Australian Government
Australian Taxation Office

Top 1,000 (income) tax performance program

Findings report 30 June 2020

Contents

We are publishing our updated findings from streamlined assurance reviews covering 799 taxpayers to help you understand how we apply the justified trust methodology to:

- obtain greater assurance that large public and multinational taxpayers are paying the right amount of income tax, or
- identify areas of tax risk for further action.

We previously published a Top 1,000 Tax Performance Program (income tax) Findings Report outlining our findings as at March 2019. This Findings Report builds on the March 2019 Report with:

- updated statistics encompassing reviews completed from the inception of the program to the end of June 2020
- additional findings, and
- comparisons to the statistics previously published for reviews completed to the end of January 2019.

We aim to finalise the Top 1,000 tax performance program by December 2020 (the finalisation of reviews was delayed due to the impacts of COVID-19). A new Top 1,000 combined assurance program covering income tax and GST will commence later this year.

Top 1,000 tax performance program

The Top 1,000 tax performance program (the program) was established in July 2016 to:

- obtain greater assurance that large public and multinational economic groups are reporting the right amount of income tax, or
- identify areas of tax risk for further action.

The program covers public and multinational groups and large superannuation funds with annual turnover above $250 million. It does not cover groups that continuously engage with us through our Top 100 program.

The Top 1,000 population:

- consists of public and multinational businesses and super funds that have substantial economic activity related to Australia
- is a large contributor to corporate income tax, excise, and petroleum resource rent tax (PRRT) collections
- reported $26.3 billion or 32% of all corporate income tax for 2017–2018 paid by public and multinational businesses
- includes some of the largest remitters of goods and services tax (GST).

As the Top 1,000 can impact the health of our tax system, we engage with them on a periodic basis to manage their compliance and assure their tax performance.

The Justified Trust program benefits Top 1,000 taxpayers, their shareholders, key stakeholders and the wider community. The program:

- provides certainty about their tax outcomes and effectiveness of tax governance processes
- ensures boards can be confident they are aware of and understand the tax profile of their organisations, and
- provides an objective mechanism to understand how the tax profile of their organisation compares to their peers and others in the market.

By disclosing their assurance ratings shareholders, key stakeholders and the community can gain insights and confidence about the Australian tax outcomes and contribution of the organisation.

The Top 1,000 program covers a diverse range of groups in terms of their ownership, business models, industries and size. Where the economic group has more than one taxpayer, we usually review those taxpayers with turnover above $250 million. In appropriate circumstances we may review smaller taxpayers within the group. Where we identify areas of concern these are addressed through our Next Actions Program.

Our approach

The program applies a consistent, structured approach in our reviews. A dedicated program team supports the consistent application of this approach by our specialist assurance teams that are located across Australia.

Our teams engage with each taxpayer using streamlined assurance reviews (reviews). Typically, a review will cover the last four income years.

We apply the justified trust methodology and seek to obtain assurance of the following four focus areas:

1. appropriate tax risk and governance frameworks exist and are applied in practice
2. none of the specific tax risks we have flagged to the market are present
3. the tax outcomes of atypical, new or large transactions are appropriate
4. any misalignment between tax and accounting results is explainable and appropriate, and the right amount of tax on profit from Australia-linked business is being recognised in Australia.

This paper outlines our findings for the four justified trust focus areas in relation to 799 reviews finalised by the end of June 2020. It will be updated as our coverage of large public and multinational groups continues to expand.

We have published various guidance to help taxpayers prepare for their reviews, including:

- typical questions and
- a guide to help taxpayers to

- understand what attracts our attention
- prepare for engagements with us,
- and improve their (and our) confidence in their tax outcomes.

Combined assurance reviews

We aim to finalise the Top 1,000 tax performance program by December 2020 (the finalisation of reviews was delayed due to the impacts of COVID-19). A new Top 1,000 assurance review program covering both income tax and GST will commence later this year. Where we review a taxpayer a second time, we expect to see that they have implemented recommendations from their first Top 1,000 review. We are looking for improvements in these second time reviews.

