

LARGE BUSINESS

G100 CFO'S

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**Australian Government**

**Australian Taxation Office**

# 'A spirit of engagement'

Speech by Michael D'Ascenzo, Commissioner of Taxation  
to chief financial officers at the G100 function,  
Sydney, 28 May 2008

Speaking to a convention of large corporates just over two weeks ago, I unveiled our new compliance product for large corporates.

Tonight I'd like to revisit this new territory which we've dubbed Annual Compliance Arrangements, exploring some of the key principles that underpin how this approach helps to achieve a level of practical certainty in managing tax compliance.

I'll also share with you some of the thinking that we've done in relation to questions that have been raised by large corporates in the past fortnight.

This new approach is possible as a result of the significant strides taken in recent years in enhancing the relationship with large business.

Our co-designed priority rulings process features early and open engagement to help meet the timeframes of large business.<sup>1</sup> I would like to announce in this forum that the processes that now apply to Priority Private Binding Rulings as outlined in our Practice Statement PS LA 2005/10 will apply to Class Ruling requests which meet the same criteria. Given the Board level consideration of Mergers and Acquisitions and the public disclosure requirements associated with them, we see such a priority process as particularly applicable to these transactions.

To some extent we are already applying the principles outlined in PS LA 2005/10 in many merger and acquisition matters where taxpayers have been willing to engage with us early in the process, where they put to us matters that are in serious contemplation, and where transparency and full and true disclosure has occurred. I have received very positive feedback about the effectiveness of these processes in providing timely advice and certainty in such cases.<sup>2</sup>

In relation to mergers and acquisitions we will be providing additional guidance to business taxpayers and their advisers. This will include examples of matters that may be contentious in relation to such arrangements. This guidance will help companies with their governance of tax issues and may also assist them in their disclosure to the public.<sup>3</sup>

We are also developing a 'Framework for Understanding Complex Mergers and Acquisitions' to improve the tax and commercial expertise of our officers working in this area. If useful, we will co-design with large businesses and

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<sup>1</sup> There has been an improvement in our timeframes for all our rulings work. Currently, 5-10% of ruling requests from large business are priority private binding rulings. The average turnaround time is three months from the time of notification. Early engagement and pre-lodgment discussions involving the in-house tax manager, the external tax advisers and the ATO are important factors in shorter timeframes, as is telling us the full story. If we are asked to rule on only a part of a transaction, then the certainty around our advice is severely constrained.

<sup>2</sup> Material changes to a proposal would represent a new matter/request and should be seen that way by all parties in terms of timeliness.

<sup>3</sup> It also reflects a "prevention is better than cure" approach by the ATO.

representative bodies similar guidance that could be made publicly available to assist companies with their governance and risk management.

In enhancing the relationship with large businesses we are also working to reduce the timeframes around old audit cases.<sup>4</sup> Our policy to remit interest accruing after more than two years reflects the seriousness of our commitment.<sup>5</sup>

Our [Large business and tax compliance](#) booklet which is akin to a charter, is 'jointly owned' by many corporates and their advisers, and is frequently cited back to us.<sup>6</sup>

Our program of senior level meetings with the largest corporates (the top 100) is going well with 84 corporates having participated so far.<sup>7</sup>

We are also learning much since our Forward Compliance Arrangement (FCA) initiative was introduced in 2006. Companies with FCAs such as ANZ in relation to GST and FBT, and BP Australia in relation to GST and Excise are generally free from audits on these matters.

### **Annual Compliance Arrangements**

As you might be acutely aware, our compliance work can typically look back as far as four years – and even longer in some cases – to examine issues.<sup>8</sup>

This can leave the taxpayer in the dark, never knowing if or when we might contact them and say, 'there's an issue going back to an earlier year we would like to discuss'.

That's not an ideal operating environment for any of us. It raises the prospect of additional costs of penalties and interest, and of opportunity costs associated with senior management's attention to past matters.

