance for low-risk transactions. This is where a critical tension lies in the current draft instructions.

In what follows, we focus on the non-reportable examples to show the uncertainty and lack of clarity:

Non Reportable Example 3

Even though this example doesn't involve any Australian tax or non-financial impact, if internal or external tax advisers thought about (or cast their mind to) the Australian tax impact, the example would indicate it still needs to be reported.

Non Reportable Example 5

The question that arises with this example is 'what if the loan in question is not repaid by 31 December 2024 but repaid on 1 January 2025 or sometime in the next reporting period'? Is it 'significant' that the loan is outstanding at 31 December 2024, and is it 'significant' for 2025 that it is repaid on 1 January 2025 when viewed from a 'yearly' temporal perspective even though it is not 'significant' from an overall perspective? Are taxpayers to report it in 2024 and/or in 2025 or not at all? The example appears to indicate you would report in both years.

This highlights the need for low-risk examples of more common transactions because of the breadth given to the definition of "restructure", "significant" and focus on "non-financial" issues.

This includes:

1. Clear examples of reportable intangibles "creations" that are not transferred, used or otherwise shared with offshore related parties.
2. Whether the payment of dividends need reporting as it "is a change in equity"?
3. Does borrowing from a related party to buy trading stock or fixed assets from an unrelated party need reporting as it is a change in arrangements with related parties?
4. Do changes to the quantum or amount of existing related party non-core services need reporting?
5. Does the simple offshoring of back-office functions to an unrelated service provider need reporting?
6. Does onshoring of back-off functions to Australia need reporting?
7. Does the transfer of an asset (e.g. land, plant & equipment) between Australian related parties need reporting, even if between members of a consolidated group?
8. Does entering into a new supply contract with a third party need to be reported?
9. Does the issue of new shares by an overseas related party to its Australian parent need reporting?
10. Does a 'check the box' election of a new US-incorporated subsidiary that is consolidated within a US taxpayer group need reporting?

Whilst of course we recognise examples are not definitive, it is understanding what is not significant via more the low-risk examples that would assist. This is creating reporting uncertainty and angst given the size of SGE penalties for the most minor breach of disclosure.

Applying the SFLF to the creation of intangibles

The current instructions note a clear focus on the transfer and/or licencing/service provision of intangibles involving an international related party. The draft instructions expand this to the creation of intangibles.

The extension to the creation of intangibles has taken the concept to a far broader place than is currently contemplated or required. Creation of intangibles by an Australian consolidated group then takes it even further to the point of impossibility to comply particularly given the breadth of the concept of intangibles to include more than just legally protected intangibles such as copyright, trademark and patents. For example:

- R&D activities are conducted regularly in Australia to help further develop/enhance IP that is owned in Australia and used in the Australian market – this may not result in any formal IP as the R&D may not succeed. It still creates an intangible in the know how generated, which in time may be further used as lessons can be learned and continued experimentation happens. This intangible may be documented through R&D process documents and claims in which case the ATO will have that information and can access it that way. In some cases, where an R&D claim is not able to be made, documentation may be challenging as a register of this work won't be kept. Trying to collate this type of intangible from within a business will be very difficult.

- Process improvements are commonplace within organisations striving to continuously improve. These improvements may not be documented and so again, accessing them will be difficult. Even when documented, where these process improvements are locally beneficial and have no bearing on cross-border related party arrangements, the effort to extract and report details of them would be incredibly burdensome for no perceived risk to the revenue from a data risk assessment perspective.

- Intangibles are created in the simple task of preparing and providing tax advice as an in-house tax team to business units. If you take this to its natural extension, are details of this form of copyright creation designed to be captured and reported?

- The ATO's broad definition of intangibles includes data created as a matter of routine business. Many businesses rely significantly on valuable data generation but do not keep records of such as an intangible asset.

Where intangibles are "migrated" (which of course includes transferred), there will also be a simultaneous disclosure of that even in the RTP schedule at questions 44 and 45 – this information will also be disclosed to the ATO at the time the return is lodged which is sooner for most people than they will file their SFLF.