The new program will provide:

- an avenue for large corporates (and their boards) to gain certainty about their tax outcomes, and
- an opportunity to improve assurance ratings obtained under the current program – we will review improvements and remediation activities undertaken following the first Top 1,000 review.

Taxpayers are less likely to experience protracted reviews or next actions activities where they:

- follow our guidance and any recommendations arising from their first Top 1,000 review, and
- provide information requested in a timely manner.

As we are taking a 'top up' approach, we will not seek the same level of information in the second Top 1,000 reviews as for the first Top 1,000 review unless there are significant changes in your business. We will continue to publish guidance to help taxpayers prepare for these reviews and obtain higher assurance ratings.

Overall levels of assurance

At the end of our review, we consider whether enough objective evidence has been obtained that would lead a reasonable person to conclude a taxpayer paid the right amount of Australian income tax according to the law. The overall level of assurance is based on an objective view of whether the taxpayer is considered to have paid the right amount of tax.

Most taxpayers reviewed obtained an overall medium assurance rating. We set out in the streamlined tax assurance report (STAR) the steps for the taxpayer to take to obtain high assurance next time we review their tax affairs. We will seek to understand steps taken to address our recommendations through the new Top 1,000 combined assurance program (to the extent the matters are not otherwise reviewed as part of the Next Actions program).

We will follow up taxpayers with overall low assurance ratings, or where we identified higher risk concerns during the review as part of our Next Actions Program. The Next Actions program can include specific or comprehensive reviews of high-risk areas and may also result in some matters being escalated directly to audit.

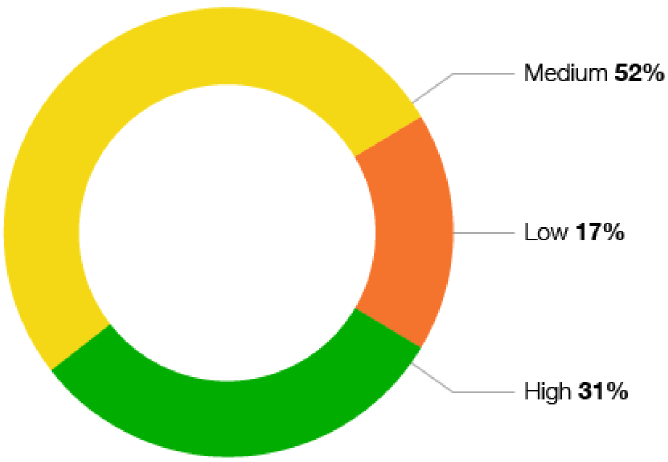
Ratings

We apply consistent rating categories when considering the overall level of assurance.

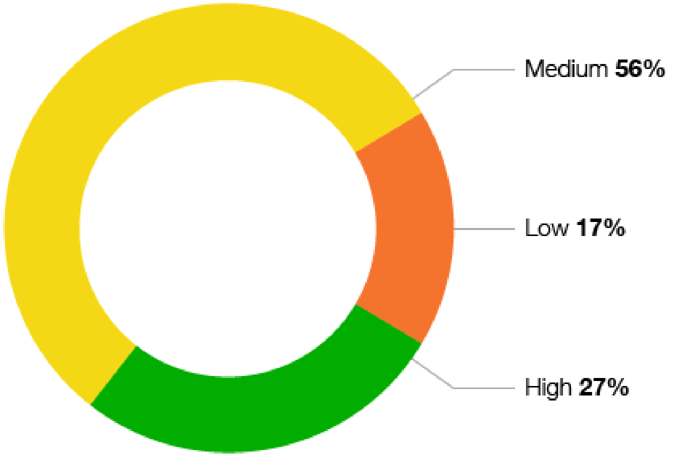
High	We obtained assurance that you paid the right amount of Australian income tax for the income years reviewed. This means we are unlikely to contact you again in relation to the income years reviewed unless something new comes to our attention.
Medium	We obtained assurance in relation to some but not all areas reviewed. For those areas not yet assured, further evidence and/or analysis will be required before we obtain assurance that you paid the right amount of Australian income tax.
Low	We have specific concerns around your compliance with the Australian income tax laws and the amount of Australian income tax paid for the income year(s) reviewed.