It presents difficulties in piecing together information on transactions from several years earlier, which puts significant pressure on all of us.

It also makes your job of managing stakeholder expectations more difficult, including managing the expectations of your Board and shareholders.

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4 Aged audit cases are being resolved earlier, with audits now taking nearer to three years rather than five.

5 Subject to reasonable co-operation from the taxpayer.

6 The Ombudsman's comments in relation to Charters are apt in relation to Large business and tax compliance booklet. John McMillan in 'Celebrating 10 Years of the Taxpayer' Charter (August 2007) notes, a 'charter is a public commitment by the agency...they provide a positive definition of good administrative conduct and service delivery [and]...charters are accessible to the public. They tell the public what to expect, and where to complain when things go wrong.'

7 Openness and accountability is one of our corporate values: Strategic Statement 2006-2010.

8 As a matter of symmetry, taxpayers too can go back four years and seek credit amendments.

The Annual Compliance Arrangement (ACA) will go a long way down the path of providing practical certainty by looking at tax risks in real time or at the time that the tax return is lodged.

The ACA offers a 'no surprises' approach that large corporates have told us is their overriding desire.

ACAs are built around two concepts:

1. the company having sound tax risk management processes; and
2. full and true disclosure.

The key features of the ACA are:

1. Confirmation, from the CFO or CEO on behalf of the Board, that the company meets the key corporate governance guidelines set out in our 2006 [Large business and tax compliance](#) booklet and has a genuine commitment to putting all cards on the table.
2. Workshopping with us during the year major transactions or tax positions which have a level of uncertainty so we could jointly assess the tax risks.
3. Once the tax return is lodged, undertaking jointly with us a review of the tax return and other information including the statutory accounts, and book to tax adjustments.

The main difference between the ACA and audits and risk reviews is that we ask companies to put their tax risks on the table and to discuss with us how risk has been mitigated. This requires a sound approach to tax governance and having a clear view of the kinds of things that the ATO would see as a risk.

In return taxpayers will get a significant level of practical certainty. With both the taxpayer and the ATO having looked at tax risks broadly the ATO would not as a general rule allocate scarce resources to low risk matters.

Taxpayers who choose to use an ACA are therefore able to manage their planning and compliance from a position of greater certainty, with 'no surprises' if material risks have been disclosed, and with little or no exposure to penalties and interest.<sup>9</sup>

This is best position for managing stakeholder expectations, and for having a forward focus on your business.

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<sup>9</sup> There is also potential for this approach to make compliance cost savings for you.

## **Clarifying some of the questions about ACAs**

With all complex relationships there are issues to be worked through, clarified and refined.

Some of the issues that are under discussion relate to key concepts and definitions such as full and true disclosure that underpin the operation of the ACA.

For example:

### What risks and issues need to be disclosed?

Under an ACA the taxpayer puts their tax risks on the table and discusses them with us, including their mitigation strategies.

Our [Large business and tax compliance](#) booklet provides good guidance on what tax risk looks like from our perspective.

Under 'What attracts our attention', the factors are identical to the broad criteria for disclosure. That is, we would expect disclosure where:

- the law is unclear or ambiguous
- a major transaction is entered into
- an unusual transaction is entered into
- there are significant cross jurisdictional issues
- tax outcomes are inconsistent with economic substance, and
- The ATO or a court might take a different view.

Ultimately it's a question of the company exercising its judgment about whether there's a risk or uncertainty. If that's the case then we recommend that the risk be disclosed to provide you with more certainty.

### How much information needs to be disclosed?

We would like to see enough information about the risk to be able to understand the transactions, to know what's happening, and to form a view about the tax impact.

The question of 'how much information' will be subject to ongoing dialogue with all concerned. We expect some examples or case studies to be developed to provide further guidance.

### Surely there must be a materiality test?

'Full and true disclosure' will also be based on a level of materiality so we also need to have a shared understanding of what 'materiality' means.