The overall assurance ratings have not significantly changed since the March 2019 Findings Report (for reviews completed up to the end of January 2019). The reviews completed up to the end of January 2019 and June 2020 resulted in the following ratings:

Overall Assurance Ratings, January 2019

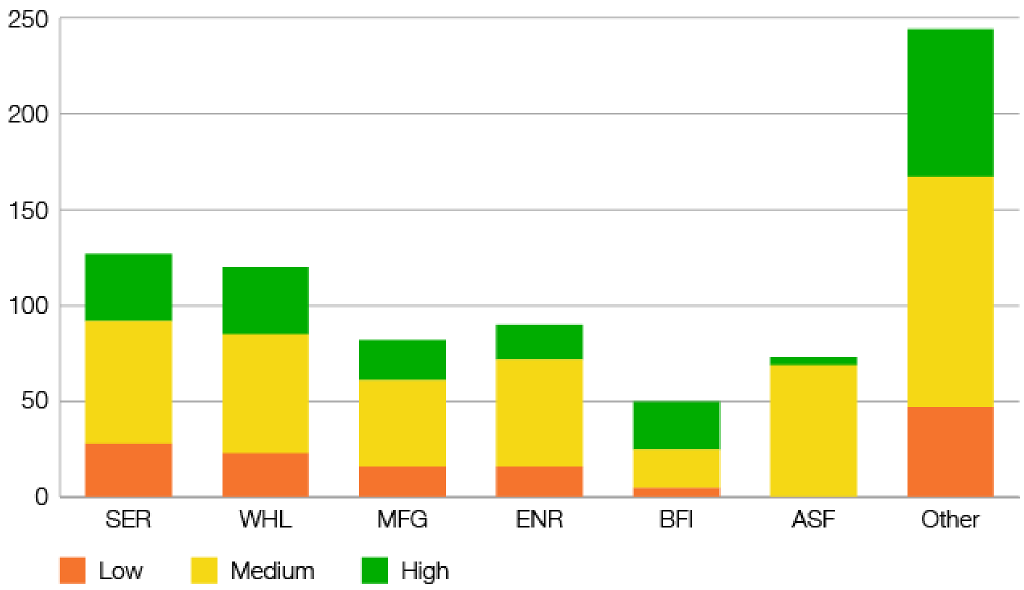


Overall Assurance Ratings, June 2020



The proportion of different overall assurance ratings differed between various industries. The ratings received across the 6 key industries for the reviews completed up to the end of June 2020 are shown below.

Overall assurance rating by industry as at June 2020



Note: The table shows the overall assurance ratings by the number of taxpayers for the following key industry groupings:

- Services (SER)
- Wholesaling (WHL)
- Manufacturing (MFG)
- Energy and Resources (ENR)
- Banking, Finance and Investment (BFI)

- APRA-Regulated Superannuation Funds (ASF)
- all other non-grouped taxpayers.

The Banking, Finance and Investment key industry grouping obtained the highest overall assurance ratings. This is a diverse grouping that includes taxpayers such as listed investment companies, credit unions and smaller domestic banks to global financial services groups such as foreign banks.

Our experience was that smaller domestic groups were often able to obtain higher assurance ratings. Groups with significant global operations were often able to only obtain medium levels of overall assurance, reflecting in part the high proportion of international-related party transactions.

Where we have identified concerns, we have directed the taxpayer to our specific public guidance. We will seek to understand steps taken to address unassured areas through the new Top 1,000 combined assurance and the Next Actions programs.

Most large APRA-regulated superannuation funds obtained an overall medium assurance rating. Assurance over investment activities relies on superannuation funds' tax risk management and governance, due to the number and complexities of these investments, and outsourcing nature of the industry and size of funds under management. Funds that achieved higher overall ratings were likely to have less complexity in their operations and investments.

Tax risk management and governance

We consider the existence, design and operation of a tax control framework for income tax focusing on the 6 controls set out in the director's summary in the Tax Risk Management And Governance Review guide (the Guide).

The Guide:

- sets out principles for board-level and managerial-level responsibilities
- provides examples of evidence that demonstrates the design and operational effectiveness of tax control frameworks
- focuses on the processes and controls in place and may not necessarily reflect the tax risk appetite or capabilities and experience of the tax or finance team, or their advisers.

Ratings

We apply a consistent rating system when reviewing and assessing tax governance. To find out more, see our practical guidance about how we rate tax governance.

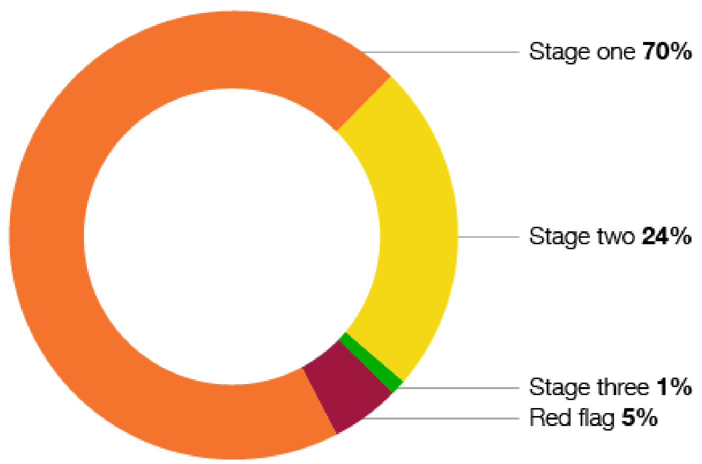
Stage 3	You provided evidence to demonstrate that a tax control framework exists, has been designed effectively and is operating effectively in practice.
Stage 2	You provided evidence to demonstrate that a tax control framework exists and has been designed effectively.
Stage 1	You provided evidence to demonstrate a tax control framework exists.
Not evidenced or concerns	You have not provided sufficient evidence to demonstrate a tax control framework exists or we have significant concerns with your tax risk management and governance.

While there has been no significant change in the ratings for tax risk management and governance since the last Findings Report in March 2019, we are observing increased awareness of our expectations in this area.

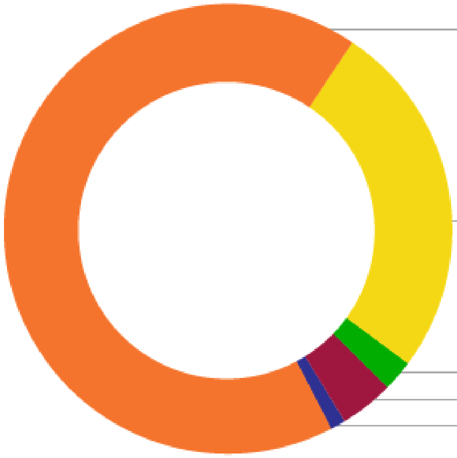
As part of new Top 1,000 combined assurance program, we will evaluate whether our recommendations have been implemented for practices of previously reviewed businesses.

The reviews completed up to the end of January 2019 and tax risk management and governance June 2020 resulted in the following ratings:

Tax Risk Management and Governance assurance ratings, **January 2019**



Tax Risk Management and Governance assurance ratings, June 2020



Observations

In our reviews we focus on the following controls set out in the Guide which are aligned with the following justified trust objectives:

- understanding an entity's tax control framework
  - Board-level control 4: Periodic internal control testing
  - Managerial control 1: Roles and responsibilities are clearly understood
  - Managerial control 6: Documented control frameworks
- identifying risks flagged to the market
  - Board-level control 3: The board is appropriately informed
- understanding significant and new transactions
  - Managerial control 3: Significant transactions are identified
- understanding why the accounting and tax results vary
  - Managerial control 7: Procedures to explain significant differences

Stage 1 rating

The most common rating continues to be Stage 1. This reflects that many large businesses are still in the process of documenting and formalising their tax control frameworks and/or lack objective evidence that their tax control framework is designed effectively.

Some taxpayers have enterprise-wide policies and governance frameworks that may encompass the tax function rather than having a specific tax risk management and governance framework that is in accordance with the Guide. While such enterprise-wide policies/frameworks may demonstrate some level of tax control framework exists, they are often too general in nature and lack some of the specific features we require to evidence an effective tax control framework. We encourage taxpayers to put in place a tax risk management and governance framework that meets the recommendations in the Guide.