We agree that large businesses deal in very large numbers and that the risks that should be disclosed need to be sufficiently material either in a revenue or reputation sense to warrant attention.

Are there penalty concessions?

The normal penalty arrangements that are set out in ATO practice statements apply to an ACA. The difference is that as a result of being in an ACA the taxpayer is less exposed to penalties and interest because we are reviewing the risks in real time. So in most cases the question of penalties should not arise.

Some taxpayers have asked us about concessions for inadvertent errors that are discovered after the return is lodged and we are developing some case studies so we can develop this with further clarification in mind. However, penalties do not apply where there has been reasonable care, so if your governance framework is robust, there is reduced risk here also.

Are there circumstances where the ATO would reopen an issue or risk?

The ATO would retain the right to reopen issues where there is:

- fraud or evasion
- an issue subsequently comes to light involving a material tax risk that the taxpayer should have disclosed (in other words there hasn't been a full and true disclosure).

What about risks that may not have been obvious at the time of the ACA?

These will need to be looked at in all the circumstances, including whether or not they warrant review. However, where a company has a robust governance framework and made a genuine effort to operate in the spirit of the ACA, then that would be relevant to the resolution of the issue. Such an approach would, for example, mitigate potential penalty and interest exposure.

Does the ACA cover the back years and legacy issues?

A commonsense approach would be to say, let's get these issues out of the way and then start working on a real time arrangement.

The focus of an ACA is one year – normally starting with the current one.

If there are open issues on back years we expect that we could use some of the ACA features, for example, assurance by the Board on tax risk management and the annual discussion to help resolve identified risks.

### How will the ATO ensure the success of ACAs?

We recognise that it's critical for us to have clear governance and escalation processes over each ACA. This is one of the learnings from our experience with Forward Compliance Arrangements.

We are managing each ACA as a project and will put in place working group and steering arrangements for each one. The taxpayer is included in these arrangements.

Each ACA will have one of our senior executives directly responsible for it.

These arrangements will provide governance over the real time discussions, provide an escalation point, and help to keep things on track.

We are conducting seminars with our officers, continuing to embed in our culture the cooperative approaches that are necessary to allow these new arrangements to succeed.

In the event of a dispute, we would be open to alternative resolution processes. Good outcomes have been reached for all parties in resolving GST disputes using these processes.

### How will the ATO continue to enhance the ACA model?

In my recent address to large corporates I announced that the ATO will establish a new Large Business Advisory Group as the peak consultative forum for large corporates.

The plan is that the new Large Business Advisory Group will work with us to identify improved operational and administrative processes with a view to reducing compliance costs<sup>10</sup>, as well as resolving technical and administrative issues, and provide a vehicle to promote improvements to the system.<sup>11</sup> The group, for example, could work through a range of indicators and guidelines to further clarify materiality and other concerns you may have.

We expect this group will have a key role in developing guidance for taxpayers to support implementation of the ACA product.

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10 Unnecessary compliance costs adversely impacts on the efficiency of the tax system and the international competitiveness of business.

11 Three of my most senior people will manage this group – Deputy Commissioner, Large Business and International, Paul Duffus, Deputy Commissioner, Goods and Services Tax, Shane Reardon and our Chief Tax Counsel, Kevin Fitzpatrick.

## **Conclusion**

CEOs globally, operating as they are in an increasingly connected world, regard collaboration as a source of business success, and one that extends to public/private sector relationships.<sup>12</sup>

ACAs offer a practical means of moving further away from an adversarial relationship to a more constructive one underpinned by collaboration, trust and openness.

The top 50 corporates now have the option to explore this new approach. I encourage them to do so and to help us provide them with a competitive edge.

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<sup>12</sup> PriceWaterhouse Coopers : Regulate and Collaborate – What is success in a connected world? Global Annual CEO Survey 2008, p3.