While many taxpayers remain in the Stage 1 category, we are seeing more taxpayers at the upper end of this band. It is not uncommon for taxpayers to fail to obtain Stage 2 as their tax control framework did not include a requirement to undertake periodic testing of their tax controls. We encourage these taxpayers to start taking steps to move to Stage 2.

Stage 2 rating

A Stage 2 rating gives taxpayers, and us, confidence that the tax control framework is effective. For many taxpayers, a Stage 2 rating will be a satisfactory assurance rating. We continue to encourage taxpayers to improve their governance framework to achieve this level of assurance.

To obtain a Stage 2 rating for tax governance, the tax control framework must be designed effectively. This requires clients to have addressed all relevant Justified Trust controls in their tax control framework including BLC 4 (periodic controls testing).

We are seeing more taxpayers undertaking a gap analysis and presenting this to us during the review. Where the gap analysis highlights areas where changes are recommended, to obtain Stage 2 we need to see:

- that these recommended changes have been implemented
- a description of your compensating controls, or
- documentation setting out why particular aspects of the Guide may not be applicable to your circumstances.

We observe Top 1,000 clients failing to distinguish between:

- having periodic control testing as part of their tax governance framework (which is needed to get to stage 2), and
- actually undertaking testing of the controls (the results of which confirm that the controls are operating in practice for stage 3).

To obtain stage 2, there must be a periodic control testing plan within the tax governance framework. While most clients in Top 1,000 now have a tax governance framework, many do not have a periodic control testing plan as part of their tax governance framework.

Having someone (for example, an independent adviser) undertake testing of the controls as a 'one-off' for the purposes of an assurance review does not meet the requirements for a tax control framework to be designed effectively. This is a common scenario which results in many clients only obtaining a Stage 1 rating for tax governance.

Where Top 1,000 clients can demonstrate that they have a definite plan endorsed by senior management to undertake periodic controls testing as part of their tax governance framework, the taxpayer can obtain a stage 2 rating.

Finally, we note that in assessing BLC 4 for income tax we apply the same broad principles as set out at section 4.3 of our new GST Governance, Data Testing and Transaction Testing guide.

Stage 3 rating

To obtain a Stage 3 rating we look for evidence that the documented tax control framework is designed effectively and is operating effectively in practice. It continues to be the case that few taxpayers can provide evidence that they have independently tested the operation of the framework in practice.

This stage requires evidence in the form of a report of findings by an independent party (such as an internal auditor) that have tested the operation of the framework in practice. The report of findings should conclude that the documented tax control framework is operating effectively. Where improvements or enhancements are recommended, we will seek to understand whether these have been (or will be) implemented.

Some taxpayers with well documented tax control frameworks do not obtain a Stage 3 rating because evidence obtained during the review (e.g. substantial errors demonstrates that their framework is not operating effectively in practice.

Red flag rating

A red flag rating is only applied after careful consideration where we have significant concerns with the taxpayer's tax control framework as evidenced by:

- the high level of errors identified, and/or
- fundamental concerns about the robustness of existing tax processes.

At this stage of the program, there were still several taxpayers that were not able to demonstrate that a tax control framework exists. Nevertheless, this remains a small percentage of the overall Top 1,000 population.

Not rated

In rare instances, we may not provide an assurance rating for tax governance. This is generally where the taxpayer joins a new tax consolidated or MEC group and we provide an assurance rating for the tax control framework of the group that acquired the taxpayer under review.

Significant and new transactions and specific tax risks

We seek to understand and review the income tax treatment of the taxpayer's business activities, particularly significant and new transactions. We also look for and review risks or concerns communicated to the market and determine if they are present.

In June 2020 we published a guide to help taxpayers covered by the program to:

- understand what attracts our attention
- prepare for engagements with us, and
- improve their (and our) confidence in their tax outcomes.

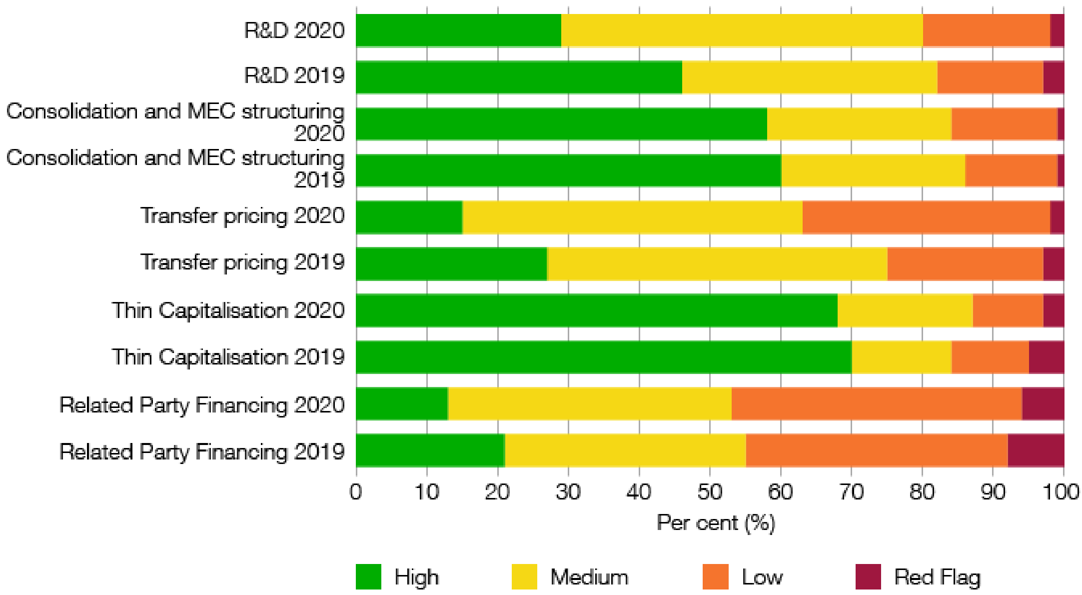
Ratings

We apply a consistent rating system when reviewing and assessing the income tax treatment of taxpayer's business activities including significant and new transaction and tax risks communicated to the market.

●	High	We obtained a high level of assurance that the right Australian income tax outcomes were reported in your income tax return(s). This means we are unlikely to contact you again in relation these matters for the income years reviewed unless something new comes to our attention.
●	Medium	More evidence and/or analysis is required to establish a reasonable basis to obtain a high level of assurance.
●	Low	More evidence and/or analysis is required to determine whether a tax risk is present.
●	Red flag	Likely non-compliance with the income tax law.
●	Out of scope	We have not evaluated this item and not expressed a rating.

The ratings for some of the common areas arising in reviews completed up to the end of January 2019 and June 2020 are shown below:

Assurance Ratings for common review areas as at January 2019 and June 2020



The most significant shifts in assurance ratings we have observed relate to R&D, transfer pricing and related party financing. Our insights about what is driving these shifts and links to additional guidance on how to obtain high assurance are contained below.

Observations

In our reviews we consider all relevant taxpayer alerts and practical compliance guidelines to assess whether they apply to the taxpayer's circumstances. We also review all reportable tax position (RTP) schedule disclosures.

The issues identified may have substantial tax consequences. Typically, this is where most of our time during the review is spent to obtain higher levels of assurance.

Structured arrangements designed to reduce Australian tax

Low assurance or red flag ratings are sometimes associated with related party transactions (including third party back-to-back transactions) promoted or designed to achieve Australian tax savings including:

- related party financing transactions with special terms designed to
  - defer or eliminate withholding tax while preserving annual Australian income tax deductions
  - achieve cross-border hybrid mismatch outcomes (e.g. double deductions or deductions with no corresponding income), and/or

  - circumvent specific anti-avoidance rules such as thin capitalisation and debt/equity classification rules
- changes in membership of Australian tax groups through internal transactions or decisions designed to
  - increase or accelerate deductible losses or depreciation
  - generate Australian tax deductions for anticipated asset write offs
  - avoid tax on anticipated terminations or disposals, and/or
  - generate foreign tax credits
- migration of Australian generated intangible assets to overseas related parties in order to reduce Australian taxable income
- interposing partnerships or other entities designed to do any of the following
  - shift recognition of income
  - change the nature of income
  - reduce or eliminate withholding tax
  - avoid the application of targeted anti-avoidance measures.

Transfer mis-pricing

Transfer pricing is the most common area with nearly 80% of Top 1,000 taxpayers disclosing related party dealings. Multiple issues arise including:

- inbound and outbound supplies of goods and services
- international related party financing
  - cross border dealings in general
  - interest free loans outbound and inbound
  - cash pooling arrangements
  - related party derivatives
  - guarantee fees
- management and administrative services, and other back office services
- payment of licence fees and royalties
- technical services
- research and development (R&D) performed on behalf of overseas related parties
- migration, sale or use of Australian intangible property overseas
- offshore hubs or service centres
- attribution of profits to a permanent establishment.

Transfer pricing is not reviewed where the years under review are covered by an advance pricing Arrangement or settlement.

Common issues arising in relation to transfer pricing analyses include:

> Limited information (documentation) on the global value chain and/or functional analysis of the entities to the arrangement.

> Over-reliance on the whole-of-entity Transactional Net Margin Method. There are circumstances where other methods, including transactional approaches, may be more appropriate.

> Lack of comparability analysis in applying the transfer pricing methodology. Where a comparability analysis has been included, there are often significant differences between the tested transaction/entity and the benchmarks provided.

> Changes in transfer pricing policy or methodologies without an underlying change to taxpayer functional analysis, and inappropriate methodologies being selected given the taxpayer functional profile.

> The application of the Simplified Transfer Pricing Record Keeping rules, as per Practical Compliance Guidance PCG 2017/2 Simplified transfer pricing record-keeping options, without evidence of how the taxpayer has met the eligibility criteria.

In respect of specific transactions, we are often seeing:

> In relation to financing transactions – the commercial purpose or arm's length nature of terms and conditions is not well documented or evidenced (for example, subordination, security) and other options realistically available may not be clearly considered.

> In relation to services transactions – the beneficial nature of services and appropriateness of allocation keys may not be well documented/evidenced. Further, the cost base of the services is rarely explained or evidenced.

> In relation to royalty, licensing or intellectual property arrangements – the beneficial nature and development, enhancement, maintenance, protection and exploitation activities may not be not well documented or evidenced.

Other areas where we often do not obtain high assurance

Other areas that we often do not obtain high assurance include:

> inbound and outbound holding structures

> consolidation

- asset recognition (including treatment of rights to future income and intangibles)
- valuation to support tax cost setting calculations (including evidence to support allocation of value to certain assets vis-à-vis goodwill)
- formation or structuring of tax consolidated groups and MEC groups (including contrived changes to tax residency)

> R&D

- nexus of expenditure to R&D activities

  - methods of allocation of expenditure
- thin capitalisation
  - insufficient evidence or analysis to support the use of the arm's length debt test or worldwide gearing method
  - revaluation of assets
  - valuation of debt capital
  - insufficient documentation to support safe harbour calculations where the financial accounts for the accounting group differs or do not apply to the relevant tax group/ taxpayer
- tax losses
  - generation, carry forward, transfer and utilisation
- capital allowances
  - we may see the governance and processes surrounding capital allowances undertaken by personnel with limited understanding of the differences between accounting standards and the applicable tax laws. Commonly we identify errors
    - in determining the effective lives of assets,
    - general reconciliation errors, and
    - failure to differentiate between different rules applicable to capital works deductions available under Division 43.

Broadly, these areas have remained consistent over the program. We continue to provide public advice and guidance in respect of many of these areas.

Medium ratings – more evidence or analysis required

For some of these issues or transactions, we will require more evidence and analysis to obtain high assurance.

Transfer pricing, valuations or historic tax loss generation are some more common examples. We find the provision of well-constructed position papers and relevant documentation assists us in obtaining high assurance within the time constraints of the review. We encourage taxpayers to provide us with high quality information as soon as possible to assist us to obtain higher levels of assurance during the review.

Guide to help prepare for engagements with us

In June 2020 we published a guide to help large public and multinational companies covered by this program understand:

- what attracts our attention
- prepare for engagements with us, and

> improve their (and our) confidence in their tax outcomes.

The guide sets out the standard of information and documentation we typically look for to obtain assurance. We will update this guide to cover other issues that attract our attention in program engagements. The guide currently covers:

- Capital allowances
- Research and development (R&D)
- Tax losses
- Consolidation

Alignment of tax and accounting outcomes

We analyse the differences between the accounting and tax results. This includes understanding the effective tax rates and effective tax borne. We seek to understand and be able to explain any variances between tax and accounting outcomes. This provides an objective basis to obtain greater assurance.

Ratings

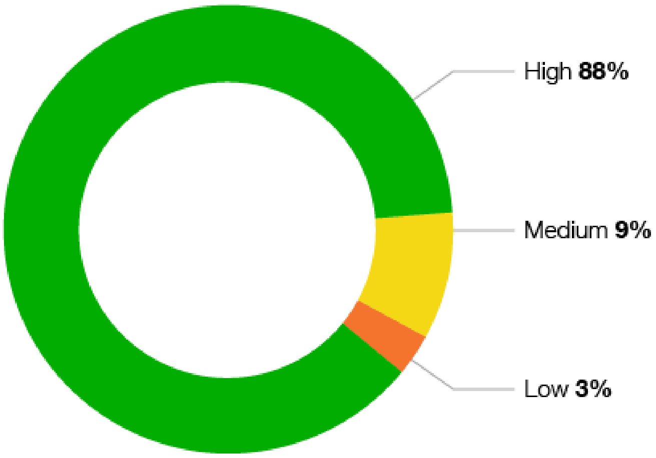
We apply a consistent rating system when reviewing and assessing the alignment of tax and accounting outcomes, which is outlined below.

🟢	High	We understand and can explain the various streams of economic activity and why the accounting and income tax results vary.
🟡	Medium	Further analysis and explanation required to understand the various streams of economic activity and/or why the accounting and tax results vary.
🟠	Low	We identified concerns from our analysis of the various streams of economic activity and/or why accounting and tax results vary.
🔴	Red flag	We do not understand and cannot explain the various streams of economic activity and/or why accounting and tax results vary.

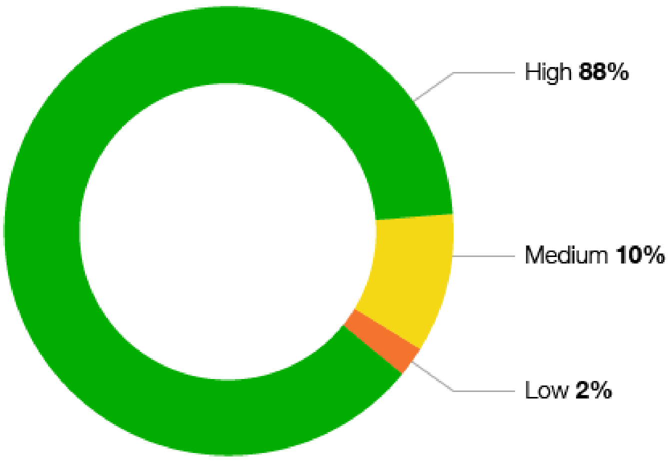
We have not observed a significant difference in the proportion of the ratings obtained by taxpayers in STARs since the March 2019 Findings Report.

The reviews completed up to the end of January 2019 and June 2020 resulted in the following ratings:

Alignment between accounting and tax results, January 2019



Alignment between accounting and tax results, June 2020



Observations

We generally obtain high assurance over reported income and expenses as:

> most taxpayers have audited financial statements, and

> we are able to review the reconciliation between financial statements with the starting profit and loss disclosed in the relevant tax return.

This is more challenging for MEC groups, foreign bank branches and stapled groups. We are also seeing good procedures for calculating taxable income from accounting results. The ratings for this focus area do not include those issues/transactions that have been separately rated in the review. For example, it will not reflect transfer mis-pricing results or results from other identified risk areas such as thin capitalisation or tax consolidation. This results in overall higher ratings in this focus area.